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

Friday 12 January 2024

Afternoon (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 Which **one** of the following is an economic factor that might constrain the rate of economic growth of a country?

- ☐ **A** A high level of corruption
- ☐ **B** A reduced threat of terrorism
- ☐ **C** An increased access to credit
- ☒ **D** A lack of foreign currency

(Total for Question 1 = 1 mark)

2 In 2022 the Government of Brazil spent $160 million on 762 infrastructure projects.

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

- ☐ **A** Expenditure on transfer payments
- ☐ **B** Current expenditure
- ☒ **C** Capital expenditure
- ☐ **D** Consumer expenditure

(Total for Question 2 = 1 mark)

3 Between 2021 and 2022 the European Union (EU) recorded an increase in the capital and financial account surplus of the balance of payments.

Ceteris paribus, which **one** of the following is the most likely reason for this increase in the EU's capital and financial account surplus?

- ☒ **A** An increase in inward foreign direct investment (FDI) and portfolio investment
- ☐ **B** An increase in the value of EU exports and a decrease in the value of EU imports
- ☐ **C** An increase in public sector borrowing and an increase in public sector debt
- ☐ **D** An increase in inflows into the primary income component of the EU's balance of payments

(Total for Question 3 = 1 mark)

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4 Globalisation has been associated with an increase in real GDP per capita in many countries. However, some economists consider that there are costs associated with globalisation.

Ceteris paribus, which **one** of the following is a possible cost of globalisation on the global economy?

- ☒ **A** Lower prices and higher consumer surplus
- ☒ **B** Lower rates of unemployment
- ☒ **C** Higher long-run average costs for transnational companies
- ☒ **D** Higher external costs arising from increased trade

(Total for Question 4 = 1 mark)

5 In 2022 the value of Japan's currency, the yen, depreciated significantly against the US dollar. Japan'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 Japan's central bank be most likely to use if it wanted to raise the value of the yen against the US dollar?

		Japanese yen	US dollar
☒	**A**	Buy	Buy
☒	**B**	Buy	Sell
☒	**C**	Sell	Buy
☒	**D**	Sell	Sell

(Total for Question 5 = 1 mark)

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6 The table shows Bosnia and Herzegovina's index of export prices and index of import prices between 2018 and 2020, (2000=100).

Year	Index of export prices	Index of import prices
2018	379.7	219.1
2019	354.4	214.2
2020	331.8	191.9

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

☒ **A** Between 2000 and 2018 Bosnia and Herzegovina's terms of trade worsened by 73.3%

☒ **B** Between 2000 and 2020 Bosnia and Herzegovina's terms of trade improved by 72.9%

☒ **C** Bosnia and Herzegovina had to export the same amount of goods and services to purchase a given quantity of imports each year

☒ **D** Bosnia and Herzegovina's index of import prices exceeded its index of export prices each year

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

Study Figures 1 and 2 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 Figure 1 and Figure 2, calculate the value of Greece's national debt in 2022. You are advised to show your workings.

(2)

(b) Explain what is meant by 'deflationary fiscal policies' (Extract A, line 10).

(4)

(c) With reference to the third paragraph of Extract A, examine **two** measures that the Government of Greece could take to increase the country's international competitiveness.

(8)

(d) With reference to Extract A, analyse **two** roles of the European Central Bank (ECB).

(6)

(e) With reference to the information provided and your own knowledge, discuss the likely economic benefits of a decrease in national debt, as a proportion of GDP, on the economy of Greece.

(14)

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(a) With reference to Figure 1 and Figure 2, calculate the value of Greece's national debt in 2022. You are advised to show your workings.

(2)

National debt = debt-to-GDP ratio × GDP

In 2022: national debt = 171.4% of GDP (Figure 2), GDP = $221.3 billion (Figure 1)

National debt = 1.714 × $221.3 billion

= $379.31 billion

(b) Explain what is meant by 'deflationary fiscal policies' (Extract A, line 10).

(4)

Deflationary fiscal policies are changes in government spending and taxation that reduce aggregate demand: the government cuts public expenditure and/or raises taxes, such as income tax or VAT. This reduces the budget deficit and inflationary pressure, but also slows economic growth.

In Greece these policies were a condition of the $146 billion of loans from the IMF and the EU, because the Government had to reduce a national debt that rose from 109.4% to 147.5% of GDP between 2008 and 2010. They included cutting pensions to the elderly. As AD fell, the rate of economic growth fell by 25%, disposable incomes fell by almost 30% and unemployment rose, so many young people left Greece to find work.

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(c) With reference to the third paragraph of Extract A, examine **two** measures that the Government of Greece could take to increase the country's international competitiveness.

(8)

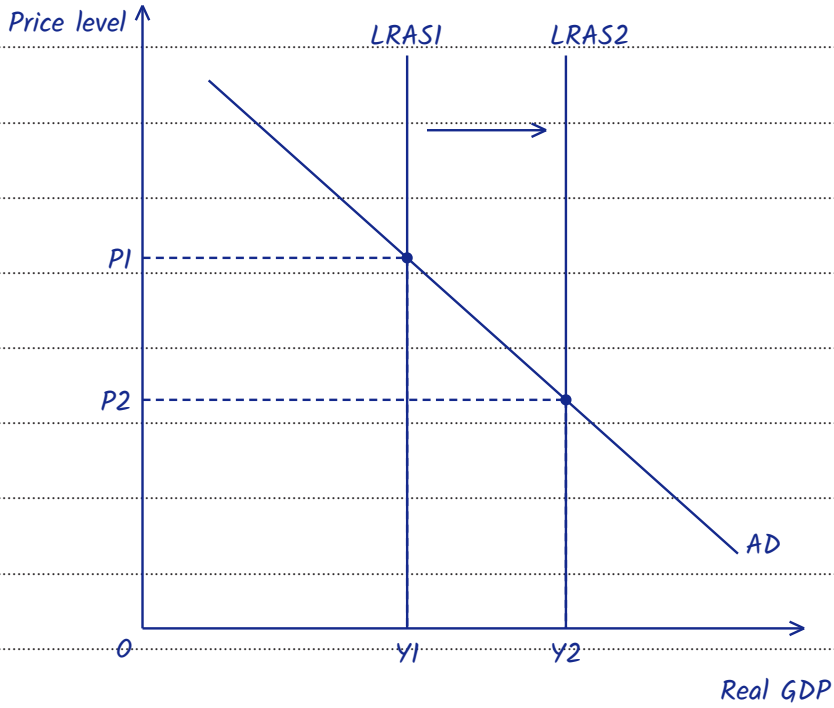
International competitiveness is the ability of a country's firms to sell goods and services abroad on price and quality. Extract A says Greece's competitiveness is "significantly lower" than other eurozone members, ranked only 47th out of 63 comparable countries, and the ECB advised capital investment.

Measure 1: investment in infrastructure. The Government could spend on transport links such as ports, railways and roads, and on digital communications and energy networks. This cuts firms' transport and production costs and delivery times, so unit costs fall. Greek exporters can then lower prices relative to other eurozone producers, so exports become more price competitive and trade increases.

Measure 2: investment in human capital. Spending on education, vocational training and healthcare reduces the skills gap and keeps workers healthy, so labour productivity rises. Higher output per worker lowers unit labour costs and improves quality, which matters because, inside the euro, Greece cannot devalue its currency to regain competitiveness. Both measures shift LRAS right from LRAS1 to LRAS2, so the price level falls from P1 to P2 and real GDP rises from Y1 to Y2, as in the diagram.

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Evaluation: Greece's debt-to-GDP ratio is still the highest in the eurozone at 171.4% of GDP, so extra spending raises the budget deficit and debt and may cause financial crowding out, especially now the ECB has raised interest rates to 3%. There is also an opportunity cost, as money spent here cannot be used elsewhere. Time lags are long: new infrastructure and better skills may take years to raise productivity, while in the short run the extra spending raises AD and could add to inflation, already 5.6%, which reduces price competitiveness. The impact depends on the magnitude of the investment and how well it is managed, since there is a risk of government failure.

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(d) With reference to Extract A, analyse **two** roles of the European Central Bank (ECB).

(6)

Role 1: setting monetary policy to control inflation. The ECB sets the base rate of interest for the whole eurozone to meet its inflation target of 2%. Because inflation in the eurozone was high, it raised the base rate from 2.5% to 3% in March 2023, an increase of 0.5 percentage points. Commercial banks pass on the higher rate, so the cost of borrowing rises and the reward for saving rises. Consumption and investment fall, so aggregate demand shifts left and demand-pull inflation falls, though growth and employment slow. This matters for Greece, which had the highest inflation in the eurozone at 5.6%.

Role 2: forecasting and giving advice to governments. The ECB monitors and forecasts the state of eurozone economies and recommends policies to national governments. Extract A shows it advised the Government of Greece to make capital investments in infrastructure, human capital and healthcare, because Greece's competitiveness was far below other members. Following this advice raises productivity and long run aggregate supply, which supports sustainable economic growth and employment in Greece and helps the eurozone avoid another debt crisis that could threaten the stability of the euro.

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(e) With reference to the information provided and your own knowledge, discuss the likely economic benefits of a decrease in national debt, as a proportion of GDP, on the economy of Greece.

(14)

National debt is the total accumulated stock of government borrowing that has not yet been repaid. Figure 2 shows Greece's debt fell from 206.3% of GDP in 2020 to 171.4% in 2022, a fall of 34.9 percentage points, partly because real GDP grew from $188.9 billion to $221.3 billion (Figure 1).

Lower borrowing costs and a better credit rating. A lower debt ratio means a lower risk of default, so Greece's credit rating has improved from "CCC" to "B+". Investors then demand a lower interest rate (yield) on Greek government bonds, so the cost of servicing the debt falls. In 2010 Greece was "unable to service its debt" and needed $146 billion from the IMF and EU, so a lower ratio reduces the need for future bailouts and the harsh conditions, such as pension cuts, that came with them.

Less crowding out and more investment. When the government borrows less, it competes less with firms for loanable funds, so interest rates on private loans can fall. Firms invest more in capital, which raises AD in the short run and productive capacity (LRAS) in the long run, increasing economic growth. Greater confidence also attracts foreign direct investment, bringing jobs and technology.

More spending on public services. Lower interest payments reduce the opportunity cost of debt: money no longer needed for interest can be spent on health, education and infrastructure, which the ECB advised, improving competitiveness and living standards. Future generations face a smaller burden of higher taxes to repay the debt, and the government has "fiscal space" to use expansionary policy in a future recession.

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Lower inflationary pressure. With sustainable debt, investors willingly buy government bonds, so there is less pressure to finance spending by increasing the money supply, which helps reduce inflation of 5.6%.

Evaluation. First, the benefits depend on how the ratio fell. Much of the fall came from GDP growth after the 2020 crisis: the value of the debt fell only slightly, from about $389.7 billion in 2020 (206.3% × $188.9 billion) to $379.3 billion in 2022. If growth slows, as the reduced 2023 forecast suggests, the ratio could rise again. Second, the magnitude of the benefit is limited because the ratio is still the highest in the eurozone, so Greece's rating of "B+" is still below investment grade and borrowing costs remain high, especially as the ECB raised the base rate from 2.5% to 3%, so crowding out may continue. Third, if the debt is reduced by austerity, cutting productive spending on health and education, the costs could outweigh the benefits: 2010 to 2020 showed growth falling by 25% and young workers emigrating, which harms long run growth. Finally, high inflation erodes the real value of debt anyway, and much of Greece's debt is held by official lenders at low interest rates over long periods, so the interest saving may be smaller than expected.

Overall, a lower debt-to-GDP ratio is likely to benefit Greece mainly through greater confidence, a better credit rating and lower borrowing costs, which allow more investment. However, the size of the benefit depends on the ratio continuing to fall through economic growth rather than spending cuts, and on whether the debt can be reduced further from such a high level.

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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.

Write your answer to your FIRST chosen question on page 17.

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

8 Between 2007 and 2022 income inequality increased in both Sweden and the USA.

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

(Total for Question 8 = 20 marks)

9 According to the World Trade Organization (WTO), between 1995 and 2022, the share of developing economies' exports in world trade increased and the share of developed economies' exports decreased.

Evaluate factors influencing patterns of trade between countries.

(Total for Question 9 = 20 marks)

10 In South Sudan HDI was 0.43 in 2010 and 0.39 in 2022.

Evaluate market-orientated 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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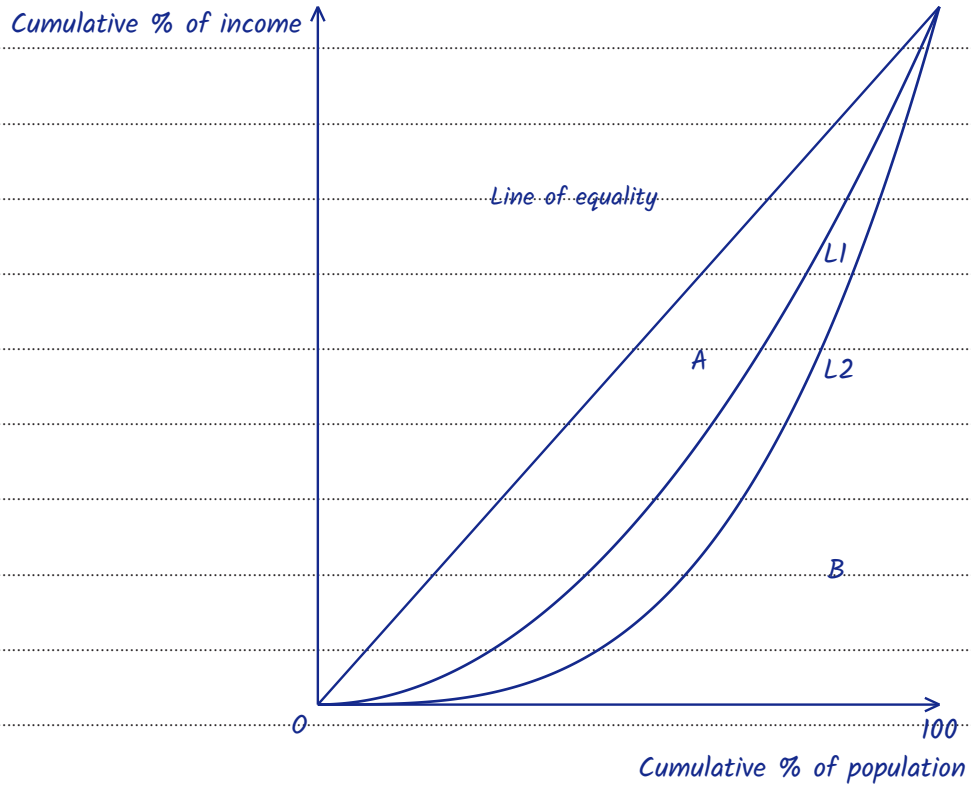
Write the answer to your FIRST chosen question here.

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** ☐

Income inequality is the unequal distribution of income between households in a country. It can be shown by a Lorenz curve and measured by the Gini coefficient, the ratio of area A to areas A + B in the diagram, where 0 is perfect equality and 1 is perfect inequality. An increase in inequality means the Lorenz curve moves further from the line of equality, from L1 to L2, so the Gini coefficient rises. I will use the USA, where the top 1% now receives around a fifth of pre-tax national income.



Skill-biased technological change and education. New technology, such as computers, automation and AI, raises the marginal revenue product of highly skilled, graduate workers but replaces routine jobs in factories and offices. Demand for skilled labour rises while demand for unskilled

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labour falls, so wage differentials widen. In the USA the earnings of graduates have grown much faster than those of workers without a degree, so gross income inequality increases.

Globalisation. Since China joined the WTO in 2001, US firms have offshored manufacturing to countries with lower labour costs. This reduced the demand for, and wages of, unskilled US manufacturing workers in regions such as the Midwest, while TNC owners, managers and shareholders gained higher profits and salaries from global markets and lower costs. So incomes at the top rose relative to those at the bottom.

Weaker trade unions and a stagnant minimum wage. Union membership in the USA has fallen to about 10% of workers, and labour markets have become more flexible, with more part-time and gig economy jobs. Workers have less bargaining power to raise wages, and firms with monopsony power can pay below the competitive wage. The federal minimum wage has stayed at $7.25 an hour since 2009, so in real terms it has fallen while average earnings have risen.

Changes in taxes and benefits. The Tax Cuts and Jobs Act of 2017 cut the top rate of income tax from 39.6% to 37% and corporation tax from 35% to 21%, which mainly raised the disposable incomes of high earners and shareholders. Less progressive taxation and limited welfare benefits mean the government redistributes less income, so disposable income inequality rises.

Rising incomes from wealth. Low interest rates and quantitative easing after 2008 raised share and property prices. Wealthy households who own these assets receive more income from dividends, rent and capital gains, while households with no assets do not, so the income share of the top 1% has risen.

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However, these causes differ in significance. Technology and education are probably the most significant long run causes, because they affect all developed countries: inequality also rose in Sweden, which has strong trade unions and high taxes, which suggests that common forces such as technology and globalisation matter more than US policies. On the other hand, the level of inequality is much higher in the USA than in Sweden, which shows that tax and benefit policy decides how much of the rise in gross inequality reaches disposable incomes.

The effect of globalisation is also debated. It created jobs in exporting industries and lowered prices of imported goods, which benefits low income households most, and it has reduced inequality between countries. Many studies find that automation explains more of the loss of manufacturing jobs than trade with China. Similarly, a stagnant federal minimum wage matters less because many states, such as California, have set minimum wages of over $15 an hour.

The answer also depends on what is measured. Gross income inequality has risen more than disposable income inequality, because taxes and transfers such as Social Security reduce it. Inequality of wealth is much greater than inequality of income and may be the more important issue. Data may also be unreliable, since top incomes are hidden through tax avoidance and some low incomes are in the informal economy. The causes also change over time: during the 2020 pandemic, young and low paid workers in hospitality lost jobs while professionals worked from home, so unemployment became a key short run cause.

In conclusion, the increase in income inequality in the USA is caused by a combination of factors that reinforce each other. The most significant cause is skill-biased technological change, which widened wage differentials, made larger by globalisation and weaker unions. Government policy is less important as an original cause but is decisive in how much inequality persists, as the comparison with Sweden shows, so policy on taxes, minimum wages and education

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determines whether the trend continues.

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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** ☐

The pattern of trade is which goods and services countries export and import, and with whom. The WTO data show a major change: developing economies such as China, India and Vietnam now produce a much larger share of world exports. China's share of world merchandise exports rose from about 3% in 1995 to about 14% in 2022.

Comparative advantage. A country has a comparative advantage when it can produce a good at a lower opportunity cost than another country. In the example below (output per worker per day), the USA has an absolute advantage in both goods, but trade is based on opportunity costs.

Output per worker	Textiles	Machinery	OC of 1 machine
China	20	4	20 ÷ 4 = 5 textiles
USA	30	15	30 ÷ 15 = 2 textiles

China gives up 5 textiles for each machine but the USA only 2, so the USA has a comparative advantage in machinery and China in textiles (opportunity cost of 0.2 machines compared with 0.5). If each specialises and they trade at a rate between 2 and 5 textiles per machine, both can consume beyond their PPFs. Because developing countries have abundant low cost labour, they have a comparative advantage in labour intensive manufacturing, which explains the rising share of their exports.

Emerging economies and FDI. The opening up of China after its economic reforms and its entry to the WTO in 2001, and the transition of Eastern Europe after communism, added huge

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numbers of workers to the world economy. Transnational companies such as Apple invested in factories there, creating global supply chains: components are traded between many countries before final assembly. FDI raises productivity in developing countries, so their exports grow, while developed countries deindustrialise and specialise in services.

Trading blocs and trade agreements. Free trade areas and customs unions, such as the EU, ASEAN and the USMCA, remove tariffs between members. This causes trade creation, so members trade more with each other, but also trade diversion away from lower cost producers outside the bloc who face the common external tariff. The EU now trades mainly within the bloc for this reason.

Exchange rates. A depreciation makes a country's exports cheaper and imports dearer. China was accused of keeping the yuan undervalued in the 2000s, which made its exports more price competitive and contributed to its large trade surplus with the USA.

Protectionism. Tariffs, quotas and subsidies change trade patterns. In 2018 and 2019 the USA imposed tariffs on about $360 billion of Chinese goods, so US imports switched from China to countries such as Vietnam and Mexico. Lower transport and communication costs, through containerisation and the internet, have also made trade over long distances cheaper.

Evaluation. Comparative advantage is the underlying factor, but the theory relies on unrealistic assumptions: constant costs, no transport costs and perfect factor mobility. In reality, rising transport costs and diseconomies of scale reduce the gains from specialisation. Comparative advantage also changes over time: wages in China have risen sharply, so labour intensive production such as clothing is moving to Bangladesh and Vietnam, and some firms are reshoring to developed countries using automation.

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The impact of trading blocs depends on whether trade creation outweighs trade diversion, and blocs can shrink, as when the UK left the EU, which reduced UK trade with the EU. Exchange rate effects are often short run, because floating currencies change again, and they depend on the price elasticity of demand for exports (the Marshall-Lerner condition). Protectionism can lead to retaliation, as when China imposed tariffs on US soybeans in 2018, so a trade war may reduce trade overall rather than simply change its pattern. Non-economic factors also matter: the 2020 pandemic and the war in Ukraine caused firms to diversify supply chains towards allies ("friend-shoring") for security, not cost.

In conclusion, the factors work in combination. In the long run, comparative advantage, based on low labour costs and supported by FDI and the opening of emerging economies, is the most significant factor and explains why developing countries' share of world exports has risen. Trading blocs, exchange rates and protectionism are less fundamental but can change patterns quickly in the short run. Their importance differs between countries, and as wages in emerging economies rise and geopolitical tensions grow, protectionism and security concerns may become more important in the future.

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TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Friday 12 January 2024

Afternoon (Time: 2 hours)

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 Greece

Figure 1 Real GDP, $ billion, 2008–2022

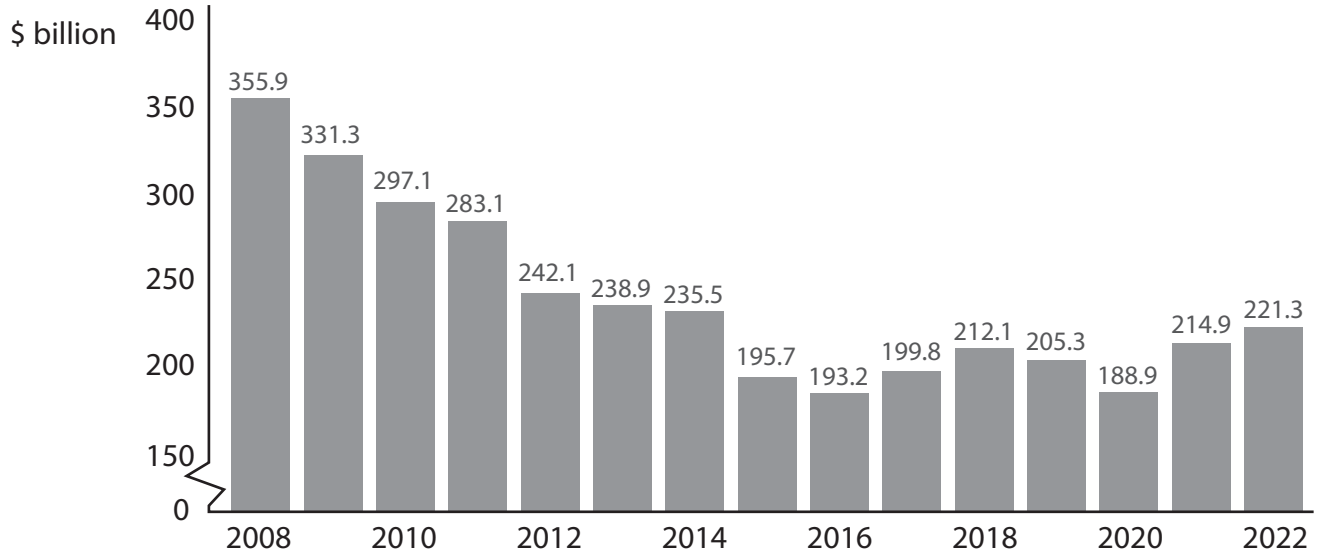
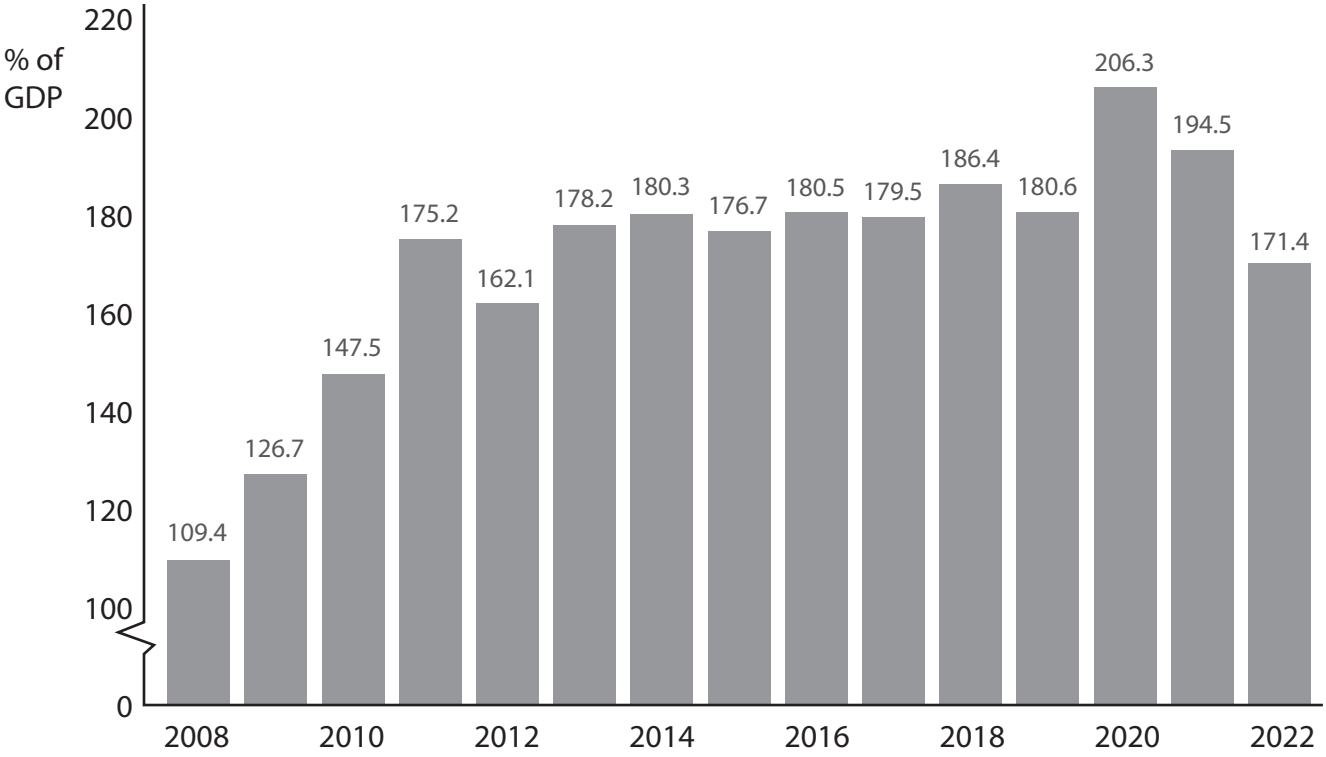


Figure 2 National debt, % of GDP, 2008–2022



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Extract A Economic outlook

Following the global financial crisis of 2008, Greece experienced a debt crisis. In 2010 the country's credit rating (an estimate of the ability of a country to repay its debts) was reduced. Greece's credit rating fell from 'A' to 'CCC'. This indicated that Greece went from having a strong ability to make repayments of its national debt to a situation in which it was unable to service its debt.

Between 2008 and 2010 Greece's national debt increased from 109.4% of GDP to 147.5% of GDP. Consequently, the Government had to borrow $146 billion from the International Monetary Fund (IMF) and the European Union. As a condition of these loans, the Government of Greece was required to implement deflationary fiscal policies to reduce its national debt. It was also forced by the IMF to reduce pensions to the elderly in return for financial support. As a result of these measures, between 2010 and 2020, the country's rate of economic growth fell by 25% and the disposable incomes of Greek citizens decreased by almost 30%. The resulting increase in unemployment led to many young citizens leaving the country in search of work.

After the global health crisis of 2020 Greece was able to reduce its national debt as a proportion of GDP. In 2022 real GDP increased by nearly 3% and its debt-to-GDP ratio fell. This helped to improve the country's credit rating to 'B+'. This improvement in the economy led the European Central Bank (ECB) to advise the Government of Greece to make capital investments in infrastructure, human capital and healthcare. This was because Greece's international competitiveness was significantly lower compared to the other members of the eurozone. Its competitiveness rank was 47th when compared with 63 other countries with similar economic prospects.

Greece continues to face significant challenges. These include:

- its debt-to-GDP ratio is falling but it still remains the highest in the eurozone area
- its forecast rate of economic growth for 2023 was reduced
- its rate of inflation, excluding changes in food and energy costs, was 5.6%. This was the highest rate of inflation in the eurozone
- the ECB raised the base rate of interest from 2.5% to 3% in March 2023 because of the high rate of inflation in the eurozone area.

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Acknowledgements

Figure 1 adapted from trading economics, https://tradingeconomics.com/greece/gdp

Figure 2 adapted from trading economics, https://tradingeconomics.com/greece/government-debt-to-gdp

Extract A adapted from FT, https://www.ft.com/content/1a568ff6-41ef-4dfe-8bcf-2137eeeb405b; IMD,

https://www.imd.org/centers/wcc/world-competitiveness-center/rankings/world-competitiveness-ranking/; tradingeconomics,

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