



Economics

A Level | Edexcel A | 9ECO

2015 specification
first exams in 2017



Data Response Case Studies Volume 2 (2022)

Theme 4: A global perspective

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Teacher's Introduction

The case studies in this series are designed to support students as they study the Edexcel A module *Theme 4: A global perspective*. These case studies cover the Edexcel A specification perfectly, and are designed as real-world contexts to complement the theoretical content of the module.

Each case study contains:

- * **Contextual information:** this is the body text of the case studies, providing the relevant information, facts and figures.
- * **Data:** each case study contains data presented in a graphical format.
- * **Data response questions:** for each case study, students are presented with two questions set in response to the data presented. Answers are included.
- * **Test your knowledge questions:** for each case study, students are presented with two questions designed to mimic short-answer examination questions. Answers are included.
- * **Extended-response question:** for each case study, students are presented with one question designed to mimic long-answer examination questions. Possible answers are included in summary form.

This resource is designed to be useful to students of all abilities. Students of the highest ability require up-to-date contextual information for use in examination, while for lower-ability students these case studies may complement class activity and help to ground theoretical content in real-world contexts.

These case studies are designed to be up to date for 2022 and provide as contemporary a snapshot of economic discussion as possible. However, it is likely that some themes which are relevant and topical at the time of teaching may not be included. It is therefore advised that these examples are used in tandem with the study of the most recent themes.

I hope this resource can contribute towards an engaging and rewarding learning environment. Best of luck with your teaching!

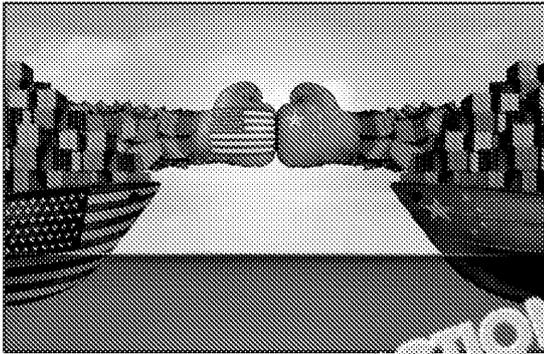
Remember!

Always check the exam board website for new information, including changes to the specification and sample assessment material.

January 2023

Superpower rivalry: US–China trade

Patterns of trade; Restrictions on free trade

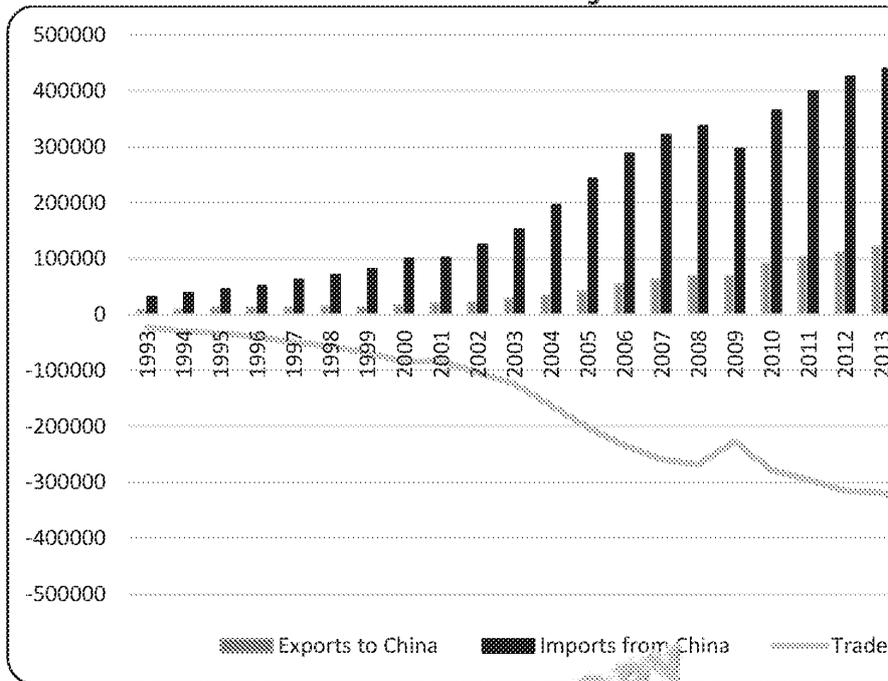


While throughout the 1990s and 2000s it appeared to be an unstoppable force, the rivalry between the United States and China – having a 'trade war' since 2018.

Implemented under the Trump administration, tariffs have been placed on Chinese goods in protest against various trade practices. In retaliation, China has placed tariffs on American goods.

In part, the US has been seeking to try to reverse the extraordinary trade deficit between the two nations. In 2017, the US presented a \$419.2 billion gap between imports and exports. However, since the tariffs were put in place has returned the gap only to pre-2015 levels. Figure 1 shows the trade deficit over the last 30 years, in millions of dollars.

Figure 1¹



There are two broader reasons for the reversal of trade liberalisation. For one, the growing superpower rivalry, as the world's biggest economies vie for influence and power and seek to become less reliant on each other – a process known as 'decoupling'.

But there is also declining domestic support for free trade. While decades of trade liberalisation have led to economic growth, the proceeds of this growth have not been distributed equally. This has manifested itself on both sides of the global divide.

For developing nations, having infant sectors of their economy opened up to the external consequences, as it forces them to compete on equal terms with far stronger and more developed nations. This can serve to lock developing economies into relations of dependence with their trading partners and stall the process of economic development completely. If a developing economy wishes to remain on a level playing field, then the principles of trade liberalisation often start to be questioned.

¹ <https://www.census.gov/foreign-trade/balance/c5700.html>

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Meanwhile, in developed economies, labour-intensive sectors such as manufacturing compete with the far cheaper labour available in developing economies. While it makes production to wherever the major input is substantially cheaper, it also contributes to sectors of an economy, and increases political demands for a less liberal approach to

Use the data

1. By what percentage did the value of Chinese exports increase between 2000

Test your knowledge...

1. Identify **two** consequences of a 'trade war'.
2. Explain **two** policy options other than tariffs, available to governments seeking to reduce trade deficits.
3. Explain the impact of a tariff, using a suitable diagram.

Extended-response question

1. Evaluate the merits of trade liberalisation.

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Global labour markets: Nike in Indonesia

Globalisation; International competitiveness

Indonesia, with its massive population of 273 million, is a key destination in the manufacture of Nike footwear products. There are 38 Nike factories in the South East Asian country, making it the third largest production location for Nike operations after China and Vietnam. 24% of Nike's footwear is produced by a total of 135,000 Indonesian labourers. A large proportion of workers in Nike's supply chain are female, with the company itself estimating this figure at more than 70%.



Nike has experienced decades of criticism for working conditions in Indonesian factories manufacturing its products. Allegations include delayed or unpaid wages, abuse of staff, the use of underage, illegal and forced labour and dangerous working conditions, such as overcrowding in dilapidated buildings. Nike is frequently accused of fostering these conditions by providing minimal investment to its factories while demanding goods excessively quickly.

Nike is also accused of being 'footloose'. It is estimated that 0.2% of the value of the local labour force. At the outset of the coronavirus pandemic, Nike factories let go a large number of workers in the district of Banten, exacerbating an unemployment crisis in the region. Nike is an American multinational corporation with its headquarters in the US state of Oregon.

In addition, Indonesia does not excel at capturing the value that could be generated by the footwear industry. **Figure 1** shows that the value of associated services as a share of production is low in Indonesia, relative to comparable economies.

Figure 1²



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² <https://www.iccc.or.id/wp-content/uploads/2020/08/An-Analysis-of-the-Global-Value-Chain-for-Indonesia>

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In Indonesia, minimum wages are set by the provincial governments and so vary across regions. The average minimum wage received by an Indonesian worker was \$307 a month, though in rural regions which are more poorly connected. Previous rules allowed firms to opt out if they could demonstrate that it reduced their profitability; however, these exemptions were only for small and medium-sized enterprises.

Although low by Asian standards, Indonesian minimum wages are relatively high compared to Cambodia, which lies directly north of Indonesia. In Cambodia the minimum wage for footwear is set at \$194 a month. Nike have been increasingly relocating their production to Cambodia and have begun opening stores in Cambodia. 65% of the population of Cambodia are under 30 years old. The Cambodian government is investing in infrastructure, and demand in the health and fitness sector is booming.

Use the data

Take a look at Figure 1 and the information in the passage.

1. Why is the range of associated services important to consider?
2. Suggest a possible reason why Cambodia has been more successful at developing around its footwear industry.

Test your knowledge...

1. How much above the absolute poverty line of \$2.15 a day is the minimum wage in Cambodia?
2. Identify four factors that affect international competitiveness.

Extended-response question

1. Evaluate whether Nike's production strategy is beneficial for Indonesian economic growth.

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Footloose TNCs: Avoiding tax in a global

Globalisation; Taxation

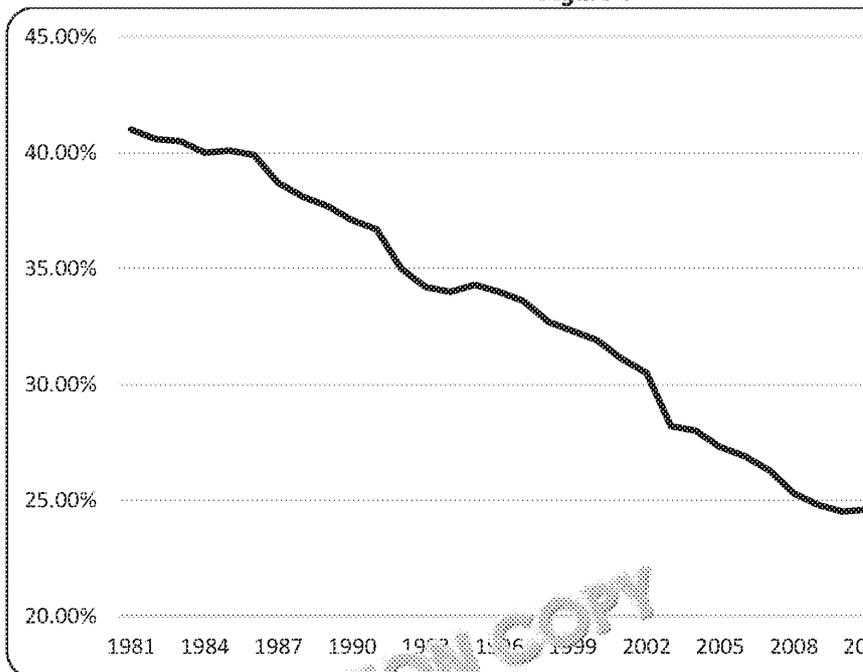
One of the features of globalisation has been the rise of transnational companies, or TNCs, which reach vast numbers of consumers around the world and often reap vast profits as a result.

On the one hand, TNCs have unparalleled access to funding and economies of scale, allowing them to provide goods and services to global consumers on a scale that would have been unthinkable a few decades ago. On the other hand, the global nature and power of TNCs have caused problems for governments, particularly when it comes to collecting taxes.

The basic problem is this: governments want to receive their fair share of tax revenue, but companies have a financial incentive to minimise their tax liability. If a firm can find a way to do this, such as funneling profits through a tax haven, then they will naturally do so.

In a globalised economy, a 'footloose' TNC can easily choose to set up shop in another country with a more accommodative tax system. One impact of this has been a 'race to the bottom' on corporate tax rates, as countries compete to lure TNC activity away from other economies and towards their own. Figure 1 shows the average corporate taxation rate worldwide, which has almost halved in the last 40 years.

Figure 1



TNCs make huge profits and the growing of their contribution to government revenue has led to a significant increase in public expenditure, which is also placing more of a tax burden on smaller businesses and individuals. Figure 2 shows a range of European countries, and the percentage of their health budgets that is funded by corporate tax avoidance in a single year.

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Figure 2



Corporate tax avoidance is a major negative consequence of globalisation. While so this doesn't change the fundamental ability of global firms to relocate. Unless all countries have a strict global tax regime, it is difficult to see how nations can stop competing over the lowest tax rates.

Use the data

- Using Figure 1, calculate the percentage decrease in UK corporation tax between 2010 and 2020. Give your answer to one decimal place.
- Amazon made a profit of \$200 billion in 2021. On average, what would be the firm's corporate tax bill, according to Figure 1?

Test your knowledge...

- Explain **two** macroeconomic objectives fair taxation of TNCs can help to achieve.
- Using a suitable diagram, explain the impact of a rise in corporation tax on market equilibrium.

Extended-response question

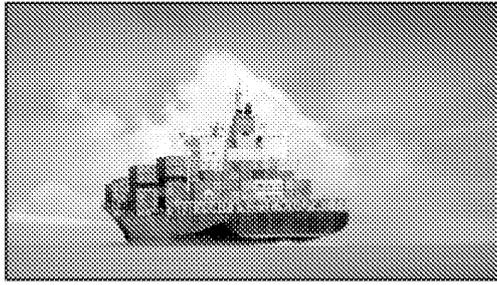
- Assess the effectiveness of increasing corporation tax to help reduce a budget deficit.

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Trading blocs and barriers: The EU and

Specialisation and trade



In 2019, the South American customs of a free trade agreement with the Euro years of negotiations. The deal propos tariffs between the two trading blocs. sought by Mercosur is the removal of t such as beef and poultry. Conversely, t on their manufactured goods, particula

The delays in the formation of the deal have been caused for a number of reasons. Govern demonstrated a tendency for cooperation between each other, rather than with other the EU, particularly among farmers and agricultural producers, is also strong. Environ few provisions protect key natural resources, such as the Amazon rainforest, to w contributor of deforestation. In addition, the recent election of a number of more pro America may further scupper the deal.

Figure 1 shows EU exports to Mercosur by type of good in 2018. Figure 2 shows the same year.

The Common Agricultural Policy (CAP) is a controversial feature of the EU's economic arrangements. The CAP amounted to exactly a third of the EU's budget in 2021, and provides extensive subsidies and a buffer stock scheme to the farming sectors in EU member states. This ensures that farmers receive a set minimum price for their goods, and are shielded from fluctuations of supply and demand in the marketplace. A frequent consequence is considerable oversupply of food in the EU. The CAP is both supported and criticised across the EU for many reasons. One key criticism is that it either shuts out or reduces in value imports of agricultural goods from developing nations, who tend to be highly reliant on exports from their primary economic sector to generate growth.

Figure 1

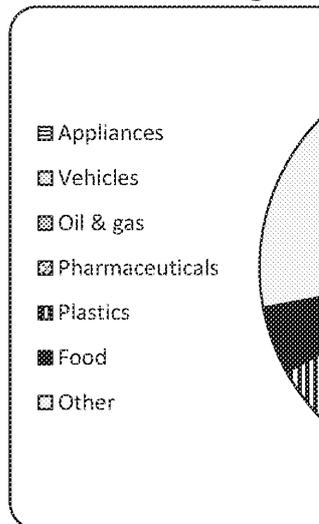
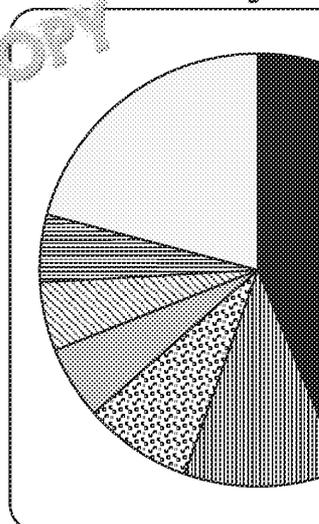


Figure 2



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Use the data

1. Using Figures 1 and 2, explain the difference between the export goods of e
2. What is distinct between the goods in Figure 1 and the goods in Figure 2?

Test your knowledge...

1. Explain the difference between a free trade area, a customs union, a common monetary union.
2. Explain a buffer stock scheme, using a suitable diagram.

Extended-response question

1. Evaluate whether protectionism undermines economic growth.

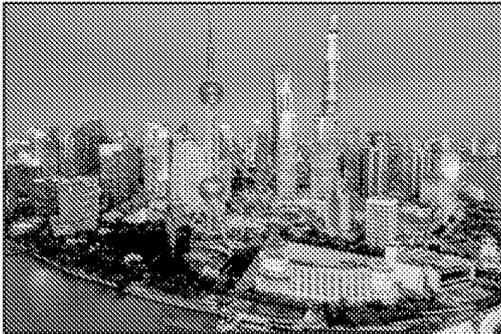
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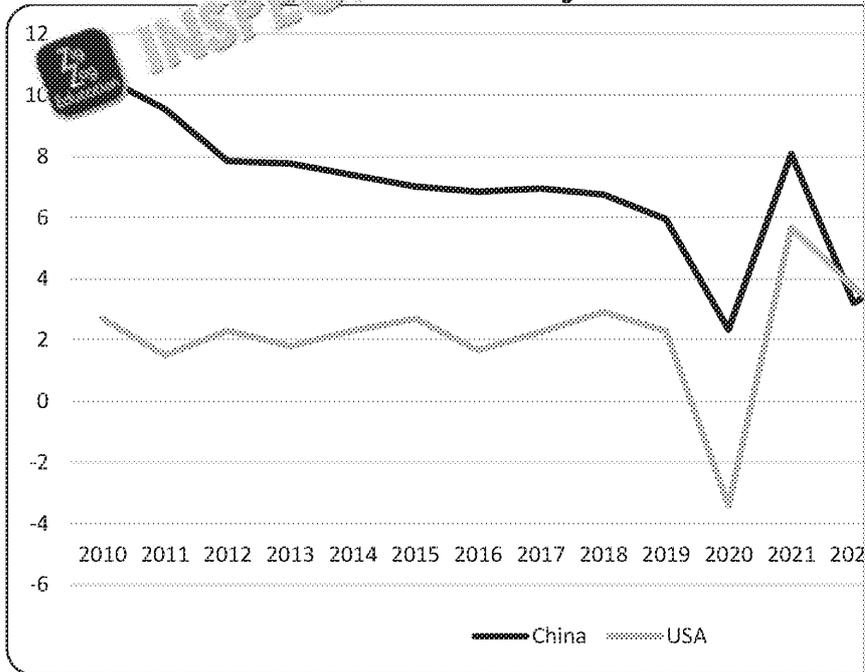
Developmental ambiguity: China at the

Terms of trade; Trading blocs; Exchange rates



The growth of the Chinese economy has, with the East Asian superpower set to become the world's nominally largest economy by 2028, led the world's few economies to avoid recession during the 2020 pandemic, instead experiencing slower growth. China's standards, but relatively improved living standards in the Global North. The growth rates of China and the United States from 2010 to 2022 are shown in the following projections until 2026.

Figure 1



By some measures of gross domestic product, however, China is already the world's largest economy, even when adjusted for local prices – known as Purchasing Power Parity, or PPP – China is comparable to the USA, and has been for many years. Some cite this as an example of China's economic success. This suggests the Chinese economy has contributed more to global growth than any other country.

Yet at the World Trade Organization, China continues to carry the status of a developing country, which causes some consternation among Western developed economies. Some also argue that China's rapid economic growth means it should give up advantages enjoyed by nations with far less economic power. Economies in the WTO are permitted to receive special and differential treatment provisions, such as longer time periods to implement trade commitments, such as the removal of tariffs. This is seen as a production-oriented model of growth, as it keeps their exports cheap.

Although economies seeking access to China's massive domestic market may view this as a disadvantage, which support China's claim of developing status. In global GDP per capita, for example, China is below Argentina and Mexico, and below the global average.

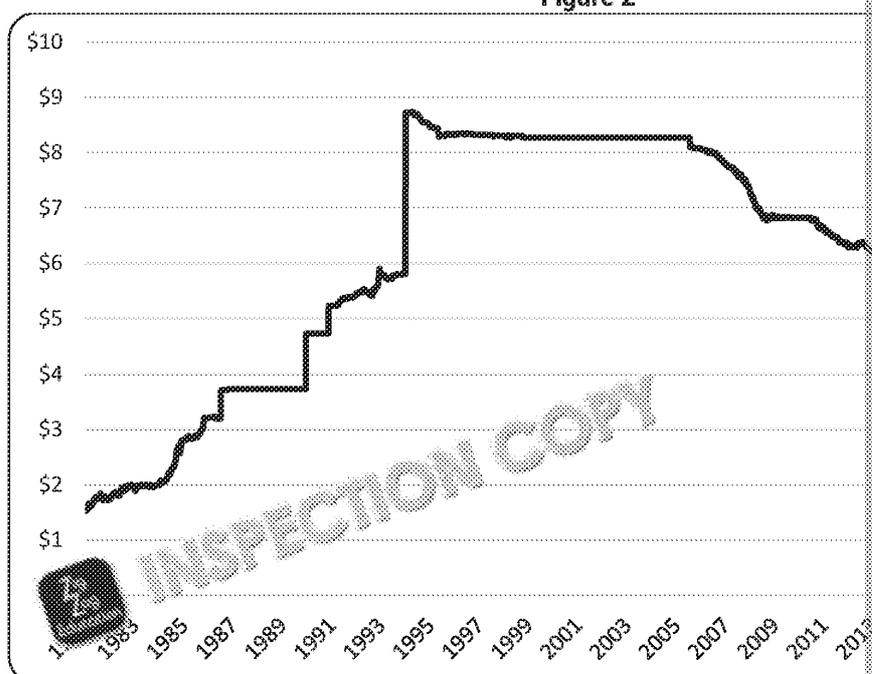
Aside from claiming developing status, Western leaders also argue that China engages in currency manipulation. They point towards the country's currency – the renminbi – which they argue is deliberately undervalued. (overleaf) shows the US dollar value of a Chinese yuan since 1981.

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Figure 2



Use the data

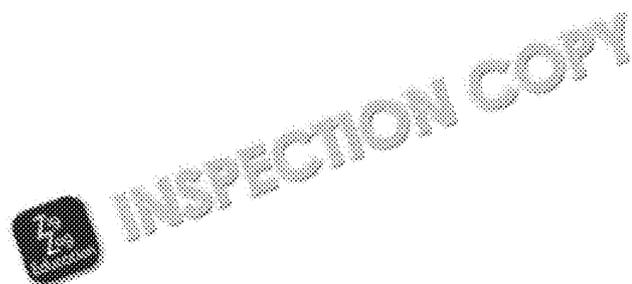
- Using Figure 1, identify what happened in 2022 for the first time since 1976
- What does Figure 2 suggest about China’s exchange rate system?

Test your knowledge...

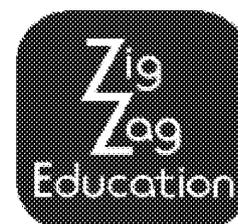
- Explain why China would deliberately devalue its currency.
- Explain **two** purposes of the World Trade Organization.

Extended-response question

- Evaluate whether the Chinese economy should still be considered developing



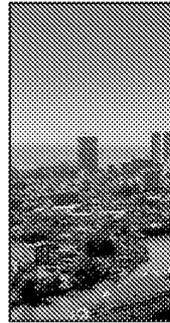
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Sovereign debt crisis: Defaulting in S

Balance of payments; Financial markets

The balance of payments current account measures the extent of a country's incomings relative to its outgoings. One reason it is important is because it also indicates the ability of a country to repay its debts, and thus can determine its ability to borrow money on international markets. If a country records too big a deficit on the balance of payments, then investors may doubt the ability of a country to repay and stop lending to their government.



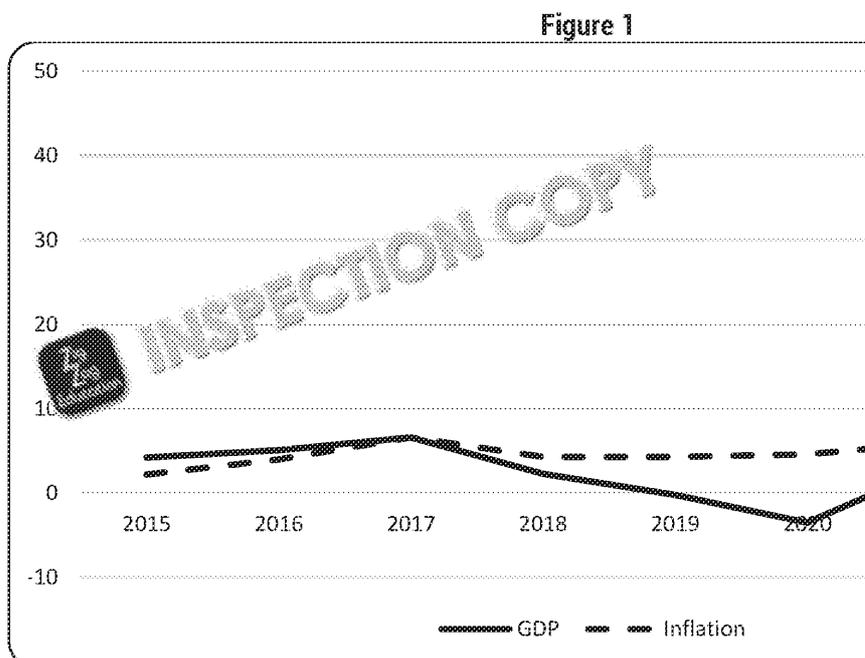
In international economics, the moment at which foreign creditors stop lending to a country is critical as it leaves the government unable to service its interest payments, and thus precipitate a debt crisis. This has happened in Sri Lanka which in recent years has plunged into economic chaos. We can trace the downward spiral of the island nation's balance of payments current account through several events.

In 2009, the Sri Lankan government took out large foreign loans, particularly from China, to fund infrastructure projects, and also in part to help fund tax cuts and boost its domestic economy. This led to a first shift in the balance of payments. Greater foreign borrowing further increases the deficit.

In 2019, a series of terrorist attacks in the capital city Colombo hobbled the country. Colombo has been a major international tourist destination, with tourism a major industry generating foreign exchange. After the attacks, this figure dropped to \$1.5 billion – a major decline in the country's foreign exchange. Tourism was further exacerbated by the coronavirus pandemic.

But perhaps most crucially an ill-fated law passed by the government to ban fertiliser exports was introduced in 2021. One of Sri Lanka's major exports is tea, and the fertiliser ban led to tea exports collapsing, while food imports into the country grew.

In dealing with the fallout of the worsening trade balance, the government doubled down on borrowing and printing money. The resultant runaway inflation was catastrophic for the country, with prices eventually leading to mass protests and ultimately the overthrow of the president. Figure 1 demonstrates the economic growth and inflation rate in Sri Lanka between 2015 and 2020.

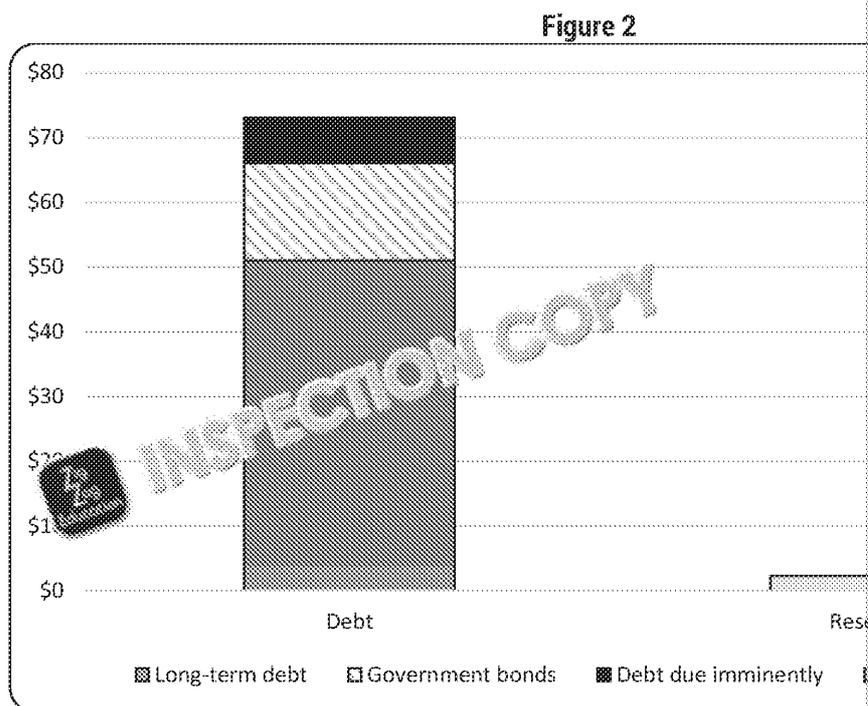


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By September 2022, the interim government had struck a deal with the International Monetary Fund for a \$2.9 billion loan, conditional on significant economic reforms being conducted. Figure 2 shows the composition of Sri Lanka's national debt, in billions of dollars, relative to its foreign exchange reserves.



Use the data

- How could the economy of Sri Lanka in 2022 be described, based on Figure 2? What problems do you think pose a problem for policymakers?
- Sri Lanka's GDP was valued at \$73 billion in 2022. Using Figure 2, calculate the national debt as a proportion of its GDP.

Test your knowledge...

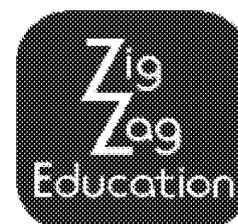
- Explain the importance of foreign exchange reserves.
- Explain the difference between a country's current account and financial account.

Extended-response question

- With reference to Sri Lanka, discuss the advantages of government borrowing.

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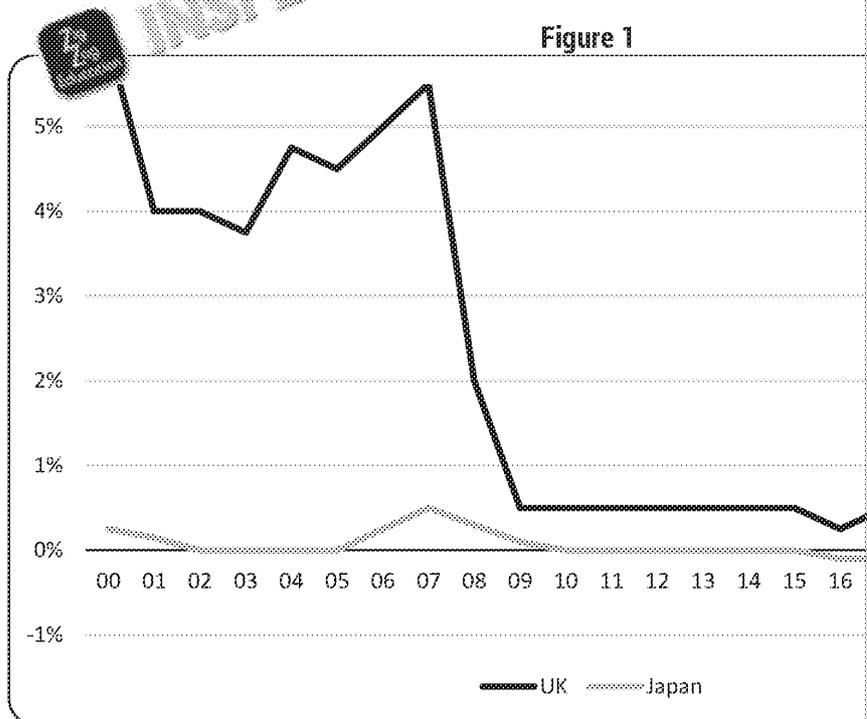
Negative interest rates: Tackling deflation

Exchange rates; Role of central banks

Reducing uncertainty is a primary goal of central banks. Interest rates are a key tool in controlling inflation, and maintaining a more stable economic environment. In economics, we normally think of high interest rates being adopted as a means of reducing inflation, and low interest rates acting as a means of increasing the inflation rate.



However, over the last few decades this dynamic hasn't exactly played out in the world's third largest economy: Japan. Since the late 1990s, Japan has experienced persistent economic stagnation since the 1990s. Japan has struggled with deflationary pressures, despite interest rates being set at rock bottom. Figure 1 shows interest rates in Japan, compared to the UK, between 2000



As a result, the country has long been stuck in a loop of low inflation and low interest rates. In an attempt to stave off deflation, Japan became one of the first countries to use negative interest rates, with the central bank lowering the rate from 0% to -0.1%. This means the Bank of Japan is effectively paying savers and a payment for borrowers, reversing the way we think about the structure of interest rates. Accumulating wealth would be even more strongly incentivised to invest, lend or spend money, as there are no costs associated with interest rates low. This would, in theory, stimulate economic activity and help to combat deflation.

It's a strange idea at first, but it has now for a long time had been rejected out of hand. How can it work? We'll explore this in more detail in the next section. Figure 2 (overleaf) shows the inflation rate of Japan from 2000 to 2022.

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Figure 2



It would appear from the data that inflation did rise after 2016, although it still remains low. The UK's economy has managed to escape the Japanese economy. However, Japan has a highly export-orientated economy and, after years of no growth, is also heavily indebted.

Ultimately inflation in Japan did rise in 2022, as around the world. But this is the result of a pickup in domestic demand. So Japan's search for growth goes on.

Use the data

- Using Figure 2, identify what is happening to the value of the currency in:
 - Japan in 2005
 - Japan in 2015
 - The UK in 2021
- Using Figure 2, identify in which year the Bank of England achieved its target.

Test your knowledge...

- Explain the consequences of deflation on an export-oriented country's international competitiveness.
- Explain why an export-orientated and heavily indebted economy might benefit from low interest rates.

Extended-response question

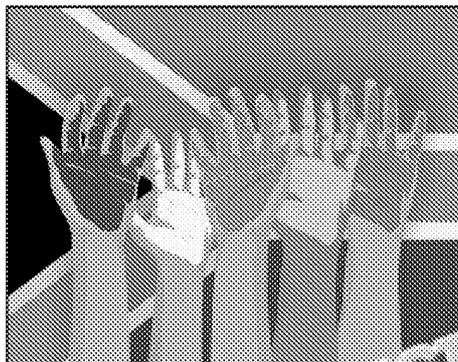
- With reference to Japan, evaluate whether monetary policy is an effective tool for achieving economic growth.

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Crippling inequality in South Africa

Inequality; Poverty; Measures of development



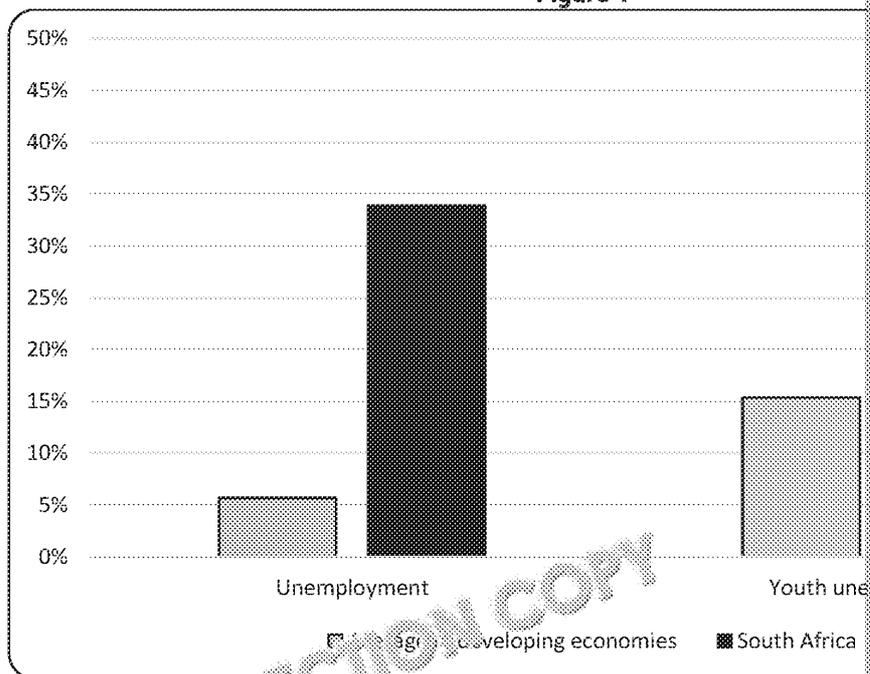
South Africa is the most unequal country in the world. The primary measure of inequality used by the World Bank is the Gini coefficient. In 2022, South Africa scores 63, which compares to a global average just below 40.

Inequality initially fell when racial apartheid ended, however, over the past two decades it has risen again. The fall of segregation and the South African government's liberalisation policies vigorously opening up the economy to global markets, some argue this has deepened inequality in industries, such as the textile and clothing sectors.

Some studies have found that 'trade-induced' technological change benefited high-skilled workers by increasing wages and opportunities for low-earning and low-skilled workers was harmed by the increased competition from cheap imports in the primary and manufacturing economy, where low earners tend to work.

This theory is consistent with sky-high unemployment figures in modern-day South Africa. South Africa's levels of unemployment are very high, even relative to similar economies.

Figure 1⁴



But it is not just economic inequality from which the country suffers – wealth disparity. Africa's population owns less than 15% of the nation's entire wealth. More than half of the richest 1% of the population, while the poorest 50% of the population have 'negative net worth' – they do not even exceed their assets. Figure 2 (overleaf) visualises this wealth disparity, comparing per capita income to net worth.

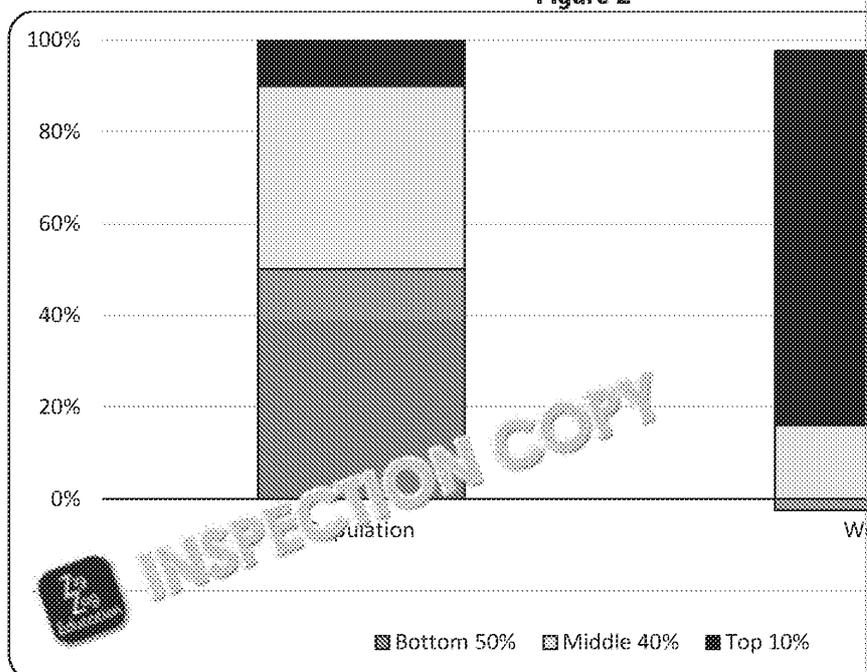
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³ http://www.tips.org.za/files/trade_thurlow.pdf
⁴ <https://www.imf.org/en/News/Articles/2020/01/29/na012820six-charts-on-south-africas-persistent-and-rising-inequality>

Figure 2⁵



Despite the impoverishment of most of the country's citizens, South Africa is the wealthiest country in the world in 2021, it was estimated that 651 billion dollars of private wealth is held in South Africa, an amount held in the next three wealthiest countries (Egypt, Nigeria and Morocco) combined.

The devastating impact of South Africa's inequality is plain to see. The country is suffering from high levels of violent crime, including some of the highest murder rates in the world. 18.2 million people live in extreme poverty. In some poorer parts of the country, the proportion of the population living in extreme poverty exceeds two-thirds. Life expectancy is 64 years old, ranking the country among the lowest of war-torn states such as Afghanistan, Sudan and Yemen. South Africa also suffers from COVID-19, home to 17% of the world's cases, despite providing just 0.7% of the world's population.

Use the data

- Using Figure 2 and the information in the text, calculate the total wealth of the bottom 50%, middle 40% and top 10%.
- Draw a Lorenz curve based on the information given in Figure 2.

Test your knowledge...

- Explain the connection between income inequality and wealth inequality.
- Why would a Lorenz curve for a country be more informative than the Gini coefficient?

Extended-response question

- With reference to South Africa, discuss the relationship between economic growth and inequality.

⁵ <https://sa-tied-archive.wider.unu.edu/article/extreme-inequalities-distribution-household-wealth-south-africa>

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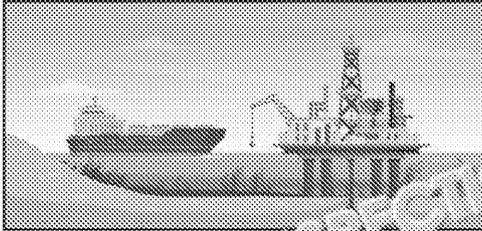
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Growth without gains: Stalled development in

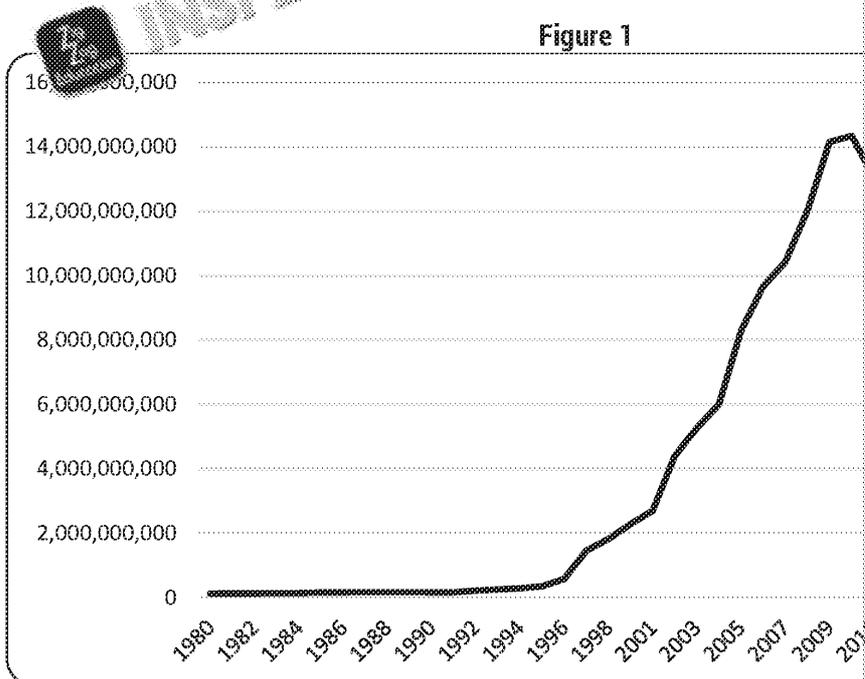
Measures of development

Students of international economics will be aware that GDP figures do not always give a true picture of living in a country. It was for this reason that the Human Development Index, or HDI, was developed using health and education metrics, as well as GDP per capita, a clearer measure of where countries are in the developmental race.



One of the major outliers identified by the HDI is the small state of just 1.5 million people on the west coast of Africa, Equatorial Guinea. It had a bare-bones economy until a large reserve of oil was discovered. The country's GDP exploded. For example, in 1996 the value of the economy was just \$1 billion, but by 2009 it had risen to \$14.5 billion.

Figure 1



As we can see, striking oil was a bonanza for the county's economy. The economy grew by 150% in 1997 alone! The gains significantly enriched the population.

In 2021 Equatorial Guinea's GDP per capita was measured at \$8,426. This puts it in the middle of the pack of countries, comparable to nations in Central America and Eastern Europe. However, by other metrics it is nowhere near. For example, it has one of the lowest life expectancies in the world, and is also placing 151st in the world in mean years of schooling. Figure 2 highlights the HDI compared to some selected nations.

Figure 2

Country	HDI value (2021)	HDI rank (out of 188)	Life expectancy at birth	Expected years of schooling
Equatorial Guinea	0.596	145	59	9.2
India	0.633	132	69.9	11.9
Cuba	0.764	83	78.9	13.8
China	0.768	80	77.1	14.2
UK	0.929	18	80.9	16.2

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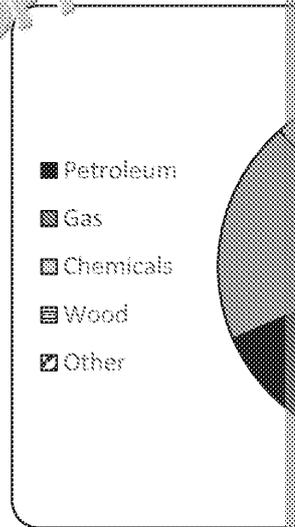
So why is Equatorial Guinea such an outlier? Quite simply, the huge economic gains distributed around the population. There is significant corruption in the country's government leading to poor humanitarian outcomes. President Teodoro Obiang Nguema Mbasogo is an authoritarian who has ruled since 1979. He has been accused of keeping the country's wealth for himself and his family while the rest of the population lives in poverty.

HDI can also help us to see where the wealth of the nation has been concentrated. In Figure 3 we can see that the poorest region – the interior area of Wele-Nzas – has the lowest HDI score in the world. By contrast, the outlying Insular Islands, where the capital city is located, has the highest. Finally, Figure 4 breaks down Equatorial Guinea's exports, showing the extent of the

Figure 3

#	Region	HDI Score
1	Insular	0.713
2	Litoral	0.639
3	Kié-Ntem	0.529
4	Central	0.506
5	Wele-nzas	0.486

Figure 4



Use the data

1. What does Figure 3 suggest about the distribution of wealth in Equatorial Guinea?
2. Take a look at Figure 4. Why might this be a problem for an economy?

Test your knowledge...

1. State **two** indicators of development, other than those included in Figure 2.
2. Explain **two** problems with GDP per capita as a measure of development.

Extended-response question

1. Assess the importance of having abundant natural resources for economic development in a country such as Equatorial Guinea.

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The curse of oil dependency: Venezuelan h

Growth and development strategies; Macroeconomic

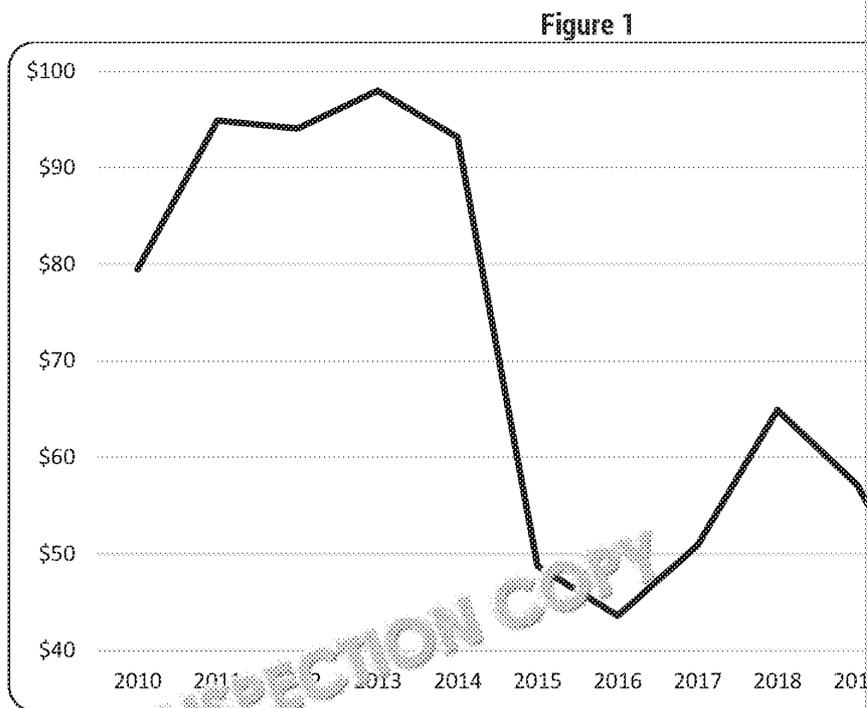
Venezuela has the largest known oil reserves of any country in the world, and is the largest producer of oil, according to the Organization of Petroleum Exporting Countries (OPEC). Oil accounts for roughly 95% of the South American nation's exports. The state-owned oil company, PDVSA, has responsibility for extraction and distribution of the oil reserves, with much of the revenue going to the state.

But, while this abundance of oil would suggest that the country should be very highly developed, instead it is in a state of years-long economic collapse.



The primary reason for this is the country's over-reliance on the natural resource. It is almost entirely dependent on the oil sector. Over the last two decades the state has used oil revenue to fund social programmes, reduce poverty and maintain economic development in part. State resources have been diverted away from promoting growth and development in other sectors and constructing more robust economic institutions capable of withstanding shocks.

The 2014–16 collapse in oil prices was among the biggest in modern history. While it was being maintained until September 2014, this suddenly plummeted throughout 2014 to a barrel in January 2016. Figure 1 highlights these fluctuations.



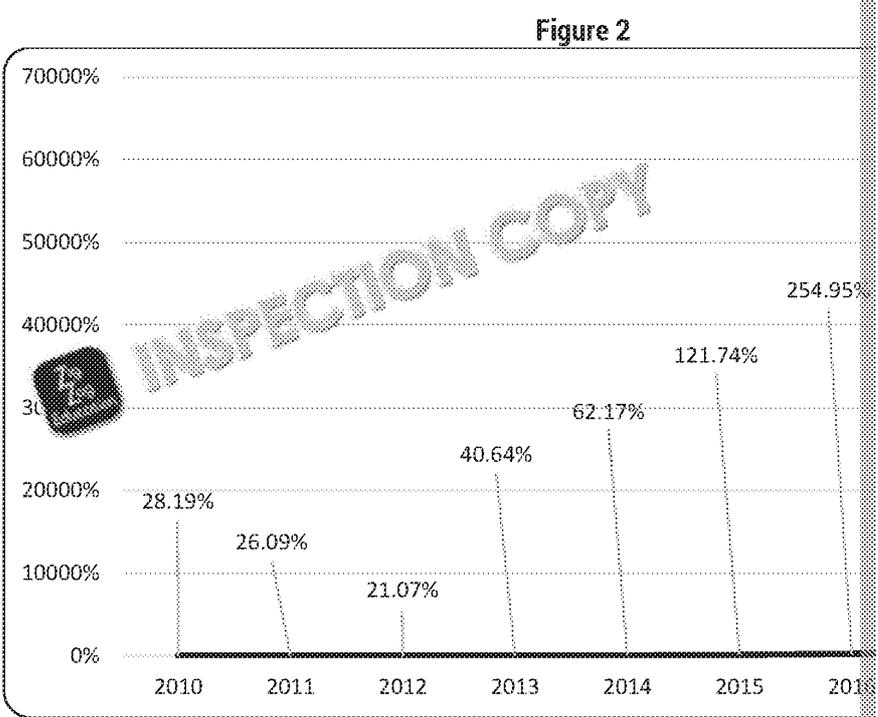
The lack of preparedness for the oil shock was in part due to the fact that there was no significant decline in prices. Instead, the decline was seemingly due to general global oversupply as a result of developing countries that boomed in the 2000s, such as China, Russia and Brazil, were slowing down and so their demand for oil reduced. The United States, the world's biggest oil producer, decided to produce its own shale oil and thus becoming less dependent on imports. The world's largest oil-consuming country, China, decided to maintain its rate of oil production, rather than slow down its production to meet demand. In Europe a shift towards gas and renewable energy was also beginning to decrease the

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The collapse in oil prices had a catastrophic effect on the economy of Venezuela. With a sharp fall in the price of oil, economic sanctions enforced by the United States, endemic government corruption and increasing political instability within the country, economic and social collapse was the result. As a result of this economic crisis has been hyperinflation. By 2017 the inflation rate had reached 400% and the government stopped producing official inflation estimates. By the end of 2019, some estimates put the inflation rate at 10,000,000%. Figure 2 highlights the pace at which hyperinflation can take hold.



Use the data

1. What does Figure 1 suggest about oil prices?
2. Identify four negative consequences of the trend in Figure 2 for individuals.

Test your knowledge...

1. Demonstrate the impact of falling oil prices, using a suitable diagram.
2. Explain **two** impacts of hyperinflation on a country's external economic relations.

Extended-response question

1. Discuss the national economic policies that Venezuela could adopt in order to stabilise its economy.

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Use the data

1. The pound started 2022 at a value of \$1.35. How much of its value had it lost by the end of the year?

Test your knowledge...

1. Explain **two** functions of the financial market.
2. Explain **two** consequences of a currency depreciation.
3. Using a suitable diagram, explain how tax cuts could contribute to economic growth.

Extended-response question

1. Assess the increasing role of the central bank in managing UK financial crises.

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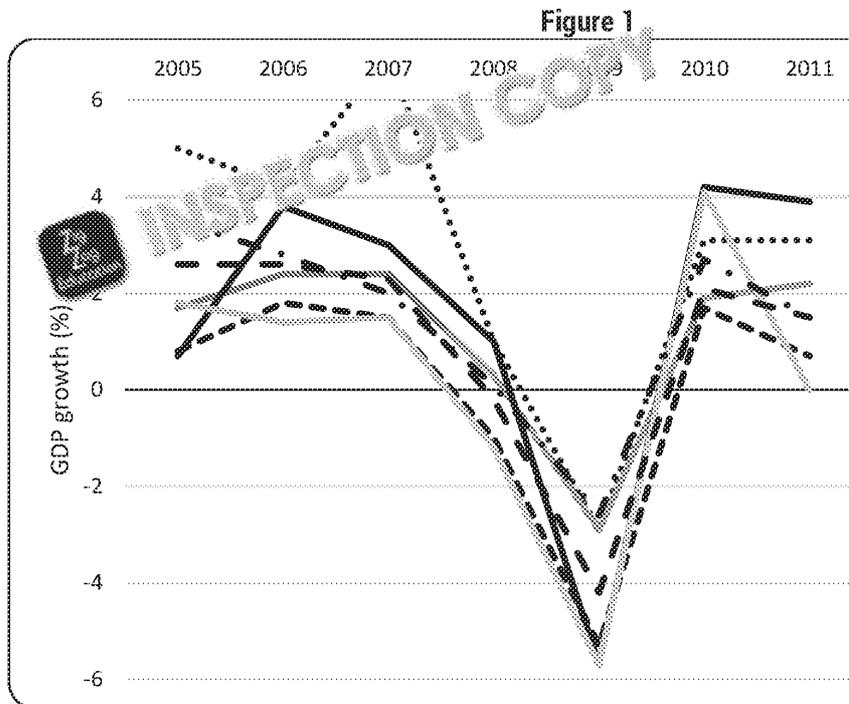
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Global financial crisis: 15 years

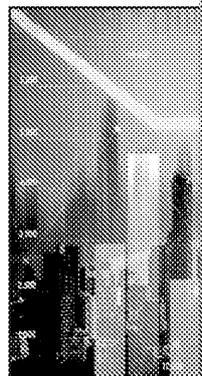
Market failure in the financial sector

Even 15 years on, the impact of the global financial crisis continues to be felt across the world. The economic growth that was pervasive in the Global North prior to the crash has never returned. The world has had to adjust to a lower-growth model which has resulted in stagnating living standards and political instability. That the effects of this moment are still felt today is testament to the fragility of markets in the functioning of the modern economy.



The big takeaway from the crisis is that it did not occur simply because people misbehaved. Instead, the real reason behind the crash was that it resulted from structural weaknesses that were built into the fabric of the international economy. These weaknesses give us a list of factors which can trigger financial crises.

Take, for instance, asymmetric information. In the US, the early 2000s were years of unparalleled prosperity. Confidence in the financial system was high. As such, some banks began extending mortgage loans to potential homeowners who were considered 'sub-prime' (that is, unlikely to pay it back). Extending these risky loans was made possible by the development of various complex financial products that shifted the burden of risk between different parts of the system.



The problem with these products was that not everyone who traded them understood what they really meant, or how risky they actually were. As such, when the credit bubble burst, banks and traders were unsure how much they actually stood to lose, triggering a panic and the ensuing financial meltdown.

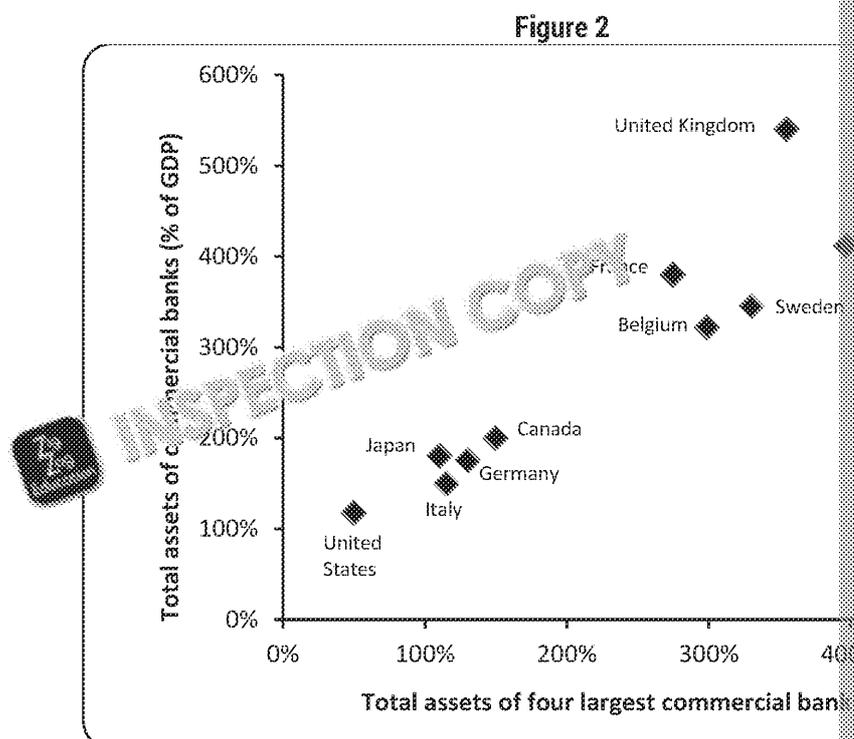
Almost all banks were very highly 'leveraged', meaning that the value of their loans far exceeded their reserve funds. This made an unexpected decline in the value of their loans devastating. The amount of reserves banks have to hold have been tightened up.

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Another aspect of market failure that emerged from the crisis was moral hazard. Governments bailed out failing banks because they hoped that it would prevent even more damage to the economy going under. Figure 2 shows us the extent of assets owned by commercial banks, compared to the total assets of the economies in which they operated.



If true free-market economics had prevailed, the banks that had taken excessive risks would have failed. Instead, the banks were 'too big to fail'. The moral hazard is the possibility that the bailout encourages bankers to continue taking excessive risks.

One lasting impact of the crash on the UK's governance has been the development of Quantitative easing. This was first used by the Bank of England as an emergency measure to stimulate the economy. However, it has since become a more permanent feature of the UK's economic policy. In the mid-2000s, the coronavirus pandemic of 2020–2021 and the financial crisis of 2008–2009.

Use the data

1. What does Figure 1 tell us about financial crises?
2. Does Figure 2 suggest that the UK was more or less exposed to a financial crisis than other countries?

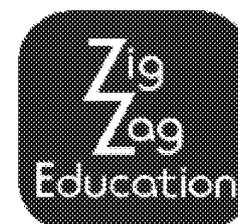
Test your knowledge

1. State **one** type of market failure not mentioned in the passage, and how it was addressed during the financial crisis.
2. Explain **two** functions of the UK's central bank.

Extended-response question

1. Discuss the benefits of greater regulation over financial institutions.

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Answers

Superpower rivalry: US–China trade war

Use the data

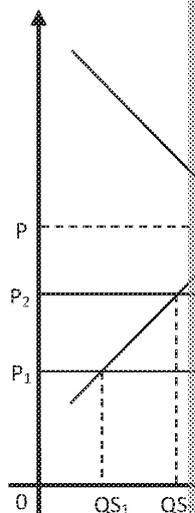
1. The answer is 400%.

Test your knowledge

1. Answers could include lower economic growth, increased business uncertainty, high reduced consumption, increased tariffs and more. Accept any two correct answers.

2. Another option could be devaluation (1): if a country operates a fixed exchange rate currency in order to reduce the price of exports and increase the price of imports (1) (1), which would increase the international competitiveness of domestic firms or increase demand for exports (1). Award 1 mark for any correct answer (any two), and a further 1 mark for an explanation of each.

3. A suitable diagram may display domestic supply and demand against world supply. As per on the right, the introduction of a tariff shifts the world supply curve upwards, increasing prices from P_1 to P_2 . Domestic consumption falls from quantity demanded 1 to QD_2 , while domestic production increases from quantity supplied 1 to QS_2 . The amount that is imported changes from the difference between QS_1 and QD_1 to the difference between QS_2 and QD_2 . Thus, the tariff has the effect of reducing imports and boosting domestic consumption. Award 1 mark for a partial explanation, 2 marks for a full explanation. Award 1 mark for a fully labelled diagram, and 1 mark for the world supply curve shifting upwards.



Extended-response question

1. Liberal trade policies have focused on the removal of trade barriers and the opening of markets. The drive for more liberal trade arrangements has been pushed by developed economies. One main advantage of free trade is that it reduces costs, making trade cheaper for importers and economies focusing on specialisation and making a particular sector as efficient as possible. Comparative advantage with firms or economies pursuing specialisation in other areas can be felt throughout the economy, improving outcomes for firms, reducing the cost of living for individuals. This should also help to improve economic growth and increase new markets and opportunities for developing countries. The removal of barriers allows developing countries to sell their produce to developed countries. This is often very lucrative for developing countries as they have a lower relative to developed nations and so they can undercut the costs of production and create employment in their own domestic market through international trade.

However, trade liberalisation is controversial and is often critiqued for a number of reasons. It is hard to compete with the more resource-rich economies in the Global North. Emerging or even established industries, which can no longer receive protectionist tariffs. A country's dependence can be 'locked in' to international trade patterns. Developing countries provide raw materials or low-tech, low-income production, while developed nations provide education, science and more developed economies can retain high-skill, high-tech production. Industrialisation in Japan and South Korea required infant industry protections. In addition, trade liberalisation is unevenly and unequally applied, with more developed nations forming 'free trade areas' internally but create new barriers for external nations, e.g. the EU. Liberal trade is also where it is accused of contributing to the decline in traditional industry sectors of the manufacturing, as developing nations can undercut production costs and force firms to close. This phenomenon can be recognised in the US and UK.

Overall, it may be concluded that while trade liberalisation clearly reduces inefficient trade restrictions can also be integral to economic development.

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Preview of Answers Ends Here

This is a limited inspection copy. Sample of answers ends here to stop students looking up answers to their assessments. See contents page for details of the rest of the resource.