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Economics
Higher level
Paper 2

Tuesday 10 May 2022 (morning)

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 Vietnam

- 1 Economic reforms in Vietnam during the past 30 years have led to rapid economic growth, which has transformed a poor nation into a lower middle-income economy. The percentage of the population with an income of less than US\$1.90 a day declined from 38 % in 2002 to below 2 % in 2018.
- 2 Vietnam used to be a food-insecure nation, in which many people sometimes lacked access to affordable food, but it is now a leading exporter of basic food commodities. It also aims to become an exporter of high quality and processed food products. However, agricultural production only accounts for 18 % of gross domestic product (GDP), although it uses 40 % of the land and employs 43 % of the labour force. Due to the growing rural population, land is often divided up between a greater number of farmers, causing some farms to become smaller. These farms have fewer opportunities to benefit from economies of scale and lower average costs of production.
- 3 Vietnam's rapid growth and industrialization, focused on export-oriented manufacturing, have had a harmful impact on the environment. Electricity consumption has tripled since 2010, growing faster than GDP. Electricity generation, which mainly uses fossil fuels, accounts for approximately 60 % of Vietnam's carbon emissions. Demand for water continues to increase. Unsustainable exploitation of natural resources, such as land, fisheries, and timber, could negatively affect prospects for long-term growth. In addition, Vietnam's primary sector is highly vulnerable to the climate and is therefore subject to supply shocks.
- 4 Vietnam has signed several free trade agreements (FTAs). Its first FTA was a partnership with Japan in 2008. Both Vietnam and Japan are members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which took effect at the beginning of 2019. These FTAs also promote inward foreign direct investment (FDI). In addition, Vietnam has introduced policies to attract foreign investment, such as tax incentives and spending on infrastructure.
- 5 Japan is the biggest provider of foreign aid to Vietnam and the largest source of FDI. Japanese firms and aid agencies are jointly financing large-scale projects, including port infrastructure and a high-speed railway, which will reduce the Hanoi to Ho Chi Minh journey time from about 35 hours to under six hours. Other Japanese-funded aid projects are in the areas of health care, education, and the environment.

Text B — Trade and investment flows between Vietnam and Japan

- 1 Japan imports seafood and consumer products such as textiles, leather shoes and processed foods from Vietnam, because Vietnam has a comparative advantage in such items. Conversely, Vietnam imports machinery, technology, and raw materials for production from Japan. Gradually barriers to trade are being removed. In 2020, Vietnam began exporting lychees (a luxury fruit) to Japan after five years of negotiations on quality standards. The improved access to the Japanese market has increased the number of consumers and the revenue earned by Vietnamese lychee farmers.

(This question continues on the following page)

(Question 1 continued)

- 2** Japanese firms invest in Vietnam, particularly in urban areas, because wages are low and they can export from Vietnam to other CPTPP members and to China and Indonesia. Panasonic, a Japanese multinational company (MNC), relocated a major factory, which manufactures refrigerators and washing machines, from Thailand to Vietnam in 2020. The construction of a coal-fired power plant is mainly funded by Japanese firms. The Japanese government is promoting further investment by subsidizing over 30 firms that are relocating from China to Vietnam. Most of these firms are food processors or producers of manufactured goods (for example, medical equipment).

Text C — Roles of the central bank in Vietnam

- 1** The central bank in Vietnam has been lowering interest rates since mid-2019. However, it has kept the minimum reserve requirement at 3% of commercial bank deposits, despite suggestions that this requirement could be lowered.
- 2** The central bank also regulates the exchange rate of the dong (Vietnam’s currency). It actively intervenes in the foreign exchange market to stabilize the rate when necessary. In April 2020, there was downward pressure on the dong due to the lower interest rates and fewer foreign tourists. However, the central bank has a large amount of reserve assets, which were used to prevent the dong from depreciating.

Table 1: Economic data for Vietnam

	2015	2019
GDP (real growth rate, %)	4.77	6.90
Real GDP per capita (US\$ PPP)	6103	8374
Current account balance (US\$ million)	–2041	5899*
Foreign direct investment, net inflows (US\$ billion)	11.8	15.5*
Debt servicing costs on external debt (US\$ billion)	6.63	18.4*
Exports of goods to Japan (US\$ million)	15 141	22 475
Imports of goods from Japan (US\$ million)	12 531	16 484

* 2018 figure

Table 2: Development data for Vietnam

	2015	2019
Life expectancy at birth (years)	70.5	76.3
Gini coefficient	0.35	0.37*
Net bilateral aid flows from Japan (US\$ million)	678	484

* 2018 figure

(This question continues on page 5)

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(Question 1 continued)

- (a) (i) Define the term *debt servicing* indicated in bold in **Table 1**. [2]
- (ii) Define the term *Gini coefficient* indicated in bold in **Table 2**. [2]
- (b) (i) Sketch a demand and supply diagram to show the effect on revenue earned by Vietnamese farmers with improved access to the Japanese market (**Text B**, paragraph **1**). [3]
- (ii) Using information from **Table 1**, calculate the change in the surplus on Vietnam's balance of trade in goods with Japan between 2015 and 2019. [2]
- (c) Explain **two** economies of scale which may **not** be available to smaller farms (**Text A**, paragraph **2**). [4]
- (d) Using a production possibilities curve (PPC) diagram to show comparative advantage, explain why Vietnam would export seafood to Japan while Japan would export machinery to Vietnam (**Text B**, paragraph **1**). [4]
- (e) Using a demand and supply of money diagram, explain the likely effect on interest rates of a reduction in the minimum reserve requirement for banks (**Text C**, paragraph **1**). [4]
- (f) Using an exchange rate diagram, explain how the central bank in Vietnam could prevent the dong from depreciating by using its reserve assets (**Text C**, paragraph **2**). [4]
- (g) Using information from the texts/data and your knowledge of economics, discuss the view that trade with Japan is more beneficial for Vietnam's economic development than foreign direct investment (FDI) from Japan. [15]

Turn over

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

Text D — Overview of Malawi

- 1 Malawi is a landlocked country in southern Africa. Its development plans contain 169 targets, based on the Sustainable Development Goals. Ineffective institutions and inequalities, however, make it difficult to reach every target. Although poverty in urban areas has declined, the level of absolute poverty has been increasing in rural areas where 85 % of the population lives. Causes of poverty include land degradation (80 % of the land is eroded or lacks nutrients), poor healthcare and rapid population growth. There is also a lack of human capital, which is often due to the difficulties that households have in obtaining loans for education or training. Approximately 75 % of households do not have access to formal banking services.
- 2 Aid agencies are providing assistance. The World Bank's Human Capital Project will increase investment and encourage reforms, such as promoting the education of teenage girls. In 2020, the World Bank also approved US\$157 million (50 % as a loan and 50 % as a grant) for a government project. This project aims to increase sustainable land management practices and build water-related infrastructure, such as small dams and irrigation schemes.
- 3 The government has encouraged the establishment of microfinance groups that act as rural banks. They provide some finance and guidance for programmes that introduce new types of crops and techniques in order to improve agricultural efficiency.
- 4 Although 2019 was a difficult year due to drought, insect infestations, and a tropical cyclone, Malawi's real gross domestic product (GDP) grew by 4.5 %. There is a large budget deficit and the amount of government debt (at approximately 60 % of GDP) is considered to be too high. Therefore, the government has announced plans to reduce its spending. Inflation had been forecast to increase to 14 % in 2020. Due to the planned contractionary fiscal policies, however, inflation may fall below 10 % from 2021 onwards.
- 5 Export revenues account for over 30 % of GDP. Malawi aims to increase its exports of cotton, nuts, tea and sugar. Rising exports and lower fuel import prices could reduce the current account deficit. Despite the persistent trade deficit, Malawi is resisting calls for further trade protection. It has signed bilateral trade agreements with both South Africa and Zimbabwe. **Tariffs** are gradually being reduced, while other indirect and direct taxes are being raised.

Text E — Agricultural Production

- 1 Approximately 80 % of the labour force is employed in agriculture, with few job opportunities available in manufacturing and services. Agricultural productivity is low for many reasons. The government promotes manufacturing industries and cultivation of crops for export by large-scale farms. However, small-scale and subsistence farmers have received little support in the past. Farmers use less fertilizer and irrigation than is typical in other countries. Only 3 % of cultivated land is irrigated, compared to the global average of 21 %. Other challenges are the inadequate road and rail links to markets and the limited availability of electricity and fuel.
- 2 Maize is the most important staple food in Malawi. The government uses price controls when trying to ensure that maize is available at affordable prices for low-income households. However, the maximum price set by the government is often too low to persuade farmers to supply the maize or to provide them with sufficient revenue. In 2020, the maximum price was raised from 250 to 310 kwacha per kilogram. Even at the higher price, shortages remain.

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(Question 2 continued)

- 3** The government is planning to invest in commercial agriculture to improve productivity and promote diversification. The 2020 budget includes subsidies on fertilizer for 4.3 million small-scale farmers, which could possibly double maize output but may also pollute waterways. The support given to farmers will improve the nutrition of Malawians and stimulate the rural economy.

Text F — Tobacco Exports

Tobacco is Malawi’s major export, providing over 50% of foreign currency earnings. Due to lower global demand and the purchasing policies of multinational tobacco firms, prices paid to farmers in Malawi are low and falling. To reduce costs, farmers resort to using child labour. Following allegations of labour exploitation, the United States has restricted tobacco imports from Malawi. There is concern that other importing countries might also impose restrictions.

Table 3: Economic data for Malawi

	2010	2019
GDP (nominal, US\$ million)	6960	29882
GDP price deflator	100	389.6
Population (million)	14.5	19.1
Government debt (% of GDP)	29.7	62.9*
Debt servicing costs (% of Gross National Income (GNI))	0.3	1.1*
Trade balance (nominal, US\$ million)	–1420	–1826

* 2018 figure

Table 4: Development data for Malawi

	2010	2018
Life expectancy at birth (years)	55.6	63.8
School enrolment, secondary, male (%)	36.1	39.9
School enrolment, secondary, female (%)	31.9	40.6
Gini coefficient	0.46	0.45*
Official development assistance received (US\$ million)	959.82	1222.50

* 2016 figure

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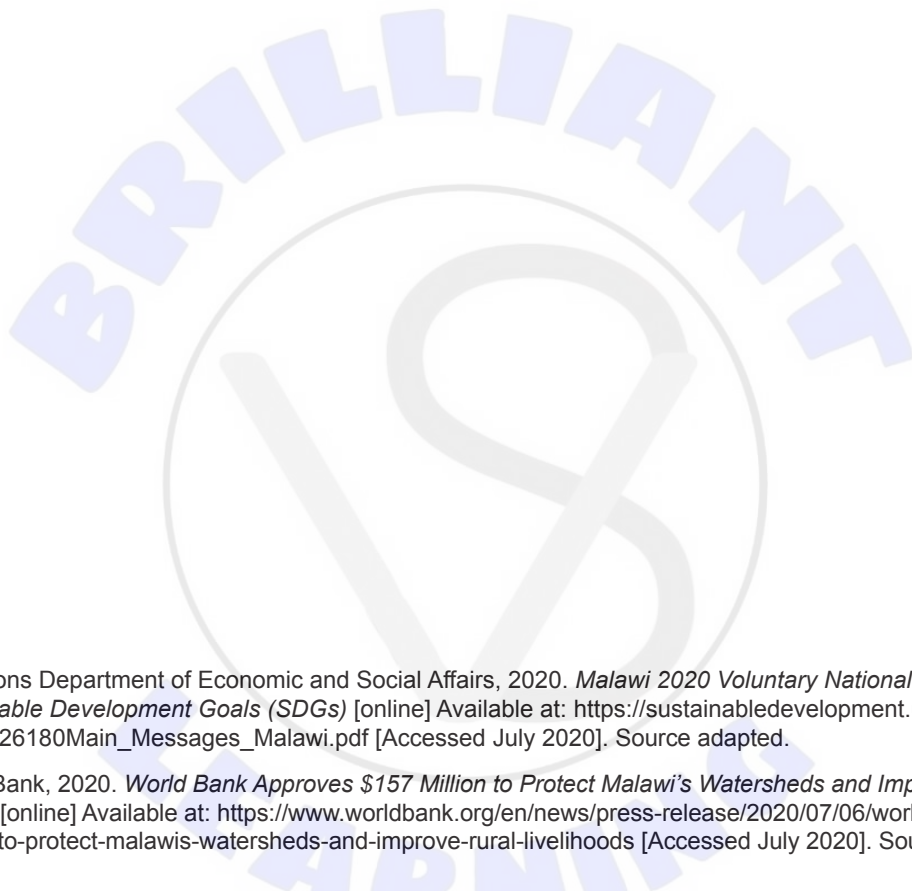
(Question 2 continued)

- (a) (i) List **two** of the Sustainable Development Goals (**Text D**, paragraph **1**). [2]
- (ii) Define the term *tariffs* indicated in bold in the text (**Text D**, paragraph **5**). [2]
- (b) (i) Sketch a production possibilities curve (PPC) diagram to show the effect of improved human capital on Malawi's potential output (**Text D**, paragraph **2**). [3]
- (ii) Using information from **Table 3**, calculate real GDP (at 2010 prices) in 2019 using the price deflator. [2]
- (c) Using a poverty cycle diagram, explain how an increase in funds for the education of teenage girls could break the poverty cycle (**Text D**, paragraph **2**). [4]
- (d) Using an AD/AS diagram, explain how a reduction in government spending may reduce inflation (**Text D**, paragraph **4**). [4]
- (e) Using an exchange rate diagram, explain how a reduction in the current account deficit could affect the exchange rate for the kwacha (**Text D**, paragraph **5**). [4]
- (f) Using a demand and supply diagram, explain how the rise in the maximum price of maize would change the welfare loss associated with the maximum price (**Text E**, paragraph **2**). [4]
- (g) Using information from the texts/data and your knowledge of economics, evaluate the government's policies to promote economic growth and economic development in Malawi. [15]
-



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- Table 1** World Bank Data Bank, World Development Indicators, n.d. [online] Available at: <https://databank.worldbank.org/reports.aspx?source=2&country=VNM> [Accessed July 2020]. Source adapted.
- Table 2** World Bank Data Bank, World Development Indicators, n.d. [online] Available at: <https://databank.worldbank.org/reports.aspx?source=2&country=VNM> [Accessed July 2020]. Source adapted.



- Text D** United Nations Department of Economic and Social Affairs, 2020. *Malawi 2020 Voluntary National Review Report For Sustainable Development Goals (SDGs)* [online] Available at: https://sustainabledevelopment.un.org/content/documents/26180Main_Messages_Malawi.pdf [Accessed July 2020]. Source adapted.
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- Fabricius, P., 2020. *Malawi sets stellar example with push for food security* [online] Available at: <https://www.businesslive.co.za/bd/opinion/2020-07-13-peter-fabricius-malawi-sets-stellar-example-with-push-for-food-security/> [Accessed July 2020]. Source adapted.
- Text F** AFP, 2019. *US restricts tobacco imports from Malawi over labour abuses* [online] Available at: <https://www.theeastafrican.co.ke/business/US-restricts-tobacco-imports-from-Malawi-over-labour-abuses/2560-5369826-vhw4q7z/index.html> [Accessed July 2020]. Source adapted.
- Table 3** World Bank Data Bank, World Development Indicators n.d. [online] Available at: <https://databank.worldbank.org/reports.aspx?source=2&country=MW> [Accessed July 2020]. Source adapted.
- Table 4** World Bank Data Bank, World Development Indicators, n.d. [online] Available at: <https://databank.worldbank.org/reports.aspx?source=2&country=MW> [Accessed July 2020]. Source adapted.