

Economics
Standard level
Paper 2

Specimen paper

1 hour 45 minutes

Instructions to candidates

- Do not open this paper until instructed to do so.
- You are permitted access to a calculator for this paper.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- 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]**.

Answer **one** question.

1. Read the extracts and answer the questions that follow.

Text A — Overview of Nigeria

- 1 With a population of 173 million people, Nigeria is the most populated country in Africa and accounts for 47 % of West Africa's population. It is the biggest oil exporter in Africa and also has the largest natural gas reserves in the continent.
- 2 **Economic growth** is estimated to have been 6.1 % in 2014, owing to continued strong performance mainly in services, but also industry (apart from oil mining) and agriculture. The oil and gas sector was in decline, although at a slower rate than in the previous year. Revenues from oil and gas were estimated to have declined by 1.3 %, relative to a decline of 13.1 % in 2013. The sharp decline in oil prices since the third quarter of 2014 has posed major challenges to the country's **current account** balance and public finances. Oil contributes close to 90 % of export revenues and roughly 75 % of the country's total budget revenues.
- 3 Lower oil prices will continue to pose strong challenges for public finance at all levels of government during the year and will also represent a major constraint on the ability of the new government to introduce some of its ambitious programs. It is focusing on anti-corruption, the economy, including jobs and unemployment, and security.
- 4 In the North East of Nigeria, Boko Haram, an extremist group, remains a threat. Millions of displaced persons require assistance. There has been major destruction of infrastructure, loss of lives and increased poverty in this region. The government will have a difficult time financing the major programs that it wants to introduce, as well as reconstructing the North East devastated by the activities of the violent extremists.
- 5 The major medium-term challenge for the government is to accelerate the creation of productive jobs through private sector growth and to make improvements in education (skills). So far, the pace of job creation has been inadequate, leading to increasing frustration among underemployed Nigerian youth.

Text B — Oil spills in Nigeria

- 1 In January 2015, Royal Dutch Shell, a multinational oil company, finally agreed to pay more than US\$83 million to residents of a Nigerian fishing community that was devastated by two oil spills in 2008. This was the largest ever compensation related to an oil spill in Nigeria, a country plagued by oil-related market failure.
- 2 Over 15 000 residents in the town of Bodo will each receive about US\$3 250, adding up to approximately US\$53 million. The remaining money will go into a community fund for health clinics, education centers and other projects.
- 3 In 2006, the Nigerian government asked the United Nations Environment Programme to study the extent of delta oil pollution. In its report, published in 2011, the agency recommended that the government establish a fund with an initial investment of US\$1 billion. The Nigerian government and the oil industry should finance the fund, the agency said.

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(Question 1 continued)

- ④ Now, in August 2015, the Nigerian government has finally put in place a fund from which to finance cleanup efforts in one of the world’s most contaminated areas. However, there is little money in the account and the companies responsible for the spills are not required to pay very much. The Nigerian government has set aside only US\$10 million and Shell, a leading contributor to the region’s contamination, is only required to finance 30% of the fund.

Text C — Nigeria Hikes Key Rate to 14% in July 2016

The central bank of Nigeria raised its base interest rate to 14% in July 2016. It was the second rate increase in the year, after the central bank abandoned the fixed exchange rate to the US dollar in June. Since then, the naira, Nigeria’s currency, plunged more than 55% to an all-time low. In addition, the inflation rate kept its upward trend and reached 16.5% in June, the highest since 2005.

Table 1: Economic data for Nigeria

	Previous data	2015 data
GDP (real growth rate, %)	5.4 (2013)	2.7
GDP per capita (US\$ PPP)	5900 (2013)	6100
Unemployment rate (%)	10.3 (2013)	8.9
Public debt (of GDP, %)	10.8 (2014)	11.7
Inflation rate (%)	8 (2014)	9
Central bank interest rate (%)	4.25 (2010)	10.15
Current account balance (US\$)	1.28 billion (2014)	–11.92 billion
External debt (US\$)	18.76 billion (2013)	20.93 billion

Table 2: Development data for Nigeria

	2010	2014
Human Development Index (HDI)	0.493	0.514
Gini index	0.40	0.43
Life expectancy at birth (years)	51.3	52.8
Adult literacy rate (% ages 15 and older)	51.1	51.1

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(Question 1 continued)

- (a) (i) Define the term *economic growth* indicated in bold (Text A, paragraph 2). [2]
- (a) (ii) Define the term *current account* indicated in bold (Text A, paragraph 2). [2]
- (b) (i) Using information from Text A, paragraph 1, and Table 1, calculate the GDP in US\$ PPP for Nigeria for 2015. [3]
- (b) (ii) Using information from Table 1, calculate the real central bank interest rate for 2015. [2]
- (c) Using a market failure diagram, explain how the “two oil spills in 2008” could represent a negative externality (Text B, paragraph 1). [4]
- (d) Using an AD/AS diagram and information from Text C, explain the likely cause of the increasing inflation rate. [4]
- (e) Using an exchange rate diagram, explain how the increase in the interest rate by the Nigerian central bank might prevent the continued fall in the value of the naira (Text C). [4]
- (f) Using a Lorenz curve diagram, explain what happened to income inequality in Nigeria between 2010 and 2014 (Table 2). [4]
- (g) Using information from the text/data and your knowledge of economics, discuss methods that the Nigerian government might employ to achieve greater economic growth and/or economic development. [15]

2. Read the extracts and answer the questions that follow.

Text D — Overview of Mexico

- ❶ The Mexican economy continued to expand at an annual rate of 2.5% through most of 2015 and early 2016. However, the growth is expected to be about 2% in 2016. Future growth now fully relies on private consumption, since weak investment and export **demand** are no longer contributing to growth. Increased external competitiveness following a substantial depreciation of the Mexican peso with respect to the US dollar, has not yet led to a boost in demand for exports.
- ❷ The Mexican peso is freely floating and there has been a significant depreciation against the US dollar over the past two years. Up to now, the effect of currency depreciation on domestic prices has been limited. Inflation decreased to slightly below the central bank's target of 3%. Additional currency depreciation remains a major concern for the monetary authorities. In response, they have raised the interest rate to 4.25%.
- ❸ Monetary and fiscal policy responses to currency depreciation are likely to have a negative impact on aggregate demand in the short term. Another challenge comes from the oil industry where there has been a decline in the volume of oil production. This is due to falling output from older oil fields and insufficient investments in exploration for new oil fields. This will reduce future annual growth rates by about half a percentage point.
- ❹ On the positive side, several factors are expected to boost private investment and exports, and improve economic growth in the medium term. These include: economic and financial stability; further progress in the implementation of an ambitious structural reform programme; and the increase in external competitiveness following the depreciation of the currency.
- ❺ The Mexican economy continues to face a complex external environment. Persistently low oil prices, an increase in interest rates in the United States, a slowdown in global trade and economic growth, and a number of geopolitical uncertainties may pose challenges to the country's economic and financial stability and growth outlook. Policy priorities should remain focused on sensible economic policies to create the conditions for stronger growth in the medium term.

Text E — The sugar industry in the USA

- ❶ The United States (USA) is the fifth largest sugar producer and fifth largest consumer of sugar in the world. The US sugar industry has enjoyed trade protection since 1789. US protectionist sugar policy consists of three main elements: subsidies through preferential loans, **minimum prices**, and tariffs and quotas.
- ❷ It has been estimated that in 2012, Americans paid an average of 95.5 cents per kilo for inefficiently produced domestic sugar instead of 58.3 cents per kilo for more efficiently produced world sugar.
- ❸ The US International Trade Commission has ruled that large tariffs on imported Mexican sugar should continue until December 2019, stating that Mexican subsidies on sugar allow Mexican companies to sell sugar in the United States at 40% below market value.

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(Question 2 continued)**Text F — US production line closes**

Mondelēz bakeries closed down production of Oreo biscuits in its Chicago (US) factory, as part of its plan to shift some of its production to Mexico, making about half of the Chicago bakery's 1200 workers unemployed. The firm said that they could save US\$46 million a year by installing state-of-the-art production lines in Salinas, Mexico, rather than Chicago.

Table 3: Economic data for Mexico

	Previous data	2016 data
GDP (real growth rate, %)	2.2 (2014)	2.1
GDP per capita (US\$ PPP)	18400 (2014)	18900
Unemployment rate (%)	4.4 (2014)	4.4
Inflation rate (%)	2.7 (2015)	2.7
Central bank interest rate (%)	3.42 (2015)	4.3
Current account balance (US\$)	–32.71 billion (2015)	–29.03 billion
Exchange rate (MX\$ per US\$)	15.84 (2014)	18.34
External debt (US\$)	441.6 billion (2015)	484.6 billion
Foreign direct investment (FDI) net inflows (US\$)	26.5 billion (2010)	32.1 billion

Table 4: Development data for Mexico

	2010	2015
Population (million)	118.62	127.02
Human Development Index (World ranking)	0.750 (56)	0.756 (74)
Gini index	0.4813	0.4821

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(Question 2 continued)

- (a) (i) Define the term *demand* indicated in bold (Text D, paragraph ②). [2]
 - (a) (ii) Define the term *minimum price* indicated in bold (Text E, paragraph ①). [2]
 - (b) (i) Using information from Table 3, calculate the value of one Mexican peso in US dollars for 2014 and 2016. [2]
 - (b) (ii) Using information from Table 3, calculate the nominal GDP growth rate for Mexico for 2016. [3]
 - (c) Using an appropriate diagram, explain the type of unemployment being created in Chicago (Text F). [4]
 - (d) Using an AD/AS diagram, explain the possible effects of currency depreciation on inflation (Text D, paragraph ②). [4]
 - (e) Using an exchange rate diagram, explain **one** measure that the Mexican government might take to prevent the “substantial depreciation of the Mexican peso” (Text D, paragraph ①). [4]
 - (f) Using a poverty cycle diagram, explain how the net increase in foreign direct investment (FDI) in Mexico between 2010 and 2015 might lead to an improvement in economic development (Table 3). [4]
 - (g) Using information from the text/data and your knowledge of economics, discuss possible economic outcomes for economic growth and economic development that might arise from Mexico’s current international trade prospects. [15]
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