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 4 June 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.

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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 best describes the role of the World Bank?

- ☐ **A** To maintain exchange rate stability by ensuring international monetary cooperation between countries
- ☐ **B** To provide loans to countries that experience temporary current account deficits on their balance of payments
- ☐ **C** To resolve trade disputes between countries and set the rules of trade
- ☒ **D** To promote economic development through poverty reduction programmes

(Total for Question 1 = 1 mark)

2 The Government of Hungary operates an income tax system in which the proportion of income paid in tax by individuals remains constant as incomes increase.

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

- ☐ **A** Hungary has a progressive tax system
- ☐ **B** Hungary has a regressive tax system
- ☒ **C** Hungary has a proportional tax system
- ☐ **D** Hungary has a specific tax system

(Total for Question 2 = 1 mark)

3 In 2018 the UK Government introduced tariffs on imported steel. In 2022 it decided to maintain these tariffs until 2024.

Which **one** of the following is the most likely reason why the UK Government maintained these tariffs until 2024?

- ☐ **A** To increase the level of unemployment in the UK steel industry
- ☒ **B** To prevent dumping of steel in the UK from foreign countries
- ☐ **C** To protect transnational companies supplying steel to the UK
- ☐ **D** To decrease government revenue from tariffs on imported steel

(Total for Question 3 = 1 mark)

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4 In 2021 Tanzania's index of export prices was 142.3 and its index of import prices was 121.3.

Which **one** of the following was Tanzania's terms of trade in 2021?

- ☒ **A** 21.0
- ☒ **B** 85.2
- ☒ **C** 117.3
- ☒ **D** 263.6

(Total for Question 4 = 1 mark)

5 The table shows selected economic data in 2021 for Chile and Uruguay.

	Human Development Index (HDI) value	Mean years of schooling (adults over 25 years old)	Life expectancy at birth (years)	Gross National Income per capita (2017 PPP)
Chile	0.855	10.9	78.9	$24 563
Uruguay	0.809	9.0	75.4	$21 269

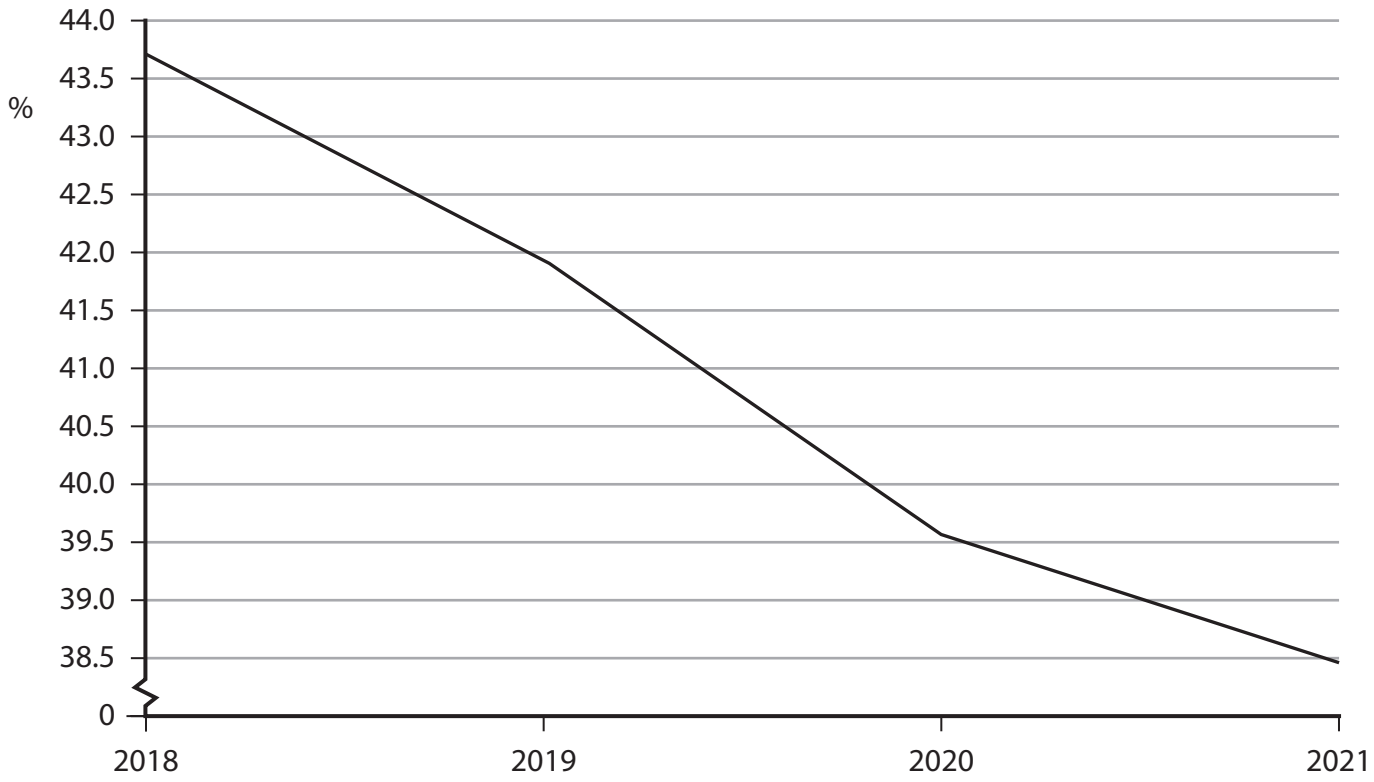
Which **one** of the following statements can be deduced from the data in the table?

- ☒ **A** Literacy rates must be higher in Uruguay than in Chile
- ☒ **B** Uruguay is less economically developed than Chile
- ☒ **C** Average incomes are higher in Uruguay than in Chile
- ☒ **D** Uruguay has better provision of healthcare than Chile

(Total for Question 5 = 1 mark)

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6 The chart shows the Dominican Republic's Gini coefficient, expressed as a percentage, between 2018 and 2021.



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

- ☒ **A** Between 2018 and 2021 the Lorenz curve shifted closer to the line of perfect equality
- ☒ **B** Between 2018 and 2019 the distribution of income became more unequal
- ☒ **C** Between 2019 and 2020 there was perfect income inequality
- ☒ **D** Between 2020 and 2021 income inequality increased by approximately 1.1%

(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) In 2022 Indonesia's current account surplus was 1% of its GDP.

With reference to line 26 of Extract A, calculate Indonesia's GDP in 2022.
You are advised to show your working.

(2)

(b) With reference to Figure 1, explain the difference between a balance of trade deficit and a balance of trade surplus.

(4)

(c) With reference to Extract A, analyse **two** benefits of Indonesia's increasing population to its economy.

(6)

(d) With reference to Extract A, examine **two** likely problems for the Indonesian economy of its dependence on commodities.

(8)

(e) With reference to Extract A and your own knowledge, discuss market-orientated strategies that the Indonesian Government might use to increase its rate of economic growth.

(14)

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7 (a) In 2022 Indonesia's current account surplus was 1% of its GDP.

With reference to line 26 of Extract A, calculate Indonesia's GDP in 2022.
You are advised to show your working.

(2)

Current account surplus in 2022 = $13.2 billion (line 26) = 1% of GDP

GDP = $13.2 billion ÷ 1 × 100

= $1 320 billion ($1.32 trillion)

(b) With reference to Figure 1, explain the difference between a balance of trade deficit and a balance of trade surplus.

(4)

A balance of trade deficit is when the value of a country's imports of goods and services is greater than the value of its exports, so (X – M) is negative. A balance of trade surplus is when the value of exports is greater than the value of imports, so (X – M) is positive.

Figure 1 shows Indonesia had a balance of trade deficit in January 2019 (about –$1 billion) and again between November 2019 and January 2020, when the monthly balance was below zero. From May 2020 to December 2022 Indonesia had a continuous balance of trade surplus, rising to a peak of about $7.5 billion a month in 2022, when the value of its exports far exceeded the value of its imports.

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(c) With reference to Extract A, analyse **two** benefits of Indonesia's increasing population to its economy.

(6)

Extract A states that Indonesia's population was 276 million in 2022, the largest in Southeast Asia, and had increased by 26 million since 2012, from 250 million, a rise of 26 ÷ 250 × 100 = 10.4%.

Benefit 1: a larger supply of labour. A growing and relatively young population increases the size of the labour force. The greater supply of workers puts downward pressure on wage rates, which lowers firms' costs of production. Lower costs allow Indonesian firms to cut prices, so exports of manufactured goods such as textiles and garments become more internationally competitive, and the larger workforce also raises the productive potential of the economy, shifting LRAS to the right and the PPF outwards.

Benefit 2: higher consumer spending and tax revenue. 26 million more people means a larger domestic market, so consumption rises. As consumption is the largest component of aggregate demand, AD shifts right and real output increases, supporting real GDP growth like the 5.3% achieved in 2022. A bigger market also lets firms gain economies of scale and attracts FDI. Higher incomes and spending raise income tax and indirect tax revenue, which the Government can spend on human capital and infrastructure to improve labour mobility.

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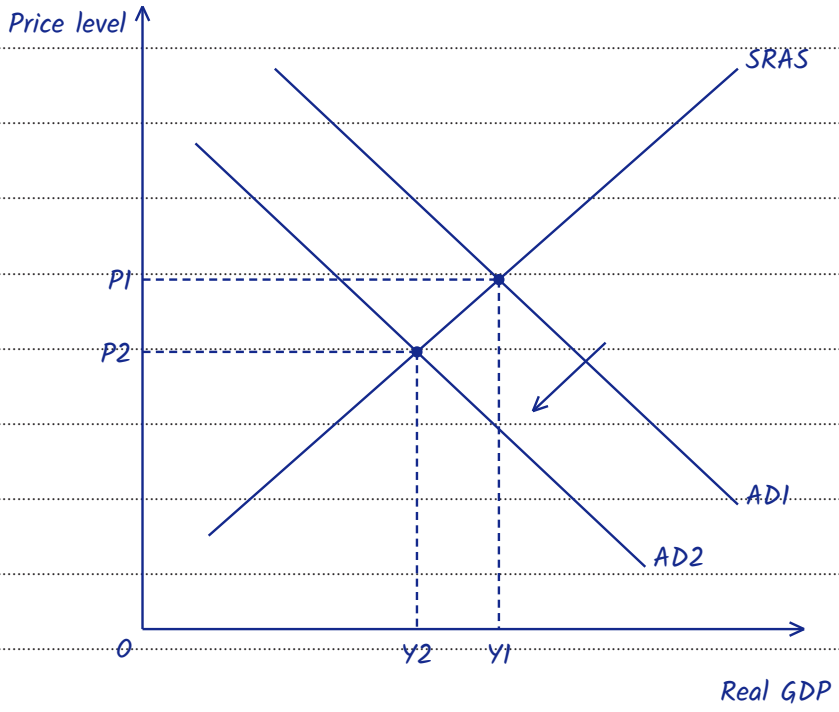
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(d) With reference to Extract A, examine **two** likely problems for the Indonesian economy of its dependence on commodities.

(8)

Indonesia is a net exporter of commodities such as nickel, coal, rubber and palm oil, and is the world's largest producer of nickel. Commodity exports made a more significant contribution to its current account surplus and growth rate in 2022 than manufactured exports.

Problem 1: volatile prices and slower growth. Demand and supply of commodities are price inelastic, so commodity prices fluctuate widely. Extract A says advanced economies were forecast to grow more slowly in 2023, which "would result in a fall in demand for Indonesia's commodities". Lower prices and volumes reduce export revenue, so net exports fall and AD shifts left from AD1 to AD2. Real output falls from Y1 to Y2 and, through the multiplier, unemployment rises. Unstable incomes also make it hard for producers to plan investment.



Problem 2: a deterioration in the balance of trade and terms of trade. The current account surplus rose from $3.5 billion in 2021 to $13.2 billion in 2022 mainly because of high commodity prices. If prices fall and stay low, export earnings fall and the surplus shrinks or

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becomes a deficit, while tax revenue from the commodity sector also falls, worsening the public finances. In the long run the Prebisch–Singer hypothesis suggests the terms of trade of primary producers decline, because commodities have a low income elasticity of demand, so each unit of exports buys fewer imports.

However, these problems may be limited. Producers can use forward markets to fix prices and reduce the impact of fluctuations. Demand for nickel may keep rising because of the global growth in electric vehicles, and Indonesia has a comparative advantage in it. Manufacturing exports also increased in 2022, so dependence on commodities may fall in the long run.

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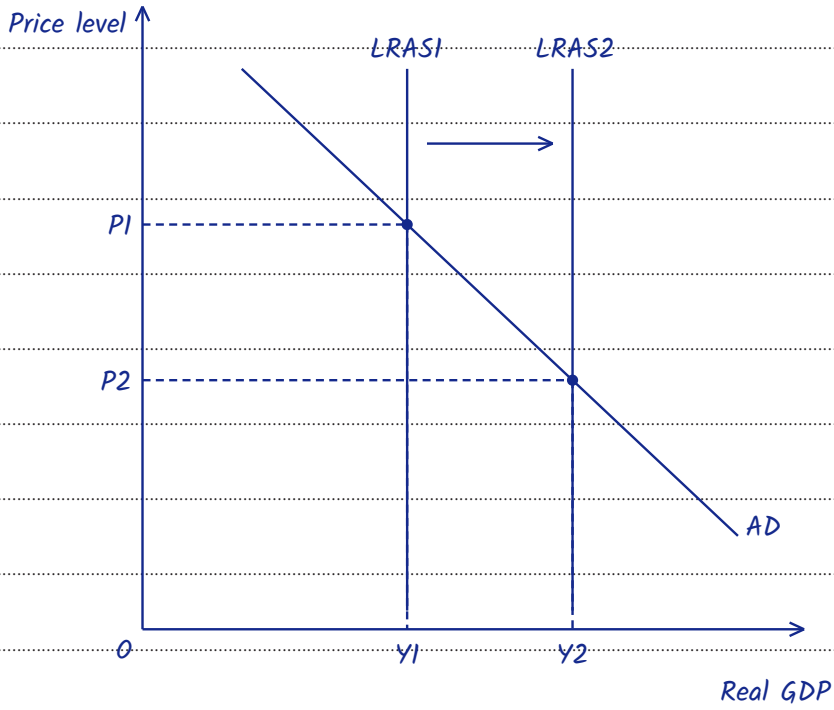
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(e) With reference to Extract A and your own knowledge, discuss market-orientated strategies that the Indonesian Government might use to increase its rate of economic growth.

(14)

The rate of economic growth is the percentage increase in real GDP over a period; Indonesia's real GDP grew by 5.3% in 2022. Market-orientated strategies aim to raise growth by reducing the role of the state and letting the price mechanism and private firms allocate resources.

Privatisation. The Government plans to increase privatisation. Transferring state-owned firms to the private sector gives owners a profit incentive, so firms cut costs and become more productively efficient. Private firms can raise finance on capital markets, so investment rises, which increases AD in the short run and the capital stock in the long run, shifting LRAS right from LRAS1 to LRAS2 and raising potential output from Y1 to Y2.



Promoting FDI. The Government wants to attract FDI to take advantage of rising global demand for electric vehicles, using its nickel to build battery and car plants. FDI is an injection into the circular flow, so AD rises with a multiplier effect, and TNCs bring technology transfer and

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training, raising labour productivity. Many foreign producers are already shifting manufacturing away from China.

Deregulation of labour markets. Relaxing strict employment regulations reduces firms' costs of hiring and of compliance, so firms create more jobs, fill vacancies and innovate. A more flexible labour market makes Indonesia more attractive to FDI and raises employment and output.

Removal of subsidies, a floating exchange rate and trade liberalisation. Removing oil and fuel subsidies frees government revenue for other uses and forces firms to use energy more efficiently. Keeping a floating rupiah lets the exchange rate adjust to keep exports competitive, and cutting trade barriers increases competition and allows Indonesia to specialise where it has a comparative advantage, promoting export-led growth.

Evaluation. Each strategy has costs. Removing fuel subsidies raises costs and prices: inflation is forecast to rise from 4.6% to 5.5% in 2023, partly as a result. Indonesia is a net importer of oil, so poorer households face higher fuel prices and absolute poverty may increase. If the central bank raises its base rate to control inflation, investment and consumption fall, which could reduce the growth rate the strategies are meant to raise. Privatisation may simply turn state monopolies into private monopolies that raise prices and cut quality unless there is effective regulation. TNCs may exploit labour and the environment, for example in nickel mining, and use transfer pricing to avoid tax, so the gains to Indonesia are smaller. Deregulation could lead to exploitation of workers with low wages and poor conditions.

The effectiveness also depends on institutions. Indonesia scored only 38 out of 100 on the corruption index, lower than Vietnam and China, so privatised assets may be sold cheaply to connected insiders and foreign investors may be deterred by bribery and uncertainty. In addition,

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market-orientated strategies work slowly and depend on the global economy: with advanced economies forecast to grow more slowly, demand for exports may be weak whatever the supply-side reforms.

Finally, economists argue the Government "must aim to develop the country's human capital and infrastructure". These interventionist policies may be more important, because FDI goes where workers are skilled and transport is good, and better education improves the mobility of the young labour force.

Overall, promoting FDI is likely to be the most effective market-orientated strategy, since it links Indonesia's nickel to the fast-growing electric vehicle market and diversifies the economy away from raw commodities. However, its success depends on tackling corruption and combining it with interventionist investment in human capital and infrastructure, so a mix of market and interventionist strategies is likely to raise long-run growth most.

(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 2022 the value of Japan's currency, the yen, fell by 35% against the US dollar.

Japan's central bank intervened in the currency markets to increase the external value of the yen. This intervention cost the central bank $20.8 billion.

Evaluate policies that can be used to prevent a country's exchange rate from depreciating. Refer to a developed country of your choice in your answer.

(Total for Question 8 = 20 marks)

9 The eurozone is an economic and monetary union. Member countries of this union share a single currency, the euro. Romania is hoping to become a member of the eurozone by 2026.

Evaluate the costs to a country of becoming a member of an economic and monetary union. Refer to a country of your choice in your answer.

(Total for Question 9 = 20 marks)

10 From 2017 to 2021 public expenditure as a proportion of GDP rose from 25.1% to 29.5% in Azerbaijan and from 12.5% to 15.9% in India.

Evaluate possible causes of an increase in public expenditure as a proportion of GDP in a developing economy 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 20.

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

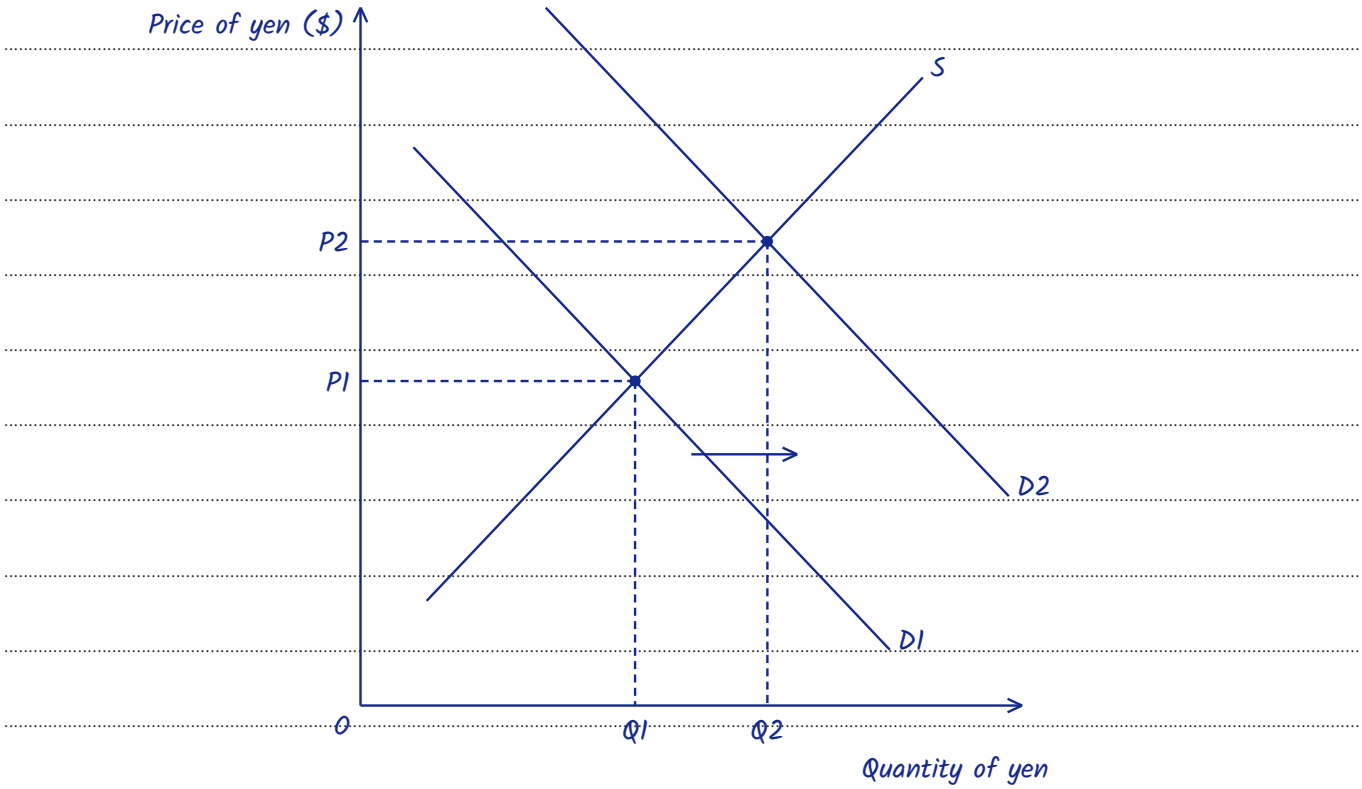
An exchange rate is the price of one currency in terms of another. A depreciation is a fall in the value of a floating currency caused by market forces. In 2022 the Japanese yen fell by 35% against the US dollar, mainly because the Bank of Japan kept its policy interest rate at −0.1% while the US Federal Reserve raised rates to over 4%. Investors sold yen to buy higher-yielding dollar assets, increasing the supply of yen on the foreign exchange market. Several policies can prevent such a depreciation.

1. Direct intervention using foreign currency reserves. The central bank sells foreign currency, such as dollars, from its reserves and uses it to buy its own currency. In September and October 2022 Japan bought yen at a cost of $20.8 billion. Buying yen increases the demand for yen, shifting demand from D1 to D2 in the diagram, so the price of the yen rises from P1 to P2 and the depreciation is reversed.

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2. Raising interest rates. A higher policy rate relative to other countries raises the return on deposits and bonds in yen, attracting hot money inflows. Foreign investors buy yen and Japanese investors keep their savings at home, so demand for yen rises and supply falls. Ending quantitative easing and yield curve control works the same way by reducing the money supply and allowing bond yields to rise. When the Bank of Japan widened its bond yield band in December 2022, the yen appreciated.

3. Other policies. The country could peg its currency to a stable currency such as the dollar. It could also encourage inflows of FDI and portfolio investment, which increase the demand for yen, or restrict outflows of capital such as capital flight and profit repatriation, which reduce the supply of yen. Protectionism would cut imports, so fewer yen are sold to buy foreign currency.

Evaluation of intervention. Its effectiveness is limited by the size of reserves. Japan has very large reserves of over $1 trillion, so $20.8 billion is affordable, but it is small compared with

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daily trading in the yen of hundreds of billions of dollars, so the effect may only be temporary unless the cause of the depreciation, the interest rate gap, changes. A country with small reserves would quickly run out: in 1992 the UK spent billions of pounds of reserves and raised interest rates from 10% to 12% but still could not keep the pound in the ERM. Selling dollar reserves can also be politically sensitive, as Japan holds large amounts of US government debt.

Evaluation of interest rates. This addresses the main cause, but it conflicts with other macroeconomic objectives. Japan had low growth and decades of weak inflation, so higher interest rates would reduce consumption and investment, lowering AD, growth and employment. Japan's government debt is around 250% of GDP, so a rise in rates would sharply increase debt interest payments. Also, it is the relative interest rate that matters: if the Fed keeps raising rates, a small rise in Japan may not attract hot money.

Evaluation of other policies. A peg removes flexibility and has to be defended with reserves and interest rates anyway, so it may face speculative attacks. Capital controls and protectionism break WTO and OECD commitments, invite retaliation and deter future investment, so they are unsuitable for an open developed economy like Japan.

It is also worth asking whether preventing the depreciation is desirable. A weaker yen makes Japanese exports such as cars cheaper, which can boost net exports and help end deflation. However, Japan imports most of its energy and food, so the depreciation raised import prices and inflation reached about 4% by the end of 2022, the highest in around 40 years, which squeezed real incomes. The size of the depreciation, 35%, explains why the authorities acted.

In conclusion, intervention using reserves is the best short-run policy for a country like Japan with very large reserves, as it can stop a sudden fall without harming growth. However, it only

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treats the symptom. In the long run, the most effective policy is to narrow the interest rate gap through gradual monetary tightening, though this must be balanced against slow growth and high public debt. A combination of the two, timed with changes in US interest rates, is likely to be most successful.

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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** ☐

An economic and monetary union is the highest form of economic integration before full political union: members form a single market with free movement of goods, services, labour and capital and a common external tariff, and they also share a single currency with one central bank setting monetary policy. The eurozone is an example: 20 countries use the euro and the European Central Bank (ECB) sets one interest rate for all. Romania, an EU member that still uses the leu, aims to join by 2026.

1. Loss of independent monetary policy. The National Bank of Romania would no longer set interest rates; the ECB sets one rate for the whole eurozone, based on average conditions, which are dominated by large economies such as Germany and France. Romania has had much higher inflation than the eurozone average, over 10% in 2022 and 2023, so the ECB rate may be too low for Romania, causing excess credit growth, demand-pull inflation and asset bubbles. This happened in Ireland and Spain in the 2000s, when low ECB rates fuelled property booms that collapsed in 2008. In a recession, the rate may be too high. "One size fits all" policy is costly when member economies are not synchronised.

2. Loss of the exchange rate as an adjustment tool. With the euro, Romania could not let its currency depreciate to restore competitiveness after an asymmetric shock, such as a fall in demand for its car and machinery exports. Instead adjustment must come through lower wages and prices (internal devaluation), which is slow and painful. Greece could not devalue after 2010, and unemployment rose to over 25%.

3. Fiscal restrictions. Members must keep within the Stability and Growth Pact, with budget

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deficits below 3% of GDP and debt below 60% of GDP. Romania's budget deficit was over 6% of GDP in 2023, so it would need spending cuts or tax rises, reducing AD and growth. In a recession, the limits restrict expansionary fiscal policy just when monetary and exchange rate policies are no longer available.

4. Other costs. There are high transition costs of replacing leu notes and coins, changing prices, computer systems and vending machines, and firms may round prices up at changeover. Members may have to contribute to bailouts of other members, such as Greece, Ireland and Portugal after 2010, and leaving the union is extremely difficult. As part of the single market there may also be trade diversion, where imports switch from cheaper producers outside the bloc, and emigration of skilled workers: millions of Romanians already work in other EU countries, a loss of human capital.

However, these costs must be weighed against the benefits. Using the euro removes transaction costs and exchange rate risk on trade with the eurozone, which buys the large majority of Romania's exports, so trade and investment become cheaper and more certain. Price transparency increases competition and efficiency. Membership is likely to attract more FDI from TNCs wanting to produce inside the eurozone at lower labour costs, and a credible ECB could lower Romania's inflation expectations and borrowing costs, as the euro is more stable than the leu.

The size of the costs also depends on how far Romania's economy has converged with the eurozone. If its business cycle moves with Germany's, because of close trade links, the ECB rate will suit Romania more often and asymmetric shocks will be rare, so the loss of monetary and exchange rate policy matters less. Slovakia, which joined in 2009, has grown strongly. The costs are also mostly short run: transition costs are one-off, while the benefits from lower transaction costs continue.

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Finally, some costs are not avoided by staying out. The fiscal rules of the Stability and Growth Pact already apply to all EU members, and Romania must meet the Maastricht convergence criteria on inflation, deficits, debt and two years in ERM II before joining, which may discipline policy and reduce the costs. Labour mobility also already exists through the single market.

In conclusion, the most significant cost of membership is the loss of independent monetary and exchange rate policy, because it leaves a country without tools to respond to shocks. For Romania, with higher inflation, a large budget deficit and lower income than the eurozone average, these costs are currently large. However, if Romania first converges, cutting inflation and its deficit, the costs would fall and the long-run gains in trade and FDI are likely to outweigh them, so joining is best delayed until convergence is achieved.

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TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Tuesday 4 June 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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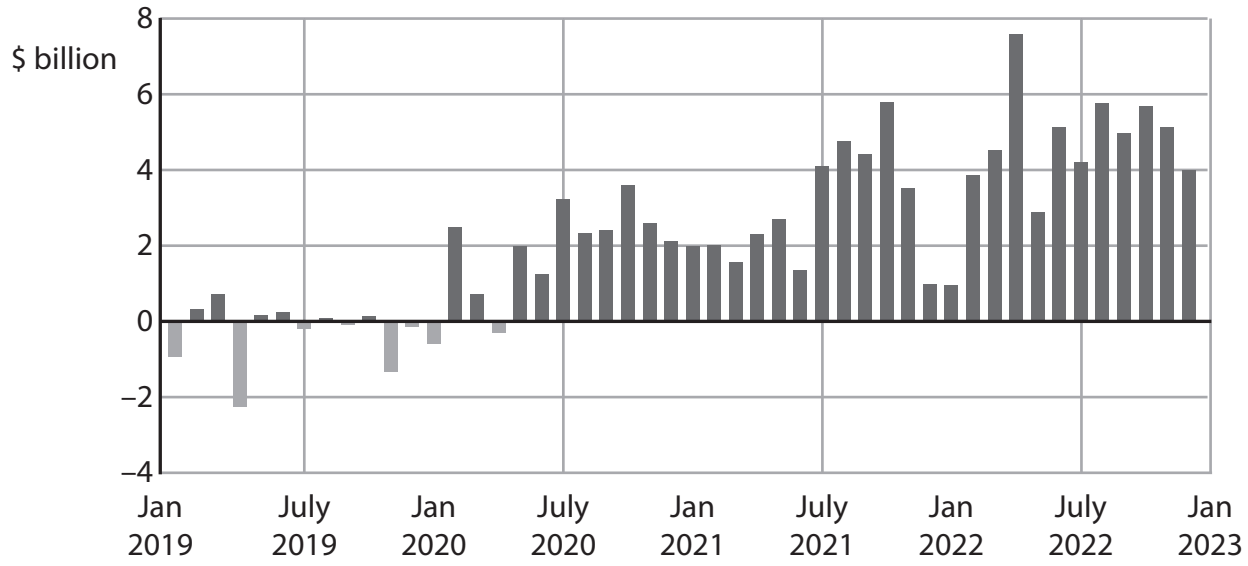
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Sources for use with Section B

The Indonesian economy

Figure 1 Monthly balance of trade in goods and services, $ billion, January 2019 to December 2022



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Extract A Economic outlook

In 2022 Indonesia had a population of 276 million people. This was the largest in Southeast Asia and had increased by 26 million since 2012. In 2022 the global economy was weak and many countries experienced high rates of inflation. By contrast, Indonesia's economy performed better than several advanced economies. The country's real GDP increased by 5.3%. This was above the forecast rate of economic growth. Its annual rate of inflation of 4.6% was one of the lowest globally. However, this was before the Government removed subsidies on oil and fuel. Indonesia is a net importer of oil.

During 2022 Indonesia's currency, the *rupiah*, had the best-performing floating exchange rate to the US dollar in Asia. The *rupiah* depreciated less than the currencies of Vietnam and China, its main trading partners.

Indonesia is a resource-rich country and it is a net exporter of commodities such as nickel, coal, rubber and palm oil. In 2022 the country benefited from rising global commodity prices. It is the world's largest producer of nickel, an important component in electric vehicle batteries.

To take advantage of the rising global demand for electric vehicles, the Government announced plans to increase privatisation and promote foreign direct investment (FDI).

Exports from the manufacturing sector increased during 2022. These included electronics, machinery, textiles and garments. The Government relaxed its previously strict employment regulations to create more jobs, fill vacancies and promote innovation. This encouraged more FDI, as many foreign producers shifted manufacturing away from China.

In 2022 Indonesia's exports of commodities made a more significant contribution to the country's current account surplus and to its economic growth rate than its exports of manufactured goods. The country's current account surplus increased from $3.5 billion in 2021 to $13.2 billion in 2022. It was forecast that advanced economies would experience lower rates of economic growth in 2023. This would result in a fall in demand for Indonesia's commodities.

In 2023 it was forecast that Indonesia's rate of inflation would increase to 5.5% partly as a result of the removal of fuel subsidies. The country's central bank could respond to the rising rate of inflation by increasing its base rate of interest.

There are concerns about the level of corruption in the country. Indonesia scored 38 out of 100 on the corruption index – the lower the score, the greater the level of corruption. This is the same score as Brazil but lower than that of Vietnam and China. This indicates that Indonesia has relatively more corruption than Vietnam and China.

To remain internationally competitive, many economists have recommended that Indonesia should diversify away from its dependence on commodities. They have suggested that the Government must aim to develop the country's human capital and infrastructure, in order to improve the labour mobility of its relatively young population.

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Acknowledgements

Figure 1 adapted from: Trading Economics, https://tradingeconomics.com/indonesia/balance-of-trade

Extract A adapted from: FT, https://www.ft.com/content/f179df5b-1dc7-46f4-88dc-97ddfe1d2fe4