Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Pearson Edexcel
International Advanced Level

Centre Number	Candidate Number

Thursday 21 January 2021

Morning (Time: 2 hours)	Paper Reference **WEC14/01**

Economics

International Advanced Level
Unit 4: Developments in the global economy

You must have:
Source Booklet (enclosed)

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **ALL** questions in Section A and Section B.
- Answer **TWO** questions in Section C.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ▶

P67152A

©2021 Pearson Education Ltd.

1/1/1/1/

P 6 7 1 5 2 A 0 1 2 8

Pearson

SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 In September 2019 the European Central Bank (ECB) decided to restart its quantitative easing programme in the eurozone area.

Ceteris paribus, which **one** of the following is the most likely effect of this decision by the ECB for an economy in the eurozone?

- ☒ **A** A decrease in the money supply
- ☒ **B** A decrease in economic growth
- ☒ **C** An increase in unemployment
- ☒ **D** An increase in the rate of inflation

(Total for Question 1 = 1 mark)

2 Which **one** of the following theories suggests that a *savings gap* is a constraint on growth and development?

- ☒ **A** The Harrod–Domar model
- ☒ **B** The Lewis structural dual-sector model
- ☒ **C** The Marshall–Lerner condition
- ☒ **D** The Prebisch–Singer hypothesis

(Total for Question 2 = 1 mark)

3 Between June 2018 and October 2019 the Australian dollar fell by 7.4% against the US dollar.

Ceteris paribus, which **one** of the following is the most likely impact of this depreciation on Australia's economy?

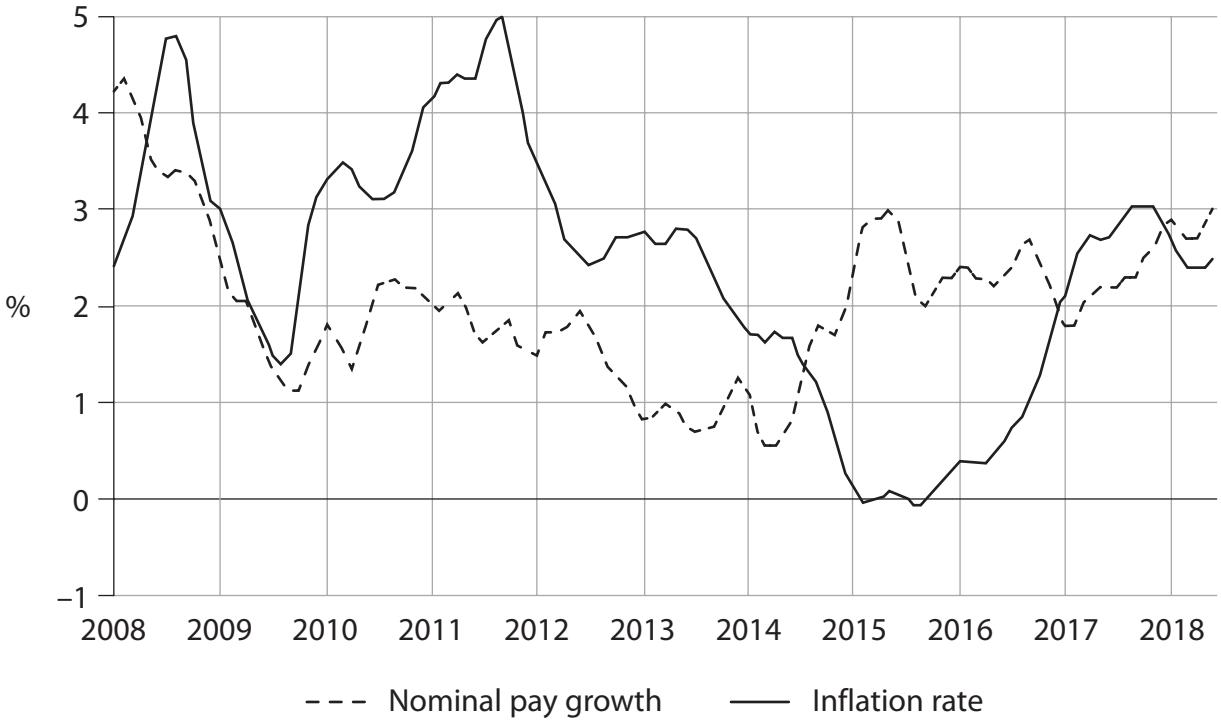
- ☒ **A** A fall in the price of imports and a rise in the price of exports
- ☒ **B** An increase in public sector borrowing and an increase in national debt
- ☒ **C** An improvement in the capital and financial account of the balance of payments
- ☒ **D** A decrease in the cost of borrowing and a decrease in the reward for saving

(Total for Question 3 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

4 The chart shows the UK inflation rate (as measured by the Consumer Price Index) and UK nominal pay growth, annual percentage change, 2008 to 2018.



Which **one** of the following can be deduced from this chart?

- ☒ **A** Pay growth not adjusted for inflation was lowest in 2009
- ☒ **B** Pay growth adjusted for inflation was highest in 2015
- ☒ **C** Disinflation occurred between 2016 and 2017
- ☒ **D** Deflation occurred between 2012 and 2014

(Total for Question 4 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

5 In 2019 India's international competitiveness rank was 10 places lower than it was in 2018.

Which **one** of the following is the most likely reason for this fall in India's international competitiveness?

- ☒ **A** A decrease in its inflation rate relative to other countries
- ☒ **B** A decrease in its unit labour costs relative to other countries
- ☒ **C** A decrease in its labour productivity relative to other countries
- ☒ **D** A decrease in its transportation costs relative to other countries

(Total for Question 5 = 1 mark)

6 The table shows the maximum possible production of cars and lorries by Country A and Country B in a given year.

Country	Cars		Lorries
A	40 000	**OR**	20 000
B	16 000	**OR**	16 000

Which **one** of the following can be deduced from this table?

- ☒ **A** Both countries will not benefit from specialisation and trade
- ☒ **B** Country A has a comparative advantage over Country B in the production of cars and lorries
- ☒ **C** Country B has an absolute advantage over Country A in the production of cars and lorries
- ☒ **D** Country B has a lower opportunity cost of producing lorries whereas Country A has a lower opportunity cost of producing cars

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

BLANK PAGE

SECTION B BEGINS ON THE NEXT PAGE.

stemup.co.uk

SECTION B

Study Figure 1 and Extract A in the Source Booklet before answering Question 7. Write your answers in the spaces provided on the following pages.

7 (a) With reference to the second paragraph of Extract A, calculate the share of global wealth of high-income advanced countries and middle-income developing countries in 2000. You are advised to show your working.

(2)

(b) With reference to Figure 1, analyse the likely effect on inequality of the change in the global Gini coefficient from 2000 to 2014. Illustrate your answer with a Lorenz curve diagram.

(6)

(c) Explain what is meant by 'relative poverty' (Extract A, line 12).

(4)

(d) With reference to Extract A, examine **two** causes of income inequality *within* advanced economies.

(8)

(e) With reference to Extract A, discuss policies that a government could implement to reduce income inequality within its economy.

(14)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

(a) With reference to the second paragraph of Extract A, calculate the share of global wealth of high-income advanced countries and middle-income developing countries in 2000. You are advised to show your working.

(2)

High-income advanced countries in 2000 = 71% + 9 percentage points = 80%

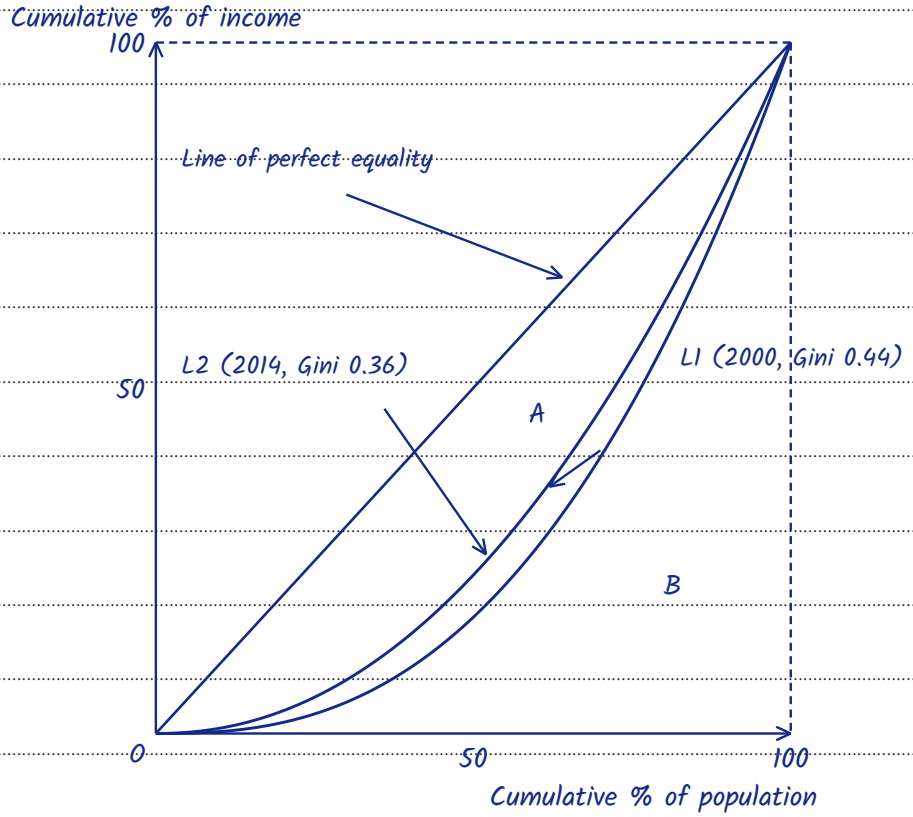
Middle-income developing countries in 2000 = 22% – 8 percentage points = 14%

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

(b) With reference to Figure 1, analyse the likely effect on inequality of the change in the global Gini coefficient from 2000 to 2014. Illustrate your answer with a Lorenz curve diagram.

(6)



The Lorenz curve shows the cumulative % of income received by the cumulative % of the population. The Gini coefficient = area A ÷ (area A + area B), so 0 is perfect equality and 1 is perfect inequality.

Figure 1 shows that the global Gini coefficient fell from 0.44 in 2000 to 0.36 in 2014, a fall of 0.08. On the diagram this is shown by the Lorenz curve shifting inwards from L1 to L2, closer to the line of perfect equality, so area A becomes smaller.

This means global income inequality decreased and income became more equally distributed. A given percentage of the population at the lower income levels, for example the poorest 50%, now receives a higher proportion of total global income, while the richest people receive a lower share. However, most of the fall happened before 2008 (0.44 to 0.38), and a value of 0.36 still shows

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

significant inequality.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

(c) Explain what is meant by 'relative poverty' (Extract A, line 12).

(4)

Relative poverty is when a household's income is below a certain proportion of the median income of the country in which they live, usually 60% of median income (some measures use 50%). These people cannot afford the standard of living that is considered normal in their own society, so it is measured relative to others rather than against the fixed minimum needed to survive (absolute poverty).

Extract A shows that relative poverty rates in advanced economies increased from 23% of the population in 1985 to 30% in 2016, and almost one in seven people living in advanced economies remains in relative poverty even after taxes and transfer payments. Relative poverty can rise even when real incomes of the poor rise, if their incomes grow more slowly than median income.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

(d) With reference to Extract A, examine **two** causes of income inequality *within* advanced economies.

(8)

One cause is discrimination by gender and age. Extract A states that women earn only $0.84 for every $1 men earn, even though women are now more likely to have a degree, and young people have lower earnings and wealth than older people. If employers discriminate, women and young workers are paid less than their marginal revenue product and have fewer chances of promotion into high paid jobs. This keeps their incomes and wealth low, so the gap between the top and the bottom of the income distribution widens.

A second cause is growing wage differentials due to automation and globalisation. The extract shows a decrease in wages as a share of global GDP, reflecting slow growth of real wages and the increased use of automation. As firms replace routine medium-skilled jobs with machines and move low-skilled production to lower-cost countries, the demand for unskilled and medium-skilled labour falls, while demand for highly skilled workers and the returns to owners of capital rise. Therefore real disposable incomes of middle earners have fallen since 2005, while the top 1% almost doubled their share of pre-tax income from 6% in 1980 to 11% in 2014, so income inequality increases.

However, the significance of each cause differs between advanced economies. Wage differentials from technology are probably the most significant, as they affect the whole labour market, whereas the gender pay gap has been narrowing. Also, part of the lower pay of women and young people may reflect experience and career breaks rather than discrimination, and the figures are averages across many countries, so they may be unreliable for any single economy.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

(e) With reference to Extract A, discuss policies that a government could implement to reduce income inequality within its economy.

(14)

Income inequality is the unequal distribution of income between households in an economy. Extract A shows the top 1% almost doubled their share of pre-tax income to 11% by 2014 and relative poverty affects 30% of the population, so government intervention is needed.

One policy is a more progressive tax and benefit system, for example raising the top marginal rate of income tax, adding more tax bands, raising the tax-free personal allowance and increasing means-tested benefits such as housing benefit. Higher earners then pay a larger proportion of their income in tax, while the disposable income of low income households rises. This is a direct redistribution of income, so the Lorenz curve shifts towards the line of equality and the Gini coefficient falls, which reflects the extract's call for "a reconsideration of how economic gains are shared". However, higher top tax rates may reduce the incentive to work and invest, and encourage tax avoidance, evasion or tax exiles. As the Laffer curve suggests, if rates are already high, tax revenue could even fall, leaving less to fund benefits. Means-tested benefits can also create a poverty trap, because benefits are withdrawn as income rises, and they are costly to administer.

A second policy, given in the extract, is providing wider access to high quality education and training. This raises the human capital and productivity of low-skilled workers, so their marginal revenue product and wages rise. It also helps workers whose jobs are threatened by automation to retrain, reducing structural unemployment, and it increases long-run aggregate supply. This tackles a root cause of inequality rather than just its symptoms. However, there is a long time lag before benefits appear, the spending has an opportunity cost, and success depends on the quality of the courses. The extract shows women and young people are now more likely to have a degree but still earn less, so education alone may not close the gap.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

A third policy is increasing the minimum wage. This directly raises the incomes of the lowest paid workers, moving them closer to median income and reducing relative poverty. However, if it is set above the equilibrium wage, the demand for unskilled labour contracts, causing unemployment, and firms may speed up automation. Those who lose their jobs become poorer, so inequality could increase. The effect depends on the size of the rise and the wage elasticity of demand for labour, and it does not help the unemployed or pensioners. Laws to reduce discrimination, such as equal pay legislation, could also help narrow the $0.84 gender pay gap, although part of it may reflect cultural norms that are slow to change.

Overall, no single policy is enough. Progressive taxes and means-tested benefits have the fastest impact, but education and training is likely to be the most effective in the long run because it addresses the causes of low pay. The best approach is a combination, although, as Extract A says, a significant challenge is reaching agreement among policymakers, business leaders and citizens, and the government's budget position limits how much it can spend.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

(Total for Question 7 = 34 marks)

(TOTAL FOR SECTION B = 34 MARKS)

stemup.co.uk

SECTION C

Answer TWO questions from this section.

8 Between 2000 and 2018 Cambodia's terms of trade fell by 31.3%.

Evaluate the macroeconomic effects of a fall in a country's terms of trade on a government's macroeconomic objectives. Refer to a country of your choice in your answer.

(Total for Question 8 = 20 marks)

9 In 2017 Yemen received over $3 billion of development aid, an increase of almost 200% since 2013.

Evaluate the case for promoting *economic development* through aid. Refer to a developing country in your answer.

(Total for Question 9 = 20 marks)

10 Between 2012 and 2018 Spain's public expenditure as a proportion of GDP fell from 48.1% to 41.3%.

Evaluate the likely economic effects of a reduction in public expenditure as a proportion of GDP. Refer to a developed country of your choice in your answer.

(Total for Question 10 = 20 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

Write the answer to your FIRST chosen question here

Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Write the answer to your SECOND chosen question on page 22.

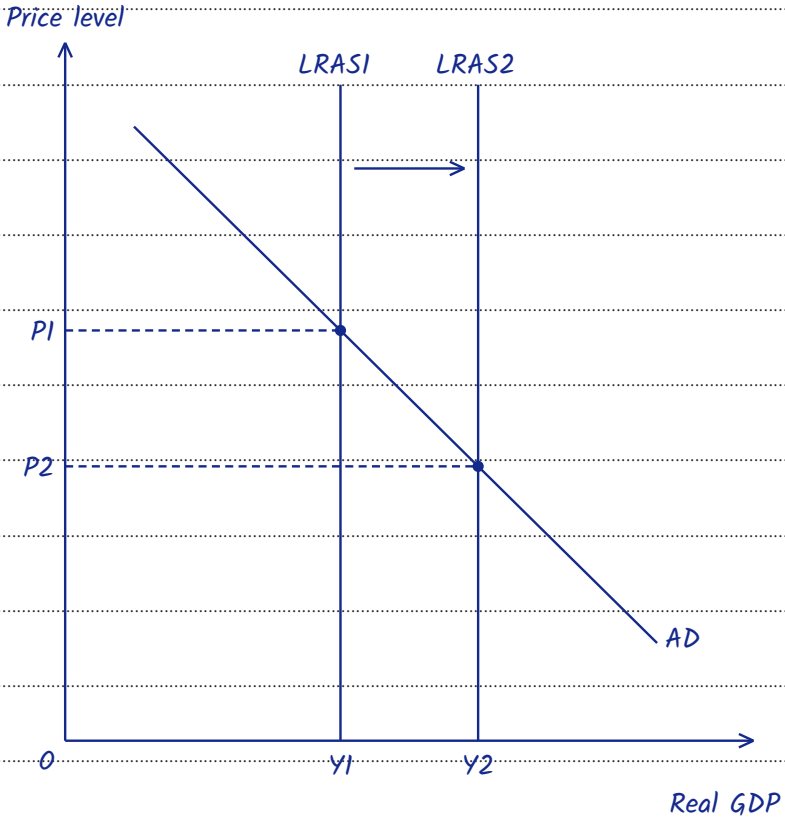
Chosen question number: **Question 8** ☐ **Question 9** ☒ **Question 10** ☐

Economic development is an improvement in living standards and welfare, including higher incomes, better health and education and less poverty, often measured by the HDI. Aid is the voluntary transfer of resources from one country to another, either bilaterally or multilaterally through organisations such as the World Bank, as grants, concessional loans or technical assistance. In 2017 Yemen received over $3 billion of development aid, an increase of almost 200% since 2013.

The main case for aid comes from the Harrod–Domar model. Growth depends on the savings ratio and the productivity of capital. In a low income country such as Yemen most income is spent on consumption, so savings are low and there are not enough funds to finance investment: a savings gap. Aid fills this gap, so investment in capital rises, which increases productive capacity. As shown in the diagram, this shifts LRAS from LRAS1 to LRAS2, so real output rises from Y1 to Y2 and the price level falls from P1 to P2. Higher real output means higher incomes and employment, so GNI per capita increases.

Aid also fills the foreign exchange gap. Developing countries often lack foreign currency to import capital equipment, medicines and technology. Aid given in foreign currency allows these imports without causing a current account crisis, so firms can modernise and growth prospects improve.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA



Aid can be used for infrastructure such as roads, power, water and sanitation. This is an injection into the circular flow, creating a multiplier effect on income, and it lowers costs for firms and increases the mobility of labour, so people gain access to jobs, schools and hospitals. Aid spent on healthcare and education raises human capital: vaccinations and clean water reduce child and maternal mortality, raising life expectancy, and more schools raise mean years of schooling. These are components of the HDI, so development improves directly. In Yemen, where civil conflict since 2015 has destroyed infrastructure and caused severe food shortages, humanitarian aid can reduce absolute poverty immediately and save lives.

However, aid has many limitations. First, corruption and weak institutions mean funds may be diverted to government officials or, in a conflict zone like Yemen, never reach the people for whom it is intended. Second, aid can create a dependency culture: governments may rely on aid rather than pursuing sound macroeconomic policies or collecting taxes, which is a form of moral hazard, and dependency theory argues it reinforces the dominance of donor countries.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

Third, much aid is tied, meaning it must be spent on goods and services from the donor country, which may be more expensive and not suited to local needs, so resources are allocated inefficiently. Conditions attached by the IMF and World Bank, such as cutting food subsidies or removing import controls, may harm the poor in the short run. Aid in the form of concessional loans must be repaid with interest, which has an opportunity cost because less can be spent on education and health later. Large inflows may also distort market forces, for example food aid lowering prices received by local farmers.

The effect also depends on the size and type of aid. Yemen's rise of almost 200% is significant, but much of it is emergency humanitarian aid, which saves lives but does little for long-run investment, so it may not raise the savings ratio as the Harrod–Domar model assumes. The model also assumes that investment automatically raises growth, ignoring the need for skilled labour, political stability and good governance. Aid is often small relative to the needs of a country and some goes to relatively rich developing countries rather than the poorest.

In conclusion, there is a strong case for aid in the short run, particularly humanitarian aid for a country in crisis such as Yemen, as it directly reduces absolute poverty and improves health. However, for long-term development aid is only effective if it is untied, targeted at education, health and infrastructure, and accompanied by good governance and peace. In the long run, policies that promote trade, FDI and domestic savings are likely to be more sustainable than relying on aid.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

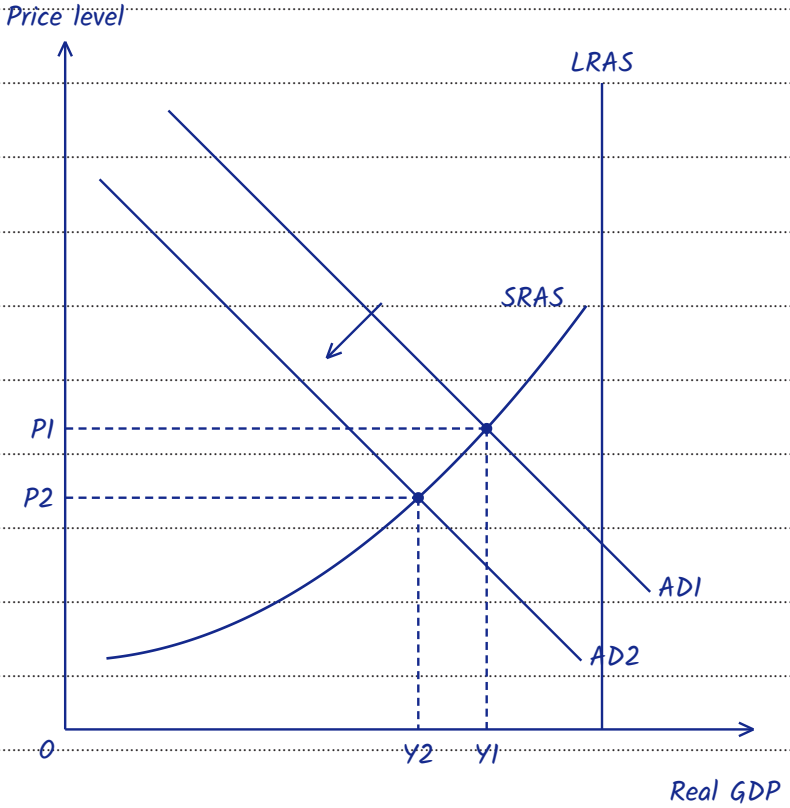
Write the answer to your SECOND chosen question here

Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: **Question 8** ☐ **Question 9** ☐ **Question 10** ☒

Public expenditure as a proportion of GDP is total government spending, on items such as healthcare, education, infrastructure and welfare benefits, divided by nominal GDP, as a percentage. Between 2012 and 2018 Spain's public expenditure fell from 48.1% to 41.3% of GDP, a fall of 6.8 percentage points, as the government introduced austerity after the eurozone debt crisis.

Government spending is a component of aggregate demand (AD = C + I + G + X − M) and an injection into the circular flow of income. A cut in spending shifts AD to the left from AD1 to AD2, and through the negative multiplier effect the fall in real output is larger than the initial cut, because workers who lose income spend less. As shown in the diagram, real GDP falls from Y1 to Y2 and the price level falls from P1 to P2, so economic growth slows.



DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

P 6 7 1 5 2 A 0 2 2 2 8

stemup.co.uk

Lower output reduces the derived demand for labour, so unemployment is likely to rise, especially in the public sector. Spain's unemployment rate was already above 25% in 2013, so cuts could deepen hardship. Income inequality may also rise if austerity reduces transfer payments such as unemployment benefits, and lower quality and quantity of public services means less access to healthcare and education, so living standards fall. If spending on infrastructure and education is cut, the productive potential of the economy falls and LRAS may shift left, damaging long-run growth.

On the other hand, there are positive effects. The budget deficit falls, so the government needs to borrow less and can begin to stabilise or repay national debt. This can improve confidence in the public finances, lowering government bond yields and interest rates. Less financial crowding out means more funds are available for private investment, and less resource crowding out means more land, labour and capital for the private sector, which may be more efficient because of the profit motive. Lower AD also reduces demand-pull inflationary pressure, which helps international competitiveness within the eurozone, where Spain cannot devalue its currency.

The size of these effects depends on several factors. The negative multiplier depends on the marginal propensity to withdraw; if spare capacity is large, as in Spain in 2012, the fall in output is bigger. The fall in the ratio was partly due to GDP growing quickly after 2014, rather than only actual spending cuts, so the real effects may be smaller than the 6.8 point fall suggests. It also depends on which spending is cut: cutting inefficient subsidies does little harm, but cutting capital spending harms LRAS. Other components of AD may offset the fall, for example Spain's exports and tourism grew strongly, and ECB low interest rates and quantitative easing supported consumption and investment. In the short run the effects are mostly negative, but over the long run the private sector may grow as confidence returns.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

In conclusion, a reduction in public expenditure as a proportion of GDP is likely to reduce growth and raise unemployment and inequality in the short run, especially in a recession. However, Spain returned to growth while cutting the ratio, suggesting that when it is combined with rising exports and supportive monetary policy, the long-run benefits of lower debt and less crowding out can outweigh the short-run costs, provided spending on education, health and infrastructure is protected.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

TOTAL FOR SECTION C = 40 MARKS

TOTAL FOR PAPER = 80 MARKS

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

BLANK PAGE

stemup.co.uk

BLANK PAGE

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

Pearson Edexcel International Advanced Level

Thursday 21 January 2021

Morning (Time: 2 hours) | Paper Reference **WEC14/01**

Economics

International Advanced Level

Unit 4: Developments in the global economy

Source Booklet

Do not return this Booklet with your question paper.

Turn over ▶

P67152A

©2021 Pearson Education Ltd.

1/1/1/1/

P 6 7 1 5 2 A

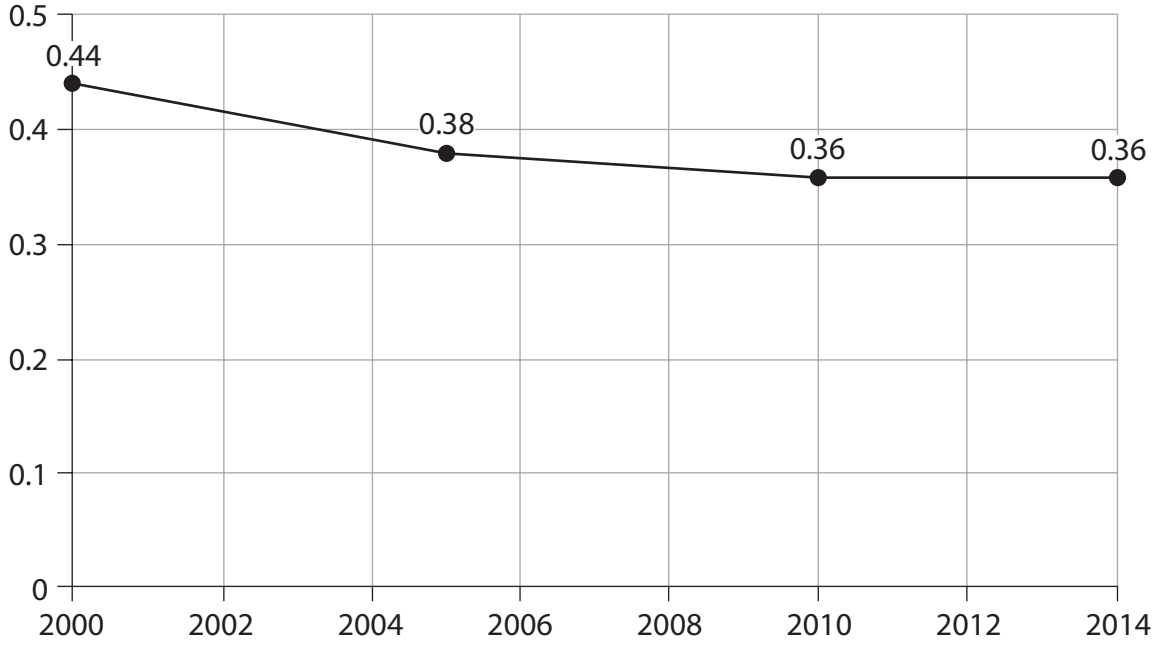
Pearson

stemup.co.uk

Sources for use with Section B.

Inequality

Figure 1 Global Gini coefficient (for income) 2000–2014



stemup.co.uk

Extract A Inequality – causes and policies

Inequality is a social and political issue in many advanced economies. This has led to a debate about its causes and solutions. It has also resulted in public discontent with governments and other institutions.

Wealth inequality has decreased between high-income advanced countries and middle-income developing countries. Between 2000 and 2014 the share of global wealth of high-income countries fell by nine percentage points to 71%. Over the same period the share of wealth of middle-income developing countries rose by eight percentage points to 22%.

However, income inequality within the advanced economies has increased. The top 1% of income earners almost doubled their share of total pre-tax income from 6% in 1980 to 11% in 2014. Relative poverty rates have also increased, from 23% of the population in 1985 to 30% in 2016. On average, almost one in seven people living in advanced economies remains in relative poverty after taxes and transfer payments.

Personal factors such as gender, age, and place of residence continue to affect inequality in advanced economies. Even though women are now more likely to have a degree, their earnings and wealth are still lower than those of men. Women have narrowed the wage gap but earn only $0.84 for every $1 men earn. Similarly, a higher proportion of young people have a degree but their earnings and wealth are lower than those of older people. Residents living in urban areas are more likely to have a higher level of education than rural residents. However, unemployment in urban areas is higher and rising.

Since 2005 real disposable incomes have fallen in advanced economies. The effects of this have been most significant for middle-income earners and those in medium-skilled jobs. Over the same time period, the costs of housing, healthcare and education have risen faster than the average price level. Household debt has also increased from 87% of disposable income in 1995 to 123% in 2017.

Long-term global trends are affecting incomes and may increase income inequality in the future. For example, there has been a decrease in wages as a share of global GDP. This reflects the underlying trends of the slow growth of real wages and the increased use of automation in the global economy.

Government intervention is needed to reduce inequality. These policies could include:

- providing wider access to high quality education and training
- providing better quality healthcare
- measures to reduce discrimination
- increasing minimum wages.

Challenges related to inequality require a reconsideration of how economic gains are shared. In addition, welfare support needs to be reformed for current and future generations.

A significant challenge is how to reach agreement among policymakers, business leaders and citizens on measures to reduce income inequality.

stemup.co.uk

Acknowledgements

Figure 1 and Extract A based on data taken from https://www.mckinsey.com/industries/public-sector/our-insights/inequality-a-persisting-challenge-and-its-implications?cid=eml-web