

Economics
Higher level
Paper 2

Wednesday 2 May 2018 (morning)

1 hour 30 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is **[40 marks]**.



Section A

Answer **one** question from this section.

1. Study the extract below and answer the questions that follow.

Canada takes US paper fight to the World Trade Organization (WTO)

- ① Canada has filed a complaint against the United States (US) over anti-dumping tariffs imposed on imports of "specialty paper", which is paper used in glossy magazines and catalogues. Canada said that the tariffs were inconsistent with World Trade Organization (WTO) rules.
- ② Four Canadian companies supply about 60 % of the specialty paper market in the United States. The tariff was imposed after the US Department of Commerce decided that Canada has been providing its paper companies with subsidies and that this had been damaging American manufacturers.
- ③ Many US manufacturers have initiated trade disputes on a range of products including steel and paper, as the US dollar has gained in strength against the Canadian dollar. As one Canadian analyst has noted, "Producers can't do anything about the **exchange rate**, which is determined by market forces, so they are fighting back using trade rules".
- ④ Revenues of US paper manufacturers have also been harmed because demand for the specialty paper has fallen by 5 % annually over the past three years as magazine readers have switched to digital (on-line) products.
- ⑤ The highest tariff of 20 % is being placed on paper from the Canadian company, Port Hawkesbury. The US government said that the company arranged a favourable electricity supply contract that was approved by the Canadian government. They argued that this is equivalent to a **subsidy**. However, the company argued that the electricity was negotiated with a private power company, and so this is not the same as a government subsidy.
- ⑥ Two other companies, JD Irving Paper Ltd and Catalyst Paper Corporation are fighting the tariff, saying that not only did they not receive any subsidies, but also that they weren't even part of the investigation following the complaint by the US producers.
- ⑦ Politicians from Maine, which is the US state where the American producers operate, are pleased with the tariff. They say that it will help to "level the playing field". However, they are not happy with the decision to put the tariff on JD Irving Paper Ltd and Catalyst Paper Corporation because they have not been investigated.

(This question continues on the following page)



(Question 1 continued)

- 8 The governor of Maine has written a letter to the national government and the International Trade Commission asking for separate investigations for the two other companies, JD Irving Paper Ltd and Catalyst Paper Corporation, which also have operations in Maine. In the letter, the governor wrote: "Both JD Irving Paper Ltd and Catalyst Paper Corporation have significant investments in our state, and together employ more than 1200 people in Maine and support thousands of indirect jobs".

[Sources: adapted from www.theglobeandmail.com, 17 November 2015; www.theglobeandmail.com, 30 March 2016; www.pressherald.com, 16 October 2015 and <http://ca.reuters.com>, 31 March 2016]

- (a) (i) Define the term *exchange rate* indicated in bold in the text (paragraph 8). [2]
- (ii) Define the term *subsidy* indicated in bold in the text (paragraph 9). [2]
- (b) Using an exchange rate diagram, explain **one** possible reason for the rise in value of the US dollar (paragraph 8). [4]
- (c) Using a demand and supply diagram, explain why American firms are experiencing lower revenues (paragraph 9). [4]
- (d) Evaluate the consequences of the US decision to impose tariffs on Canadian glossy paper. [8]

2. Study the extract and data below and answer the questions that follow.

Britain's current account deficit

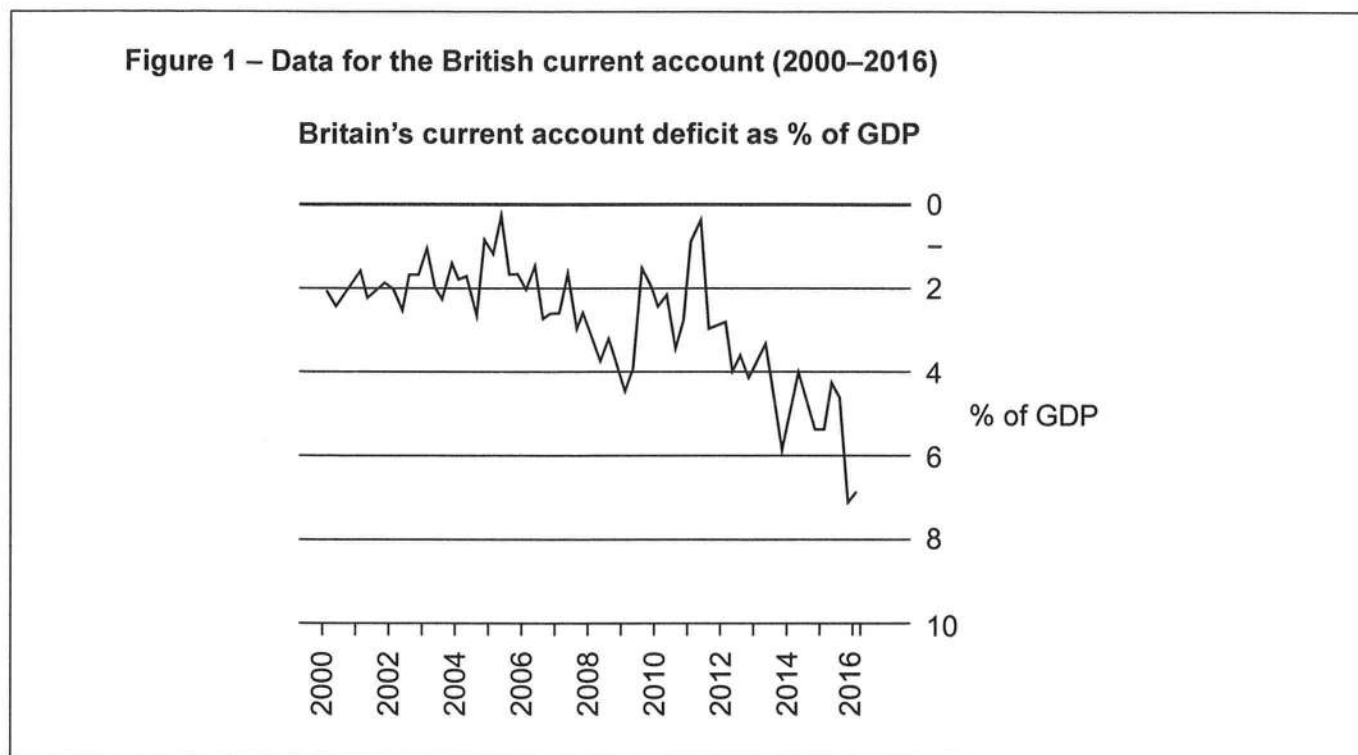
- ① In 2016 a public vote resulted in the decision that Britain would leave the European Union. This became known as "Brexit". Since the Brexit vote, the pound (Britain's currency) has fallen from almost US\$1.50 to around US\$1.30 against the pound as a result of investor uncertainty.
- ② Currency **depreciation** can be a very useful tool for countries when they have become locked in to an overvalued exchange rate. For example, in 1992 Britain abandoned its managed exchange rate system and the pound fell rapidly. Following this, the economy picked up quickly and the inflationary impact was limited. However, the circumstances at that time were very different; interest rates were 12%, there was a lot of spare capacity in the economy and unemployment was 10%. Now interest rates are just 0.5% and unemployment is 5%.
- ③ Britain's current account deficit is at around 7% of its gross domestic product (GDP), which is said to be "highly uncomfortable" (see Figure 1). Prior to the Brexit vote, the deficit was not seen as a concern due to the fact that Britain was very successful in attracting **foreign direct investment**. Now, foreign investors are uncertain about economic prospects and seem to be holding back on investments in Britain. The property market is also seeing signs of reduced demand.
- ④ One economist said that "there is a substantial danger that the United Kingdom (UK) will find it increasingly hard to attract the inward flows of capital needed to finance the current account deficit, particularly given its recent credit rating downgrades and the very real possibility of more uncertainty". A ratings agency predicted that investment will fall by 5% in 2017 because of the uncertain climate created by the Brexit vote. In addition, the country will struggle to attract foreign savers because interest rates are near zero.
- ⑤ Theoretically, the fall of the pound will make British assets attractive to foreign investors. However, one research agency argues this may require a very steep depreciation of the exchange rate. It estimates that the pound/dollar exchange rate will settle at around US\$1.42 to the pound. In order to eliminate the current account deficit the exchange rate would have to fall to a value of US\$1.00 to the pound. This is unlikely to happen.
- ⑥ In theory, depreciation could be good for exports. Britain experienced one big depreciation in the pound in 2009, which reduced the current account deficit for a while, but the effect was only temporary.
- ⑦ Another economist indicated that Britain's current account deficit will limit the government's flexibility in the use of demand-management policies.

[Sources: adapted from www.economist.com, 7 July 2016; www.economist.com, 9 July 2016 and www.bbc.com, 30 June 2016]

(This question continues on the following page)



(Question 2 continued)



[Source: Bank of England, Haver Analytics]

- (a) (i) Define the term **depreciation** indicated in bold in the text (paragraph ❷). [2]
- (ii) Define the term **foreign direct investment** indicated in bold in the text (paragraph ❸). [2]
- (b) Using an exchange rate diagram, explain why “investor uncertainty” resulted in a fall in the value of the pound (paragraph ❶). [4]
- (c) Using a Keynesian AD/AS diagram, explain the meaning of the phrase “a lot of spare capacity in the economy” (paragraph ❷). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the consequences of a persistent current account deficit for the British economy. [8]

Section B

Answer **one** question from this section.

3. Study the extract and data below and answer the questions that follow.

Economic Growth in Cote d'Ivoire (Ivory Coast)

- ① The Cote d'Ivoire economy remained strong in 2015. Economic growth held steady at around 9% per year, supported by public and private investment, rapid growth in building and public works and growth in the finance sector.
- ② However, Cote d'Ivoire must now tackle the challenge of sharing the benefits of the growth, considering that this sound performance is not being reflected in a significant decline in the **relative poverty** rate. Many people are caught in a poverty trap (poverty cycle).
- ③ The mining, finance and communications sectors are making a significant contribution to economic growth. However, they generate few jobs and have little direct impact on the vast majority of households. Before the 2014–2015 period, the agricultural sector was less productive than other sectors, despite the fact it employs the majority of Cote d'Ivoire's poor people. The recent improvement in this sector is expected to lead to a sharp fall in rural poverty, mainly because of the 17% increase in the world market price of cocoa in October 2015. Cote d'Ivoire is the world's top exporter of cocoa and raw cashew nuts, as well as being a net exporter of oil.
- ④ Cote d'Ivoire has a large working-age population, which is expected to double over the next 15 years. There is currently an unemployment rate of just 7%. This relatively low unemployment rate is partly explained by the use of statistical categories that are not adapted to the situation in Africa and hides the vast amount of **underemployment** in the country. It can also be attributed to the fact that being unemployed in Cote d'Ivoire is not an option as unemployment benefits are not available there. Most people work long hours without earning an income that allows them to enjoy a decent standard of living.

(This question continues on the following page)



(Question 3 continued)

- 5 The World Bank recommends improvements in the agricultural and mining sectors to increase efficiency as well as a structural change of the labor market to allow for a gradual transfer of workers to non-agricultural jobs. There is also a need to encourage workers to move from the large informal sector to the formal sector. To achieve these changes, productivity in the employment categories of “non-agricultural employment” and “agricultural and mining employment” need to be increased through the following actions:

Non-agricultural employment

- support young entrepreneurs, including women, through training
- promote apprenticeships
- encourage new businesses by improving administrative procedures and reducing excessive bureaucracy
- make access to credit easier by providing more information
- increase the provision of micro-credit
- improve partnerships between government departments and businesses.

Agricultural and mining employment

- facilitate the emergence of economies of scale for small farmers
- promote access to, and the use of, new technologies by farmers to help lower their production and transaction costs
- encourage foreign direct investment.

Figure 2 – Income Gini coefficient data for Cote d’Ivoire

	Cote d’Ivoire
Income Gini coefficient (2002)	0.413
Income Gini coefficient (2014)	0.462

[Sources: adapted from “The Might of the Elephant: Benefiting from Strong Growth to Create Better Jobs”, 17 December 2015; www.worldbank.org and http://hdr.undp.org]

- (a) (i) Define the term *relative poverty* indicated in bold in the text (paragraph 2). [2]
- (ii) Define the term *underemployment* indicated in bold in the text (paragraph 4). [2]
- (b) Using an AD/AS diagram, explain how “public and private investment” might lead to economic growth (paragraph 1). [4]
- (c) Using a Lorenz curve diagram, explain what happened to income inequality in Cote d’Ivoire between 2002 and 2014 (**Figure 2**). [4]
- (d) Discuss market oriented and interventionist policies that the government of Cote d’Ivoire might employ to achieve economic development. [8]

4. Study the extract and data below and answer the questions that follow.

Nigeria

- ① In August 2016 Nigeria, the largest economy in Africa, went into **recession**. This was accompanied by rising inflation and growing unemployment.
- ② 80% to 90% of Nigeria's export revenue is earned from oil exports. The recent fall in the world price of oil has had a significant impact on export revenues. Therefore, government revenue has fallen by about 30%. This has prompted economists to argue that Nigeria should not be so dependent on oil and needs to diversify.
- ③ Until the end of the 1960s, Nigeria was food self-sufficient and a net exporter of agricultural products. This changed in the early 1970s when the dependence on oil started. Researchers have suggested that Nigeria should start to focus on the production of agricultural goods for export. It has also been suggested that Nigeria should try to promote tourism. Government officials have said that agriculture is the most viable option for Nigeria to create employment for the large number of unemployed young people.
- ④ Farmers have asked the government for more protection against foreign agricultural products. The government has already banned several agricultural imports. It also imposed strict currency controls that limit how much foreign currency Nigerians can spend online and how much businesses and individuals can exchange on a daily basis, limiting imports further. The evidence is clear that the government is adopting an import-substitution strategy.
- ⑤ In the state of Osun, the first step towards diversification has been made. The cocoa processing industry has been revived to produce globally competitive chocolates and other cocoa products. The state governor said that it is slowly leading to more employment and higher revenues for firms. However, many firms remain small and are unable to achieve the economies of scale that would make them more competitive.
- ⑥ The government is planning to create jobs in other areas such as the textile industry. 6000 young people will be trained and provided with facilities like sewing machines, fabrics and other equipment to make school uniforms for the growing young population. The president said that youth employment is needed to help eradicate poverty.
- ⑦ One of Nigeria's challenges is the existence of powerful monopolies in some sectors, including the electricity sector. These monopolies refuse to lower prices for businesses and households, creating a welfare loss.
- ⑧ To help the process of diversification, the country urgently needs better private sector regulation to increase healthy competition, reduce monopoly power, remove illegal **cartels**, lower corruption and encourage technological innovation.

[Sources: adapted from www.vanguardngr.com, accessed 17 August 2016 and www.sciedupress.com, accessed 18 August]

(This question continues on the following page)



(Question 4 continued)

Figure 3 – Selected economic data for Nigeria

Human Development Index (HDI)	0.514; rank 152 (2015)
Absolute poverty rate	46% (2009)
Population	182 million (2015)
Population under the age of 25	62% (2015)
GDP growth rate	-2.06% (July 2016)
Core inflation rate	17.1% (July 2016)
Unemployment rate	13.3% (July 2016)

[Sources: adapted from www.tradingeconomics.com, accessed 14 August 2016; <http://hdr.undp.org>, accessed 14 August 2016; www.cia.gov, accessed 14 August 2016; <http://data.worldbank.org>, accessed 14 August 2016; <http://allafrica.com>, accessed 13 August 2016; www.theguardian.com, accessed 13 August 2016; www.theguardian.com, accessed 13 August 2016 and www.proshareng.com, accessed 2 October 2016]

- (a) (i) Define the term *recession* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *cartels* indicated in bold in the text (paragraph ❸). [2]
- (b) Using a cost diagram, explain how economies of scale would make Nigerian firms more competitive. [4]
- (c) Using a monopoly diagram, explain why monopolies refusing to lower prices for consumers create a “welfare loss” (paragraph ❷). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate import-substitution and diversification as a means of achieving economic development in Nigeria. [8]