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.

Turn over ▶

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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 In 2021 the US dollar appreciated by around 10% against the euro.

Which **one** of the following factors is likely to have caused this appreciation of the US dollar?

- ☒ **A** A decrease in confidence in the USA's economy by currency speculators
- ☒ **B** A decrease in the USA's rate of economic growth
- ☒ **C** An increase in capital flight out of the USA into the eurozone
- ☒ **D** An increase in the USA's base interest rate relative to the eurozone

(Total for Question 1 = 1 mark)

2 Between 2012 and 2021 Paraguay's national debt increased from $3.6 billion to $13.3 billion.

Which **one** of the following is the most likely effect of an increase in the national debt of a country?

- ☒ **A** A decrease in the rate of inflation
- ☒ **B** A decrease in debt servicing costs
- ☒ **C** An increase in crowding out
- ☒ **D** An increase in tax revenues

(Total for Question 2 = 1 mark)

3 In 2021 the Nigerian Government introduced a tax of N10 per litre on sugary drinks.

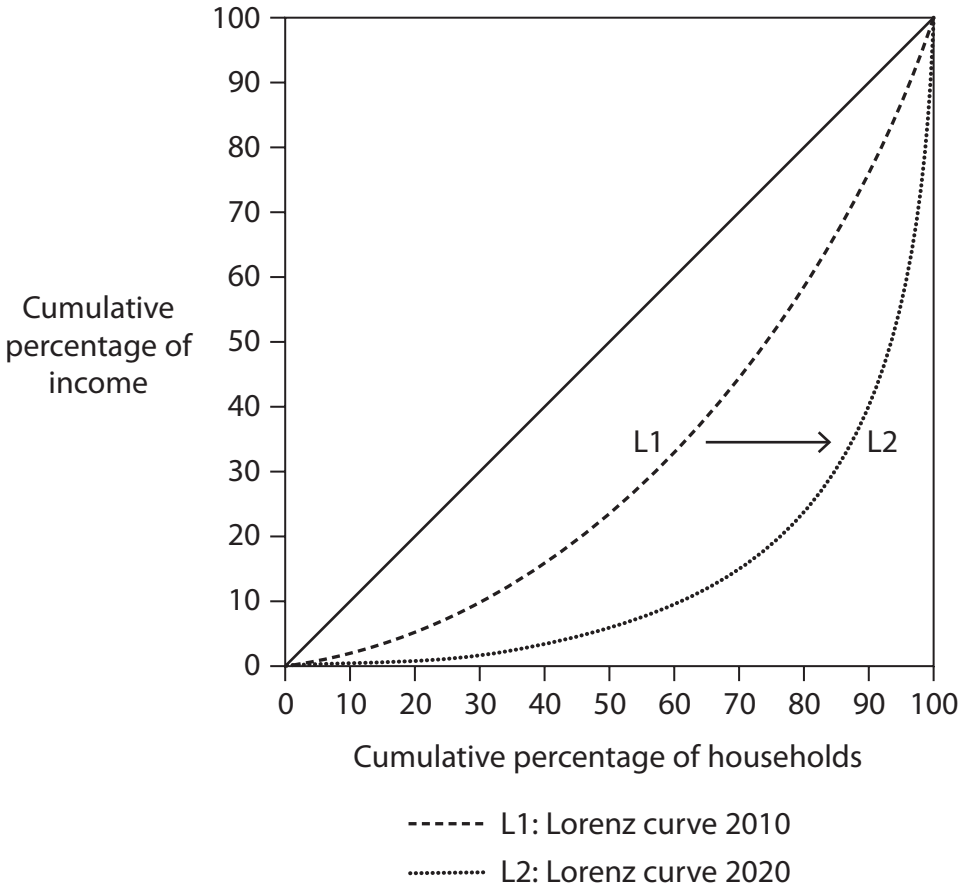
Which **one** of the following can be deduced from this information?

- ☒ **A** It is an ad valorem tax
- ☒ **B** It is a specific tax
- ☒ **C** It is a tax on income
- ☒ **D** It is a tax on company profits

(Total for Question 3 = 1 mark)

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4 The diagram illustrates the Lorenz curves for an economy in 2010 and 2020.



Which **one** of the following is most likely to have caused the shift in the Lorenz curve from L1 to L2?

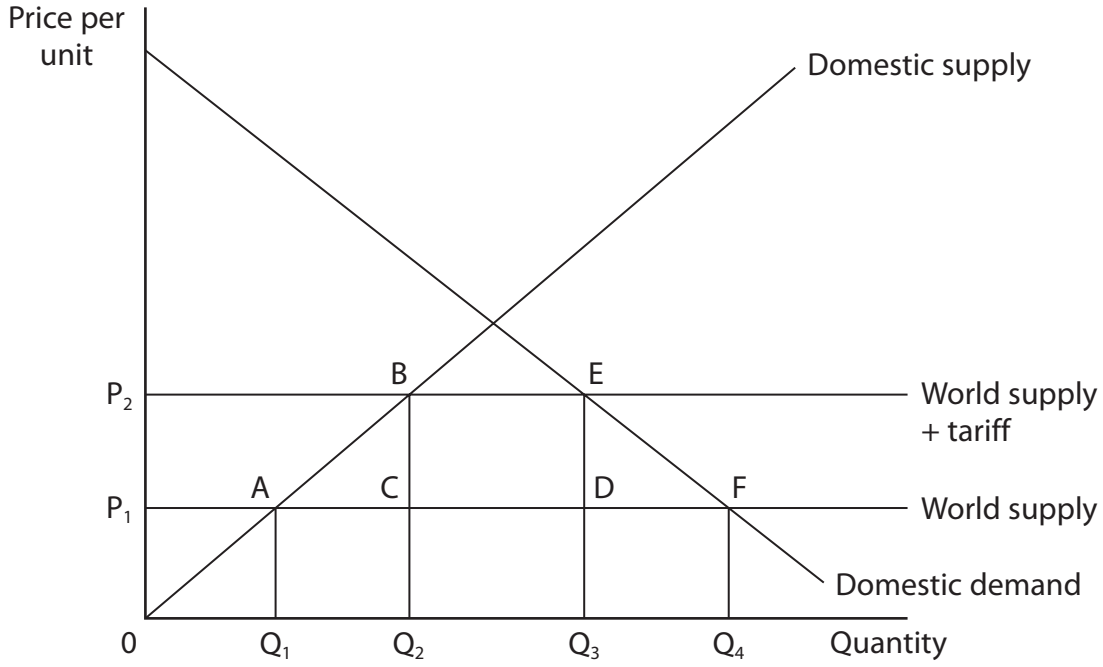
- ☒ **A** A decrease in public expenditure on transfer payments
- ☒ **B** A decrease in the rate of unemployment
- ☒ **C** An increase in the national minimum wage
- ☒ **D** An increase in spending on training for unskilled workers

(Total for Question 4 = 1 mark)

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5 The diagram illustrates the imposition of a tariff.



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

- ☒ **A** Consumer surplus has increased by the area P_1P_2EF
- ☒ **B** Government tax revenue is the area ABEF
- ☒ **C** Net welfare loss areas are ABC and DEF
- ☒ **D** Producer surplus has decreased by the area P_1P_2BA

(Total for Question 5 = 1 mark)

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6 Between 2019 and 2020 France's rank on the Global Competitiveness Index decreased from 31st to 32nd. This was as a result of a significant decrease in its labour productivity.

Which **one** of the following combinations is the most likely effect of a decrease in labour productivity?

		Unit labour costs	Export prices
☒	**A**	Fall	Fall
☒	**B**	Fall	Rise
☒	**C**	Rise	Fall
☒	**D**	Rise	Rise

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

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

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

7 (a) Between Q1 2020 and Q4 2021 the average annual rate of inflation in New Zealand increased from 2.5% to 5.4%.

Calculate the change in the rate of inflation between Q1 2020 and Q4 2021. You are advised to show your working.

(2)

(b) With reference to Figure 1 and the first paragraph of Extract A, analyse **two** causes of the increase in the rate of inflation.

(6)

(c) Explain what is meant by 'monetary policy instruments' (Extract A, line 9).

(4)

(d) Examine **two** 'problems facing central banks when applying monetary policies to reduce the rate of inflation' (Extract A, lines 11–12).

(8)

(e) With reference to Extract B, discuss how demographic factors may constrain economic growth of developed economies.

(14)

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(a) Between Q1 2020 and Q4 2021 the average annual rate of inflation in New Zealand increased from 2.5% to 5.4%.

Calculate the change in the rate of inflation between Q1 2020 and Q4 2021.
You are advised to show your working.

(2)

Change in the rate of inflation = 5.4% − 2.5%

= 2.9 percentage points

As a percentage change: (5.4 − 2.5) ÷ 2.5 × 100 = 116% increase in the rate

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(b) With reference to Figure 1 and the first paragraph of Extract A, analyse **two** causes of the increase in the rate of inflation.

(6)

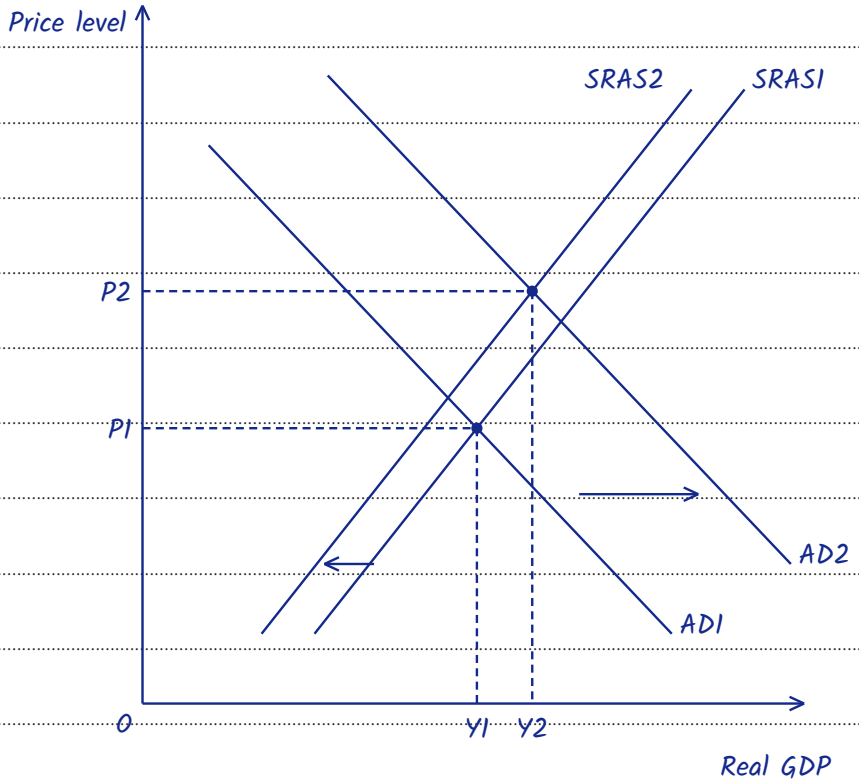
Figure 1 shows inflation rose sharply in 2021: in the USA it increased from about 1.9% in Q1 2021 to about 6.4% in Q4 2021, and in the UK it rose from about 0.6% to about 4.2%, an increase of roughly 3.6 percentage points.

Cause 1: cost-push inflation from supply chain disruptions. Extract A states that price levels rose because of "disruptions to global supply chains" caused by restrictions during the global health crisis. Shortages of components and higher shipping and energy costs raised firms' costs of production, so firms supply less at each price level and SRAS shifts left from SRAS1 to SRAS2. This raises the price level from P1 to P2 while real output falls.

Cause 2: demand-pull inflation. As restrictions eased, "demand for goods, services and energy increased", and the "significant rise in average house prices" created a positive wealth effect, raising consumer confidence and consumption. Higher consumption increases aggregate demand, so AD shifts right from AD1 to AD2. With firms unable to expand capacity quickly, the excess demand pulls the general price level up from P1 to P2, as shown below.

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(c) Explain what is meant by 'monetary policy instruments' (Extract A, line 9).

(4)

Monetary policy instruments are the tools a central bank uses to change the supply of money, and the cost and availability of credit, in order to influence aggregate demand and achieve macroeconomic objectives, mainly price stability. They include the base interest rate, quantitative easing (asset purchases that increase the money supply), reserve (liquidity) requirements on commercial banks and changes in lending criteria.

Extract A says central banks with a 2% inflation target "can adjust their monetary policy instruments to meet this target", for example the Bank of England raised Bank Rate from 0.1% to 0.25% in December 2021 as UK inflation rose. However, these instruments work through demand, so they are "less effective in tackling inflation created by a lack of supply".

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(d) Examine **two** 'problems facing central banks when applying monetary policies to reduce the rate of inflation' (Extract A, lines 11–12).

(8)

Problem 1: inflation caused by external factors. Extract A states policymakers are unable to control rising inflation "caused by external factors", such as the "one-off increase in supply chain disruptions" and higher world energy prices. Raising interest rates reduces domestic consumption and investment, so AD falls, but it cannot lower the world price of oil or clear blocked supply chains. So inflation stays high while the higher interest rates reduce output and raise unemployment, making the policy costly and ineffective.

Problem 2: knowing whether inflation is temporary or permanent. Some policymakers believe the rise is temporary, caused by short-term external shocks, while others believe it is permanent because of "rising wages", which could start a wage-price spiral. Monetary policy works with a time lag of around 18 to 24 months. If the central bank raises the base rate significantly but inflation was only temporary, the economy may be pushed into recession when the shock has already passed. If it waits and inflation is permanent, inflation expectations become embedded and larger rate rises are needed later.

However, the significance of these problems depends on the economy. A small open economy such as New Zealand imports more of its inflation, so external factors matter more there than in the USA. Also, central banks can use forward guidance and historical data on past shocks to judge whether inflation is temporary, and information is becoming more accurate over time, so the second problem may be less serious. In addition, if the government follows reflationary fiscal policy, this can offset the monetary tightening, which may be a bigger problem than either of these.

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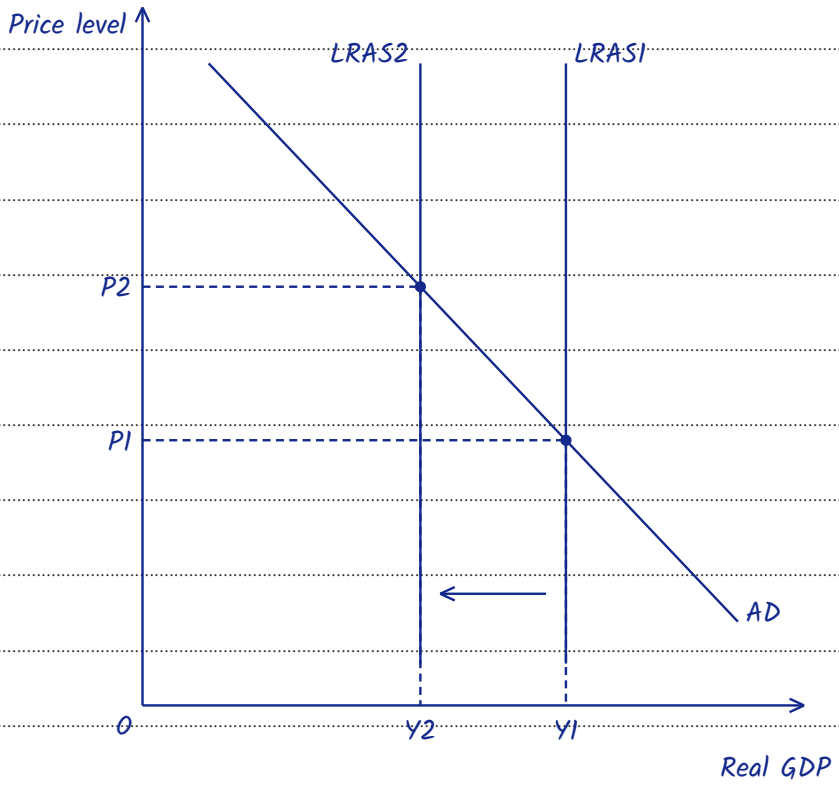
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(e) With reference to Extract B, discuss how demographic factors may constrain economic growth of developed economies.

(14)

Economic growth is an increase in real GDP over time; long-run growth is an increase in the productive potential of the economy, shown by LRAS shifting right. Demographic factors are characteristics of the population, such as its age structure, size and migration.

First, Extract B states many developed countries have "ageing populations and a falling proportion of people of working age", and that "many workers have retired early". This reduces the quantity of labour, a factor of production, so the productive capacity of the economy falls and LRAS shifts left from LRAS1 to LRAS2, reducing potential real GDP from Y1 to Y2. Extract B confirms that because of this fall in labour supply "many companies have been forced to decrease production". Labour shortages also push up wages, raising unit labour costs and causing cost-push inflation, which reduces international competitiveness and net exports.



Second, an ageing population raises the dependency ratio. Governments must spend more on

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pensions and healthcare while older people pay less income tax. This may lead to higher taxes on the working population, reducing incentives to work and invest, or to higher government borrowing. There is also an opportunity cost: less spending on infrastructure and education, so productivity and long-run growth fall.

Third, Extract B notes "a decline in international migration". Migrants are usually of working age and fill skills gaps, so fewer migrants means job vacancies remain unfilled and human capital is lower. Fewer people also means lower consumption, so AD and real output grow more slowly.

However, the impact differs between developed countries. In the USA "more than four million workers have left the labour force", but in the eurozone employment has "almost returned to its pre-crisis level" and in France and Spain the participation rate is "already higher than it was before the crisis". So demographics alone may not constrain growth; the decision of workers to leave the workforce after the crisis may be the more important, and possibly temporary, factor.

Also, growth depends on productivity as well as the size of the workforce. Firms can respond to scarce labour by investing in automation and technology, and Extract B says employers will "offer greater incentives" to attract workers back. Governments can raise the retirement age or relax migration rules, and older workers who stay in work bring valuable skills and experience. Retired grandparents providing childcare can also allow younger parents to work.

Overall, demographic factors are likely to constrain growth in the long run, since ageing is a slow, persistent trend that cannot quickly be reversed. However, the size of the constraint depends on the country and on whether productivity growth and policies on migration and retirement can offset the smaller labour force.

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(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 February 2021 the UK Government applied to join one of the world's largest free-trade areas, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

Evaluate the likely economic benefits to a country of joining a trading bloc.

(Total for Question 8 = 20 marks)

9 In 2021 Singapore's surplus on its current account of the balance of payments was over $60 billion.

Evaluate possible causes of a current account surplus. Refer to a developed country of your choice in your answer.

(Total for Question 9 = 20 marks)

10 In Libya the HDI was 0.80 in 2010 and it was 0.72 in 2019.

Evaluate interventionist strategies that a government in a developing country of your choice might use to increase *economic development*.

(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** ☐

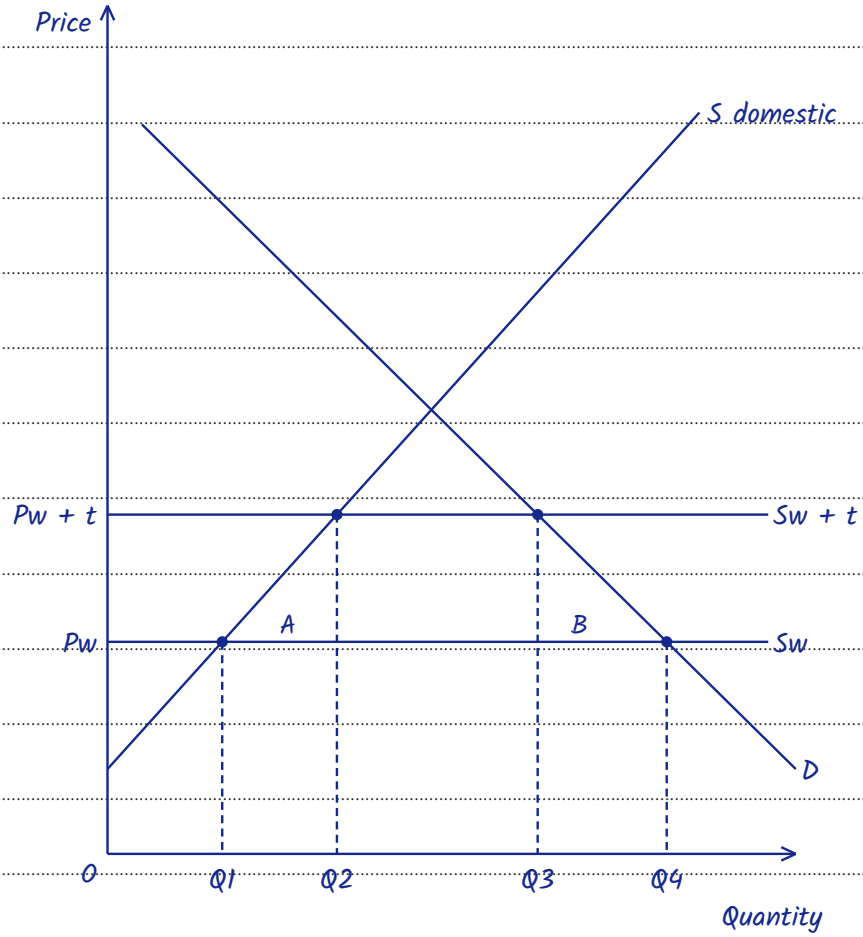
A trading bloc is a group of countries that agree to reduce or remove barriers to trade, such as tariffs and quotas, between members. The CPTPP is a free trade area: members remove tariffs on trade with each other but each keeps its own tariffs on non-members. Its members include Japan, Canada, Australia, Mexico, Singapore, Vietnam and New Zealand, together about 13% of world GDP.

The main benefit is trade creation. When the UK joins, tariffs on imports from members are removed, so higher cost domestic production is replaced by lower cost imports from more efficient producers in the bloc. In the diagram, before joining the price is Pw + t: domestic firms supply Q2 and consumption is Q3. After the tariff is removed the price falls to Pw, consumption rises to Q4 and domestic supply falls to Q1. Consumer surplus increases and the deadweight loss triangles A and B are removed, so there is a net welfare gain.

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This trade creation follows the law of comparative advantage: each country specialises in what it produces at the lowest opportunity cost, so world output rises. UK consumers gain from lower prices and more choice, for example cheaper Australian beef or Malaysian palm oil, raising real incomes.

Second, UK firms gain access to a large market of over 500 million consumers. UK exporters of services, whisky and cars face lower tariffs and less bureaucracy, so sales increase. As output expands, firms benefit from economies of scale, so average costs fall, making UK exports more price competitive. Higher exports raise AD, increasing real GDP and employment through the multiplier, and can improve the current account of the balance of payments.

Third, there is more competition. UK firms now compete with efficient firms from Japan and Singapore, so they must cut x-inefficiency and lower prices towards marginal cost, improving

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allocative efficiency. Competition and the transfer of ideas also encourage innovation, increasing dynamic efficiency and long-run growth. Being in a bloc also gives a country more weight in international trade negotiations.

However, the benefits may be small. The UK already had trade deals with most CPTPP members, and its own government estimated joining would increase UK GDP by only around 0.08% in the long run. The members are geographically distant, so high transport costs limit trade, compared with the EU, which took around 40% of UK exports. So the magnitude of the gain depends on how much trade barriers actually fall.

Also, a trading bloc can cause trade diversion. If imports switch from a low cost producer outside the bloc, which still faces tariffs, to a higher cost producer inside the bloc, resources are allocated inefficiently and comparative advantage is distorted, so welfare could fall. This is more likely in a customs union with a common external tariff than in a free trade area like the CPTPP, where the UK sets its own external tariffs.

Furthermore, some domestic producers lose. Inefficient UK firms, such as some farmers, may be unable to compete with cheaper imports and close, causing structural unemployment in the short run. Imports may rise faster than exports, worsening the current account. Membership also increases interdependence, so external shocks in large members such as Japan spread to the UK, and the UK loses some sovereignty over trade rules, which larger, longer-standing members may dictate.

In conclusion, joining a trading bloc is likely to bring benefits through trade creation, economies of scale and greater competition, which raise consumer welfare and long-run growth. However, the size of the benefit depends on the bloc: the gains are largest when members are close,

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already trade heavily and have high initial tariffs. For the UK and the CPTPP the benefits are positive but probably small in the short run, though they may grow over time as more members such as other Asian economies join and these fast-growing markets expand.

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Write the answer to your SECOND chosen question here.

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

The current account of the balance of payments records trade in goods, trade in services, primary income (such as profits, interest and dividends) and secondary income (transfers). A surplus means total credits are greater than total debits, so more money flows into the country than out. Germany, a developed country, has had one of the largest current account surpluses in the world, around 7 to 8% of GDP for much of the 2010s. Singapore's surplus of over $60 billion in 2021 is about 15% of its GDP of roughly $400 billion.

Cause 1: strong non-price competitiveness. Germany has a highly skilled workforce, trained through its apprenticeship system, and has invested heavily in modern technology. This gives high labour productivity and a reputation for high quality, reliable manufactured goods such as cars and machinery from firms like Volkswagen, BMW and Siemens. Demand for these exports is relatively price inelastic, so export revenue remains high even when prices rise, creating a large surplus on trade in goods.

Cause 2: a relatively low exchange rate. Germany uses the euro, whose value reflects weaker eurozone economies such as Italy and Greece, so it is lower than a German currency would be. This makes German exports relatively cheap abroad and imports relatively expensive, so the value of exports rises and imports fall. If the Marshall-Lerner condition holds (PED for exports plus PED for imports greater than 1), a low exchange rate increases the current account balance.

Cause 3: low inflation and wage restraint. German unit labour costs grew slowly in the 2000s after labour market reforms, so its inflation rate was below that of trade partners. Its goods became more price competitive over time, increasing exports. Wage restraint and a high savings

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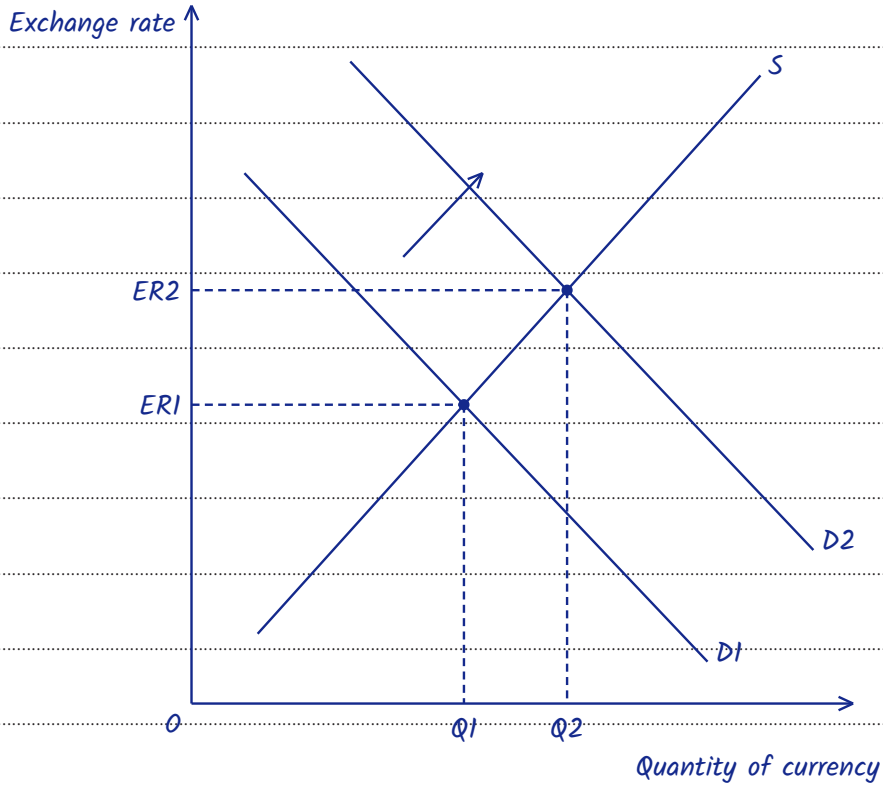
ratio also keep domestic consumption, and so spending on imports, relatively low.

Cause 4: primary income. Countries with past surpluses build up large overseas assets. Germany and Singapore receive substantial interest, profits and dividends from their foreign investments, which adds to the primary income surplus. Rising world demand, for example from China for German capital goods, also increases exports.

However, the importance of each cause differs between countries and over time. Singapore's surplus comes largely from its role as a trading, refining and financial hub, including petroleum exports, while Germany's comes mainly from manufactured goods. Prioritising causes, non-price competitiveness is likely to be the most important for Germany because it is a long-run supply-side strength, while a weak exchange rate or high commodity prices can quickly reverse.

Also, a surplus may not last. Under a floating exchange rate, a surplus increases demand for the currency, as foreigners buy it to pay for exports, so the currency appreciates from ER1 to ER2. This makes exports dearer and imports cheaper, reducing the surplus. Germany avoids much of this because it shares the euro, which is one reason its surplus has persisted.

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Moreover, data for a single year may be misleading: Singapore's 2021 figure may reflect the temporary recovery in world trade after the global health crisis. It also depends on which component causes the surplus: a surplus from weak domestic demand, with low consumption and investment, is a sign of imbalance rather than strength.

In conclusion, a current account surplus is usually caused by a combination of factors. For Germany, high productivity and quality-based non-price competitiveness are the most important long-run causes, reinforced by a relatively weak euro and low wage growth. However, the significance of each cause depends on the country, the exchange rate system and the time period considered.

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TOTAL FOR SECTION C = 40 MARKS

TOTAL FOR PAPER = 80 MARKS

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Time 2 hours

Paper reference **WEC14/01**

Economics

International Advanced Level
UNIT 4: Developments in the global economy

Source Booklet

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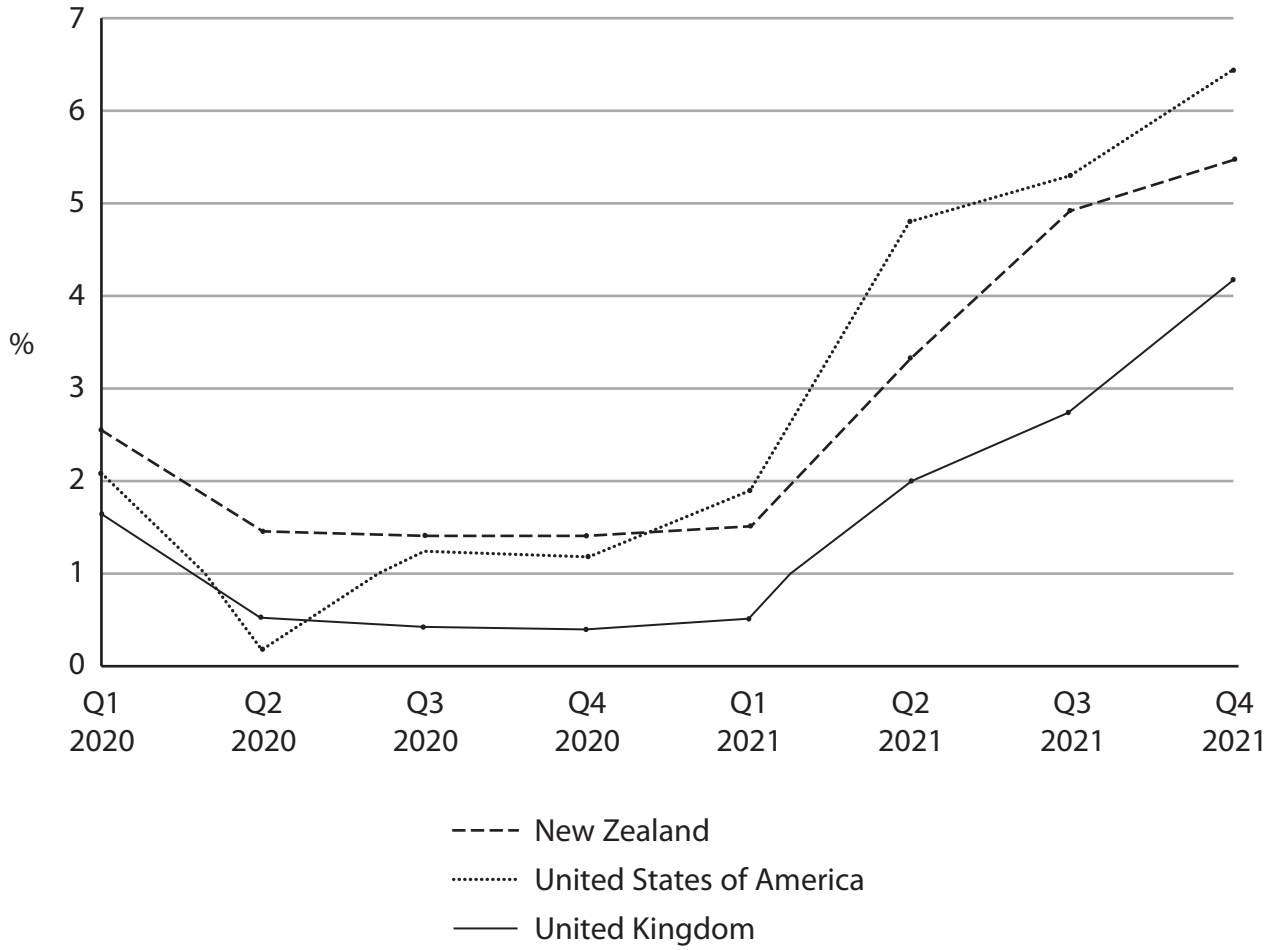
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Sources for use with Section B

Inflation and labour markets in developed economies

Figure 1 Annual inflation rate for selected countries (%), as measured by the consumer price index (CPI), Q1 2020–Q4 2021



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Extract A Rising rates of inflation

In 2021 many developed countries experienced an increase in the rate of inflation. Average price levels increased as a result of disruptions to global supply chains. These were caused by restrictions that had been in place during the global health crisis. As developed countries eased these restrictions, demand for goods, services and energy increased. There was also a significant rise in average house prices.

Rising rates of inflation are a challenge for central banks, especially for developed countries that have an inflation target of 2%. The central banks of these countries can adjust their monetary policy instruments to meet this target. Nevertheless, these instruments are less effective in tackling inflation created by a lack of supply.

There are problems facing central banks when applying monetary policies to reduce the rate of inflation. One problem is the inability of policymakers to control the rising rate of inflation caused by external factors. Another problem is estimating whether the increase in the rate of inflation is temporary or permanent.

Policymakers who believe that this is a temporary issue suggest that the rise in the rate of inflation is as a result of short-term external shocks. They attribute it to a one-off increase in supply chain disruptions and a one-off increase in consumer demand. By contrast, policymakers who believe that this is a permanent issue indicate that the increase in the average price level is a result of rising wages.

Extract B Labour markets

Many developed countries have ageing populations and a falling proportion of people of working age. Since the global health crisis there has been instability in global labour markets. Many workers have retired early whilst others have left the workforce to focus on other personal objectives. There has also been a decline in international migration. As a result of this fall in the labour supply, many companies have been forced to decrease production. This represents a considerable threat to global economic recovery.

The critical question is whether workers will rejoin the labour force or whether employers and policymakers will need to adapt to a world in which labour becomes an even scarcer resource. In the USA more than four million workers have left the labour force since the crisis. However, employment in the eurozone has almost returned to its pre-crisis level and the labour force participation rate has risen rapidly. For example, in France and Spain this rate is already higher than it was before the crisis.

Employers are preparing for a future in which they will need to offer greater incentives to attract more workers back into the labour market.

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Acknowledgements

Figure 1 adapted from OECD, https://data.oecd.org/price/inflation-forecast.htm

Extract A adapted from FT, https://www.ft.com/content/088d3368-bb8b-4ff3-9df7-a7680d4d81b2

Extract B adapted from FT, https://www.ft.com/content/3cff0294-4c4d-4e29-b482-1f6f41889399