

Economics
Higher level
Paper 2

Thursday 1 November 2018 (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.

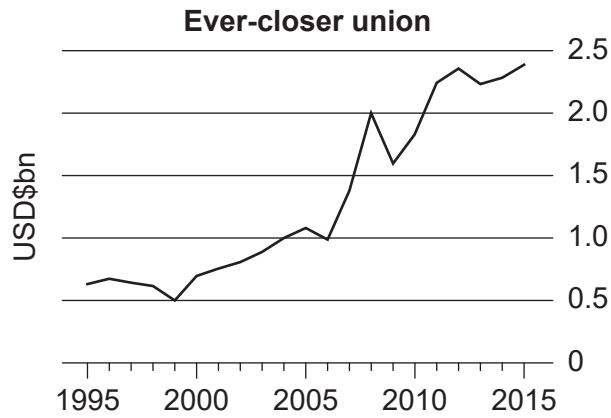
South Sudan joins the East African Community

- ❶ The East African Community (EAC) is the most integrated trading bloc in Africa. In 2005, the members established a customs union, and then in 2010 it became a common market. There are ambitious plans to establish a **monetary union** by 2024.
- ❷ According to a recent report, the region is wealthier and more peaceful as a result of the increased integration. Economic models suggest that bilateral trade between member countries was 213 % higher in 2011 than it would have been without the integration. This is despite the fact that progress on fully eliminating trade barriers has been rather slow and there are still a large number of non-tariff barriers.
- ❸ Until recently the customs union was made up of Burundi, Kenya, Rwanda, Tanzania and Uganda. Very recently, South Sudan joined the bloc. This presents a tremendous opportunity for South Sudan, which was recently recognized as an independent country.
- ❹ South Sudan is one of many developing countries that are dependent on oil exports for the majority of its export revenues and oil prices have been falling due to increased supply of oil in the market. The deteriorating terms of trade have resulted in a worsening of the current account and lower government revenues. Regional economic integration might help South Sudan to diversify its economy.
- ❺ Agriculture is one potential area that South Sudan could focus on to diversify its economy. According to some estimates, 70 % of land is suitable for agriculture, but less than 4 % is currently being cultivated. The large flood plains in the country are suitable for rice production and the hope is that South Sudan can develop a **comparative advantage** in this essential food.
- ❻ South Sudan is landlocked and most of its road network is unpaved. This is just one example of its poor infrastructure. Since infrastructure is an expensive investment, regional cooperation will be vital for improving its road systems. Furthermore, effective transport links to sea ports in Kenya and Tanzania will allow for greater trade and therefore economies of scale.
- ❼ In the short term, there will be challenges for South Sudan associated with joining the common market. For example, before Rwanda joined the EAC in 2007, there were lower tariffs on many imported inputs. However, the cost of living for the poor population rose because of trade diversion that occurred after joining the EAC. South Sudan is likely to face the same problem.
- ❽ Labour costs in South Sudan are higher than those of other member countries and years of conflict have left the population with low levels of education and skills. This may present a barrier for South Sudan in attracting foreign direct investment, despite being part of the common market.

(This question continues on the following page)

(Question 1 continued)

Figure 1: Intra-East African Community* trade in goods (USD\$bn)



*Burundi, Kenya, Rwanda, Tanzania and Uganda.
Not including South Sudan, which acceded to the treaty in 2016.

[Source: Text: Paragraphs 1–3 adapted from “Trade in East Africa: Worth Celebrating”, © The Economist Newspaper Limited, London (June 9, 2016); paragraphs 4–8 adapted from a paper/article written by Astrid R.N. Haas (and co-authors) with funding from the International Growth Centre.
Graph: IMF, www.eacgermany.org, accessed 3 May 2018]

- (a) (i) Define the term *monetary union* indicated in bold in the text (paragraph ❶). [2]
- (ii) Define the term *comparative advantage* indicated in bold in the text (paragraph ❷). [2]
- (b) Explain why “deteriorating terms of trade have resulted in a worsening of the current account” in South Sudan (paragraph ❹). [4]
- (c) Using a cost diagram, explain how membership in the common market may allow producers in South Sudan to gain economies of scale (paragraph ❸). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely impact on South Sudan of its membership of the EAC common market. [8]

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

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(Question 2 continued)

- (a) (i) Define the term *inflation* indicated in bold in the text (paragraph 6). [2]
- (ii) Define the term *devaluation* indicated in bold in the text (paragraph 7). [2]
- (b) Using an exchange rate diagram, explain how the central bank could “use its foreign reserves” to restore the value of the Nigerian naira (paragraph 5). [4]
- (c) Using an AD/AS diagram, explain how a decision to “tighten monetary policy” might be harmful to the economy (paragraph 7). [4]
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely effects of Nigeria’s change from a fixed exchange rate system to a managed exchange rate system. [8]

Section B

Answer **one** question from this section.

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

Solar power in Kenya

- ❶ Kenyan shopkeepers are able to use mobile phones and a small deposit to buy solar panels. This gives them 24-hour access to electricity and also lowers their fuel bills. Before this, the shopkeepers struggled to get a connection to electricity. M-Kopa is the company that provides these solar panels.
- ❷ M-Kopa estimates that 80 % of its customers live on less than US\$2 a day, and without access to credit, are caught in a **poverty trap** (poverty cycle). Many of them rely on subsistence farming or run a small business as their source of income. Energy accounts for a significant amount of their spending.
- ❸ Kopa means “to borrow” in Swahili, and each panel the company sells is in effect a loan of about US\$165. M-Kopa’s solar panels cost US\$200. Clients pay US\$35 upfront and agree to make a daily payment of 45¢ for a year, after which the solar panel is theirs.
- ❹ When M-Kopa’s customers are reaching the end of their loan terms, an M-Kopa representative calls to offer another product, in exchange for reopening the account and making payments for another few months. M-Kopa has sold around 325 000 solar panels so far and 50 000 of their buyers, who have already paid off their loans, have extended their credit to buy other products offered by M-Kopa. Ideally, these new products will also save customers money over time. They include fuel efficient stoves that save charcoal, a bicycle that cuts transportation costs and water tanks to store rainwater. M-Kopa also sells Samsung smartphones and offers loans to pay for school fees.
- ❺ M-Kopa is replacing kerosene lamps with solar power technology. Kerosene lamps emit a dangerous smoke that burns the eyes, irritates the throat and slowly turns walls and ceilings black. They are also expensive. According to a 2014 survey, an average household in Kenya, without access to electricity, spends about US\$164 a year on kerosene. M-Kopa estimates that a customer saves about US\$750 over the first four years by switching to solar panels. Given Kenya’s climate, solar power is an obvious source of energy.
- ❻ Since its commercial launch in October 2012, the company’s **total revenue** has risen rapidly, from US\$15 million in 2014 to US\$30 million in 2015, and the company says it will double this in 2016. Every day, about 600 new customers are purchasing solar panels, meaning that the company is extending loans of almost US\$100 000 a day to people who might otherwise not have access to credit.
- ❼ According to a company representative, “If you take the long-term view and if you treat low-income people as customers, not charity cases, you can change the world. In our view, it is one of the advantages that foreign direct investment can bring to a country. Our customers’ lives are improved as our lives are improved”.

[Source: adapted from “Special Report: On the Move,” © The Economist Newspaper Limited, London (14 April 2016), <https://www.economist.com/special-report/2016/04/16/on-the-move>; and “The Solar Company Making a Profit on Poor Africans,” By Stephan Faris, 2 December 2015, <http://www.bloomberg.com/features/2015-mkopa-solar-in-africa>. Used with permission of Bloomberg L.P. Copyright ©2017. All rights reserved.]

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(Question 3 continued)

- (a) (i) Define the term *poverty trap* indicated in bold in the text (paragraph ②). [2]
- (ii) Define the term *total revenue* indicated in bold in the text (paragraph ⑥). [2]
- (b) Using an externalities diagram, explain how the widespread use of solar panels will decrease the negative externalities of consumption caused by the use of kerosene lamps (paragraph ⑤). [4]
- (c) Using a theory of the firm diagram, explain the output and pricing decision of M-Kopa if it chooses to pursue the goal of revenue maximization (paragraph ⑥). [4]
- (d) Using information from the text/data and your knowledge of economics, examine the extent to which access to credit and appropriate technology can contribute to economic development in Kenya. [8]

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

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(Question 4 continued)

- (a) (i) Define the term *infrastructure* indicated in bold in the text (paragraph ❶). [2]
 - (a) (ii) Define the term *sustainability* indicated in bold in the text (paragraph ❷). [2]
 - (b) Using a production possibilities curve (PPC) diagram, explain how “public investment in infrastructure” can affect the production possibilities in Myanmar (paragraph ❸). [4]
 - (c) Using an externalities diagram, explain how the “construction of a copper mine” might lead to market failure (paragraph ❹). [4]
 - (d) Using information from the text/data and your knowledge of economics, evaluate the likely impact of foreign direct investment on Myanmar’s economic development. [8]
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