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

Tuesday 13 June 2023

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 suggests that *primary product dependency* is a constraint on growth and development?

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

(Total for Question 1 = 1 mark)

2 In 2022 the Australian Government announced that it would invest nearly $13.6 billion in major infrastructure projects.

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

- ☐ **A** Transfer payments
- ☐ **B** Automatic stabilisers
- ☐ **C** Current expenditure
- ☒ **D** Capital expenditure

(Total for Question 2 = 1 mark)

3 In 2022 South Korea's international competitiveness ranking was four places lower than it was in 2021.

Which **one** of the following measures is most likely to increase South Korea's international competitiveness?

- ☐ **A** Stricter regulation of product markets
- ☒ **B** Privatisation of state-owned enterprises
- ☐ **C** Greater restrictions on free trade
- ☐ **D** Less spending on education and training

(Total for Question 3 = 1 mark)

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4 The chart shows average global container shipping costs, in $ thousands, between January 2020 and October 2021.



Ceteris paribus, which **one** of the following is most likely to result from this trend in global container shipping costs?

- ☒ **A** Costs of production for businesses will fall
- ☒ **B** Global inflationary pressures will not change
- ☒ **C** Patterns of world trade will not change
- ☒ **D** Trade as a proportion of world GDP will fall

(Total for Question 4 = 1 mark)

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5 The table shows the maximum production possibilities for Country M and for Country Z in a given year using all available resources.

Country	Televisions		Computers
M	24 000	**OR**	24 000
Z	60 000	**OR**	60 000

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

- ☒ **A** Country M and Country Z will both benefit from specialisation and trade
- ☒ **B** There are zero opportunity costs for both countries in producing televisions or computers
- ☒ **C** Country Z has an absolute advantage over Country M in the production of televisions and computers
- ☒ **D** Country M has a comparative advantage over Country Z in the production of televisions and computers

(Total for Question 5 = 1 mark)

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6 In July 2022 the Central Bank of India aimed to increase the value of the Indian rupee against the US dollar.

Which **one** of the following combinations of foreign currency transactions would the Central Bank of India use to increase the value of the rupee against the US dollar?

		Rupee	Dollar
☒	**A**	Buy	Buy
☒	**B**	Sell	Buy
☒	**C**	Buy	Sell
☒	**D**	Sell	Sell

(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 spaces provided on the following pages.

7 (a) With reference to Figure 1, calculate the increase in the price of coal between January 2020 and April 2022. You are advised to show your working.

(2)

(b) Explain what is meant by 'interest rates' (Extract A, line 4).

(4)

(c) With reference to the third paragraph of Extract A, examine **two** economic benefits of the increase in the number of tourists visiting Southeast Asian countries.

(8)

(d) Analyse why Thailand **and** Singapore 'are experiencing low rates of economic growth' (Extract A, line 22).

(6)

(e) With reference to the information provided and your own knowledge, discuss factors that might cause an improvement in the *terms of trade* of Southeast Asian countries.

(14)

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(a) With reference to Figure 1, calculate the increase in the price of coal between January 2020 and April 2022. You are advised to show your working.

(2)

Index of coal prices: January 2020 = 100, April 2022 = 500 (Figure 1)

Increase = 500 − 100 = 400 index points

Percentage increase = (400 ÷ 100) × 100 = 400%

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(b) Explain what is meant by 'interest rates' (Extract A, line 4).

(4)

Interest rates are the cost of borrowing money and the reward for saving, expressed as a percentage of the sum borrowed or saved per year. The base interest rate is set by the central bank and is the main instrument of monetary policy: it affects all other interest rates and so is used to control aggregate demand and inflation.

In Extract A, many central banks raised base interest rates in response to inflationary pressure from rising fuel, food and commodity prices. For example, the European Central Bank increased its base interest rate from 0% to 1.25% between January and September 2022. This is deflationary (contractionary) monetary policy: higher rates reduce borrowing and spending, so AD falls, but this also slows growth and adds to the risk of stagflation.

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(c) With reference to the third paragraph of Extract A, examine **two** economic benefits of the increase in the number of tourists visiting Southeast Asian countries.

(8)

Extract A says Governments relaxed border controls introduced during the global health crisis, and between February and May 2022 the number of tourists rose by 1 050% in Indonesia and by 8 629% in Vietnam.

Benefit 1: higher economic growth. Spending by foreign tourists on hotels, food and transport is an export of services, so it is an injection into the circular flow that raises the (X – M) component of aggregate demand. AD shifts right and, through the multiplier effect, real GDP rises by more than the initial spending. Extract A confirms that in Indonesia, Vietnam and Malaysia GDP growth is higher than inflation partly because of tourism. The extra foreign currency earned also improves the current account and helps to close the foreign exchange gap.

Benefit 2: more employment and higher incomes. Tourism is labour intensive, so the derived demand for workers in hotels, restaurants and transport rises. Unemployment falls, household incomes and living standards rise, and the Government receives more tax revenue from tourist spending, which can fund infrastructure or redistribution.

Evaluation: the benefits are likely to be large because the percentage increases are huge, and Vietnam should gain more than Indonesia since its increase was 7 579 percentage points greater. However, the increases are from a very low base after borders were closed, so tourist numbers may still be below pre-pandemic levels. The gains may also be short-lived, as employment in tourism is seasonal and border controls could be reintroduced if the health crisis re-emerges. Some benefit leaks abroad if foreign hotel chains repatriate profits, and more tourists bring external costs such as pollution and congestion.

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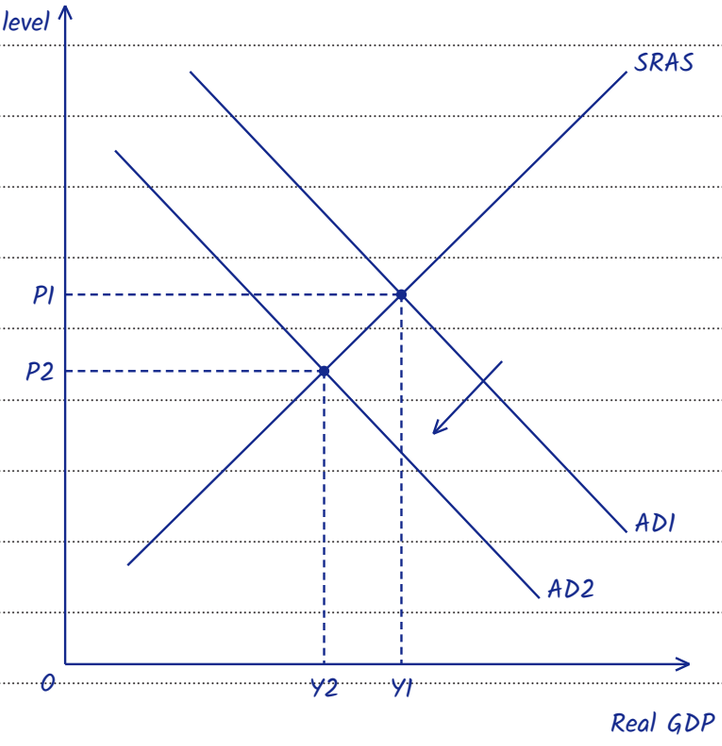
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(d) Analyse why Thailand **and** Singapore 'are experiencing low rates of economic growth' (Extract A, line 22).

(6)

Thailand: Extract A states that the rate of inflation is rising faster than the GDP growth rate, so inflation is reducing real incomes. With lower purchasing power, households can afford fewer goods and services, so consumption, the largest component of aggregate demand, falls. AD shifts left from AD1 to AD2 and, via the negative multiplier, real output falls from Y1 to Y2, so economic growth is low.



Singapore: growth is low because of the slowdown in China's economy, and China is Singapore's main trading partner. As Chinese incomes grow more slowly, China buys fewer imports from Singapore, so Singapore's exports fall. Net exports (X – M), an injection into the circular flow, decrease, so AD shifts left as in the diagram. Singapore is a very open economy with exports large relative to GDP, so the fall in real output is significant.

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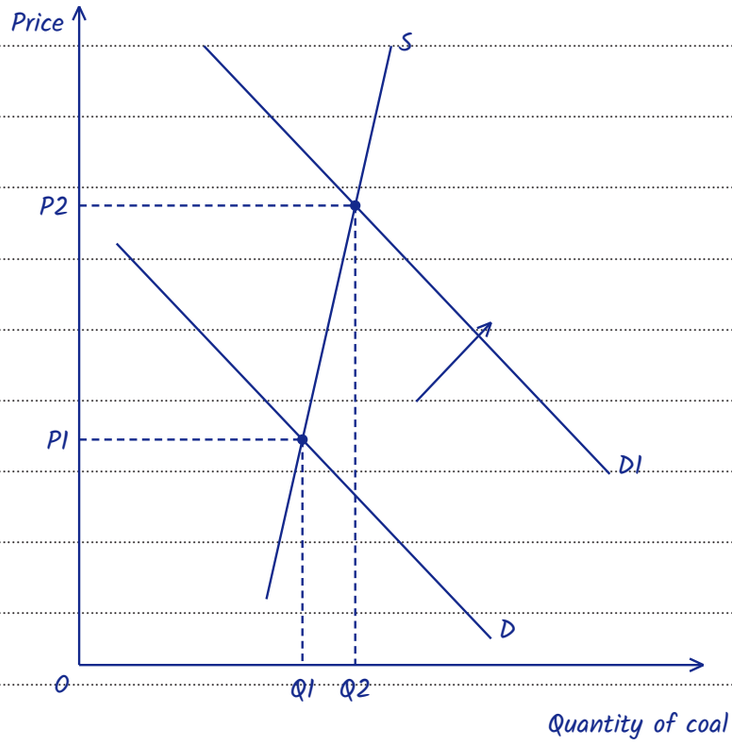
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(e) With reference to the information provided and your own knowledge, discuss factors that might cause an improvement in *the terms of trade* of Southeast Asian countries.

(14)

The terms of trade measure the price of a country's exports relative to the price of its imports: (index of average export prices ÷ index of average import prices) × 100. An improvement means the ratio rises, so each unit of exports buys more imports.

Rising world commodity prices. Figure 1 shows the price index of coal rose from 100 in January 2020 to 500 in April 2022, palm oil to about 220 and rubber to about 150. Indonesia exports coal and palm oil and Malaysia exports rubber and palm oil, so their export prices rise faster than import prices and Extract A says their terms of trade improved. World demand for commodities rose from D to D1 as economies recovered from the global health crisis, and because supply of commodities is price inelastic in the short run, prices rose sharply from P1 to P2.



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Exchange rate appreciation. Central banks are raising interest rates to fight inflation; if a Southeast Asian country raises its rates relative to other countries, hot money inflows increase demand for its currency, which appreciates. Export prices in foreign currency rise and import prices in domestic currency fall, so the terms of trade improve.

Higher relative inflation and costs. In Thailand and Singapore inflation is rising faster than GDP growth. If their inflation, wage costs or unit labour costs rise faster than those of trading partners, or productivity grows more slowly, export prices rise relative to import prices, improving the terms of trade.

Lower import prices. A cut in tariffs or a fall in world food and fuel prices would reduce import prices. This matters most for the Philippines, which relies on imports of rice and is a net importer of food and fuel.

Evaluation: an improvement is not always beneficial. If it is caused by inflation or appreciation, exports lose price competitiveness and, if demand is price elastic, export revenue falls and the current account worsens. The commodity gains are also likely to be temporary because commodity prices are volatile: Figure 1 shows coal peaked at about 650 in early 2022 and then fell below 400 within weeks. In the long run the Prebisch-Singer hypothesis suggests the prices of primary products fall relative to manufactures, so primary product exporters such as Indonesia may see their terms of trade worsen again. The factors also differ by country: the Philippines is a net importer of commodities, so rising commodity prices worsen its terms of trade, while Singapore exports manufactures and services and gains little.

Overall, the most significant factor in 2022 is rising world commodity prices, as the size of the increases in Figure 1 dwarfs exchange rate or cost changes. However, this only applies to net

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commodity exporters such as Indonesia and Malaysia, and the improvement is likely to be short term, so a combination of factors determines each country's terms of trade.

(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 Between September 2021 and September 2022 the US dollar appreciated by nearly 18% against the euro.

Evaluate the likely economic effects of an appreciation of a country's currency on its economy. Refer to a developed country of your choice in your answer.

(Total for Question 8 = 20 marks)

9 In 2020 the International Monetary Fund (IMF) provided financial assistance of $13 billion to low-income developing countries. In addition, the World Bank provided financial assistance of $43 billion to low-income developing countries.

Evaluate the role of international institutions in promoting *economic development*. Refer to examples of developing countries in your answer.

(Total for Question 9 = 20 marks)

10 Between 2003 and 2019, income inequality, as measured by the Gini coefficient, increased from 0.25 to 0.29 in Sweden and from 0.32 to 0.37 in Indonesia.

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

(Total for Question 10 = 20 marks)

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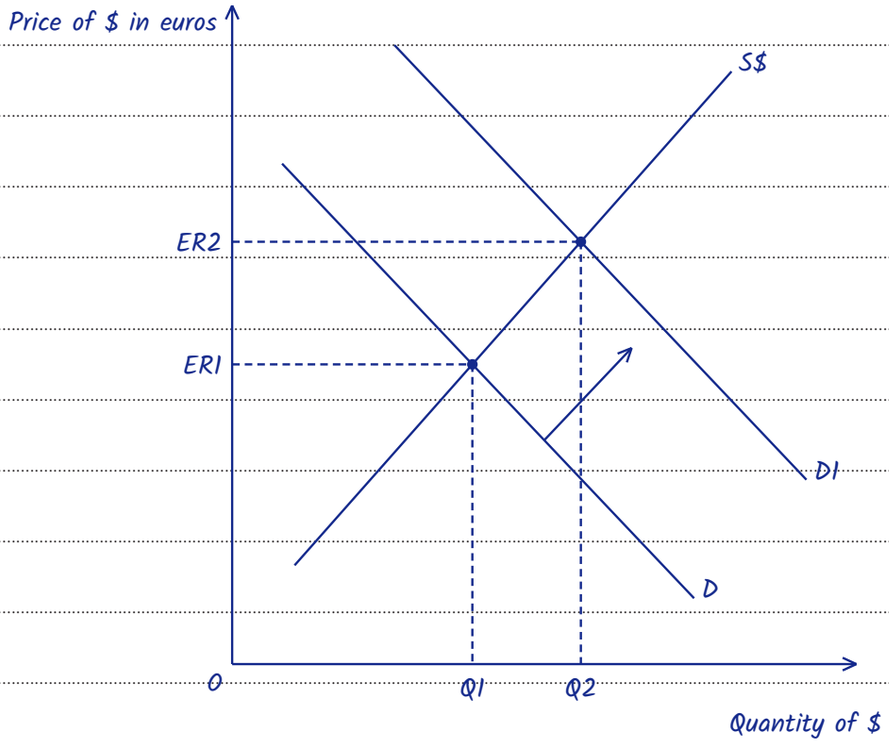
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Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

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

An appreciation is a rise in the value of a currency against another currency in a floating exchange rate system. Between September 2021 and September 2022 the US dollar appreciated by nearly 18% against the euro, and by September 2022 one euro was worth less than one dollar. The main cause was the US Federal Reserve raising its interest rate from near 0% in March 2022 to 3% to 3.25% by September 2022 to fight inflation, which peaked at 9.1% in June 2022. Higher US interest rates attracted hot money inflows, and demand for dollars as a safe haven also rose, so demand for dollars shifted from D to D1 and the exchange rate rose from ER1 to ER2.



Current account. The appreciation raises the price of US exports in foreign currency and lowers

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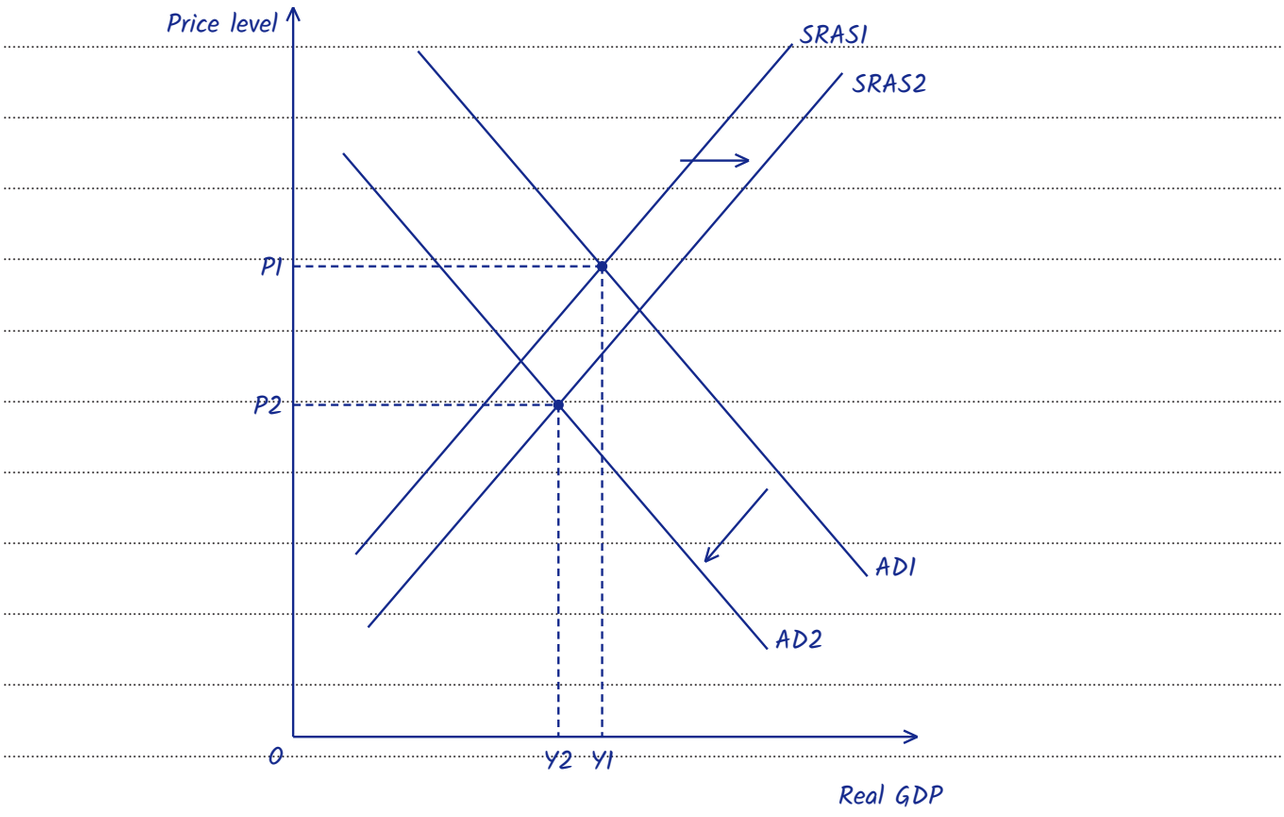
the price of imports in dollars. US exports such as cars, agricultural goods and tourism services become less price competitive, so export volumes fall, while Americans buy more cheaper imports. The US current account deficit, already large, is likely to widen.

Economic growth and unemployment. Lower net exports mean lower injections and higher leakages, so aggregate demand shifts left from AD1 to AD2 and, via the multiplier, real GDP falls from Y1 to Y2 or grows more slowly. Because the demand for labour is derived from the demand for output, firms in export industries and in industries competing with imports cut jobs, so unemployment may rise.

Inflation. This is the main benefit for the USA in 2022. Lower AD reduces demand-pull inflation. In addition, imported raw materials, components and finished goods become cheaper in dollars, reducing firms' costs, so SRAS shifts right from SRAS1 to SRAS2. Both effects reduce the price level from P1 to P2, helping the Federal Reserve to bring inflation back towards its 2% target.

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The diagram shows the price level clearly falls, while the effect on real output depends on whether the fall in AD or the rise in SRAS is larger. The terms of trade also improve, as export prices rise relative to import prices, so each unit of US exports buys more imports, raising living standards for US consumers. Foreign assets become cheaper for US firms, increasing outward FDI, while inward FDI into the USA becomes more expensive.

Evaluation. First, the effect on the current account depends on price elasticities. The Marshall-Lerner condition states that a change in the exchange rate only changes the current account in the expected direction if the sum of the price elasticities of demand for exports and imports is greater than one. In the short run demand is inelastic because contracts are fixed, so the current account may at first improve before worsening, a reverse J-curve. Many US exports, such as aircraft, software and financial services, compete on quality and brand, so their non-price competitiveness makes demand less price sensitive and the fall in exports smaller.

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Second, the size of the impact on growth is limited. US exports are only around 11% of GDP, so the USA is a relatively closed economy and consumption, about two thirds of GDP, matters far more for AD. A fall in net exports could be offset by higher consumption or investment, and the final effect depends on the size of the multiplier. Higher interest rates themselves are probably a bigger cause of slower US growth than the stronger dollar.

Third, the fall in inflation depends on whether firms pass lower import costs on to consumers or instead widen their profit margins. Much of US inflation in 2022 came from energy and a tight labour market with rising wages, which the exchange rate does not directly address. Oil is priced in dollars, so its price to Americans does not fall directly when the dollar rises, and the cost-push benefit on energy is small.

Fourth, the effects depend on time and magnitude. An 18% rise in a year is large, but it was against the euro, which was weakened by the energy crisis in Europe; against other currencies the dollar rose by less. If the appreciation is temporary because the Federal Reserve is expected to cut rates later, firms may not change their export or import plans, and many firms hedge their currency risk.

In conclusion, the appreciation's most significant effect on the USA is to reduce inflationary pressure, which was welcome in 2022, at the cost of a wider current account deficit and some loss of jobs in export industries. Because the USA is relatively closed and its exports are less price sensitive, the overall effect on growth and unemployment is likely to be small, and the outcome depends mostly on how long the appreciation lasts.

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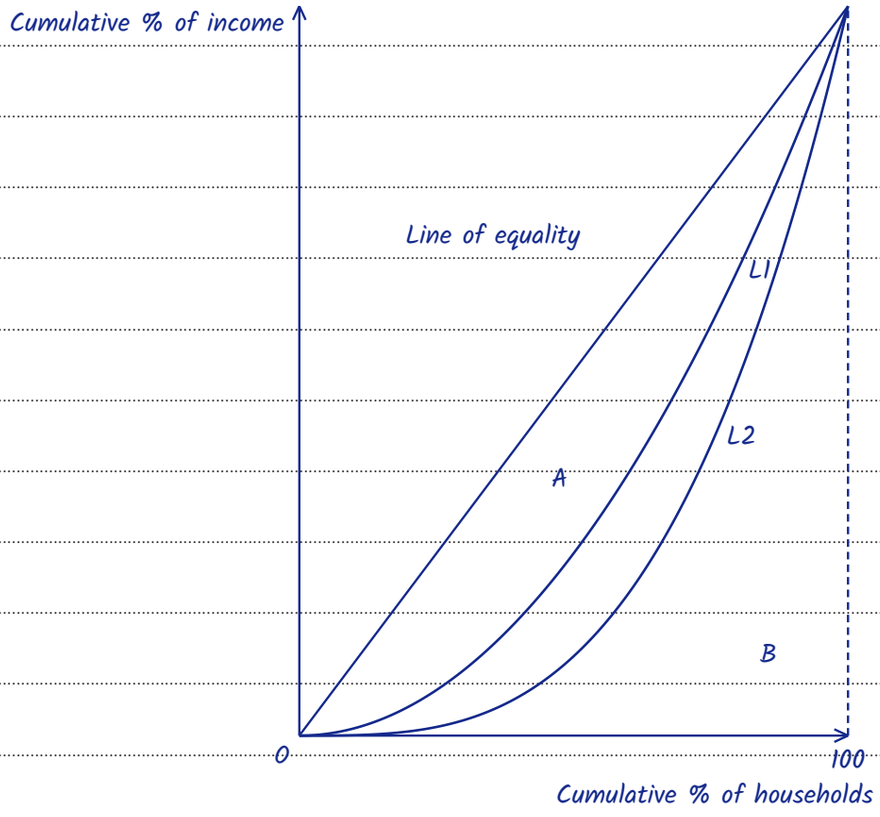
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Chosen question number: **Question 8** ☐ **Question 9** ☐ **Question 10** ☒

Income inequality is the unequal distribution of income between households or individuals in a country. It is shown by the Lorenz curve, which plots the cumulative percentage of income received against the cumulative percentage of households, ranked from poorest to richest. The Gini coefficient is the ratio of the area between the line of perfect equality and the Lorenz curve (A) to the total area under the line of equality (A + B). It ranges from 0 (perfect equality) to 1 (perfect inequality). In Indonesia the Gini coefficient rose from 0.32 to 0.37 between 2003 and 2019, an increase of about 16%, so the Lorenz curve moved further from the line of equality, from L1 to L2.



The first cause is the commodity boom and rising returns to capital. Indonesia is a major

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exporter of coal and palm oil, and world commodity prices rose strongly in the 2000s. The profits went mainly to the owners of mines, plantations and land, who are already in the top income groups, while wages of plantation and mine workers rose far less. Income from capital (profit, rent and interest) is far more unequally distributed than income from work, so as its share of national income rose, the share of the top 10% rose and the Gini coefficient increased.

The second cause is widening wage differentials linked to skills and education. As Indonesia's economy shifted from agriculture towards manufacturing and services, the demand for skilled and university-educated workers grew faster than their supply, so their wages rose quickly. Meanwhile, over half of workers are in the informal sector, often in agriculture, where productivity and wages are low and workers are not covered by minimum wages or social protection. The gap between urban skilled workers and rural unskilled workers therefore widened.

The third cause is a tax and benefit system that does little to redistribute income. Indonesia's tax revenue is only around 10% of GDP, with few people paying income tax, so the progressive element of the system is weak. The Government relies heavily on indirect taxes such as VAT, which are regressive because poorer households spend a larger proportion of their income. For many years large fuel subsidies benefited richer households that use more fuel and own cars more than the poor, limiting the money available for transfers to low-income households.

A fourth cause is globalisation and FDI. Transnational companies investing in Indonesia pay higher wages to skilled managers and technical staff, and the gains from trade go mainly to those with capital and skills, while unskilled workers face competition from other low-wage economies, keeping their wages down.

Evaluation. The most significant cause is probably the commodity boom, because the rise in

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inequality was fastest during the 2000s commodity price boom and slowed when commodity prices fell in the 2010s. This shows that different causes matter at different times over the 16-year period. However, the causes are linked: the skills gap meant that most workers could not move into the higher-paid jobs created by growth, so it is a combination of factors rather than one alone.

The measurement of the Gini coefficient should also be questioned. Indonesia's official Gini is based on household consumption surveys rather than income. Rich households save a larger share of income and are less likely to respond to surveys, so the true rise in income inequality is probably greater than 0.32 to 0.37 suggests. The Gini coefficient also ignores wealth inequality, which is greater than income inequality and is itself a cause of income inequality through rent, interest and dividends.

Rising inequality may also partly be a natural stage of development. The Kuznets curve suggests inequality rises as a country industrialises and then falls as incomes grow. Over the same period absolute poverty in Indonesia fell sharply, so the poor became better off in real terms even though their share of income fell. Since 2014 policies such as the national health insurance scheme (JKN), conditional cash transfers (PKH) and the 2015 cut in fuel subsidies have aimed to reduce inequality, so the role of the tax and benefit system as a cause may be falling.

In conclusion, the increase in Indonesia's income inequality was mainly caused by the uneven distribution of the gains from commodity-led growth, which favoured owners of capital and skilled workers, and a weak tax and benefit system allowed this to persist. The importance of each cause depends on the time period, and since the Gini coefficient probably understates inequality, the problem may be more serious than the data shows.

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TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Tuesday 13 June 2023

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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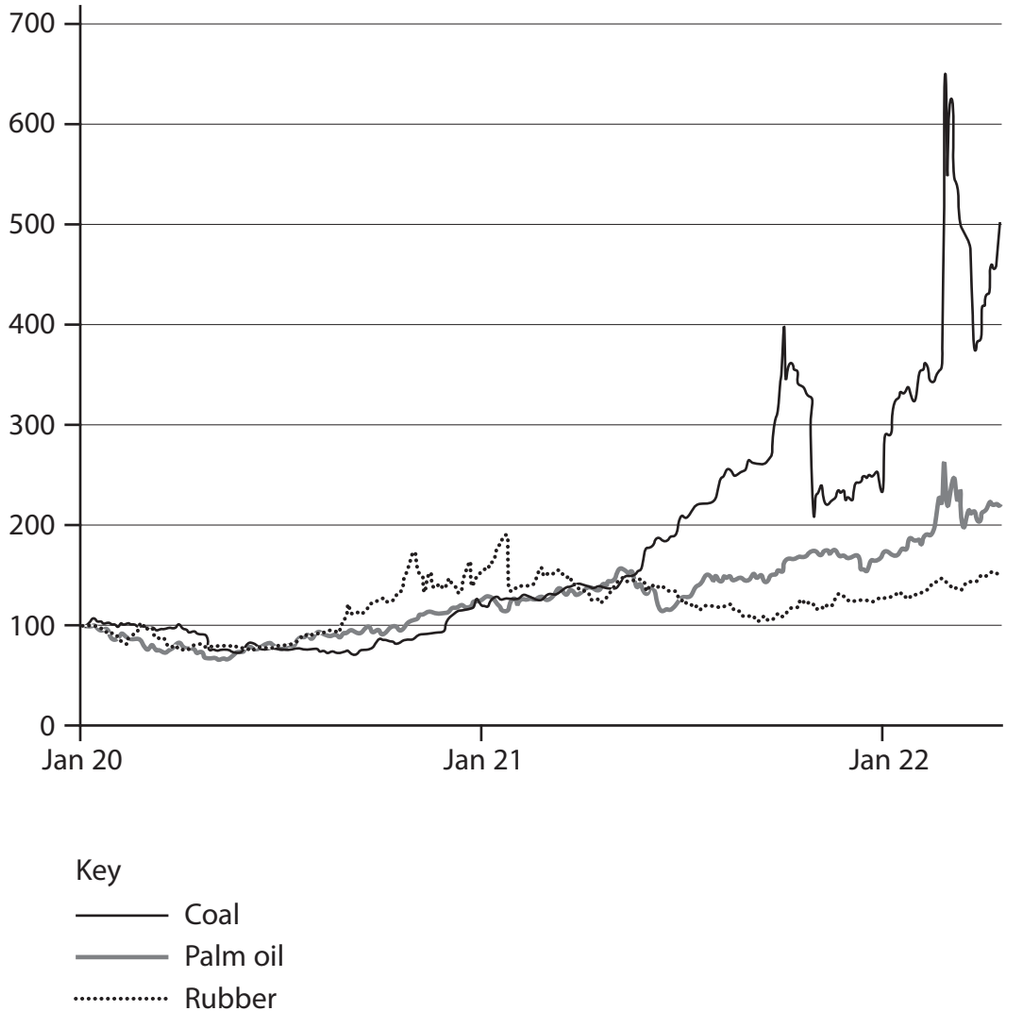
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Sources for use with Section B

Southeast Asian economies

Figure 1 Index of global prices for selected commodities, January 2020 to April 2022 (January 2020=100)



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Extract A Economic outlook 2022

Economies around the world are facing the threat of stagflation: a period of high inflation and low economic growth. This is a result of increasing global prices for fuel, food and other commodities. Many central banks have raised base interest rates in response to this inflationary pressure. For example, the European Central Bank increased its base interest rate from 0% to 1.25% between January and September 2022.

However, Southeast Asia is one region that is likely to avoid stagflation. Southeast Asia is a region situated south of mainland China. It comprises 11 countries that include Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam.

In countries such as Indonesia, Vietnam and Malaysia, the rate of increase in Gross Domestic Product (GDP) is higher than the rate of inflation. This increase in economic growth rates is partly as a result of an increase in the number of tourists visiting these countries. Each of these Governments have relaxed border controls that were introduced during the global health crisis. For example, between February 2022 and May 2022 the number of tourists increased by 1 050% in Indonesia and by 8 629% in Vietnam.

The majority of Southeast Asian countries are experiencing a steady growth in their exports. The rising prices of fuel, food and other commodities have benefited countries that export them in large quantities, for example, coal (Indonesia), rubber (Malaysia), and palm oil (Indonesia and Malaysia). These countries have experienced an improvement in their terms of trade.

By contrast, in Thailand and Singapore, the rate of inflation is rising faster than the GDP growth rate. Both countries are experiencing low rates of economic growth. In Thailand, inflation is reducing real incomes. In Singapore, the economic growth rate is low because of the slowdown in China's economy. China is Singapore's main trading partner.

Some countries in the region are highly exposed to external shocks in the global economy. For example, the Philippines relies on imports of rice and overall it is a net importer of food and fuel.

In Malaysia and Indonesia maximum prices have been imposed on certain commodities. This has helped to control the rising rate of inflation. Governments in other parts of the region are also considering the implementation of price controls. The President of the Philippines promised to decrease the price of rice by imposing a maximum price.

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Acknowledgements

Figure 1 and Extract A adapted from FT, https://www.ft.com/content/d1d5f596-d8af-4fcf-a01a-25b9fec8e245



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