Diploma Programme
Programme du diplôme
Programa del Diploma

Economics
Standard level
Paper 2

Wednesday 4 November 2015 (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 extract below and answer the questions that follow.

Clean energy products

❶ In a speech on climate change, President Obama announced a plan for the United States (US) to work with trading partners and the World Trade Organization (WTO) towards global free trade in clean energy products, such as solar panels and wind towers.

❷ The US will build on the Asia-Pacific Economic Cooperation (APEC)* agreement where member economies agreed to remove quotas and reduce tariffs to 5% or less by 2015 on a negotiated list of 54 clean energy products.

❸ However, the APEC agreement does not include reducing anti-dumping tariffs. Such tariffs are allowed under WTO rules. When importers are suspected of **dumping** clean energy products on the domestic market, industries seek protection by putting pressure on government to impose anti-dumping tariffs.

❹ In recent years, anti-dumping tariffs on clean energy products have increased. In 2011 China was found to be subsidizing and dumping wind towers on the US market. In retaliation, the US imposed an anti-dumping tariff of between 45% and 71%. In addition, a similar tariff was imposed on Vietnamese wind tower imports.

❺ In the solar industry in 2012, a group of seven US solar panel manufacturers sought protection from cheap Chinese imports. After investigating claims of dumping, the US imposed anti-dumping tariffs ranging from 24% to 36% on Chinese solar panel producers.

❻ The Coalition for Affordable Solar Energy (CASE), which represents importers, installers and solar power generators, supports the President’s strategy to address climate change by making imports of environmental goods more affordable and giving consumers choice. However, the National Association of Manufacturers (NAM), representing domestic producers of clean energy products, are hostile, claiming that the strategy “runs a serious risk of punishing Americans with higher energy bills, fewer jobs, and a weaker economy, while delivering negligible benefits to the environment”.

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(Question 1 continued)

❼ Similar trade issues have arisen between China and the European Union (EU). In 2011, solar panels made up 6.5% of China's exports to Europe at a value of around US$27 billion. In 2012, Belgian solar panel manufacturers claimed that these products were being dumped in the EU market. In June 2013, the EU announced that it would impose anti-dumping tariffs of up to 47% on Chinese solar products. In retaliation China threatened to impose a tariff on EU wine, arguing that EU farm subsidies had resulted in European countries dumping wine in China. After these Chinese threats of retaliatory trade measures the EU reduced the solar panel tariff to 12%.

[Source: adapted from http://cato.org/, 20 August 2013; http://thehill.com/blogs, accessed 20 August 2013; http://economist-pick-research.hktdc.com, accessed 20 August 2013 and http://bbc.co.uk/news, accessed 6 October 2013]

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* Asia-Pacific Economic Cooperation (APEC): member economies are Australia, Brunei Darussalam, Canada, Chile, China, Chinese Taipei, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, People's Republic of China, Peru, Republic of Korea, Russia, Singapore, Thailand, The Philippines, The United States and Vietnam

(a) (i) State **two** functions of the World Trade Organization (WTO) (paragraph ❶). [2]

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

(b) Using an international trade diagram, explain the effects on individual APEC "member economies" of removing a quota on the market for clean energy products (paragraph ❷). [4]

(c) Using a demand and supply diagram, explain how a tariff on solar panels would affect the market for solar power electricity (paragraph ❺). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the arguments for and against free trade in the global market for clean energy products. [8]

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

Gulf banks debating currency peg to US dollars

❶ Qatar's central bank suggests some Gulf States* should consider moving from a **fixed exchange rate**, with their currencies pegged to the US dollar, to a floating exchange rate system. Bankers and economists throughout the region are debating this issue.

❷ Qatar's central bank governor said the country planned no change to its peg to the dollar, with the exchange rate now fixed at QAR3.64/US$1. However, "with increasing integration in international trade, services, and asset markets, a higher degree of exchange rate flexibility may become more desirable" he said. Qatar is battling against higher rates of inflation in 2013. Inflation is at the highest level since 2009.

❸ Saudi Arabia and the United Arab Emirates (UAE) have pegged their currencies to the dollar for decades. They have been able to do this because their inflation rates have been low and stable, and they have had substantial oil export revenues giving them large reserves of foreign currency.

❹ As a result there has been no need to change official exchange rates, said the chief economist at National Bank of Abu Dhabi: "Fixing the currency gives stability and visibility for business contracts". There are good arguments for pegging the currency to the US dollar. However, it can result in imported inflation from other economies. In 2007, the US was cutting interest rates. This meant that, in order to maintain the fixed exchange rate, the UAE also had to cut its interest rates. This was at a time when the UAE was booming and experiencing high inflation.

❺ Currently there is no pressure on the pegged rate and if necessary a central bank can revalue or devalue its currency when required. It is commonly agreed that the best time to change a fixed currency regime is when there is no pressure.

❻ A senior economist at a commercial bank agrees that the UAE should consider dropping its currency peg to the US dollar and moving to a floating exchange rate for the dirham (the UAE currency). He says that the US dollar's weakness relative to other currencies was a positive stimulus for **economic growth**. However, growth in the UAE is already quite strong and so having its currency pegged to a weak currency could harm the economy by leading to higher inflation.

[Source: Albawaba extract: Republished with permission from Albawaba, http://www.albawaba.com/business/qatars-currency-peg-here-stay-514355, 'Qatar's currency peg here to stay', 18 August 2013, permission conveyed through Copyright Clearance Center, Inc.
Extracts from *The National*, Abu Dhabi: http://www.thenational.ae/business/industry-insights/finance/uae-should-drop-dirhams-peg-to-us-dollar-says-economist#ixzz2cfjYpl71, 22 November 2011
http://www.thenational.ae/business/industry-insights/economics/gulf-banks-debating-currency-peg-to-us-dollar#ixzz2cfivZBbz, 7 June 2013]

* Gulf States: include Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates

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(Question 2 continued)

(a) (i) Define the term *fixed exchange rate* indicated in bold in the text (paragraph ❶). [2]

(ii) Define the term *economic growth* indicated in bold in the text (paragraph ❻). [2]

(b) Using an exchange rate diagram, explain how the United Arab Emirates (UAE) could maintain a fixed value of its dirham to the US dollar if there were upward pressure on the dirham. [4]

(c) Distinguish between a devaluation and a depreciation of a currency. [4]

(d) Using information from the text/data and your knowledge of economics, discuss the view that some Gulf States "should consider moving from a fixed exchange rate" to "a floating exchange rate system" (paragraph ❶). [8]

Section B

Answer **one** question from this section.

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

Democratic Republic of Congo – development affected by conflict

❶ The Democratic Republic of the Congo (DRC) is a nation with many natural resources. It is slowly recovering after decades of decline. Corruption since independence in 1960, combined with political instability and conflict that began in the mid 1990s, has dramatically affected national output and government revenue.

❷ Much economic activity occurs in the **informal sector**. However, activity in the mining sector, the source of most export income, has boosted the government's fiscal position and **gross domestic product (GDP)** growth in recent years. Mining companies are exploiting the large reserves of copper, diamonds and gold, in particular Chinese companies. In 2012, 53 % of DRC exports went to China.

❸ The greatest challenge confronting the DRC is conflict. The conflict is due to rival groups fighting to control the country's resources. Five million people have died. More than 90 % of those who died were indirect victims of violence – in other words these were people made homeless by violence who then died due to diarrhoea, malaria and pneumonia. The Human Development Index (HDI) value for the DRC was 0.304 in 2012, which was the lowest ranking in the world.

❹ However, there is hope. The DRC provides 80 % of the minerals used to make satellites and mobile phones (cell phones) and it has the agricultural potential to feed the rest of Africa. It has also averaged more than 6 % annual growth in GDP since 2004 and the World Bank has forecast economic growth of 9.6 % in 2012, with even higher growth in 2013.

❺ To add to the DRC's challenges there has been more forest clearance in the Congo Basin since 2010, much of it for palm-oil plantations. Annual rates of deforestation in the Congo Basin have doubled since 1990, according to a new study. This study lists population growth, migration, economic development and global demand for natural resources as the major pressures on the forests.

[Source: adapted from https://cia.gov/library/publications, accessed 28 July 2013; http://cifor.org/mediamultimedia, accessed 28 July 2013; http://newscientist.com, accessed 28 July 2013 and http://www.spyghana.com, accessed 28 July 2013]

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(Question 3 continued)

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

(ii) Define the term *gross domestic product (GDP)* indicated in bold in the text (paragraph ❷). [2]

(b) Explain why the Human Development Index (HDI) is considered to be a useful indicator of economic development (paragraph ❸). [4]

(c) Using an externalities diagram, explain how the establishment of palm-oil plantations could lead to market failure in the Democratic Republic of the Congo (DRC) (paragraph ❺). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the extent to which economic growth has led to economic development in the Democratic Republic of the Congo (DRC). [8]

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

World Bank to invest in African hydroelectric project

❶ The World Bank has said it will invest US$340 million into a new hydroelectric project for Burundi, Rwanda and Tanzania as part of its new low-carbon energy policy. Under the new leadership of United States (US) appointed Jim Yong Kim, the bank wants to use its loans to cut carbon dioxide and methane emissions that accelerate changes in the earth's climate.

❷ Lack of access to electricity harms development in the region. Only 4 % of the population in Burundi has access to electricity. Corresponding numbers for Rwanda and Tanzania are 13 % and 15 %.

❸ In July, the World Bank supported new lending guidelines for power projects that limit investment in coal-fired power plants and increase **concessional long-term loans** for hydroelectric power. This policy is controversial for two reasons. Firstly, coal-fired power generation has traditionally been the cheapest electricity source for poor countries. Secondly, not all US politicians believe that emissions cause changes to the climate and the US provides most of the World Bank's funds.

❹ The director of the bank's department for sustainable development in Africa said that the hydroelectric project will produce cheaper electricity at around US$0.06 per megawatt-hour. The current sources cost US$0.23 per megawatt-hour. In addition, all three countries will benefit from jobs created by construction and installation activity associated with the power plant.

❺ The hydroelectric project will provide electricity in an area of Africa where only a tiny fraction of the population have power. According to the director, "this project provides a reliable power supply, reduces electricity costs, promotes renewable energy, will boost economic growth and help end **absolute poverty**".

❻ "Besides reliable power sources helping to cut business costs, giving customers more access to services and fuelling manufacturing growth, studies have linked installation of a village light source to child intelligence as it allows more study and reading, especially with parents in the evening", he said. "There is also security: putting lights in a school means girls are more likely to attend, improving literacy rates and increasing production possibilities. These kinds of projects are transformational."

❼ In 2011, the World Bank helped to provide electricity to an additional 1.4 million people in African countries, to construct and repair 6640 kilometres of roads and to improve water supplies for more than 8 million people.

[Source: World Bank: http://go.worldbank.org/C09SUA7BK0]

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(Question 4 continued)

(a) (i) Define the term *concessional long-term loans* indicated in bold in the text (paragraph ❸). [2]

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

(b) Using an AD/AS diagram, explain how the new hydroelectric project will create jobs in the region (paragraph ❹). [4]

(c) Using a production possibilities curve (PPC) diagram, explain how "improving literacy rates" will increase production possibilities (paragraph ❻). [4]

(d) Using information from the text/data and your knowledge of economics, evaluate the role of the World Bank in promoting economic development in Africa. [8]