Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Centre Number

Candidate Number

Pearson Edexcel International Advanced Level

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.

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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 The Government of Qatar announced that it would spend $200 billion to build an airport, new roads, railways and stadiums needed for the 2022 football World Cup.

This change in public expenditure is an example of an increase in which **one** of the following?

☒ **A** Capital expenditure

☐ **B** Current expenditure

☐ **C** Progressive taxation

☐ **D** Transfer payments

(Total for Question 1 = 1 mark)

2 In 2020 the value of Norway's currency, the krone, fell significantly against the US dollar. Norway's central bank intervened in the currency markets to increase the external value of its currency.

Which **one** of the following combinations of foreign currency transactions would Norway's central bank be most likely to use if it wanted to raise the value of the krone against the US dollar?

	Krone	US dollar
☐ **A**	Buy	Buy
☒ **B**	Buy	Sell
☐ **C**	Sell	Buy
☐ **D**	Sell	Sell

(Total for Question 2 = 1 mark)

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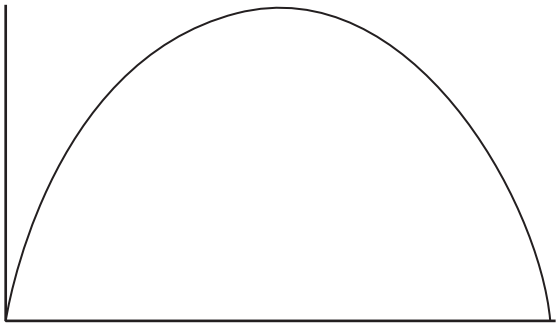
3 Chad is one of the least developed countries in the world with a HDI score of 0.40.

Which **one** of the following interventionist strategies could promote economic development in Chad?

- ☒ **A** Privatisation of nationalised industries
- ☒ **B** Removal of government subsidies
- ☒ **C** Implementation of protectionist policies
- ☒ **D** Trade liberalisation

(Total for Question 3 = 1 mark)

4 The diagram illustrates the Laffer curve for a developed country.



Which **one** of the following statements is true about the Laffer curve?

- ☒ **A** It shows the relationship between the level of investment and the savings rate
- ☒ **B** It shows the relationship between government tax revenue and the tax rate
- ☒ **C** It shows the relationship between the rate of inflation and the unemployment rate
- ☒ **D** It shows the relationship between quantitative easing and the rate of interest

(Total for Question 4 = 1 mark)

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5 The table shows Maldives' index of export prices and index of import prices between 2015 and 2018, (2000=100).

Year	Index of export prices	Index of import prices
2015	157.2	156.0
2016	154.2	150.5
2017	168.6	156.8
2018	179.2	166.6

Ceteris paribus, which **one** of the following can be deduced from this table?

☒ **A** Between 2000 and 2018 Maldives' terms of trade improved by 7.6%

☒ **B** Maldives had to export the same amount of goods to purchase a given quantity of imports each year

☒ **C** Maldives' index of import prices exceeded its index of export prices throughout the given period

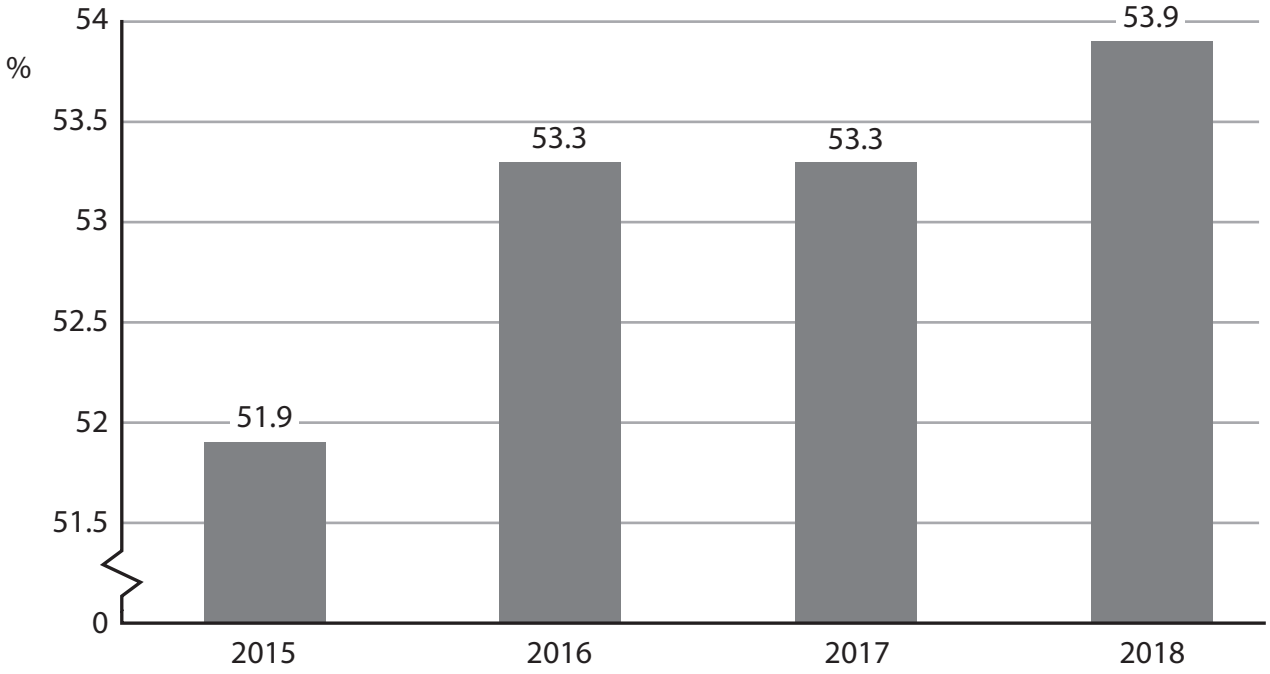
☒ **D** Between 2000 and 2016 Maldives' terms of trade worsened by 2.5%

(Total for Question 5 = 1 mark)

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6 The chart shows Brazil's Gini coefficient, expressed as a percentage, between 2015 and 2018.



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

- ☒ **A** Between 2015 and 2016 the distribution of income in Brazil became more equal
- ☒ **B** Between 2016 and 2017 Brazil experienced perfect income equality
- ☒ **C** Between 2017 and 2018 income inequality in Brazil increased by 0.6%
- ☒ **D** Between 2015 and 2018 Brazil's Lorenz curve shifted further away from the line of perfect equality

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

Study Figure 1 and Extract A in the Source Booklet before answering Question 7.

Write your answers in the space provided on the following pages.

7 (a) With reference to Figure 1, calculate the index number for international visitors to Taiwan from China in 2019, using 2015 as the base year. You are advised to show your working.

(2)

(b) Analyse **two** reasons why 'Taiwanese firms moved to China to set up their manufacturing facilities' (Extract A, lines 4–5).

(6)

(c) Explain what is meant by a 'tariff' (Extract A, line 7).

(4)

(d) With reference to the information provided and your own knowledge, examine **two** likely problems arising from the fall in the number of Chinese tourists to Taiwan.

(8)

(e) Discuss policies, apart from tourism, being implemented by the Taiwanese Government to reduce its dependence on China.

(14)

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(a) With reference to Figure 1, calculate the index number for international visitors to Taiwan from China in 2019, using 2015 as the base year. You are advised to show your working.

(2)

Index number = (value in 2019 ÷ value in base year 2015) × 100

= (2.71 million ÷ 4.18 million) × 100

= 0.6483 × 100

= 64.8

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(b) Analyse **two** reasons why 'Taiwanese firms moved to China to set up their manufacturing facilities' (Extract A, lines 4–5).

(6)

Reason 1: access to cheap labour. Extract A says Taiwanese firms "were attracted by cheap labour" in China. Wages in China were much lower than in Taiwan, and labour is a large share of costs in manufacturing such as electronics assembly. By moving production to China, firms cut their average costs of production. Lower costs mean they can either raise profit margins or lower the prices of their exports, which increases their international price competitiveness, so they win more orders and gain market share in world markets.

Reason 2: access to a large Chinese market. China has a population of about 1.4 billion, so producing inside China gives firms a much bigger customer base than Taiwan's home market. China is "Taiwan's most important trading partner" and "the main destination for Taiwan's exports". Producing locally means firms avoid transport costs and any Chinese trade barriers, and can respond quickly to Chinese consumers, so their sales revenue rises. A larger scale of output also lets them gain economies of scale, lowering average costs further.

Both reasons increase profits (total revenue – total cost), which explains why over 100 000 Taiwanese firms moved to China and why much of Taiwan's foreign direct investment goes there.

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(c) Explain what is meant by a 'tariff' (Extract A, line 7).

(4)

A tariff is a tax placed on imported goods. It is a form of protectionism, a restriction on free trade, because it raises the price of imports in the domestic market, so domestic consumers buy fewer imports and domestic producers become more price competitive. The government also gains tax revenue.

For example, in 2018 the USA imposed tariffs on several Chinese-made goods (Extract A), with an average tariff of 19.3% on US imports from China. A Chinese product with a world price of $100 would therefore cost about $119.30 in the USA. This made producing in China less attractive, so Taiwanese firms started moving production from China to other countries to avoid the tariffs on their exports to the USA.

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(d) With reference to the information provided and your own knowledge, examine **two** likely problems arising from the fall in the number of Chinese tourists to Taiwan.

(8)

Figure 1 shows visitors from China fell from 4.18 million in 2015 to 2.71 million in 2019, a fall of 1.47 million or (1.47 ÷ 4.18) × 100 = 35.2%.

Problem 1: lower foreign currency earnings and a worse current account. Spending by foreign tourists on hotels, restaurants, transport and shopping in Taiwan counts as an export of services. With 1.47 million fewer Chinese visitors, export earnings fall, so less foreign currency flows into Taiwan and the current account of the balance of payments worsens. Lower demand for the Taiwanese dollar could also lead to a depreciation.

Problem 2: slower economic growth and job losses. Tourist spending is an injection into the circular flow, so a fall in exports reduces aggregate demand, and through the negative multiplier effect real GDP grows more slowly. Tourism is labour-intensive, so hotels, tour operators and shops that relied on Chinese tour groups cut staff, increasing unemployment, especially in tourist regions. Lower spending also means less tax revenue for the government, and firms may cut investment in new hotels and facilities.

However, the problems may not be significant overall. Visitors from other countries rose sharply between 2015 and 2019: Japan by 33% (1.63 to 2.17 million), the Philippines by 264%, Thailand by 242% and Vietnam by 173%. In total, visitors from the five countries in Figure 1 were 6.22 million in 2015 and 6.21 million in 2019, so the fall in Chinese tourists was almost fully offset and total spending may not have fallen much, as Extract A says Taiwan "has made up for the fall". The impact also depends on how much each group spends per visit. Fewer tourists may even reduce negative externalities such as congestion and pollution, and lower dependence on China reduces the risk of a sudden political shock to the industry.

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(e) Discuss policies, apart from tourism, being implemented by the Taiwanese Government to reduce its dependence on China.

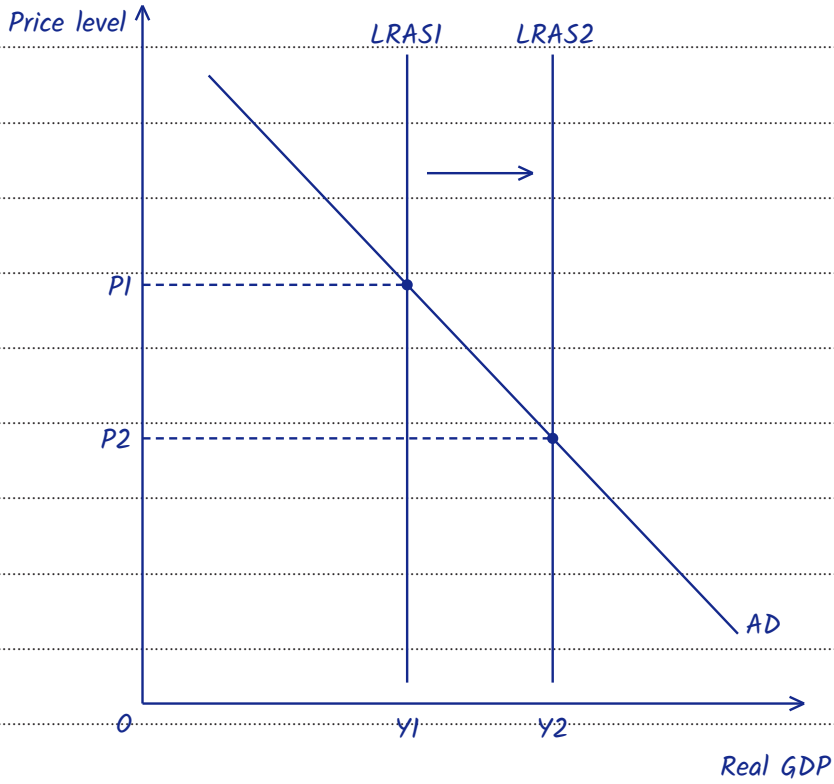
(14)

Taiwan depends heavily on China: China took nearly 40% of Taiwan's exports in 2019. To reduce this dependence, the government has used a reshoring plan from 2019 and the New Southbound Policy from 2016.

Reducing bureaucracy for land and property. The reshoring plan included "incentives that made it easier to buy land and register property". This reduces the time and administrative costs firms face when setting up a factory in Taiwan, lowering the cost of relocating and the barriers to entry for new businesses. With lower costs, expected profits from producing in Taiwan rise, so more firms move back, domestic investment increases and less of Taiwan's output depends on factories in China.

Investment in infrastructure. Government spending to "ensure the continuous provision of gas, electricity and water supply" removes bottlenecks such as power cuts and water shortages, which otherwise halt production in industries like semiconductors that need a stable supply. This raises productivity and lowers firms' average costs. In the short run it is an injection that increases AD; in the long run it increases the productive capacity of the economy, shifting LRAS right from LRAS1 to LRAS2, so, as the diagram shows, real output rises from Y1 to Y2 and the price level falls from P1 to P2.

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Subsidies and tax incentives for the technology sector. Subsidies lower firms' costs of production and tax incentives raise post-tax profits, so it becomes more profitable to produce and to fund risky research and development in Taiwan. More innovation brings dynamic efficiency and new products, strengthening Taiwan's comparative advantage in high technology goods. Taiwanese firms agreed to invest $33 billion in Taiwan between 2019 and 2021.

The New Southbound Policy. This aims to increase trade with countries in South Asia and Southeast Asia. Closer trade links allow Taiwan to specialise according to comparative advantage and sell to fast-growing markets, so export demand is spread over more countries. Diversifying exports reduces the risk that a fall in Chinese demand or a political dispute causes a large fall in Taiwan's AD.

However, these policies have had limited success so far. Of the $33 billion pledged, only $6.8 billion was invested in 2019 and $1.1 billion in 2020, so most of the reshoring has not happened. Firms said bureaucracy is still a problem and that there are "severe shortages of highly skilled

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labour", so the land incentives have not removed the main barriers. Without investment in education and training to raise human capital, firms will not return whatever the subsidies.

Infrastructure projects also have long time lags, so the supply-side benefits may take years, and they depend on the quality of the projects and the opportunity cost of the government spending. Subsidies risk government failure: officials may support inefficient firms, causing a misallocation of resources, and they add to the fiscal deficit.

The New Southbound Policy has also been weak: NSP countries took only about 20% of Taiwan's exports in 2019, half of China's share, and China's own strong trade links with Southeast Asia limit how far Taiwan can build new partnerships. Trade with China may also reflect genuine comparative advantage and the gains from a huge nearby market, so forcing trade elsewhere could cause trade diversion towards higher-cost partners.

Overall, the policies point in the right direction, and the infrastructure and technology measures are likely to be the most effective in the long run because they raise Taiwan's productive capacity. But in the short run dependence on China remains high, and success depends mainly on solving the shortage of skilled labour and the remaining bureaucracy.

(Total for Question 7 = 34 marks)

TOTAL FOR SECTION B = 34 MARKS

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SECTION C

Answer TWO questions from this section.

8 In 2019 it was estimated that a large proportion of the fiscal deficit in Japan and the UK was structural.

Evaluate whether a structural fiscal deficit is a more serious issue than a cyclical fiscal deficit. Refer to a country of your choice in your answer.

(Total for Question 8 = 20 marks)

9 Between 2007 and 2017 income inequality increased in Denmark and in Italy.

Evaluate possible causes of an increase in income inequality within a developed country of your choice.

(Total for Question 9 = 20 marks)

10 In 2020 Argentina's currency, the peso, fell by 75% against the US dollar.

Evaluate factors that influence the exchange rate of a currency. Refer to a developing country of your choice in your answer.

(Total for Question 10 = 20 marks)

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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** ☐

A fiscal deficit occurs when government spending is greater than government revenue in a year, so the government must borrow, adding to the national debt. A cyclical deficit is the part of the deficit caused by the economic cycle: in a recession tax revenues fall and spending on benefits rises through automatic stabilisers. A structural deficit is the deficit that would remain even if the economy were operating at its normal, sustainable level of output and employment, so it reflects a long-run gap between spending and taxes.

Why a structural deficit is more serious. First, it is permanent unless the government acts. A cyclical deficit disappears automatically as the economy recovers: as real GDP rises, employment and incomes increase, so income tax and VAT revenues rise and spending on unemployment benefits falls. A structural deficit does not go away with growth, so it means continuous borrowing and a national debt that grows year after year. In the UK the deficit reached about 10% of GDP in 2009 to 2010, and a large part of it was estimated to be structural because the financial crisis had permanently reduced the level of potential output and tax revenues from the financial sector.

Second, a rising national debt causes further problems. Debt interest payments rise, which has a large opportunity cost because that money cannot be spent on health, education or infrastructure. Lenders may see the debt as less sustainable, so the country's credit rating can be cut, as when Moody's removed the UK's AAA rating in 2013. This pushes up bond yields and the cost of borrowing. Heavy government borrowing may also cause financial crowding out: the government competes with firms for loanable funds, so interest rates rise and private

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investment falls, reducing long-run growth. It also places a burden on future generations, who face higher taxes to repay the debt.

Third, removing a structural deficit requires painful discretionary fiscal policy. The UK government followed austerity from 2010, cutting public spending, freezing benefits and raising VAT from 17.5% to 20% in 2011. These measures reduce AD, which can slow growth and increase unemployment and inequality, and cuts to capital spending can damage long-run productive capacity. Japan, whose national debt is over 200% of GDP, raised its consumption tax to 8% in 2014 and 10% in 2019 to tackle its structural deficit, and the 2014 rise was followed by a recession.

Why a cyclical deficit may be less of a problem. A cyclical deficit is usually temporary and can even be beneficial. In a recession, the rise in benefits and fall in taxes keep household incomes and spending up, so the deficit acts as an automatic stabiliser that reduces the fall in AD and real GDP. In 2020 the UK deficit rose to about 15% of GDP because of the pandemic, but much of this was temporary spending such as the furlough scheme, which protected jobs and helped the economy recover quickly.

However, this judgement must be qualified. First, the distinction is hard to measure. The structural deficit depends on estimates of potential output and the output gap, which cannot be observed directly and are often revised, so a deficit thought to be cyclical may turn out to be structural, as happened in the UK after 2008. Governments may also be tempted to call a deficit cyclical to avoid unpopular cuts.

Second, size and duration matter more than type. A small structural deficit of 1% of GDP, when the economy is growing at 2% a year, is sustainable because the debt to GDP ratio can still

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fall, whereas a very large cyclical deficit, like the UK's in 2020, adds massively to the national debt even if it is temporary. A deep or long recession can also cause hysteresis, as long-term unemployed workers lose skills, turning cyclical problems into structural ones.

Third, it depends on the cost of borrowing and who holds the debt. Japan has a very large structural deficit and debt, but most of it is owned by Japanese residents and the Bank of Japan at near-zero interest rates, so debt interest is low and there has been no debt crisis. A country that borrows in a foreign currency would face far more serious problems. It also depends on what the borrowing finances: a structural deficit used to fund investment in infrastructure and education may raise future growth and tax revenues, so it partly pays for itself.

In conclusion, a structural deficit is generally the more serious issue for a country like the UK, because it does not correct itself, causes a continuous rise in national debt and requires tax rises or spending cuts that damage growth. However, the seriousness depends on its size as a percentage of GDP, how long it lasts, the interest rate on the debt and whether the borrowing finances productive investment. A large, prolonged cyclical deficit can be just as damaging, so governments should judge deficits by their sustainability rather than only by their type.

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

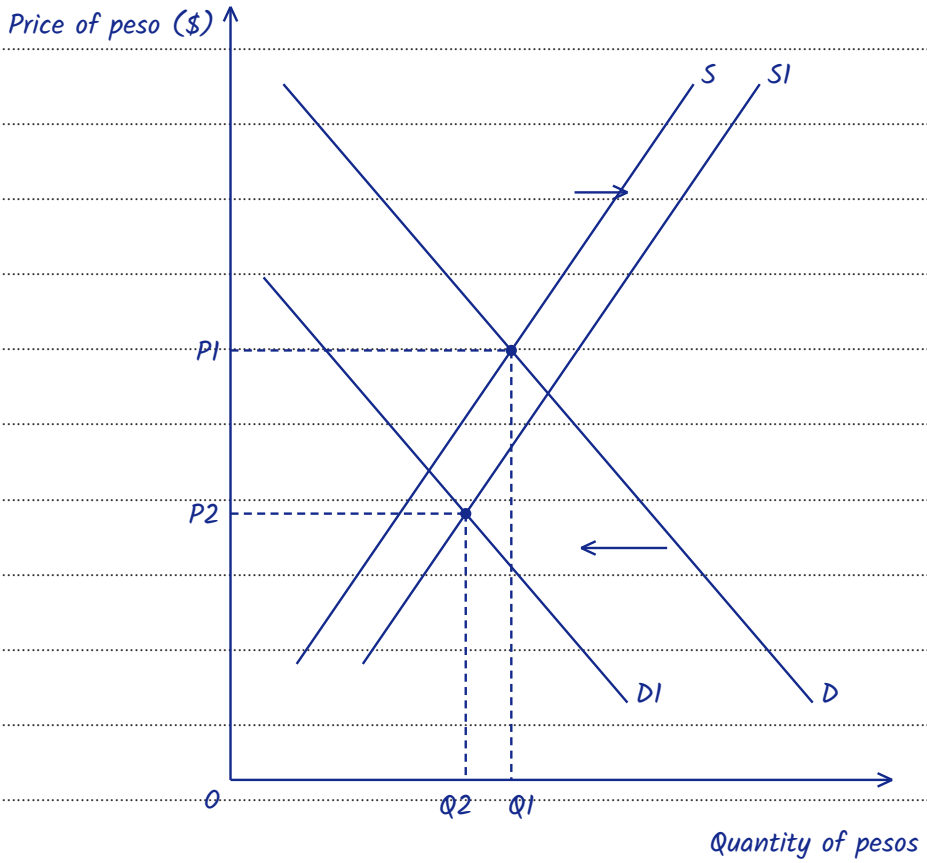
The exchange rate is the price of one currency in terms of another, for example the number of Argentine pesos needed to buy one US dollar. In a floating system it is determined by the demand for and supply of the currency on the foreign exchange market. Demand for pesos comes from foreigners buying Argentine exports and assets; the supply of pesos comes from Argentines buying imports and foreign assets. The peso fell by 75% against the dollar in 2020, a sharp depreciation.

Relative inflation rates. Argentina has had very high inflation, over 50% in 2019 and over 30% in 2020, much higher than in the USA. This makes Argentine exports such as beef and soybeans less price competitive and imports relatively cheaper. Demand for pesos falls as foreigners buy fewer exports, and supply of pesos rises as Argentines buy more imports, so the peso depreciates. Purchasing power parity theory suggests that in the long run a currency depreciates by roughly the difference between its inflation rate and that of its trading partners. Households also convert savings into dollars to protect them from inflation, increasing the supply of pesos.

Relative interest rates. If Argentina's interest rates are high relative to other countries, investors move hot money into peso deposits and bonds to earn a better return, so demand for pesos rises and the currency appreciates. When interest rates are cut, or real interest rates are negative because inflation is higher than the nominal rate, hot money flows out and the peso falls. In 2018 the central bank raised its interest rate to 60% to try to stop the fall of the peso.

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Speculation and confidence. If speculators expect the peso to fall, they sell pesos now to avoid losses, which increases supply and causes the fall to happen, a self-fulfilling expectation. Confidence in Argentina has been weak because of its history of debt defaults, including a default in 2020, and capital flight by investors leads to large outflows of money. This shifts the demand curve for pesos left from D to D1 and the supply curve right from S to S1, so the exchange rate falls from P1 to P2.



The current account of the balance of payments. A persistent current account deficit means that more pesos are supplied to pay for imports than are demanded to pay for exports, which puts downward pressure on the peso. Argentina is also a developing country that depends on primary product exports, especially soybeans, so its exchange rate is affected by world commodity prices. When soy prices fall, or a drought cuts the harvest as in 2018, export earnings and demand for pesos fall and the peso depreciates.

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Government and central bank intervention. A central bank can support its currency by buying it with its foreign currency reserves, or by imposing capital controls. Argentina reintroduced currency controls in 2019 and borrowed $57 billion from the IMF in 2018 partly to support the peso.

Evaluation. The importance of each factor depends on the time period. In the short run speculation and hot money flows dominate, because huge sums can move between currencies in seconds, while inflation and the current account matter more in the long run. Purchasing power parity also holds only approximately, since many goods are not traded and trade barriers exist.

The factors are also linked, so it is hard to isolate one. In Argentina high inflation, negative real interest rates and fears of default all reduced confidence at the same time, so the 75% fall in 2020 reflected a loss of confidence in economic management as a whole. The pandemic was also a global factor: investors moved money out of emerging markets into safe assets such as the US dollar, so many developing country currencies fell in 2020 regardless of domestic policy.

Higher interest rates do not always strengthen a currency. When investors fear default, even a 60% interest rate in 2018 did not stop capital flight, because the risk of losing the capital outweighed the higher return. Intervention is limited by the size of reserves, and Argentina's reserves are small relative to the capital outflows, so buying pesos only delays depreciation. Capital controls may slow the fall in the official rate but create a parallel black market rate that is far weaker.

In conclusion, for a developing country like Argentina, the most significant factors are relative inflation and confidence, including speculation and fears of default, because they caused persistent capital flight that interest rates and intervention could not stop. Commodity prices

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and the current account are important background factors, but their effect depends on world demand. Ultimately the stability of the peso depends on credible policies to bring inflation down and restore confidence.

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TOTAL FOR PAPER = 80 MARKS

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Paper reference **WEC14/01**

Economics

International Advanced Level
UNIT 4: Developments in the global economy

Source Booklet

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Sources for use with Section B

The economy of Taiwan

Figure 1 International visitors to Taiwan from selected countries, millions, 2015–2019

Country	2015	2016	2017	2018	2019
China	4.18	3.51	2.73	2.70	2.71
Japan	1.63	1.90	1.90	1.97	2.17
The Philippines*	0.14	0.17	0.29	0.42	0.51
Thailand*	0.12	0.20	0.23	0.32	0.41
Vietnam*	0.15	0.20	0.38	0.49	0.41

* represents Southeast Asian countries

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Extract A Economic independence

China is Taiwan's most important trading partner and it is the main destination for Taiwan's exports. Much of Taiwan's foreign direct investment also goes to China. Since the 1980s over 100 000 Taiwanese firms moved to China to set up their manufacturing facilities. They were attracted by cheap labour and a large Chinese market.

After the USA imposed tariffs on several Chinese-made goods in 2018, Taiwanese firms started moving production from China to other countries. The average tariff is 19.3% on US imports from China.

The Taiwanese Government believed that it was essential for Taiwan to become less dependent on China. This was supported by a three-year reshoring plan, starting in 2019, that involved encouraging domestic firms to move back to Taiwan. This plan included:

- incentives that made it easier to buy land and register property
- investment in infrastructure to ensure the continuous provision of gas, electricity and water supply
- subsidies and tax incentives for the technology sector.

Taiwanese firms agreed to invest $33 billion in Taiwan between 2019 and 2021. However, of that amount, only $6.8 billion was invested in 2019 and only $1.1 billion in 2020. This reluctance to invest was mainly because several large Taiwanese firms were discouraged from relocating back to Taiwan. Bureaucracy and severe shortages of highly skilled labour were the two most significant reasons given by these firms.

Even before the reshoring plan, the Taiwanese Government had initiated the New Southbound Policy (NSP) in 2016 to reduce its economic dependence on China. This policy was designed to increase trade between Taiwan and countries in South Asia and Southeast Asia. However, China accounted for nearly 40% of Taiwan's exports in 2019, twice that of the countries covered by the NSP. China also has strong trade links with Southeast Asian countries. This has limited the extent to which Taiwan can promote its own trade relationships and cooperation with these countries.

Tourism is another sector where Taiwan has reduced its reliance on China. However, Taiwan has made up for the fall in Chinese tourists by attracting more visitors from Japan and countries in Southeast Asia.

Reducing dependency on China for tourism and trade will not be easy and it is becoming an important issue for a number of countries.

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Acknowledgements

Figure 1 based on data taken from Tourism Statistics Database of the Taiwan Tourism Bureau, https://stat.taiwan.net.tw/

Extract A adapted from Taiwan Shows How to Carefully Snip Chinese Economic Ties, https://foreignpolicy.com/2020/07/24/taiwan-china-economic-ties-decoupling/