Diploma Programme
Programme du diplôme
Programa del Diploma

Economics
Higher level
Paper 2

Thursday 16 May 2019 (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]**.

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Section A

Answer **one** question from this section.

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

Canadian drywall tariffs will continue

❶ Recently imposed Canadian tariffs on drywall imports have pushed up the cost of building a new home by thousands of Canadian dollars (CA$) in the last four months. Drywall is a pre-made wall section that is used in the construction industry for building houses. Doubt as to whether the tariffs will remain is causing uncertainty for building firms, drywall manufacturers and homeowners.

❷ For now, higher prices will continue following a ruling by the Canadian International Trade Tribunal (CITT) this week. The tribunal found that United States (US) firms had been **dumping** drywall products into Western Canada over the past few years, harming the Canadian drywall industry.

❸ The ruling will end preliminary tariffs of up to 276% imposed by Canada on imports of drywall from the US. However, they will be replaced by permanent, variable tariffs that would be imposed on imported drywall products whose prices fall below the minimum prices determined by the CITT.

❹ "The preliminary tariff was very damaging to homebuilding," said a building industry spokesperson. "Not just homebuilding, but hospitals, commercial buildings, indeed any new construction," he said. "It's a cost that someone had to pay for. It lowered the profits of house builders." It has been estimated that the immediate sharp increase in **variable costs**, following the imposition of the preliminary tariff, resulted in an extra CA$3000 to CA$5000 on the cost of building some homes.

❺ The preliminary tariffs were imposed after a dumping complaint by CertainTeed Gypsum Canada (CTGC), the last drywall manufacturer in Western Canada. CTGC has three major production sites and two gypsum quarries. Gypsum is a main component of drywall.

❻ A CTGC spokesperson had said previously that its plants and quarries could be closed, at the cost of 200 jobs, if the dumping of US drywall products continued. However, since the preliminary tariffs were imposed, the firm has announced that it has hired 30 new employees.

❼ In a separate report, the CITT found that the preliminary tariffs had been "substantially reducing competition" in Western Canada, to the detriment of Canada's homebuilders. In response, supporters of the tariff have suggested that revenue from the tariffs may be used to help areas that lost large numbers of homes and other structures in devastating forest fires.

[Source: adapted from *Drywall tariffs will continue*, www.kamloopsthisweek.com, 5 January 2017]

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(Question 1 continued)

(a) (i) Define the term *dumping* indicated in bold in the text (paragraph ❷). [2]

(ii) Define the term *variable costs* indicated in bold in the text (paragraph ❹). [2]

(b) Using a tariff diagram, explain the effect of the "preliminary tariffs" on Canadian consumers of drywall (paragraph ❸). [4]

(c) Using a demand and supply diagram, explain how the "imposition of the preliminary tariff" may have affected the market for new homes built in Canada (paragraph ❹). [4]

(d) Using information from the text/data and your knowledge of economics, evaluate the effect of the tariff on drywall on different stakeholders. [8]

2. Study the following extract and answer the questions that follow.

Current account deficit poses a challenge to Pakistan's economy

❶ The president of Pakistan has expressed his concern at the significant increase in Pakistan's current account deficit. The current account deficit grew to US$12.12 billion in the fiscal year of 2016/17 compared to US$4.86 billion in 2015/16. The deficit was caused by rising imports and falling exports. The increasing current account deficit may result in Pakistan having to request a new International Monetary Fund (IMF) loan to fund the deficit. To avoid this, the president is proposing that the importing of luxury, non-essential items needs to be reduced.

❷ The governor of Pakistan's **central bank** agreed with the president's concern. He said that the "rapidly growing current account deficit is the biggest challenge facing the country's economy". He agreed that the problem is made worse because many non-essential imports are being purchased, which requires borrowing from abroad. However, he stressed that while rising non-essential imports are a problem, "32 % of imports are capital goods" and are necessary for the continued growth of small to medium enterprises (SMEs), agriculture, housing and construction.

❸ Central bank advisors have also recommended depreciating the rupee (Pakistan's currency) to reduce the trade deficit. The value of the rupee is currently controlled through a managed exchange rate system. It has been suggested that the rupee is overvalued by as much as 20 %. However, the central bank governor claims that a "depreciation has a number of negative effects".

❹ In 2016, Pakistan's economic growth reached 5.3 %, its highest point for 10 years. The government has estimated that it will be 6 % in 2017. According to the central bank governor, loans to SMEs are currently only 7 to 8 % of all loans to businesses in Pakistan. He believes that if loans to SMEs were increased to 15 to 17 % of all loans to businesses in Pakistan, there would be even higher economic growth.

❺ Along with the current account deficit, **fiscal policy** decisions have also led to a significant budget deficit. The budget deficit increased in 2016, resulting in greater public debt. The central bank recommends the government's debt to be limited to 60 % of gross domestic product (GDP).

[Source: adapted from *Current account deficit may lead to IMF loan: FPCCI chairperson*, https://www.thenews.com.pk/print/226102-Current-account-deficit-may-lead-to-IMF-loan-FPCCI-chairperson and *Current account deficit poses biggest challenge to economy: SBP*, https://www.thenews.com.pk/print/225481-Current-account-deficit-poses-biggest-challenge-to-economy-SBP. Copyright © The News International, Karachi, Pakistan.]

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(Question 2 continued)

(a) (i) List **two** functions of the central bank (paragraph ❷). [2]

(ii) Define the term *fiscal policy* indicated in bold in the text (paragraph ❺). [2]

(b) Using an exchange rate diagram, explain how the central bank might depreciate the value of the rupee (paragraph ❸). [4]

(c) Explain the difference between a current account deficit and a budget deficit (paragraph ❺). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the effects of the increasing current account deficit on Pakistan’s economy. [8]

Section B

Answer **one** question from this section.

3. Study the following extract and answer the questions that follow.

China's increasing presence in Bolivia

❶ Between 2000 and 2014, annual bilateral trade between China and Bolivia increased dramatically from US$75.3 million to US$2.25 billion. China has become the fifth-largest market for Bolivian exports, which mostly consist of raw materials such as minerals, hydrocarbons, wood and soybeans.

❷ At the same time, China has become Bolivia's main source of imports. China now supplies half of Bolivia's clothing, cars, motorcycles, cell phones, computers and other electronics. Bolivia's expenditure on Chinese imports significantly exceeds the revenue that is received from its exports to China. Since 2014, Bolivia has experienced significant current account deficits with China.

❸ In recent years, the Bolivian government has taken loans from Chinese banks to support the purchase of Chinese imports of goods and services, along with Chinese-built roads, bridges, railways, hydroelectric power plants and mining facilities. In 2015, the Bolivian government owed more than US$600 million to Chinese banks.

❹ The socialist Bolivian government wants to implement an ambitious Five-Year National Development Plan from 2016 to 2020. Faced with sharply declining export revenues and commodity prices, it will rely increasingly on foreign capital to fund its projects.

❺ All projects financed by Chinese loans must be awarded to Chinese companies, which come with their own materials, equipment and technology, and often their own labour. The new loans will have a combination of commercial **interest rates**, between 2.5 % and 4 %, and concessional interest rates, up to 1 %. The Bolivian government is expecting to be able to repay the loans through continued growth of the economy.

❻ China's foreign direct investment (FDI) is mostly being aimed at energy and infrastructure development. Chinese firms are currently involved in major road-building projects, hydroelectric power station projects, expanding airports and developing a steel-producing plant. These projects have created problems for local communities in terms of water contamination and the overuse of Bolivia's scarce water supply.

❼ This FDI strategy generates profits for Chinese firms in the short term, as they build and improve the infrastructure. Since Bolivia is a resource-rich country, Chinese firms will be looking to invest in profitable mining projects in the future, once the infrastructure is in place.

[Source: adapted from *Financial sovereignty or a new dependency? How China is remaking Bolivia*, http://nacla.org/blog/2017/08/11/financial-sovereignty-or-new-dependency-how-china-remaking-bolivia, 10 August 2017, this article was originally published by NACLA; and Trading Economics, *Bolivia Current Account*, https://tradingeconomics.com/bolivia/current-account, accessed 9 October 2017]

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(Question 3 continued)

(a) (i) Define the term *interest rates* indicated in bold in the text (paragraph ❺). [2]

(ii) Describe the nature of foreign direct investment (paragraph ❻). [2]

(b) Using information from the text, explain **two** reasons why Chinese multinational corporations (MNCs) are investing in Bolivia. [4]

(c) Using an externalities diagram, explain how the Chinese infrastructure projects have caused negative externalities (paragraph ❻). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the possible effects of Chinese involvement on economic growth and development in the Bolivian economy. [8]

4. Study the following extract and answer the questions that follow.

The World Bank reports on economic growth in Kenya

❶ The World Bank's recent overview of Kenya has given a positive assessment of Kenya's growth prospects, based on domestic and international factors. The East African nation of Kenya has a population of approximately 46.1 million, which increases by an estimated one million per year. The World Bank projected 5.9 % economic growth in 2016, rising to 6 % in 2017. This positive outlook is based on continued low oil prices, growth in the agricultural sector, expansionary monetary policy and ongoing infrastructure investments.

❷ The World Bank has identified other key contributing factors to Kenya's short-term growth. These include an expanding services sector, higher levels of construction, currency stability, low inflation, a growing middle-class and rising incomes, a surge in remittances (money sent by a foreign worker to their home country) and increased public **investment** in energy and transportation.

❸ Tourism, information and communications and public administration are among the sectors that have registered the highest growth. Inflation has been at an average of 6.3 %, which is within the Kenyan central bank's target range.

❹ The World Bank also predicted that, of 82 countries investigated, Kenya would have the highest long-term growth and that its real gross domestic product (GDP) in 2050 should be seven times larger than it is today. Fast population growth, a modest improvement in the business environment, urbanization and fast-growing neighbouring countries are all contributing factors to the positive prediction.

❺ While the growing Kenyan economy is creating more jobs now than in the past, these are mainly in the informal services sector and are low **productivity** jobs. 9 million young people will join the labour market in the next 10 years. Given the scarcity of formal sector jobs, they will continue to find jobs in the informal sector. These jobs are usually in very small businesses, often run from homes.

❻ The World Bank suggests that there is a need to increase the productivity of jobs in the informal sector. It says that this could be achieved by increasing work-related skills through training schemes, increasing communication and learning between formal and informal firms, and helping small-scale firms to become suppliers for firms in the formal sector. To create more and higher-skilled jobs, it is also essential to reduce the cost of doing business.

❼ According to the World Bank, Kenya has made significant structural and economic reforms that have contributed to sustained economic growth in the past decade. However, economic growth does not always mean economic development. The main development challenges facing Kenya include poverty, inequality, climate change, low commodity prices and the vulnerability of the economy to internal and external shocks.

[Source: adapted from The World Bank Country Overview, http://www.worldbank.org/en/country/kenya/overview, 7 March 2017; Kenya in 2050, The Economist Intelligence Unit, https://www.eiu.com/public/topical_report.aspx?campaignid=ForecastingTo2050, 13 July 2017, data reused by permission of The Economist Intelligence Unit; and World Bank economic updates, Kenya's Economy Strong in a Challenging Global Environment, http://www.worldbank.org/en/country/kenya/publication/kenya-economic-update-economy-strong-challenging-global-environment, March 2016.]

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(Question 4 continued)

(a) (i) Define the term *investment* indicated in bold in the text (paragraph ❷). [2]

(ii) Define the term *productivity* indicated in bold in the text (paragraph ❺). [2]

(b) Using an AD/AS diagram, explain how expansionary monetary policy might lead to economic growth (paragraph ❶). [4]

(c) Explain the difference between economic growth and economic development (paragraph ❼). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the extent to which continued economic growth may lead to economic development in Kenya. [8]