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Economics
Standard level
Paper 2

Monday 10 May 2021 (morning)

45 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.
- Answer one question either from Section A or from Section B.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is **[20 marks]**.

Answer **one** question **either** from Section A **or** from Section B.

Section A

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

China's trade reforms

- ❶ The Chinese government has announced a set of free trade measures, including lower import tariffs on cars, soybeans and pharmaceuticals, in an attempt to end a **trade war** with the United States (US).
- ❷ The US government has long accused China of engaging in unfair trade practices to maintain their current account surplus. The trade dispute between the two largest economies intensified when the US said it would impose anti-dumping tariffs on Chinese steel and aluminium.
- ❸ The trade war with the US comes at a bad time given the slowdown in China's domestic demand. In recent years, China's economic growth has relied less on investment and exports and more on **consumption** expenditure.
- ❹ Producers of many Chinese manufactured goods currently benefit from protectionist measures. In particular, imports of industrial equipment, medical devices, tractors and vehicles are subject to high tariffs.
- ❺ Automobile production capacity in China is growing. However, the domestic market is becoming oversupplied, with more cars being offered for sale than Chinese consumers want to buy. For this reason, Chinese car manufacturers are seeking to export their cars to other markets. They are therefore eager to see reduced trade tensions as increased US tariffs would make it harder to export Chinese cars to the US.
- ❻ Some Chinese car manufacturers are already focusing on adding advanced capabilities to their cars in order to be more competitive in global markets. China is increasing its efforts to become a world leader in self-driving cars. These will be intelligent cars that will improve transport efficiency and meet energy-saving and emission-reduction targets. Many believe that Chinese companies are so innovative that they no longer require protection from international enterprises.
- ❼ However, many Chinese firms remain dependent on imported factors of production. Approximately 30% of Chinese exports are manufactured using imported equipment and components. The reduction of tariffs would therefore lower prices not only for producers but also for consumers of Chinese goods.

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term *trade war* indicated in bold in the text (paragraph ❶). [2]
- (a) (ii) Define the term *consumption* indicated in bold in the text (paragraph ❸). [2]
- (b) Using an international trade diagram, explain how US tariffs could affect the export of Chinese steel and aluminium to the US (paragraph ❷). [4]
- (c) Using a demand and supply diagram, explain how reduced tariffs on “imported factors of production” would affect the price of Chinese goods (paragraph ❹). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the impacts of free trade measures on China’s economy. [8]

Turn over

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

The fall of the Indian rupee

- ❶ Over the past year, India's **current account** deficit widened as the 14 % increase in export revenue could not offset the rise in import expenditure. Over the same period, the value of the rupee (India's currency) has fallen by 13 %.
- ❷ The rise in import expenditure was in part caused by higher oil prices following production cuts by the Organization of the Petroleum Exporting Countries (OPEC). Another reason for the increase in import expenditure was the higher spending on machinery and capital goods needed to achieve economic growth.
- ❸ Exports of services, especially software services, have helped to boost export revenue. However, one critical weakness in India's exports of services is the lack of diversification. Exports of software services account for more than 41 % of India's total service exports and more than 90 % of its software service exports are restricted to the United States and the European Union.
- ❹ The **depreciation** of the rupee, one of the steepest seen in recent years, has resulted in fears of high inflation. An economist at the Reserve Bank of India (India's central bank) has warned that the increase in oil prices and consumers' expectations of rising inflation could worsen inflationary pressures.
- ❺ Despite calls for an increase in interest rates in order to protect the rupee from further depreciation, the Reserve Bank of India has chosen to keep interest rates unchanged. The combined effect of a fall in confidence and higher interest rates would dampen economic growth.

Table 1: Selected economic indicators for India

	2016	2017	2018
Inflation rate (%)	4.5	3.6	4.7
Real gross domestic product (GDP) growth rate (%)	7.1	6.7	7.3

(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *current account* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *depreciation* indicated in bold in the text (paragraph ❷). [2]
- (b) Using an AD/AS diagram, explain how an increase in oil prices “could worsen inflationary pressures” (paragraph ❸). [4]
- (c) Using an exchange rate diagram, explain how higher interest rates could “protect the rupee from further depreciation” (paragraph ❹). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible economic consequences on the Indian economy of a depreciating rupee. [8]

Turn over

Section B

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

Angola's economic reforms

- ❶ Following an oil price crash in 2014, Angola has endured a **recession**, a dramatic rise in inflation and empty supermarket shelves caused by severe shortages of foreign currency. Angola is highly dependent on export revenues from oil production, a major source of United States dollars. The foreign currency is needed to import manufactured goods because the country's manufacturing sector is small.
- ❷ To respond to these challenges, the president of Angola has presented a plan with desperately needed reforms to promote economic development. The plan proposes tax incentives to attract foreign investment and **privatization** of the telecommunication and railway sectors. It also aims to expand infrastructure projects with private sector involvement. In addition, reforms are recommended to make the banking sector stronger. This is important if the government wants to reduce the borrowing costs experienced by Angolan businesses.
- ❸ The recent 20% devaluation of the kwanza (Angola's currency) is another sign that the government is serious about making Angola attractive to foreign direct investment (FDI). Angola has a fixed exchange rate. As the kwanza has been overvalued, this has caused a reduction in foreign currency reserves.
- ❹ Angola's future economic growth is likely to be low. The business environment for firms remains difficult. High borrowing costs, corruption and poor infrastructure remain challenges. The government has failed to exploit Angola's vast agricultural potential. The country depends heavily on oil revenues, which are falling.
- ❺ Living conditions for households are also poor as inflation is expected to remain above 25%. Approximately 40% of Angolans live in absolute poverty and unemployment is high, especially in rural areas. Aware of the urgent need to reduce regional inequality, the government has announced plans to encourage investment in rural areas. However, there are also proposals to reduce public debt by removing some subsidies on food and by introducing *ad valorem* taxes.
- ❻ Although Angola's economic growth has been slow, it remains the third-largest economy in sub-Saharan Africa and the government is the second-largest public spender in the region.

(This question continues on the following page)

(Question 3 continued)

- (a) (i) Define the term *recession* indicated in bold in the text (paragraph ❶). [2]
- (a) (ii) Define the term *privatization* indicated in bold in the text (paragraph ❷). [2]
- (b) Using a demand and supply diagram, explain the impact on households of “removing some subsidies on food” (paragraph ❸). [4]
- (c) Using a Lorenz curve diagram, explain the likely impact on income distribution of “plans to encourage investment in rural areas” (paragraph ❹). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the effectiveness of market-oriented policies in achieving economic development in Angola. [8]

Turn over

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

Economic growth in Laos

- ❶ The construction of the China–Laos railway is a major contributor to Laos’ **economic growth**. This landlocked country is projected to grow by 7 % this year, which is a good achievement for a country still experiencing low incomes and over-reliance on the agricultural sector.
- ❷ The 420 kilometre railway line will connect China to Laos and link Southeast Asian countries all the way to Singapore. The railway will improve the communication between resource-rich Laos and its neighbours, all of which have larger markets. This will increase both trade and tourism in the region. With the help of Chinese investment, the Lao government also plans to increase its hydroelectric power generation capacity in the next 12 years. This could mean a total of 429 dams on the Mekong River by 2030. However, environmentalists say that the excessive construction of dams could destroy the ecosystem.
- ❸ Five years ago, the Lao government introduced a policy to privatize state-owned property, designed to attract foreign direct investment (FDI). The privatization policy was especially appealing to Chinese investors and has succeeded in increasing FDI in Laos. The Lao government sold a share in its telecommunication industry to a Chinese firm, which helped launch Laos’ first satellite. This not only improved internet connection quality for communication purposes but also made health services and education more accessible in rural areas, where 61 % of the labour force work as farmers.
- ❹ The Lao government hopes that Chinese investment will not only introduce technological innovations but will also bring jobs that would help many of the citizens of Laos to break out of the **poverty trap**. Six Chinese construction companies are now carrying out construction along the entire railway track and are employing a total of 50 000 workers, although these are mostly Chinese.
- ❺ Many are concerned that Laos may be heading for a debt crisis with so much investment financed through borrowing. The construction of the railway will cost an estimated US\$6 billion, which will be 60 % funded by foreign investors. The governments of China and Laos will finance the remaining 40 %. Laos’ total commitment to the building of this infrastructure is US\$840 million. Around US\$500 million of that amount will come from loans from China. The remaining amount will be drawn from the government budget.

(This question continues on the following page)

(Question 4 continued)

- (a) (i) Define the term *economic growth* indicated in bold in the text (paragraph ❶). [2]
 - (a) (ii) Define the term *poverty trap* indicated in bold in the text (paragraph ❷). [2]
 - (b) Using an AD/AS diagram, explain how the construction of the China–Laos railway will contribute to economic growth in Laos (paragraph ❶). [4]
 - (c) Using an externalities diagram, explain why the construction of dams on the Mekong River might lead to market failure (paragraph ❷). [4]
 - (d) Using information from the text/data and your knowledge of economics, evaluate the role of foreign direct investment in promoting economic development in Laos. [8]
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