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Economics
Standard 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]**.

Section A

Answer **one** question from this section.

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

United States (US) tin can manufacturers seek tariff exemption on tinsplate steel

- ❶ The Can Manufacturers Institute (CMI) has asked the US Department of Commerce to take away tariffs and other trade protection measures that are currently applied to imports of tinsplate steel. Tinsplate steel is used to make tin cans as packaging for food. The CMI represents the tin can manufacturing industry and its suppliers in the US.
- ❷ The tin can manufacturing industry accounts for the annual domestic production of approximately 124 billion tin cans. The industry employs more than 28 000 people, with factories in 33 US states, Puerto Rico and American Samoa. It generates revenue of around US\$17.8 billion. The CMI claims that the tariff on imports of tinsplate steel has a severe economic impact on the tin can manufacturing industry.
- ❸ Approximately 2% of all US steel is tinsplate. Currently, there is **excess demand** that is causing a disequilibrium in the domestic US tinsplate steel market. In 2016, US demand for tinsplate steel was 2.1 million tons, while domestic supply was 1.2 million tons, meaning that only 57% of domestic demand was met by US tinsplate steel producers. Not only is there a domestic shortage of tinsplate steel, but also the CMI claims that there has been a noticeable decline in the quality of domestically-produced tinsplate steel.
- ❹ The CMI claims that even a small increase in the price of raw materials could create a competitive disadvantage, forcing some tin can manufacturing plants to shut down. This would create **structural unemployment** for 10 000 workers in regionally-based factories. The CMI also claims that the tariff puts food can producers at a competitive disadvantage with other food packaging substitutes, such as plastic and glass. These substitutes are not subject to tariffs.
- ❺ According to the CMI, canned fruits and vegetables cost 20% less than fresh food. Because of this, people on low incomes consume canned foods at a higher rate than the average American. Canned food offers a low-cost solution to feeding the nation; especially the 42 million Americans who live in low-income households. The figure includes 13 million children. The CMI further claims that tariffs, or any trade barriers, have harsh consequences for those living in relative poverty.

[Source: adapted from www.prnewswire.com, accessed 27 August 2017]

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term *excess demand* indicated in bold in the text (paragraph ③). [2]
- (ii) Define the term *structural unemployment* indicated in bold in the text (paragraph ④). [2]
- (b) Using a supply and demand diagram and data from the text, explain how a “disequilibrium in the domestic US tinplate steel market” would occur if there were no imports (paragraph ⑤). [4]
- (c) Using an international trade diagram, explain the effect of a tariff on the imports of tinplate steel (paragraph ①). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss possible economic impacts of the tariff on tinplate steel. [8]

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

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(Question 2 continued)

- (a) (i) Define the term *appreciation* indicated in bold in the text (paragraph ③). [2]
- (ii) Define the term *monetary policy* indicated in bold in the text (paragraph ⑥). [2]
- (b) Using an AD/AS diagram, explain how increased import expenditure might affect economic growth in the Indian economy (paragraph ③). [4]
- (c) Using an exchange rate diagram, explain how reducing interest rates might lead to a fall in the value of the rupee (paragraph ⑦). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible economic consequences of the increasing value of the rupee for India's inflation rate, employment, economic growth and current account balance. [8]

Section B

Answer **one** question from this section.

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

Bhutan's growth soars amid hydropower building boom

- ❶ Bhutan is a developing Asian country, bordered by India and China. The government of Bhutan is mostly interventionist in its approach to economic growth and economic development. Situated in the Himalayan mountains, Bhutan has significant water resources that may be employed to generate hydropower.
- ❷ The most significant intervention by the government is investment in the generation of hydropower. However, funding is not possible domestically. The hydropower projects are mostly financed by **concessional long-term loans** from India. Government borrowing to finance hydropower construction has made Bhutan the second-most indebted nation in Asia. Bhutan now has a high level of government debt, equal to 118 % of annual **real gross domestic product (GDP)**.
- ❸ The funding of Bhutan's interventionist policies has created significant dependence on Indian tied aid. A condition of the aid is that Indian companies lead the infrastructure projects. The large amount of foreign aid has made achieving self-reliance difficult. At present, India finances nearly one-quarter of the Bhutan government's budget expenditures.
- ❹ When the projects are completed they will more than double Bhutan's hydropower generation capacity and over 80 % of the power generated will be exported to India. Hydropower to India is Bhutan's largest export, and the increased exports will lead to greater government revenue. Real GDP growth is expected to reach 11.7 % by 2019.
- ❺ Another significant intervention by the government is the promotion of university education for as many young people as possible, coupled with the creation of government jobs to employ them. The present level of exporting hydropower to India has provided some government revenue to pay for government jobs. However, while the number of university graduates is growing each year, the number of government jobs has not been growing at the same rate.
- ❻ In response to the current inability to provide enough jobs, the government is also implementing other programmes. Firstly, they are encouraging graduates to pursue employment in Bhutan's small private sector, which is struggling to make a meaningful contribution to economic growth. Secondly, the government is promoting tourism, making it one of the most popular alternatives to government employment. Thirdly, the government is attempting to reduce red tape (excessive regulations) in areas such as industrial licensing, trade, labour markets and finance. This red tape is a barrier to foreign direct investment. Finally, the government is trying to make employment in agriculture more appealing. Bhutan's climate means that it could be well-positioned to produce and export a variety of fruits.

[Source: adapted from Central Intelligence Agency, *The World Factbook, Bhutan*, <https://www.cia.gov/library/publications/the-world-factbook/geos/bt.html>, accessed 19 August 2017; *White-collared*, by Ross Adkin, 31 August 2016, Himal Southasian, <http://himalmag.com/white-collared-bhutan-thimphu-bureaucrats>, accessed 19 August 2017; *The World Bank: Bhutan*, <https://data.worldbank.org/country/bhutan>, © 2019 The World Bank Group, licenced under the Creative Commons Attribution 4.0 International License, <https://creativecommons.org/licenses/by/4.0/>; and *Bhutan growth soars amid hydropower building boom*, by Nidup Gyeltshen and Phuntsho Wangdi, August 17, 2017, <https://asia.nikkei.com/Economy/Bhutan-growth-soars-amid-hydropower-building-boom>, accessed 19 August 2017]

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(Question 3 continued)

- (a) (i) Define the term *concessional long-term loans* indicated in bold in the text (paragraph ②). [2]
- (ii) Define the term *real gross domestic product (GDP)* indicated in bold in the text (paragraph ②). [2]
- (b) Explain **two** possible disadvantages for Bhutan in receiving India's tied aid (paragraph ③). [4]
- (c) Using a production possibilities curve (PPC) diagram, explain how rising numbers of university graduates will affect Bhutan's potential output (paragraph ⑤). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the government policies being used to promote economic development in Bhutan. [8]

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

Chinese investment helps Peru to develop

- ❶ Over the past decade, Peru has been one of South America's fastest-growing economies, with an average economic growth rate of 5.9% and low average annual inflation of 2.9%. This has been mostly due to a favourable external environment, sensible macroeconomic policies and reforms of environmental regulations designed to increase investment in Peru's profitable mining sector. However, the deregulation in the mining sector has been opposed by environmental groups and trade unions, fearing increased pollution and poorer working conditions.
- ❷ Strong growth in employment and income has dramatically reduced poverty rates. **Absolute poverty** fell from 27.6% in 2005 to 9% in 2015.
- ❸ Gross domestic product (GDP) growth continued to accelerate in 2016, very much helped by higher mining export output as several new large mining projects entered into production and reached full capacity. Peru mines and exports many commodities, including copper, gold, lead, zinc, tin, iron ore, silver, and oil and petroleum products.
- ❹ China is Peru's main trading partner, taking 22.1% of Peru's exports and supplying 22.7% of their imports in 2016. Chinese companies are also significant suppliers of **foreign direct investment (FDI)** to Peru, recently investing over US\$2 billion to purchase a hydroelectric power plant. The second main trading partner is the United States (US), taking 15.2% of Peru's exports and supplying 20.7% of their imports in 2016.
- ❺ Peru's current account deficit declined significantly from 4.9% to 2.8% of GDP in 2016, owing to increasing export growth and lower imports. Peru's government continues to support a free trade policy; since 2006, Peru has signed trade deals with 17 different countries including the US, Canada, China and Japan. In addition, a trade deal has also been signed with the European Union.
- ❻ Real GDP growth is expected to slow slightly in 2017 due to an anticipated lower growth rate in the mining sector and weak private investment. To support the economy as mining production slows, the government is expected to increase public investment in 2017.
- ❼ Growth projections may not be achieved if any, or a combination, of the following occur: external shocks in commodities prices, a further deceleration of China's economic growth, unpredictability in world capital markets and the threat of tight monetary policy in the US. Raising economic growth requires structural and fiscal reforms to improve productivity, reduce the size of the informal sector and improve the efficiency of public services.

[Source: adapted from "The World Bank Country Overview: Peru", <http://www.worldbank.org/en/country/peru/overview>, 17 April 2017; and "The World Factbook", <https://www.cia.gov/library/publications/the-world-factbook/geos/pe.html>, 6 September 2017]

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(Question 4 continued)

- (a) (i) Define the term *absolute poverty* indicated in bold in the text (paragraph ②). [2]
- (ii) Define the term *foreign direct investment (FDI)* indicated in bold in the text (paragraph ④). [2]
- (b) Explain **two** reasons why Chinese companies may have been attracted into Peru (paragraph ④). [4]
- (c) Using a poverty cycle diagram, explain how increased foreign direct investment might break the cycle (paragraph ④). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the factors that may allow Peru to continue to achieve high rates of economic growth in the future. [8]
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