Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

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 Which **one** of the following factors has contributed to increased globalisation in the last 50 years?

- ☒ **A** An increase in the cost of transport
- ☒ **B** An increase in the cost of communications
- ☒ **C** A reduction in tariffs and quotas
- ☒ **D** A reduction in the number of trading blocs

(Total for Question 1 = 1 mark)

2 In 2021 the Reserve Bank of India decided to extend its quantitative easing programme.

Ceteris paribus, which **one** of the following is the most likely effect of this decision?

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

(Total for Question 2 = 1 mark)

3 In 2021 the governments of 136 countries agreed to set a global minimum corporation tax rate of 15%. The aim of this agreement was to make it more difficult for transnational companies (TNCs) to avoid paying corporation tax.

Which **one** of the following is also a measure that governments may use to control TNCs?

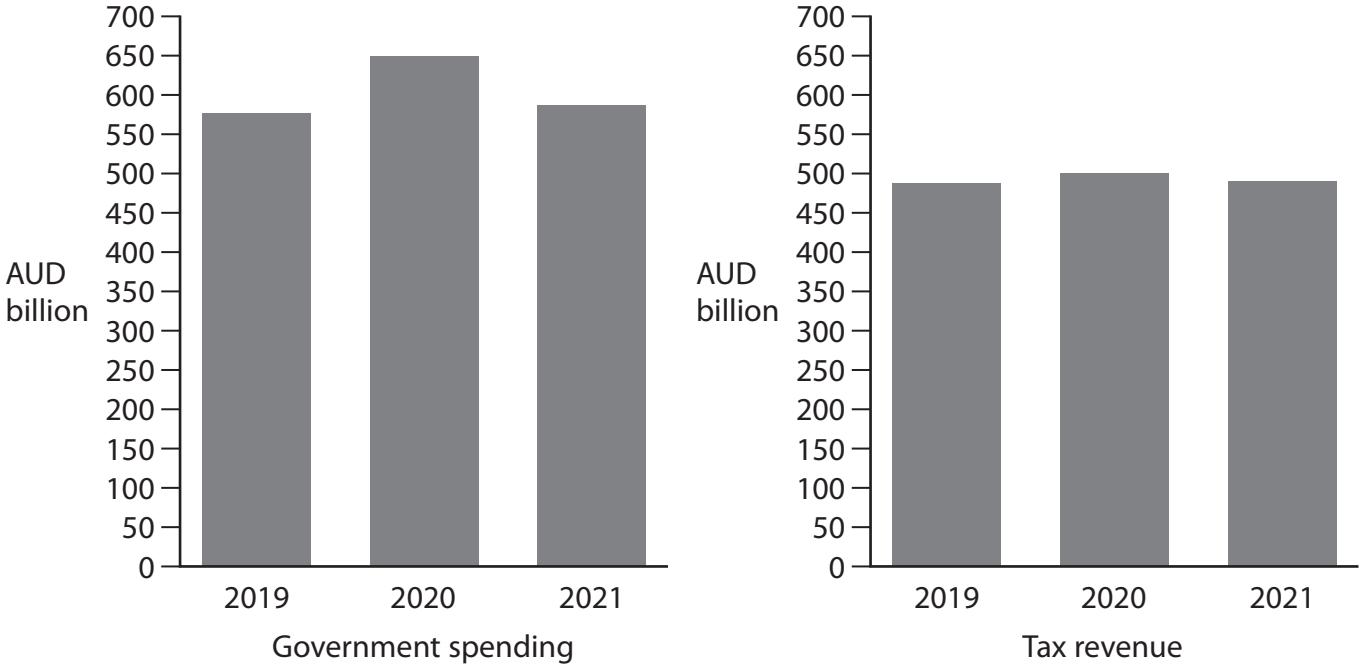
- ☒ **A** Cutting costs of bureaucracy
- ☒ **B** Improving access to banking
- ☒ **C** Increasing indirect taxes
- ☒ **D** Regulation of transfer pricing

(Total for Question 3 = 1 mark)

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4 The charts show government spending and tax revenue in Australia, AUD billion, 2019–2021.



(Source: adapted from https://www.theguardian.com/australia-news/2021/may/11/australia-federal-budget-2021-josh-frydenberg-back-in-black-how-started-going)

Which **one** of the following can be deduced from these charts?

- ☒ **A** In 2021 Australia's current account surplus was approximately AUD 100 billion
- ☒ **B** In 2020 Australia's fiscal deficit was approximately AUD 150 billion
- ☒ **C** Australia experienced a fiscal surplus throughout the given period
- ☒ **D** Australia experienced a current account deficit throughout the given period

(Total for Question 4 = 1 mark)

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5 The table shows the UK's Gross National Income (GNI) between 2018 and 2020.

Year	GNI (£ millions)
2018	2 113 914
2019	2 203 701
2020	2 073 880

(Source: https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/abmz/ukea)

If 2019 is the base year, what is the index number for 2020?

- ☒ **A** 94.1
- ☐ **B** 98.1
- ☐ **C** 104.2
- ☐ **D** 106.3

(Total for Question 5 = 1 mark)

6 Between 2000 and 2019 Afghanistan's terms of trade increased by 65%.

Ceteris paribus, which **one** of the following is most likely to have caused an increase in Afghanistan's terms of trade?

- ☐ **A** Lower relative inflation rates
- ☐ **B** A decrease in the price of exports
- ☐ **C** Depreciation of its exchange rate
- ☒ **D** A decrease in the price of imports

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B BEGINS ON THE NEXT PAGE

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SECTION B

Study Figures 1, 2 and 3 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) In 2020 Iran's GDP was $635.72 billion.

With reference to Figure 3, calculate Iran's national debt in 2020. You are advised to show your workings.

(2)

(b) With reference to Figure 3, analyse **two** disadvantages of an increase in Iran's national debt.

(6)

(c) With reference to the second paragraph of Extract A, explain what is meant by 'trade restrictions'.

(4)

(d) With reference to Figure 1, Figure 2 and the last paragraph of Extract A, examine **two** likely economic effects of trade restrictions reimposed by the US Government on Iran.

(8)

(e) With reference to Extract B, discuss the strategies introduced by the Iranian Government to promote economic development.

(14)

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(a) In 2020 Iran's GDP was $635.72 billion.

With reference to Figure 3, calculate Iran's national debt in 2020. You are advised to show your workings.

(2)

National debt in 2020 = 45.4% of GDP (Figure 3)

National debt = 0.454 × $635.72 billion

= $288.62 billion (about $289 billion)

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(b) With reference to Figure 3, analyse **two** disadvantages of an increase in Iran's national debt.

(6)

National debt is the total accumulated stock of government borrowing, the sum of all past fiscal deficits minus surpluses, that has not yet been repaid. Figure 3 shows Iran's national debt rose from 11.7% of GDP in 2010 to 45.4% of GDP in 2020, an increase of 33.7 percentage points.

Disadvantage 1: higher debt servicing costs and an opportunity cost. As the debt rises, the government must pay more interest each year. This money cannot be spent on healthcare, education or infrastructure, so there is an opportunity cost. Lower spending on human and physical capital reduces productivity, so long run economic growth and living standards may fall, and future generations face higher taxes or spending cuts to balance the budget.

Disadvantage 2: crowding out and a loss of confidence. To borrow more, the government must sell more bonds, which raises interest rates. Higher interest rates increase the cost of borrowing for firms, so private sector investment falls (financial crowding out). A rapidly rising debt may also cause Iran's credit rating to fall and reduce confidence in the Rial and in Iran's financial markets, so foreign direct investment falls and future borrowing becomes even more expensive.

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(c) With reference to the second paragraph of Extract A, explain what is meant by 'trade restrictions'.

(4)

Trade restrictions are protectionist measures or barriers that limit free trade between countries, usually to protect domestic industries or, as with sanctions, to put pressure on another country. They can take the form of tariffs, quotas, embargoes and sanctions, subsidies or other non-tariff barriers.

In Extract A, the USA and other advanced economies imposed trade restrictions on Iran's exports and imports in response to Iran's production of nuclear energy above the permitted international limit. After two years of negotiations the restrictions were gradually reduced, and this increased Iran's oil exports, its main source of export revenue.

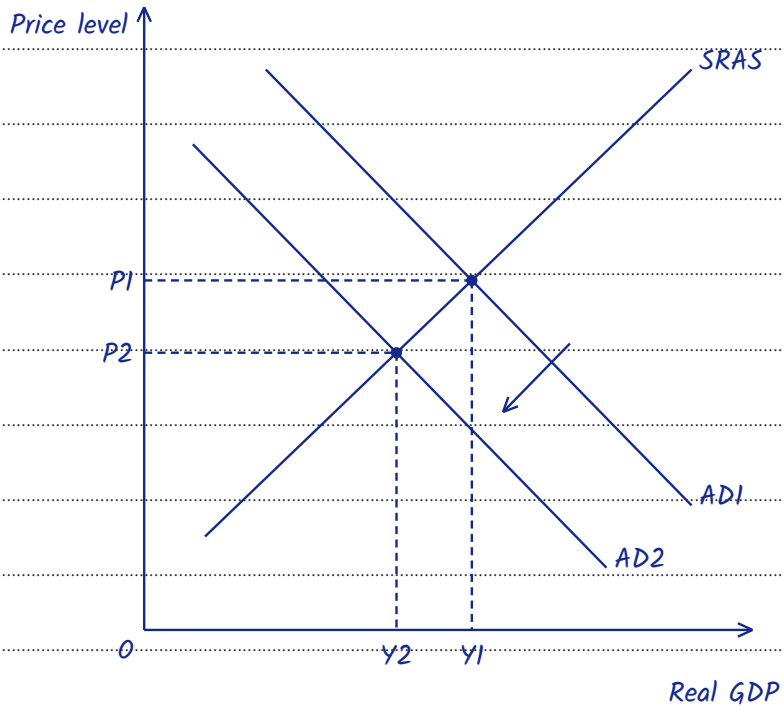
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(d) With reference to Figure 1, Figure 2 and the last paragraph of Extract A, examine **two** likely economic effects of trade restrictions reimposed by the US Government on Iran.

(8)

Effect 1: lower GDP and higher unemployment. The reimposed restrictions caused "a significant decline in oil exports", Iran's main source of export revenue. Lower exports reduce net exports (X−M), a component of aggregate demand, so AD shifts left from AD1 to AD2 and, through the negative multiplier, real GDP falls from Y1 to Y2. Firms need fewer workers, so unemployment rises. The fall in FDI also reduces injections. Figure 1 shows Iran fell into recession, with real GDP growth of about −10% in every quarter of 2019. Iran also moved from trade surpluses (2005 to 2018) to a trade deficit of $11.68 billion in 2020.



Effect 2: higher cost push inflation. The fall in oil exports and FDI reduced demand for the Rial, causing "a 75% fall in the external value" of the Rial against the US dollar. Imported raw materials, components and food became much more expensive in Rial, so firms' costs rose and SRAS shifted left, raising the price level. Figure 2 shows inflation rose from under 10% in early 2018 to over 50% in 2019.

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However, the most significant effect is the fall in oil exports, because it causes both the recession and the currency collapse. The impact may be limited in the long run: the restrictions were imposed only by the USA, so Iran can build trade links with other countries, and the weaker Rial makes non-oil exports more price competitive, which may improve the trade balance. Figure 1 shows growth briefly returned to about +2% in early 2020, suggesting the economy partly adapted.

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(e) With reference to Extract B, discuss the strategies introduced by the Iranian Government to promote economic development.

(14)

Economic development is an improvement in living standards and welfare, including income per head, health, education and freedom, often measured by the HDI. Extract B describes three strategies: diversification through industrialisation, infrastructure development and privatisation.

Industrialisation and diversification. Iran depends on oil, "its main source of export revenue", so its export earnings and tax revenue are volatile and vulnerable to sanctions. Diversifying into non-oil exports such as manufactured goods adds value to raw materials, and manufactured goods have a higher income elasticity of demand, so export revenue grows as world incomes rise. In the Lewis dual-sector model, surplus labour moves from low productivity agriculture to higher productivity industry, so wages and incomes per head rise and poverty falls. Higher profits are reinvested, so savings and investment rise, leading to further growth that can fund health and education.

Infrastructure development. Broadband users rose by 94.41 million (from 590 000 in 2014 to 95 million in 2021) and mobile phone users by 71.6 million (from 59.4 million in 2013 to 131 million in 2021). Better telecommunications reduce firms' transaction costs, give access to information, online education, banking and wider markets, and attract domestic and foreign investment. This raises total factor productivity and reduces unit costs, making exports more competitive, so LRAS shifts right and real incomes rise.

Privatisation. Selling state-run companies raises revenue the government can spend on human capital and infrastructure. Private firms have a profit incentive to cut costs and innovate, so productive and dynamic efficiency rise and prices may fall, raising real incomes. Private firms can also raise capital on the stock market and may attract FDI that brings new technology.

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Evaluation. Industrialisation is not always desirable: Iran has a comparative advantage in oil, and some countries, such as Norway, have developed using primary products. Industrial growth also creates negative externalities such as pollution, and can involve low wages and poor working conditions, so welfare may not rise as fast as GDP. Diversification also takes many years while sanctions are hurting the economy now.

Infrastructure investment has a large opportunity cost and needs high public spending, yet Iran's national debt is already 45.4% of GDP (Figure 3), so funding it may require borrowing or cuts elsewhere. There are long time lags, and the benefit depends on the quality of projects. The data must also be treated with care: 131 million mobile users is more than Iran's population of around 85 million, so it counts subscriptions, not people. Most importantly, "the Iranian Government restricts the content that its citizens can access", which limits access to information, education and freedom, key parts of development.

Privatisation may lead to job losses as private firms cut costs to maximise profit. If a privatised utility has monopoly power and the market is not contestable, it may raise prices, hurting low income households and increasing inequality. Many Iranians have put their savings into a "volatile stock market", so a crash could wipe out household wealth and reduce living standards.

Overall, infrastructure development is probably the most effective strategy, because better telecommunications raise productivity across the whole economy and support diversification. However, the success of all three strategies depends on the government's finances, on whether sanctions are lifted so that FDI and export markets return, and on reducing restrictions on content. In the short run development is likely to be slow, but the strategies could reduce oil dependency in the long run.

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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 2020 the Government of Chile increased the top rate of income tax from 35% to 40%.

Evaluate the likely macroeconomic effects of an increase in the top rate of income tax on a country of your choice.

(Total for Question 8 = 20 marks)

9 In 2020 New Zealand's productivity rate was 40% lower than the average productivity of many other advanced economies.

Evaluate factors that influence a country's international competitiveness. Refer to a developed country of your choice in your answer.

(Total for Question 9 = 20 marks)

10 Between 2008 and 2018, income inequality, as measured by the Gini coefficient, increased from 0.43 to 0.51 in Angola and from 0.34 to 0.41 in Bulgaria.

Evaluate government policies that could be used to reduce income inequality in a developing country of your choice.

(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** ☐

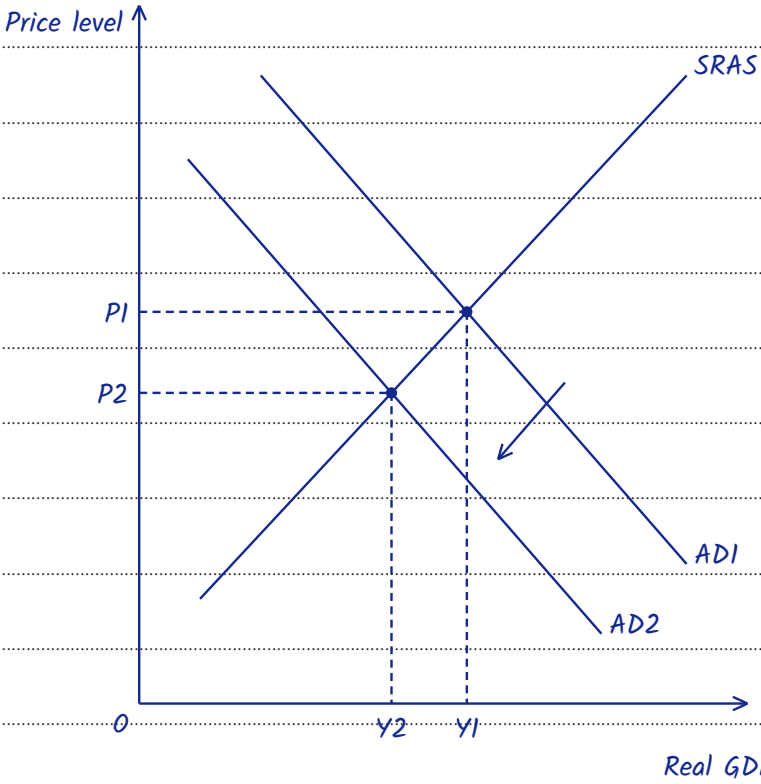
Income tax is a direct tax on the income of individuals. An increase in the top rate makes the tax system more progressive, because people on the highest incomes pay a larger proportion of their income in tax. Chile raised its top rate from 35% to 40% in 2020, an increase of 5 percentage points.

Effect on aggregate demand and growth. A higher top rate reduces the disposable income of high earners, so consumption falls. As consumption is the largest component of AD (C+I+G+X−M), AD shifts left from AD1 to AD2 in the diagram below. The fall in spending is magnified by the multiplier, because lower spending reduces other people's incomes, so real GDP falls from Y1 to Y2 and economic growth slows. Firms need fewer workers, so demand deficient unemployment rises, but demand pull inflation falls as the price level falls from P1 to P2.

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Effect on the fiscal position. Higher tax rates should raise tax revenue, which reduces the fiscal deficit. Chile's government spending rose sharply during the 2020 pandemic, so extra revenue helps limit the growth of its national debt and the cost of servicing it.

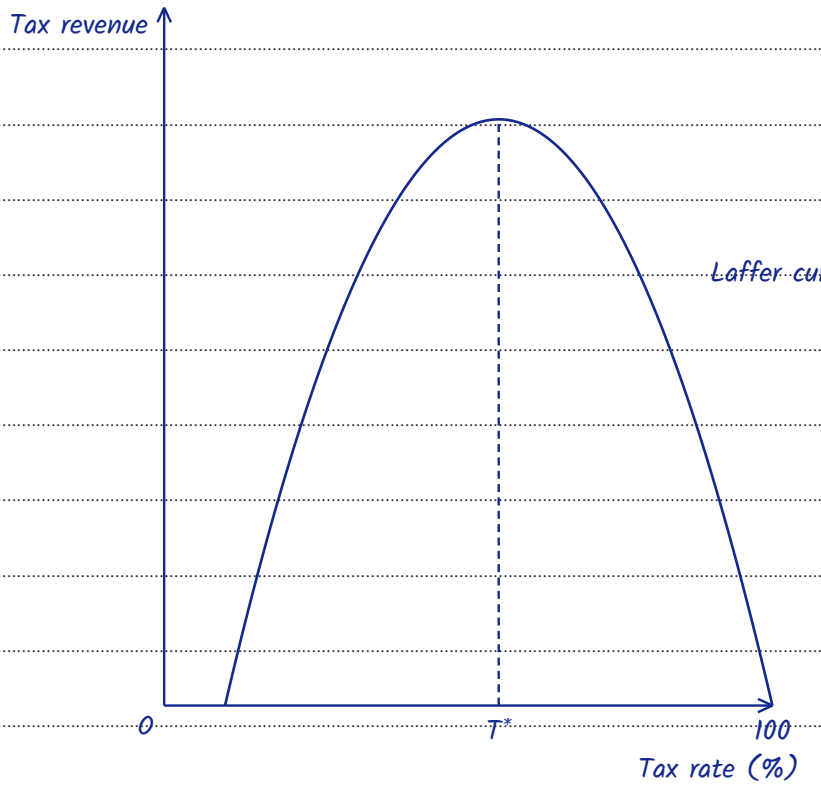
Effect on income distribution. A more progressive tax narrows the gap in post-tax incomes. If the revenue is spent on transfers and public services for low income households, such as pensions, health and education, the Lorenz curve moves closer to the line of equality and the Gini coefficient falls. This matters in Chile, one of the most unequal OECD countries, where protests in 2019 were partly about inequality.

Effect on the current account. High earners have a high marginal propensity to import, buying imported cars and foreign holidays. Lower disposable income reduces spending on imports, so the current account balance improves.

Supply side effects. A higher marginal tax rate reduces the reward for extra work, so some high

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earners may work fewer hours, avoid promotion or retire early (the substitution effect). Entrepreneurs have less incentive to take risks, and senior managers of TNCs may be less willing to move to Chile, so FDI may fall. Lower labour supply and investment reduce productive capacity, so LRAS grows more slowly. There may also be more tax avoidance, tax evasion and tax exiles moving abroad.



The Laffer curve above shows that tax revenue rises as the tax rate rises up to the optimal rate T^*, but falls beyond T^* because disincentive effects and avoidance shrink the tax base. So if the top rate is already above T^*, a rise could actually reduce revenue.

Evaluation. The size of these effects depends on the magnitude of the change. A rise of 5 percentage points only applies to income above the top threshold, and in Chile it affects only a small proportion of taxpayers, so the effect on total consumption and AD is likely to be small. High earners also have a high marginal propensity to save, so they may cut saving rather than spending, and the multiplier effect will be minimal.

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Disincentive effects may be weak. The income effect means some high earners work harder to maintain their standard of living, and many professionals are motivated by status and career rather than the marginal tax rate. At 40%, Chile's top rate is still below rates in countries such as France (45%), so it is probably below the peak of the Laffer curve and revenue should rise. However, this depends on the ability of the tax authorities to prevent avoidance and evasion, and decisions on where to live or invest depend on many other factors, such as business confidence, growth prospects, interest rates and political stability.

The overall effect on AD also depends on how the revenue is used. If the government spends the extra revenue on public services or transfers to low income households, who have a higher marginal propensity to consume, AD may not fall at all and could even rise. The effect on real GDP depends on spare capacity: in 2020 Chile was in recession, so a fall in AD would mainly reduce output and raise unemployment, whereas near full capacity it would mainly reduce inflation.

In conclusion, the most likely macroeconomic effects of Chile's increase are a small rise in tax revenue and a more equal distribution of income, with only a minor reduction in AD and growth because few people are affected and high earners save more. The risk of significant disincentive effects and lower FDI is greater in the long run, so the overall impact depends mainly on how the extra revenue is spent and how well the tax is enforced.

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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** ☐

International competitiveness is the ability of a country's firms to sell goods and services in world markets at prices and quality that are attractive compared with those of other countries. It is often measured by relative unit labour costs, relative export prices and the real exchange rate.

Productivity. Labour productivity is output per worker per hour. If productivity is low, unit labour costs (wage costs ÷ output) are high, so firms must charge higher prices for exports, and demand for exports falls. In 2020 New Zealand's productivity was 40% lower than the average of many other advanced economies, which helps explain why it relies on primary exports such as dairy and meat. Productivity depends on human capital, investment in capital goods, technology and R&D.

Relative wage and non-wage costs. Unit labour costs also depend on wages and on non-wage costs such as employer pension contributions and holiday pay. Advanced economies such as New Zealand have higher wages than developing countries, so labour intensive manufacturing is less competitive and has moved to countries such as China and Vietnam.

The exchange rate. An appreciation of the New Zealand dollar raises the foreign currency price of New Zealand's exports and lowers the price of imports, so exports become less price competitive. For example, if NZ$1 rises from US$0.60 to US$0.70, a NZ$10 kg of butter rises in price from US$6 to US$7. A depreciation has the opposite effect.

Relative inflation rates. If New Zealand's inflation is higher than that of its trading partners, its

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export prices rise relative to foreign prices and its real exchange rate rises, so competitiveness falls.

Regulation, tax and infrastructure. Strict environmental and labour regulations raise firms' costs. High corporation tax reduces the profit available for investment and deters FDI, while poor infrastructure, such as congested ports or slow broadband, adds to unit costs. New Zealand's distance from major markets also raises transport costs.

Non-price factors. Competitiveness also depends on quality, design, reliability, branding and after-sales service. New Zealand's exports, such as Manuka honey and lamb, compete on a reputation for quality and food safety rather than only on price.

Evaluation. Productivity is likely to be the most significant factor for New Zealand, because a gap of 40% is very large and it affects costs in every industry. However, productivity is hard to measure, especially in the service sector, which produces most output in advanced economies, so the 40% figure may overstate the problem. Low productivity also matters less if wages are low: high wage and non-wage costs can be offset by very high productivity, as in Norway and Denmark, so it is unit labour cost, not wages alone, that matters.

The importance of the exchange rate depends on the price elasticity of demand for exports. It is important for homogeneous products such as dairy, where demand is price elastic, but less important for branded goods. Firms can use forward contracts to limit short-term changes, and in the long run a depreciation raises import prices and inflation, which can offset the gain. Likewise, high inflation may be offset by a depreciation.

Regulation may not be significant because most advanced economies have similar standards, so

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it does not affect New Zealand's competitiveness relative to Australia or the UK. Poor infrastructure may be improved by TNCs or government investment. Corporation tax is mainly important for attracting FDI rather than for the price of existing exports. Finally, competitiveness in goods may differ from competitiveness in services: New Zealand is highly competitive in tourism and education services despite low productivity.

In conclusion, the factors are linked: productivity and wages together determine unit labour costs, and inflation and the exchange rate together determine relative prices. For a developed country such as New Zealand, which cannot compete on low wages, productivity and non-price factors are the most important in the long run, while the exchange rate has the biggest effect in the short run. Improving productivity through investment in skills, infrastructure and technology is therefore the key to raising its competitiveness.

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TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

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 Iran

Figure 1 Annual real GDP growth rate, Q1 2010 – Q4 2020

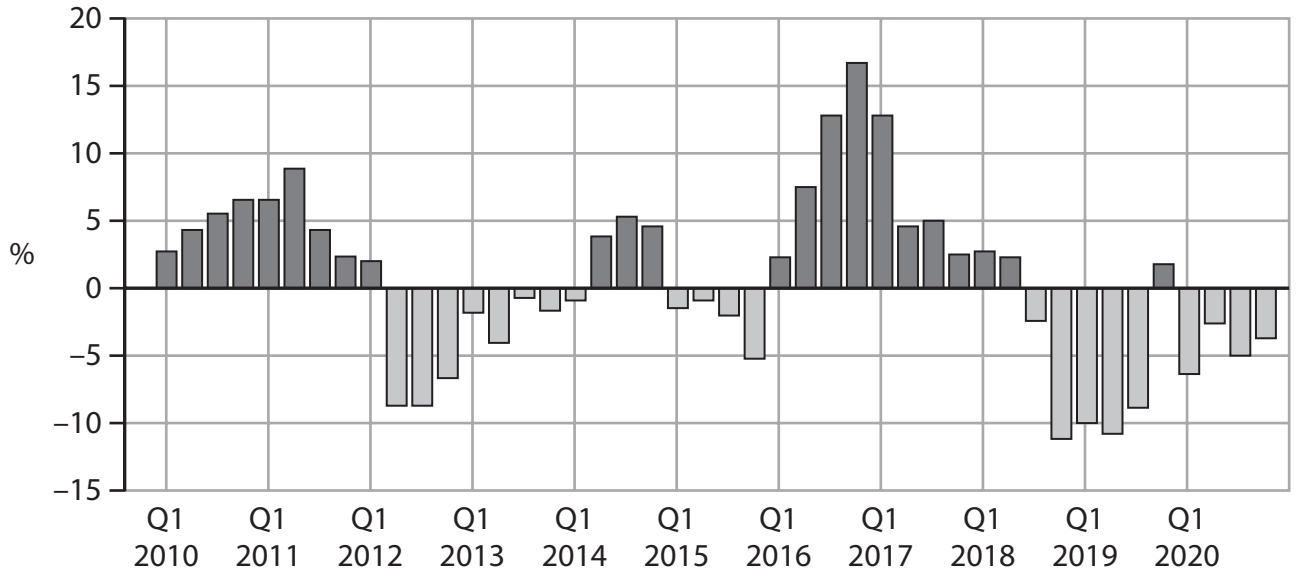
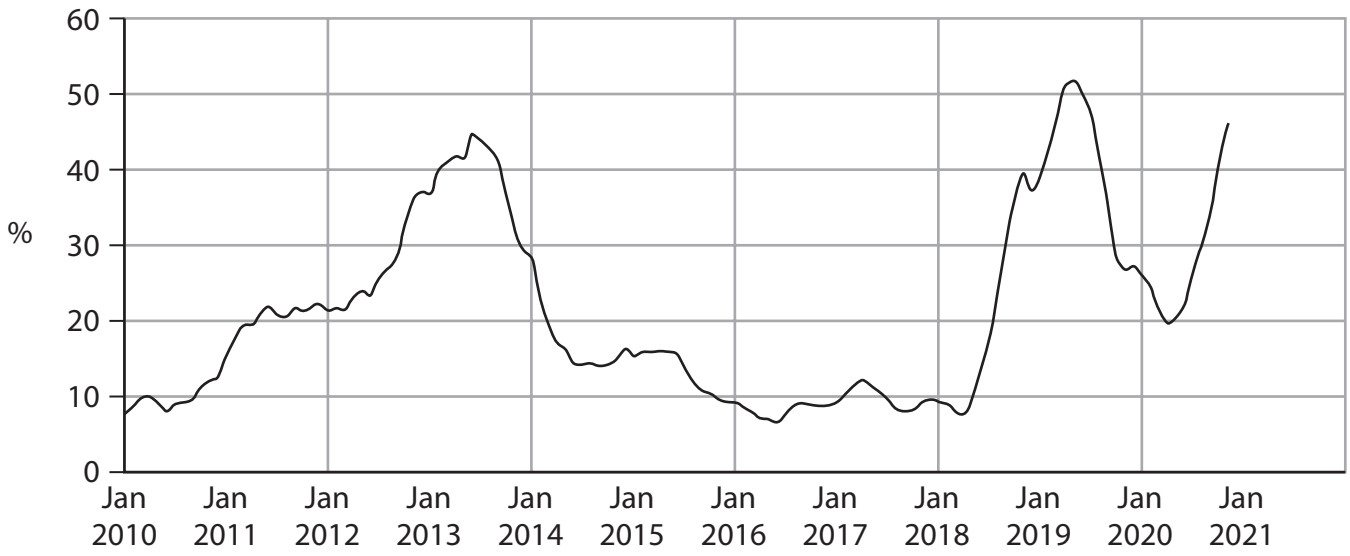
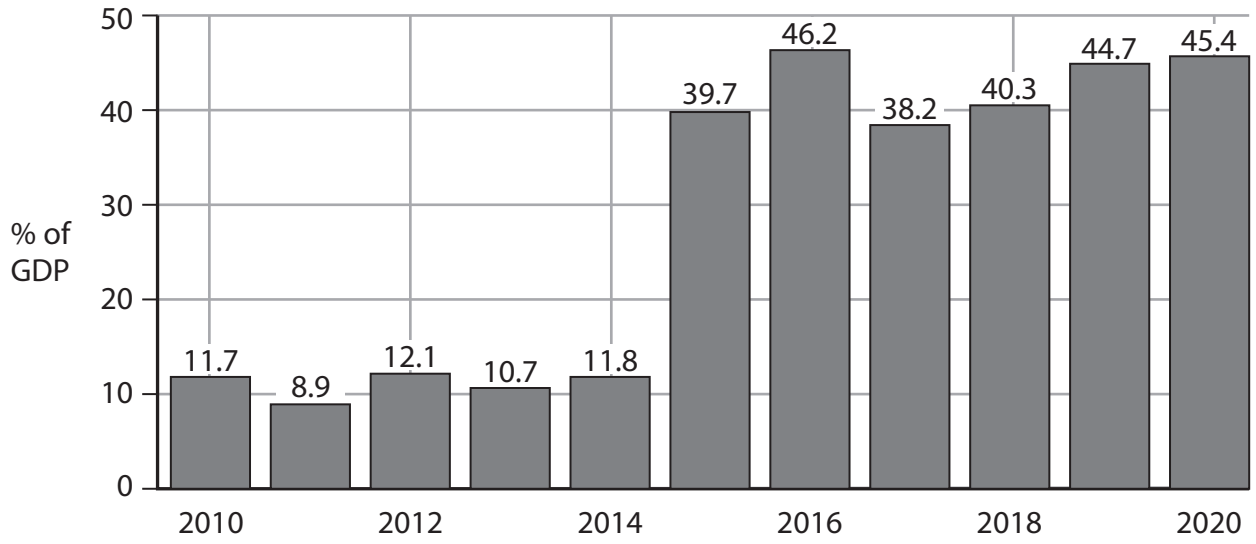


Figure 2 Monthly inflation rate, as measured by the Consumer Price Index (CPI), January 2010 – December 2020



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Figure 3 National debt, % of GDP, 2010 – 2020



Extract A Trade restrictions

When Iran's President, Mr Hassan Rouhani, was elected in 2013, he promised that his Government would solve Iran's economic crisis. He said that he would save the country's economy from collapsing and create positive relationships with the rest of the world. However, when Mr Rouhani resigned as President in June 2021 many economists claimed that his Government had not kept its promises.

During 2013 Mr Rouhani started discussions with the USA and other advanced economies to remove the trade restrictions imposed on Iran's exports and imports. These restrictions had been imposed in response to Iran's production of nuclear energy that was above the permitted international limit. After two years of negotiations, Mr Rouhani came to an agreement with these countries and the trade restrictions were gradually reduced. This resulted in an increase in oil exports, Iran's main source of export revenue.

However, the US Government accused Iran of breaking the agreement and reimposed trade restrictions in 2018. As a result, Iran suffered a significant decline in oil exports and foreign direct investment. This led to a 75% fall in the external value of the country's currency, the *Rial,* against the US dollar. Subsequently, there was a fall in Iran's GDP, an increase in its unemployment rate and an increase in its inflation rate. In 2020 Iran experienced a trade deficit of $11.68 billion, having had trade surpluses between 2005 and 2018.

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Extract B Economic development

Since 2018 the Iranian Government has implemented a strategy of diversification into non-oil exports in order to promote economic development. It has focused on a strategy of industrialisation and infrastructure development, particularly by investing in Iran's telecommunications industries. As a result, the number of people with access to broadband increased from 590 000 in 2014 to 95 million in 2021. The number of people with access to mobile phones also increased from 59.4 million in 2013 to 131 million in 2021. However, the Iranian Government restricts the content that its citizens can access.

In addition, the Government has privatised many state-run companies. Consequently, many Iranians have invested a substantial amount of their savings in the country's volatile stock market.

Acknowledgements

Figure 1 based on data taken from tradingeconomics, https://tradingeconomics.com/iran/gdp-growth-annual

Figure 2 based on data taken from tradingeconomics, https://tradingeconomics.com/iran/inflation-cpi

Figure 3 based on data taken from tradingeconomics, https://tradingeconomics.com/iran/government-debt-to-gdp

Extracts A and B adapted from FT, https://www.ft.com/content/6a2a7e0f-523b-4e79-852d-1bacba7dce70

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