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Economics
Higher level
Paper 2

Thursday 7 November 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]**.

Section A

Answer **one** question from this section.

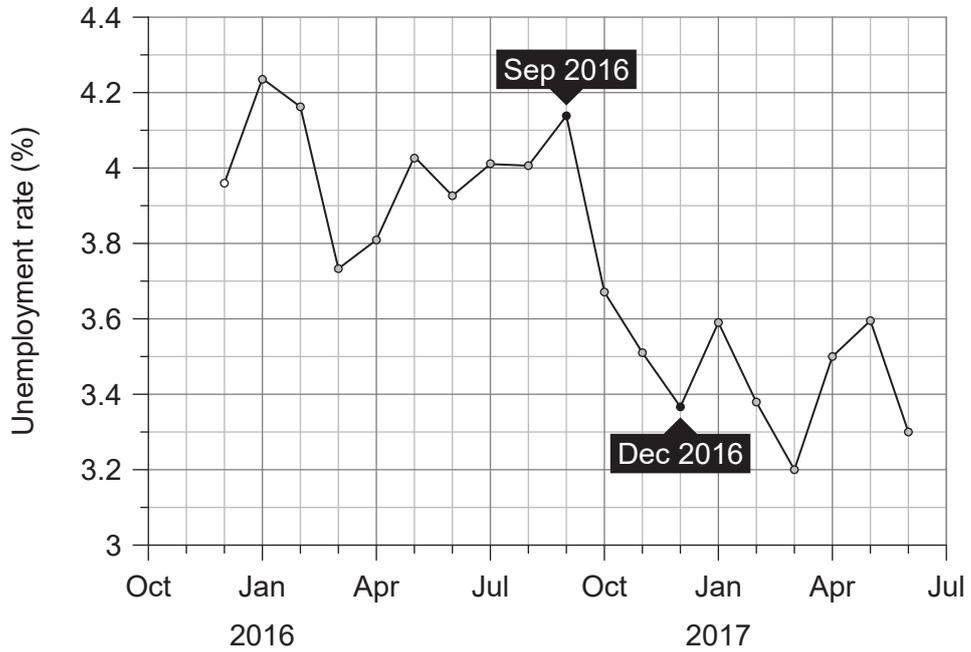
1. Study the following extract and data and answer the questions that follow.

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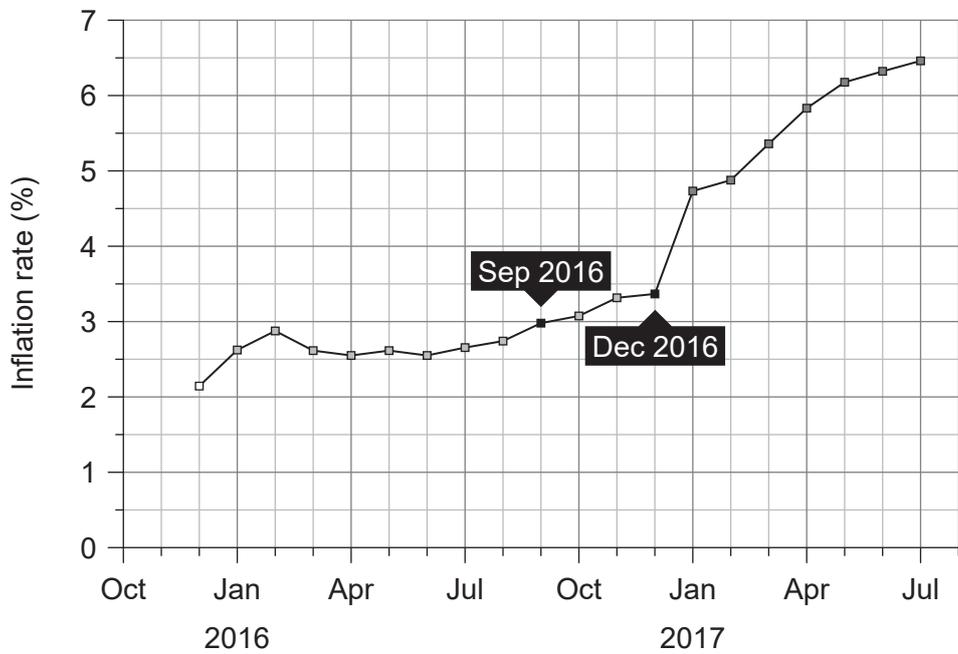
(Question 1 continued)

Figure 1: Mexico unemployment rate



[Source: adapted from <https://tradingeconomics.com>, accessed 12 August 2017]

Figure 2: Mexico inflation rate



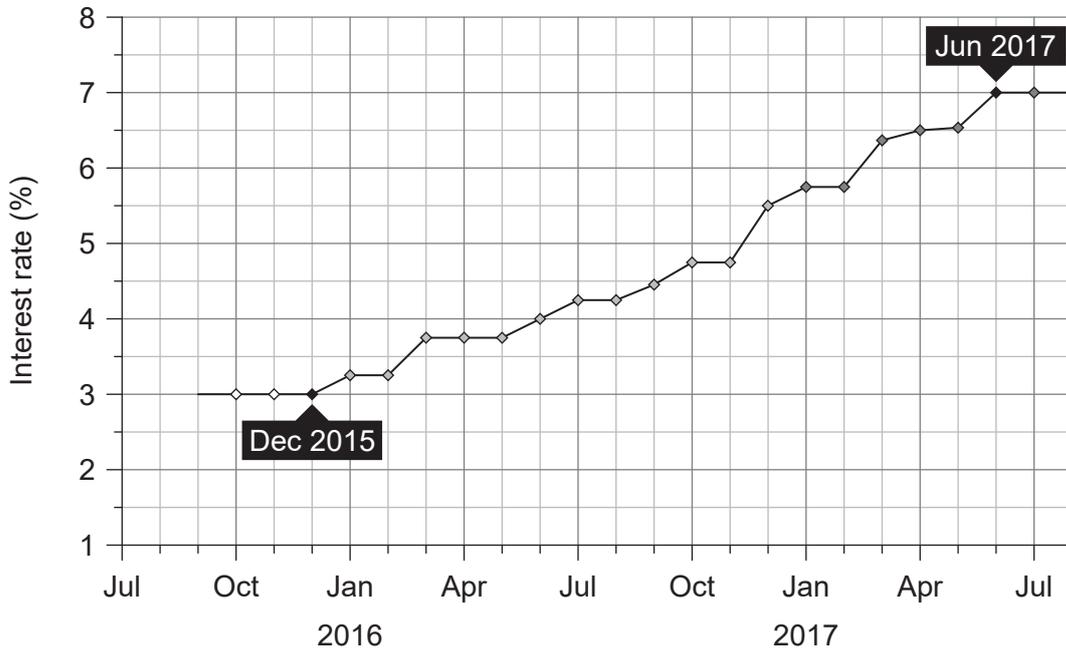
[Source: adapted from <https://tradingeconomics.com>, accessed 12 August 2017]

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(Question 1 continued)

Figure 3: Mexico interest rate



[Source: adapted from <https://tradingeconomics.com>, accessed 12 August 2017]

- (a) (i) Define the term *exchange rate* indicated in bold in the text (paragraph 1). [2]
- (a) (ii) Define the term *trade war* indicated in bold in the text (paragraph 1). [2]
- (b) Using data from **Figure 1** and **Figure 2** to create a Phillips curve diagram, explain the relationship between the unemployment rate and the inflation rate between September and December 2016. [4]
- (c) Given that Mexico has a current account deficit, explain why “a rapid rise in foreign direct investment (FDI) reduced Mexico’s reliance on portfolio investment, which has been diminishing” (paragraph 3). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible consequences on the Mexican economy of an undervalued Mexican peso. [8]

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

Turkey's rising current account deficit

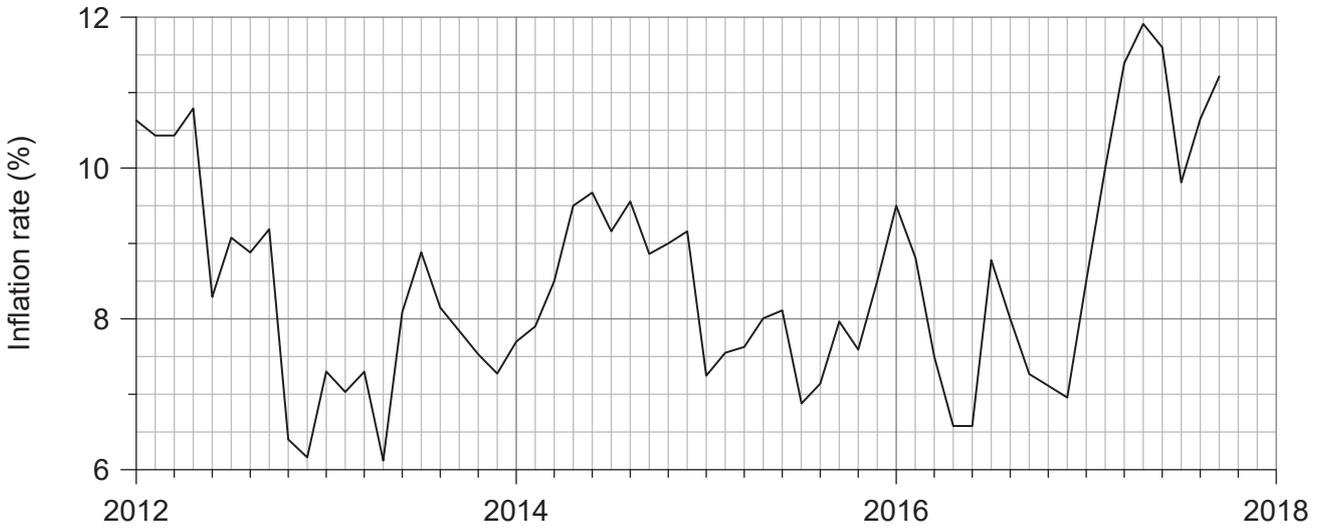
- ❶ According to forecasts from the International Monetary Fund (IMF), Turkey's current account deficit is expected to rise from 4.4 % of gross domestic product (GDP) in 2016 to 5.6 % of GDP in 2017, with real GDP growth falling from 3.3 % in 2016 to 2.9 % in 2017. The current account deficit is perceived to be the biggest problem for Turkey's economy. An international credit agency has reduced Turkey's credit rating to "negative" because risks to the country's credit profile have risen significantly in recent months.
- ❷ Economic activity has been further damaged by several factors, including political uncertainty, conflicts in neighbouring countries and trade protection by its trading partners. Turkey's tourism revenues, which contribute 10 % to the country's GDP, have fallen significantly due to security concerns related to terrorist attacks.
- ❸ The current account deficit has contributed to a massive **depreciation** of the Turkish lira (Turkey's currency), which dropped by 20 % against the United States dollar (US\$) over the previous year. This is a significant problem for Turkey, which relies on a steady inflow of overseas investment to finance its current account deficit.
- ❹ Part of the problem is Turkey's dependence on imports, especially energy. Higher import costs for energy will further worsen Turkey's current account deficit and create further pressure on inflation (**Figure 4**).
- ❺ The Turkish government has blamed the currency collapse on speculators. The president of Turkey has asked Turkish citizens to help. There is approximately US\$140 billion worth of foreign currency being held in foreign currency savings accounts in Turkey. The president wants Turkish people to use their foreign currency savings to support the Turkish lira. However, Turkish citizens seem to have ignored his wishes, and bought US\$1 billion worth of foreign currency in September 2018.
- ❻ Analysts believe that the only solution to the falling value of the Turkish lira and the current account deficit is an increase in the official interest rate by the central bank. However, Turkey's president has made it clear that he will not accept higher interest rates. In fact, he has demanded lower interest rates to stimulate the economy.

[Source: adapted from 'Battered: Turkish lira suffers worst year since 2008', by Mehreen Khan, Markets, FT.COM, 22 December 2016, 'Turks urged to trust in lira to defeat "tyranny of dollar"', by Mehul Srivastava and Jonathan Wheatley, Markets, FT.COM, 07 December 2016, 'Turkish lira tumbles amid fears on economy and terrorist threat', by Mehul Srivastava and Roger Blitz, Markets, FT.COM, 12 January 2017, used under licence from the Financial Times. All Rights Reserved; Turkey's Surging Current Account Deficit and Its Impact in 2017, by Market Realist, Apr. 21, 2017: <http://marketrealist.com/2017/04/turkeys-surging-current-account-deficit-and-its-impact-in-2017/>, 21 April 2017; Turkey's annual current account deficit growth jumps to 68 percent in May, www.intellignews.com, 13 July 2017.]

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(Question 2 continued)

Figure 4: Turkey inflation rate



[Source: adapted from <https://tradingeconomics.com>, accessed 6 September 2017]

- (a) (i) State **two** functions of the International Monetary Fund (IMF) (paragraph ❶). [2]
- (a) (ii) Define the term *depreciation* indicated in bold in the text (paragraph ❷). [2]
- (b) Using an AD/AS diagram, explain how Turkey’s reliance on energy imports is putting “further pressure on inflation” (paragraph ❹). [4]
- (c) Using an exchange rate diagram, explain what is likely to have happened to the Turkish lira when Turkish citizens “bought US\$1 billion worth of foreign currency” (paragraph ❸). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the implications of Turkey’s persistent current account deficit. [8]

Section B

Answer **one** question from this section.

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

Economic development in two West African countries

Ghana

- ❶ Ghana is the world's second largest cocoa producer and Africa's second largest gold producer. It is one of Africa's fastest growing economies and has made major progress in achieving persistent economic growth.
- ❷ Over the last decade, Ghana has enjoyed increasingly stable and improving democratic governance. Four successful elections during the decade have strengthened the effectiveness of key national institutions, improved investor confidence and created an environment that promotes investment and growth.
- ❸ Ghana enjoys a high degree of media freedom; the private press and broadcasters operate without significant restrictions. The media are free to criticize the authorities without fear of punishment, says the non-governmental organization (NGO) Reporters Without Borders. The private press is allowed to express criticism of government policy, which increases the accountability and transparency of the government.
- ❹ Although Ghana's growth has been fairly strong, the source of growth has always been dominated by commodities and the capital-intensive services sector. Neither of these has a direct effect on poverty reduction. Growth in rural areas is often limited by basic infrastructure, such as roads. This limits the ability of people in rural areas to access markets in urban areas.

Nigeria

- ❺ Nigeria is Africa's leading oil producer. In 2016, it experienced its first full year of recession in 25 years. Global oil prices reached a 13-year low and oil production was drastically cut. Oil has continued to dominate Nigeria's growth pattern, but the volatility of oil-dependent growth prevents progress in social and economic development.
- ❻ On the political front, the transition from military dictatorship to democratic rule has been acclaimed as one of Nigeria's major successes in the last decade. The 2011 general election, supported by the United Nations, was widely acknowledged by international observers and domestic monitors as one of the freest and fairest elections conducted in the country in recent years.

Ghana and Nigeria

- ❼ Both Ghana and Nigeria have cut fuel subsidies in order to reduce their budget deficits. This has had severe consequences for low-income households.

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(Question 3 continued)

Table 1: Selected economic data for Ghana and Nigeria

	Ghana	Nigeria
Human Development Index (HDI) value	0.579	0.527
HDI rank	140	151
Gross national income (GNI) per capita in purchasing power parity (PPP) terms (2011, US\$)	3839	5443
Gross domestic product (GDP) per capita in PPP terms (2011, US\$)	3953	5639
Population living below US\$ 1.90 per day (%)	25.2	53.5
Gini coefficient	0.428	0.430
Life expectancy at birth (years)	61	53
Infants who received measles* vaccinations (% of one-year-olds)	92	51
Public expenditure on health (% of GDP)	2.1	0.9
Expected years of schooling	11.5	10
Mean years of schooling	6.9	6.0
Adult literacy rate (% of ages 15 and older)	76.6	59.6

[Source: adapted from *UNDP Ghana country profile*, <http://hdr.undp.org>, accessed 19 February 2019; *UNDP Nigeria country profile*, <http://hdr.undp.org>, accessed 19 February 2019; *About Ghana*, <http://hdr.undp.org>, accessed 19 February 2019; *About Nigeria*, <http://hdr.undp.org>, accessed 19 February 2019]

* measles: a highly contagious disease that is one of the leading causes of death among young children

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(Question 3 continued)

- (a) (i) State the reason for the difference between Ghana’s GNI per capita and its GDP per capita (**Table 1**). [2]
- (ii) Define the term *Gini coefficient* indicated in bold in **Table 1**. [2]
- (b) Using an externalities diagram, explain why the percentage of infants receiving measles vaccinations in Nigeria indicates the existence of a market failure (**Table 1**). [4]
- (c) Using a demand and supply diagram, explain how the cut in fuel subsidies may have had “severe consequences for low-income households” (paragraph 7). [4]
- (d) Using information from the text/data and your knowledge of economics, compare and contrast the level of economic development in Ghana and Nigeria. [8]

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

Economic growth in Cambodia

- ❶ Cambodia has become one of the fastest growing economies in Asia and has now been classified as an upper middle-income country, according to the World Bank.
- ❷ Export promotion has helped Cambodia to grow. It has used low-cost labour to manufacture products for export. This has been helped by the fact that the price of labour has increased in China and other Asian countries. Cambodia's large supply of inexpensive, low-skilled labour has attracted much foreign direct investment (FDI) into the production of garments and footwear for export and contributed to its **economic growth**. Last year, there was a 10.2% increase in the export of garments and footwear in Cambodia, which makes up 70% of its exports.
- ❸ Throughout Asia, hundreds of millions of people have been lifted out of poverty through manufacturing jobs that allowed them to better educate their children, who could then have a better life.
- ❹ However, Cambodia's manufacturing competitiveness is being challenged by other countries in the region, particularly those that manufacture low-cost clothing. A recent increase in the minimum wage may also pose problems. Industry representatives have raised concerns that the garment industry may lose investors, who may leave to find cheaper places, if the minimum wage continues to increase.
- ❺ Cambodia needs to further diversify its economy if it hopes to maintain the high growth rates it has achieved in recent years. To support **diversification**, the government has launched an industrial development policy aimed at upgrading industry from low-cost, labour-intensive manufacturing to production with higher value added. The policy encourages the expansion and modernization of small and medium-sized enterprises, stronger regulations and enforcement, and a better environment for doing business.
- ❻ There remain many challenges to deal with. One of them is growing inequality—there is income inequality between urban and rural areas—as well as gender inequality. Women continue to face disadvantages in gaining access to higher education, well-paid employment opportunities and decision-making roles in government.
- ❼ Approximately 30 000 young Cambodians enter the labour force each year but often do not have the required skills to meet the needs of the labour market. While a large proportion of the labour force is employed, many jobs are informal, vulnerable, unstable and poorly paid. There is a critical need to address problems in education and training and to help children complete school. While 98% of children attend primary school in Cambodia, many drop out later due to a lack of funds. Only 30% of young people complete high school.

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(Question 4 continued)

③ The rapid economic and population growth in Cambodia is leading to significant environmental pollution. Environmentalists have identified garment factories as being one of the four main industrial activities that significantly contribute to air and water pollution.

[Source: adapted from Here Comes Cambodia: Asia's New Tiger Economy, Asian Development Bank, May 10, 2016, <https://www.adb.org/news/features/here-comes-cambodia-asia-s-new-tiger-economy>]

- (a) (i) Define the term *economic growth* indicated in bold in the text (paragraph ②). [2]
 - (a) (ii) Define the term *diversification* indicated in bold in the text (paragraph ⑤). [2]
 - (b) Using a demand and supply diagram, explain why the increase in the minimum wage might affect Cambodia's garment manufacturing competitiveness against other countries in the region (paragraph ④). [4]
 - (c) Using an externalities diagram, explain why the garment industry is a source of market failure (paragraph ③). [4]
 - (d) Using information from the text/data and your knowledge of economics, evaluate export promotion as a strategy for achieving economic development in Cambodia. [8]
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