Economics
Higher level
Paper 2

Thursday 27 October 2022 (morning)

1 hour 45 minutes

Instructions to candidates

- Do not open this paper until instructed to do so.
- You are permitted access to a calculator for this paper.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- 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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Answer **one** question.

1. Read the extracts and answer the questions that follow.

Text A — Overview of Tanzania

1 Tanzania is one of Africa's fastest growing economies with an average of 7 % annual economic growth since 2000. It is a politically stable country, rich in wildlife and natural resources. However, the growth has been concentrated in urban manufacturing, using capital intensive production. The benefits from this growth have not reached all people and significant inequalities exist between urban and rural areas. Although the relative poverty rate has fallen over the last 15 years, the number of people living in absolute poverty has increased.

2 Most people are employed in the slow-growing agricultural sector that relies on unskilled labour. Although incomes increased from 2008 to 2018, the **demand** for agricultural goods only increased by 21 % during this time period. Over 70 % of Tanzania's population lives in rural areas, relying on subsistence farming with limited tradable crops. Only 30 % of land is being used for agricultural production. With investment, the remaining unused land could be developed and generate income for farmers.

3 The rural sector struggles to meet Tanzania's food requirements due to low levels of skilled labour and productivity. Additionally, high youth unemployment leads to large numbers of unskilled rural youth migrating to the cities, often finding employment in the informal sector where wages and working conditions are poor. Insufficient investment and lack of government support for diversifying the agriculture sector have been blamed for the persistent inequalities and poverty.

4 Tanzania's cities have experienced a growing middle class with strong purchasing power and political influence who have placed demands on the government for cheaper electricity, better infrastructure, and more imported goods. In response, the government provided subsidies for electricity in city centres and tax benefits to foreign companies operating in Tanzania. There is concern that these measures may worsen inequality and lead to social unrest.

5 The growth of Tanzania's manufacturing and service sector was funded through aid and large government borrowing, resulting in high national debt. Most of the government borrowing was from foreign sources and in US dollars (US$), which is a concern due to a recent depreciation of the Tanzanian shilling (Tanzania's currency) against the US$. Some of the debt was borrowed domestically and placed upward pressure on interest rates. Higher interest rates have resulted in crowding out but helped keep inflation under control.

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(Question 1 continued)

Text B — Strategies and opportunities for Tanzania

1 Previous governments have used interventionist supply-side policies to improve access to water, education, and health services. However, the health service improvements are not keeping up with population growth and many young people are still not completing secondary school. Infrastructure has improved, but it is still insufficient as producers in the rural sector find it difficult to reach markets and access supplies.

2 Aid organizations are currently supporting new sustainable businesses in rural areas through training programmes, especially for women and young people, who make up most of the unemployed in rural areas. Economists have advised the government to improve access to credit through microfinance organizations and to simplify regulations to make it easier to start new businesses.

3 The government is establishing property rights in rural areas to provide security for farmers. Historically, farmers could easily lose their land, which reduced their incentive to invest in productive farming methods. The government wants to develop Tanzania's land resources and lower its reliance on imported food. To reduce food imports, a subsidy will be granted to dairy farmers to allow them to compete against imported dairy products.

4 Tanzania is a member of the East African Community (EAC) customs union and common market. However, Tanzania needs to improve human capital and encourage diversification so that the benefits of regional integration can reach the poor. These policies can also help attract foreign direct investment (FDI). Opportunities for growth through trade will expand as the EAC works towards becoming a monetary union in 2024.

Text C — Oil pipeline to be constructed

Tanzania and Uganda plan to construct a major oil pipeline from Uganda through Tanzania, ending at a port in Tanzania. This will attract FDI which could help fund infrastructure and generate jobs. However, environmentalists are concerned about potential ecological damage due to the waste created during the construction of the pipeline. Economists have suggested the waste could be avoided through a **circular economy** approach in the planning and construction stage.

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(Question 1 continued)

Table 1: Economic data for Tanzania

	2008	**2018**
Real gross national income (GNI) per capita (US$)	1880	2538
Youth unemployment rate (%)	5.7	7.5
Government (national) debt (% of GDP)	21	38.7
External debt (US$ billion)	6	23

Table 2: Development data for Tanzania

	2008	**2018**
Human Development Index (HDI)	0.465	0.524
HDI ranking	161	163
Gini coefficient	0.38*	0.41
Enrolment in secondary education (% of school-age population)	30	25
Population (million)	42	58
Government spending on health (% of GDP)	5.1	3.6
Government spending on education (% of GDP)	4.2	3.5
Absolute poverty (millions of people)	13	14
Access to electricity in rural areas (% of population)	2	16
Access to electricity in urban areas (% of population)	40	65

* Estimate

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(Question 1 continued)

(a) (i) Define the term *demand* indicated in bold (**Text A**, paragraph 2). [2]

(ii) Define the term *circular economy* indicated in bold (**Text C**). [2]

(b) (i) Using information from **Text A**, paragraph 2 **and Table 1**, calculate the income elasticity of demand (YED) for agricultural goods in Tanzania considering the change in income between 2008 and 2018. [3]

(ii) Sketch a Lorenz curve diagram to show the change in Tanzania's Gini coefficient from 2008 to 2018 (**Table 2**). [2]

(c) Using an AD/AS diagram, explain how crowding out may help control inflationary pressure in Tanzania (**Text A**, paragraph 5). [4]

(d) Using an international trade diagram, explain how a subsidy could help Tanzanian dairy farmers compete against imported dairy products (**Text B**, paragraph 3). [4]

(e) Using an exchange rate diagram, explain what could happen to the value of the Tanzanian shilling if there is increased inward foreign direct investment (FDI) in Tanzania (**Text B**, paragraph 4). [4]

(f) Using an externalities diagram, explain how the construction of an oil pipeline through Tanzania could result in market failure (**Text C**). [4]

(g) Using information from the text/data and your knowledge of economics, discuss the different barriers to economic growth **and** to economic development faced by Tanzania. [15]

2. Read the extracts and answer the questions that follow.

Text D — Overview of Lebanon

1 Lebanon is in the Middle East, bordering the Mediterranean Sea, and is home to nearly 7 million people. Lebanon is in an economic crisis, facing a recession, huge government debt and rising income inequality, poverty and inflation. Corruption and poor governance have been blamed for misallocation of funds that has led to low levels of investment and extensive capital flight. Additionally, Lebanon has one of the most unequal distributions of wealth in the world. In 2019, the top 10% of income earners owned over 70% of personal wealth in Lebanon.

2 Infrastructure in Lebanon is poor, water and sewerage systems are basic, and roads are inadequate. Electricity supply is unreliable with people going without power for much of the day. In 2020, major buildings including food storage buildings, schools and hospitals were damaged in Beirut (the capital city of Lebanon). This was concerning as 85% of the country's food arrives through Beirut. Fortunately, **humanitarian aid** was given by the international community to help rebuild the damaged buildings.

3 Despite a history of inflows from luxury tourism and remittances (money sent by a foreign worker to their home country), there is a persistent current account deficit. To help with this, the Lebanese central bank has used high interest rates to attract financial inflows. Additionally, the government has borrowed funds from overseas. However, the misuse of these funds and overspending have contributed to one of the highest foreign debts in the world. Lebanon recently defaulted on foreign debt repayments worth 1.2 billion euros, which damaged its international credit rating, making it difficult to access loans needed to help solve its current economic problems.

Text E — Further challenges facing Lebanon

1 Social unrest is prevalent and intensified when the government suggested raising revenue by imposing an indirect tax on social media applications such as WhatsApp. As the government struggles to pay its debts, people are concerned that subsidies on necessities such as wheat, medicine and fuel will be removed.

2 Mismanagement of the state-run electricity and telecommunications sectors has resulted in unreliable services and high telecommunication prices. The state-run **monopoly** firms make losses, and the electricity sector relies heavily on government subsidies, putting pressure on the budget deficit.

3 Lebanon currently has a managed exchange rate system with the Lebanese pound (Lebanon's currency) linked to the US dollar (US$). However, the government is finding it difficult to maintain the exchange rate at the desired level due to insufficient reserve assets. Recent falling remittances, low levels of exports and lack of foreign direct investment (FDI) are placing downward pressure on the Lebanese pound. Lebanon has limited natural resources and a small manufacturing industry, thus relies heavily on imports. As a consequence, the gradual depreciation of the Lebanese pound has led to cost-push inflation.

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(Question 2 continued)

Text F — Reforms and strategies for economic recovery

1 The Lebanese government is seeking help from the International Monetary Fund (IMF) to restructure the government debt and develop its infrastructure. However, loans from the IMF will require the following conditions to be met:

- procedures and processes established to ensure good governance, including enforcement of anti-corruption laws
- financial sector reforms implemented to build confidence in the banking system and laws to control capital flight
- government spending reduced and revenue increased through higher corporate, wealth and personal income taxes for high-income earners. Introduction of a tax on imported luxury goods and an increase of indirect taxes
- partially privatizing the electricity and telecommunications sectors to increase efficiency and encourage the exploration of new energy sources
- transitioning from a managed to a floating exchange rate system.

2 Other organizations are offering development aid to rebuild infrastructure and support small to medium-sized businesses to develop the manufacturing sector and attract FDI. Currently, the manufacturing sector accounts for only 12.5% of gross domestic product (GDP). Some experts recommend that Lebanon decreases its reliance on food imports by developing its own food industry. However, Lebanon must commit to establishing good governance systems before aid organizations will provide their support.

3 Lebanon has resisted seeking help from the IMF and other agencies in the past due to concerns about high levels of interference and imposed conditions that may conflict with their own government objectives.

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(Question 2 continued)

Table 3: Economic data for Lebanon

	2015	**2020**
Real GDP (annual growth rate, %)	0.21	–25
GDP (US$ billion, nominal)	50	19
Income received from abroad (US$ billion)	2.4	2.8*
Income sent abroad (US$ billion)	2.9	4.1*
Youth unemployment rate (% of population under 25 years)	17.36	34
Inflation rate (%)	–3.7	85.5
Budget deficit (% of GDP)	7.5	16.5
Government debt (% of GDP)	141	172
Current account balance (US$ billion)	–9.9	–3.1

* 2019

Table 4: Development data for Lebanon

	2015	**2020**
Human Development Index (HDI)	0.744	0.744 (2019)
Relative poverty (% of population)	27.4 (2011)	45
Corruption index ranking (1 = least corrupt country)	123	149

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(Question 2 continued)

(a) (i) Define the term *humanitarian aid* indicated in bold (**Text D**, paragraph **2**). [2]

(ii) Define the term *monopoly* indicated in bold (**Text E**, paragraph **2**). [2]

(b) (i) Using information from **Table 3**, calculate the 2015 gross national income for Lebanon. [3]

(ii) Sketch a demand and supply diagram to show the impact of an indirect tax on the market for social media applications such as WhatsApp (**Text E**, paragraph **1**). [2]

(c) Using a PPC diagram, explain the impact of the damage to the major buildings in Beirut on Lebanon's productive capacity (**Text D**, paragraph **2**). [4]

(d) Using an AD/AS diagram, explain how falling remittances may affect Lebanon's real output (**Text E**, paragraph **3**). [4]

(e) Using an exchange rate diagram, explain how Lebanon's current account balance could affect the Lebanese pound (**Text D**, paragraph **3**). [4]

(f) Using a monopoly diagram, explain why a profit-maximizing state-run telecommunications firm might be making a loss (**Text E**, paragraph **2**). [4]

(g) Using information from the text/data and your knowledge of economics, discuss the impact of the proposed IMF conditions (**Text F**, paragraph **1**) on Lebanon's economic growth **and** economic development. [15]

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