

Economics
Higher level
Paper 2

Thursday 3 November 2016 (afternoon)

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.

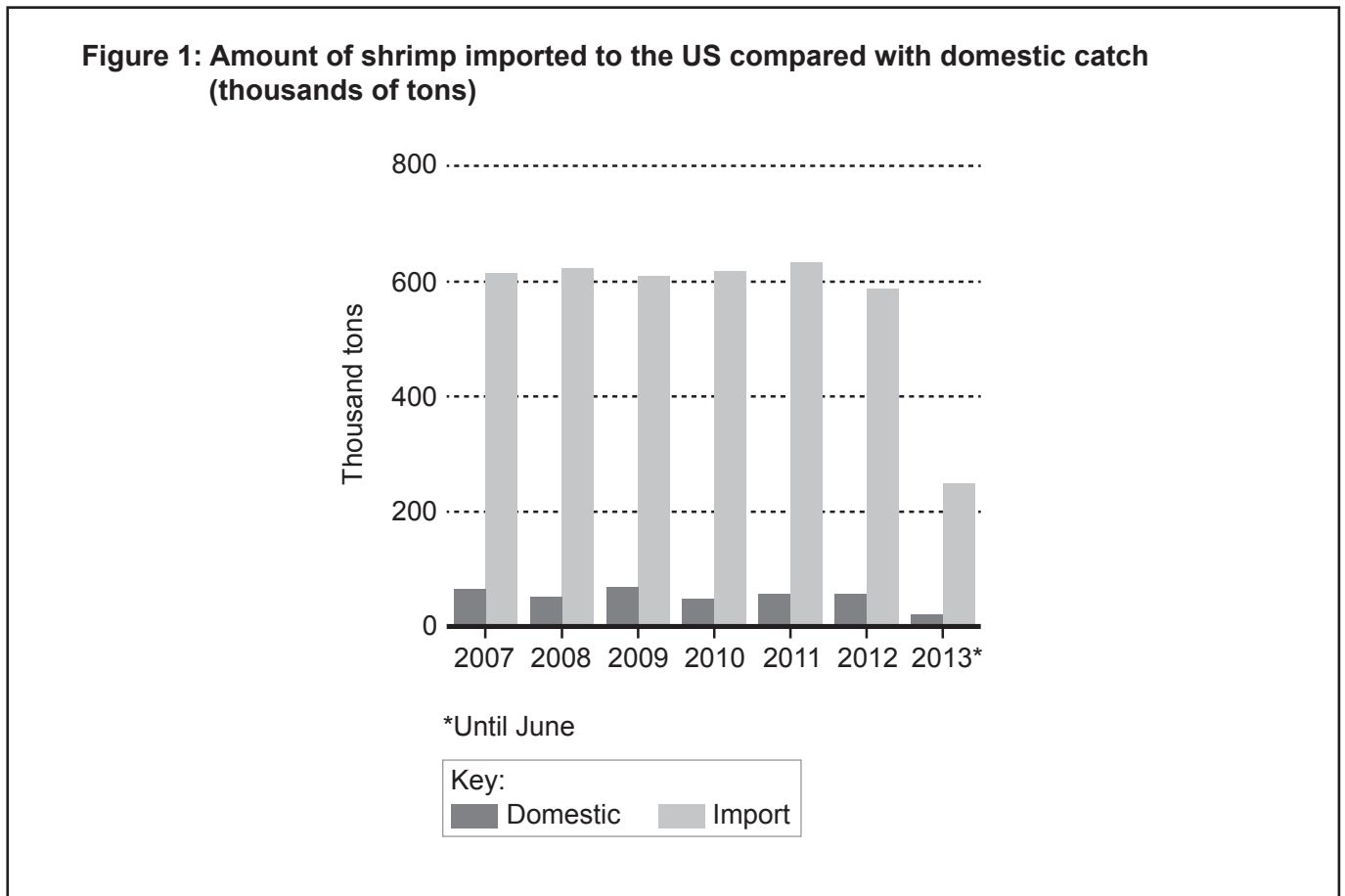
1. Study the extract and data below and answer the questions that follow.

American shrimp farmers taste victory

- ❶ American shrimp farmers have received good news from a United States (US) ruling that could lead to tariffs being imposed on imports from competing countries.
- ❷ US producers in the Gulf Coast were suffering from a significant oil spill in 2010. The higher fuel costs as a result of the spill have made it hard to compete with foreign shrimp farms, which they say receive government **subsidies**. The US producers claim such subsidies threaten to destroy the domestic shrimp business. The US imported 1200 million pounds (lb) of shrimp last year and produced 100 million pounds (lb) of shrimp domestically.
- ❸ The US Department of Commerce ruled that five countries – China, Ecuador, India, Malaysia and Vietnam – improperly subsidized shrimp that were exported to the American market. The department rejected accusations of improper subsidies by Thailand and Indonesia, two of the biggest US shrimp suppliers.
- ❹ The US International Trade Commission will now have to decide whether the subsidies harmed the American industry. If so, the US would impose tariffs on shrimp imports from the five countries. The proposed US tariffs could be as much as 54.5%.
- ❺ The US shrimp farmers claim that the Indian government pays extra to cover shipping costs on shrimp going to the US and that China provides subsidized loans to its shrimp farmers. They argue that these violate World Trade Organization (WTO) rules.
- ❻ The five countries disputed the US Department of Commerce’s decision. The Vietnamese producers state that, “This is an unfair decision affecting the lives of more than 600 000 shrimp farmers and processors in Vietnam”. Chinese officials have said that there was no evidence of improper Chinese subsidies and that US tariffs on Chinese shrimp would violate WTO rules.
- ❼ The US shrimp farmers say they need tariffs to allow them to compete fairly with Asian farmers, noting that high fuel prices are keeping some shrimp boats at the dock. “The price received by our farmers is not enough to cover their **variable costs**,” said a lawyer, who represents the US shrimp farmers.
- ❽ Large US retailers and food distributors oppose the tariffs saying that the US shrimp industry had support from the oil company, BP, which has paid billions of US dollars to those affected by its 2010 oil spill.
- ❾ US politicians and shrimp farmers commented on problems they are facing, saying that, “not only is shrimping an industry, but it is a way of life”.

(This question continues on the following page)

(Question 1 continued)



[Source: adapted from <http://online.wsj.com/news>, 13 August 2013]

- (a) (i) Define the term *subsidies* indicated in bold in the text (paragraph 2). [2]
- (ii) Define the term *variable costs* indicated in bold in the text (paragraph 7). [2]
- (b) Using a supply and demand diagram with international trade values from the text, explain the statement that “The US imported 1200 million pounds (lb) of shrimp last year and produced 100 million pounds (lb) of shrimp domestically” (paragraph 2) (Does not need to be to scale). [4]
- (c) Using an average costs diagram, explain the short-run consequence for shrimp farmers if the price received “is not enough to cover their variable costs” (paragraph 7). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the view that the US should impose tariffs on the imported shrimp. [8]

Turn over

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

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(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *interest rates* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *normal profit* indicated in bold in the text (paragraph ❸). [2]
- (b) Using an exchange rate diagram, explain how speculation is contributing to the rising value of the British pound (paragraph ❶). [4]
- (c) Using an appropriate diagram, explain why it is possible that “British firms producing exported goods that have few substitutes have reported no reduction in export revenue despite the appreciation” (paragraph ❸). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of the appreciation of the British pound. [8]

Section B

Answer **one** question from this section.

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

Inequality in China

- ❶ As China's economy first began to use **market-oriented policies** in the 1970s, it was famously suggested that some citizens, particularly through hard work, "should be allowed to get rich before others". The government still plays a dominant role in the allocation of resources and benefits, keeping most of the gains for itself and its employees. Civil servants, who are assigned government housing, have benefited more and accumulated more wealth than the private sector employees.
- ❷ Income inequality is a politically sensitive issue in China and the government has not reported on it for 26 years. In 1988, the Gini coefficient was 0.38 and the next set of figures released in 2014 give a value of 0.47.
- ❸ According to research by the China Reform Foundation (CRF), "hidden income" amounts to more than US\$1.4 trillion, or the equivalent of Australia's annual gross domestic product (GDP). "Hidden incomes" refer to money gained from bribery or other corrupt behaviour, for example, bribes for officials or corrupt payments for doctors.
- ❹ Low-income households are stuck with an outdated tax system that fails to address the inequality issue. They carry the burden of tax payments while the rich and powerful operate largely outside the tax system. Low-income households also have difficulty accessing credit.
- ❺ Although the Chinese government expenditure is high, there tends to be inadequate spending on social protection programmes relating to health and old age. The lack of social protection has resulted in a high marginal propensity to save (MPS) amongst the low-income households as they put money away to provide for future health, education and retirement needs. The high savings result in a low marginal propensity to consume at 37 % of household income (compared to an average of more than 50 % of household income in more developed-market economies). The low marginal propensity to consume and the associated high savings rate have received significant attention in domestic and international policy circles and are viewed as a key barrier to China's continuing road to development.

[Source: adapted from www.theage.com.au, 27 February 2012 and 29 July 2014;
<http://data.worldbank.org>, accessed 2 August 2014; www.oecd-ilibrary.org, 17 January 2014;
<http://stats.oecd.org>, accessed 3 August 2014, hdr.undp.org, accessed 3 August 2014 and
www.imf.org, March 2010]

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(Question 3 continued)

Figure 1: Selected economic data for China and very high human development countries

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- (a) (i) Define the term *market-oriented policies* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *GDP per capita* indicated in bold in the text (Figure 1). [2]
- (b) Explain why the Human Development Index (HDI) is considered to be a better indicator of economic development than GDP per capita. [4]
- (c) With reference to the figures on the marginal propensity to consume (paragraph ❷), explain how the value of the multiplier in China would compare with the value of the multiplier in a more developed-market economy (no calculation required). [4]
- (d) Using information from the text/data and your knowledge of economics, to what extent does unequal income distribution impact economic development in China? [8]

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

Ghana to seek help from International Monetary Fund

- ❶ Ghana has said it will seek financial aid in the form of a loan from the International Monetary Fund (IMF) to help stop the rapid decline in the value of the cedi, Ghana's currency, and close a large **budget deficit**. Ghana's transformation from one of Africa's fastest growing economies to the home of the world's worst-performing currency has become a concern. The exchange rate depreciated by 40% against the US dollar in 2014. The fall in the currency has led to increases in the price of consumer goods such as sugar and fuel; inflation is at an unacceptable 15%.
- ❷ Despite being a major exporter of gold, oil and cocoa, Ghana's current account deficit has risen sharply to 12% of its gross domestic product (GDP). This is partly due to a rapid increase in demand for imports and falling gold prices. Additionally, oil revenues have not been as strong as expected.
- ❸ The government is also struggling with a wide budget deficit, which stood at 10% of GDP last year. Ghana's good reputation for fiscal responsibility has worsened considerably as the government tripled salaries for police officers and soldiers.
- ❹ It is expected that the news of talks with the IMF will be positively received in international financial markets. The finance minister has said the step would help to stabilize the currency, to bring domestic prices under control, and also to restore investors' confidence in Ghana's economy.
- ❺ A Ghanaian spokesperson noted that the IMF would insist on the government introducing measures to tackle inflation and reduce its budget deficit. The IMF says that Ghana needs to tighten its budget immediately, by reducing public sector wages, lowering subsidies and increasing taxes. The IMF is likely to demand a limit on borrowing and perhaps some privatization of power and water companies.
- ❻ Earlier this year, problems in the economy had led to nationwide protests, with thousands of workers across the country protesting in the streets about the rise in the cost of living. The country's largest trade union says the government has been mismanaging the economy. In response to the protests, a government minister said that the government would work very hard to achieve **economic development** to make life easier for the working people of Ghana but that all Ghanaians would have to make "some sacrifices for the economy to recover".

[Source: adapted from <http://news.yahoo.com>, 3 and 4 August 2014; <http://online.wsj.com>, 3 August 2014 and www.bbc.com/news, 24 July 2014 and 4 August 2014]

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(Question 4 continued)

- (a) (i) Define the term *budget deficit* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *economic development* indicated in bold in the text (paragraph ❷). [2]
- (b) Using an exchange rate diagram, explain how the large current account deficit may have affected the value of the Ghanaian cedi. [4]
- (c) Using an AD/AS diagram, explain how the falling value of the Ghanaian cedi may have contributed to inflation. [4]
- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of International Monetary Fund (IMF) financial aid on Ghana's economic growth and development. [8]
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