Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Centre Number

Candidate Number

Pearson Edexcel International Advanced Level

Time 2 hours

Paper reference **WEC14/01**

Economics

International Advanced Level
Unit 4: Developments in the global economy

You must have:
Source Booklet (enclosed)

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **ALL** questions in Section A and Section B.
- Answer **TWO** questions in Section C.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ▶

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SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 Between 2014 and 2019 France's public expenditure as a proportion of GDP fell from 57.2% to 55.6%.

Which **one** of the following is the likely impact of a decrease in public expenditure?

- ☒ **A** A decrease in unemployment
- ☒ **B** A decrease in crowding out
- ☒ **C** An increase in injections
- ☒ **D** An increase in inflationary pressures

(Total for Question 1 = 1 mark)

2 New Zealand's Government announced that it planned to increase the tax on fuel by 4 cents per litre from July 2020.

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

- ☒ **A** Progressive tax
- ☒ **B** Proportional tax
- ☒ **C** Regressive tax
- ☒ **D** Direct tax

(Total for Question 2 = 1 mark)

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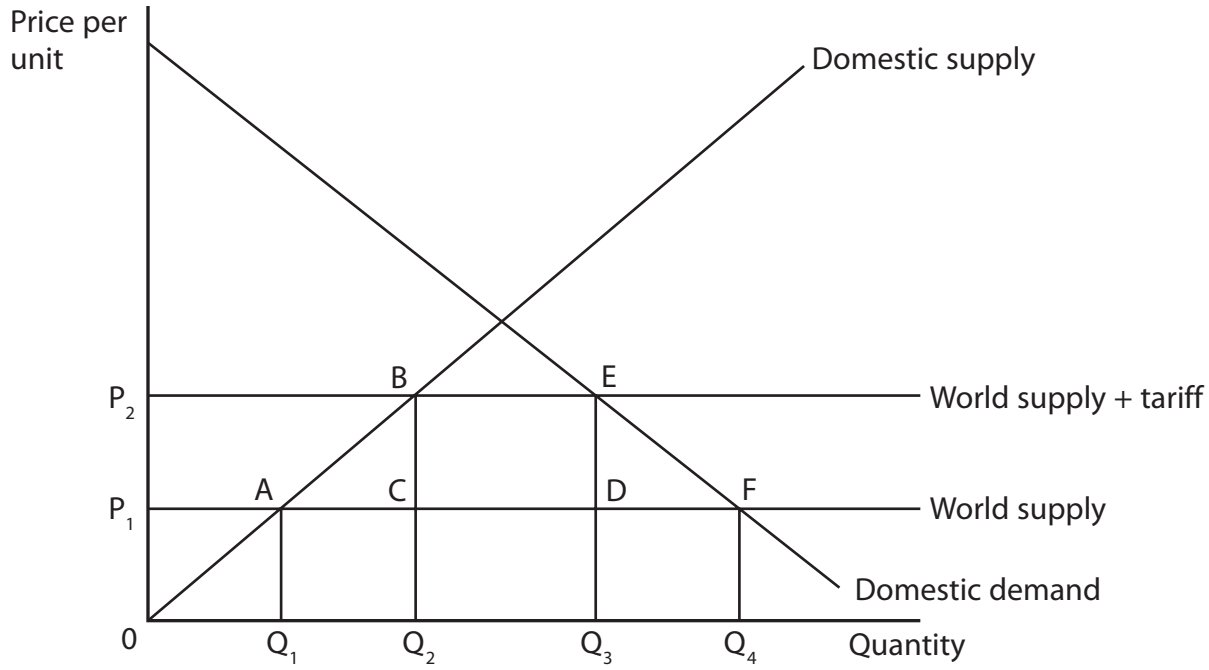
3 According to its HDI score of 0.35, Niger is the least developed country in the world.

Which **one** of the following market-orientated strategies could promote economic development in Niger?

- ☒ **A** The introduction of buffer stock schemes
- ☒ **B** State investment in human capital
- ☒ **C** State investment in infrastructure
- ☒ **D** The promotion of microfinance schemes

(Total for Question 3 = 1 mark)

4 The diagram represents the imposition of a tariff on a commodity.



Which **one** of the following statements is true?

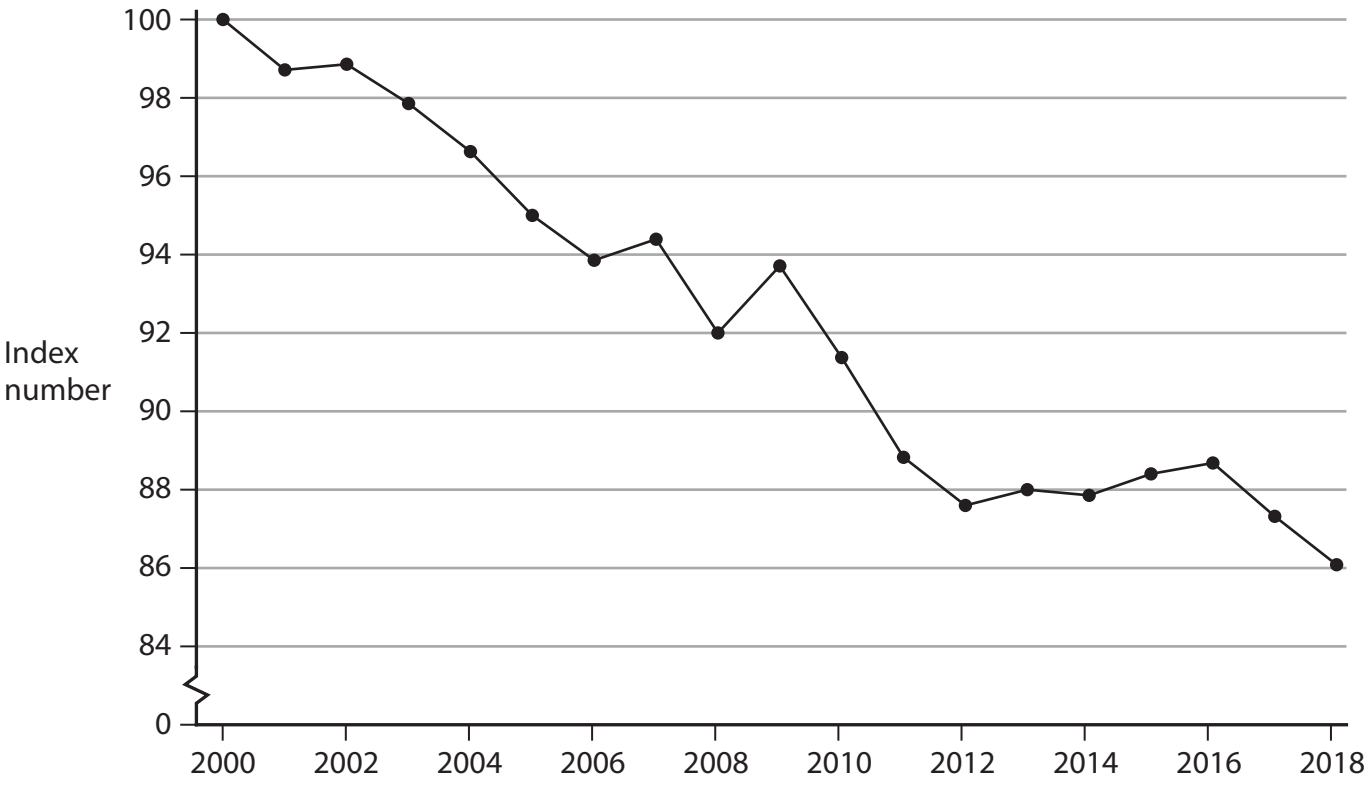
- ☒ **A** Consumer surplus has decreased by the area P_1P_2EF
- ☒ **B** Government tax revenue is area ABEF
- ☒ **C** Net welfare loss areas are ABQ_2Q_1 and EFQ_4Q_3
- ☒ **D** Producer surplus has decreased by the area P_1P_2BA

(Total for Question 4 = 1 mark)

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5 The chart shows Austria's terms of trade between 2000 and 2018, (2000 = 100).



Which **one** of the following can be deduced from the chart over the period 2000–2018?

- ☒ **A** Export prices and import prices have fallen at the same rate
- ☒ **B** Import prices have risen at a faster rate than export prices
- ☒ **C** Export prices have risen at a faster rate than import prices
- ☒ **D** Import prices have fallen relative to export prices

(Total for Question 5 = 1 mark)

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6 Between 2018 and 2019 the Netherlands' rank on the Global Competitiveness Index increased from sixth to fourth. This was as a result of an increase in its labour productivity.

Which **one** of the following combinations is the most likely impact of an increase in labour productivity?

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

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

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

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

7 (a) The Bank of Zambia raised 'the base interest rate by 1.75 percentage points to 11.5% between April and November 2019' (Extract A, lines 12–13).

Calculate Zambia's base interest rate in April 2019. You are advised to show your working.

(2)

(b) Analyse the likely impact of an increase in the base interest rate on 'Zambia's balance of trade with South Africa' (Extract A, line 15).

(6)

(c) With reference to the fourth paragraph of Extract A, explain what is meant by 'The Gini coefficient'.

(4)

(d) With reference to the information provided, examine **two** problems arising from the dependence on copper for the Zambian economy.

(8)

(e) Discuss economic factors, apart from primary product dependency, that may constrain Zambia's economic growth.

(14)

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(a) The Bank of Zambia raised 'the base interest rate by 1.75 percentage points to 11.5% between April and November 2019' (Extract A, lines 12–13).

Calculate Zambia's base interest rate in April 2019. You are advised to show your working.

(2)

Base rate in April 2019 = 11.5% – 1.75 percentage points

= 9.75%

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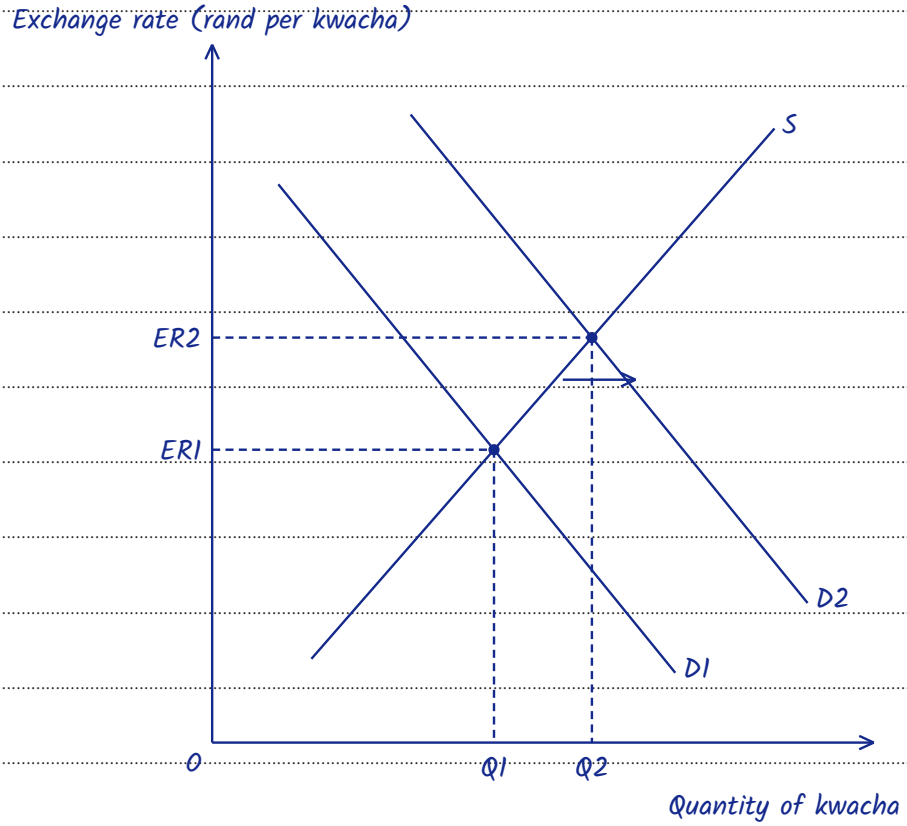
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(b) Analyse the likely impact of an increase in the base interest rate on 'Zambia's balance of trade with South Africa' (Extract A, line 15).

(6)

The Bank of Zambia raised the base interest rate by 1.75 percentage points to 11.5% to control inflation of 9.2%. Higher interest rates give a higher return on savings held in Zambian banks, so hot money flows into Zambia from abroad. To deposit funds, investors must buy kwacha, so the demand for kwacha increases from D1 to D2 and the kwacha appreciates against the South African rand from ER1 to ER2, as shown in the diagram. The extract confirms that the change in the interest rate affected Zambia's exchange rate.



The stronger kwacha means Zambian exports become relatively more expensive in rand, so South African demand for Zambian exports falls and export revenue decreases. At the same time imports from South Africa become relatively cheaper in kwacha, so Zambian consumers and firms buy more of them. As over 55% of Zambia's imports come from South Africa, the value of imports rises significantly. With exports falling and imports rising, Zambia's balance of trade with South Africa is likely to worsen, with a larger trade deficit, assuming demand for exports

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and imports is price elastic.

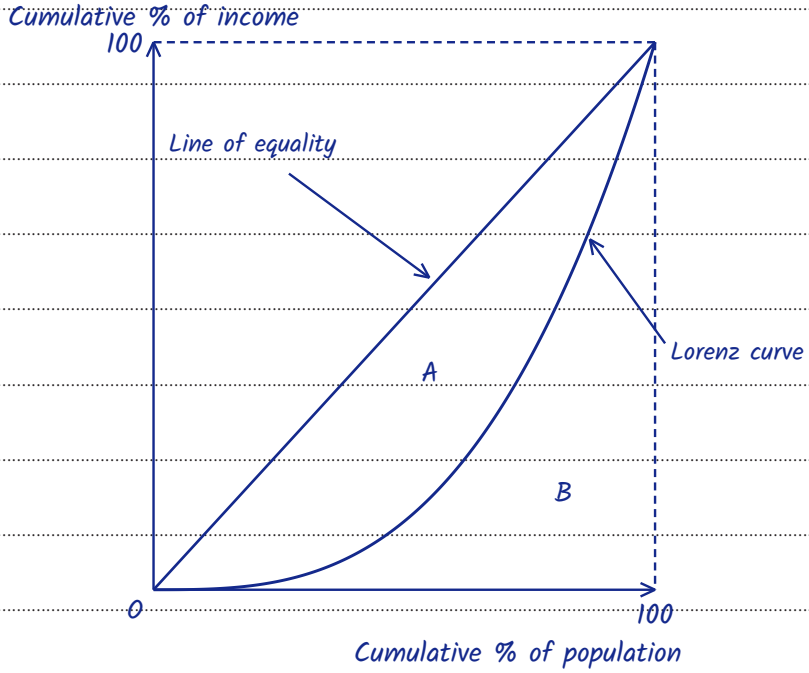
On the other hand, the higher interest rate also raises the cost of borrowing and rewards saving, so consumption falls. With a lower level of spending, fewer imports are bought, which partly offsets the effect of the stronger kwacha and could reduce the deficit.

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(c) With reference to the fourth paragraph of Extract A, explain what is meant by 'The Gini coefficient'.

(4)

The Gini coefficient is a statistical measure of the degree of income inequality in a country. It is calculated from the Lorenz curve as area A ÷ (area A + area B). It ranges from 0, which represents perfect income equality, to 1, which represents perfect inequality.



In Zambia the Gini coefficient was 0.50 in 2018, which is very high by international standards. This shows that income is very unequally distributed, as stated in the fourth paragraph.

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(d) With reference to the information provided, examine **two** problems arising from the dependence on copper for the Zambian economy.

(8)

One problem is volatile export earnings and lower economic growth. Copper accounts for 70% of Zambia's export earnings and 30% of its GDP. Figure 1 shows copper prices are very volatile; they rose from about $2.10 per pound in May 2016 to over $3.20 in early 2018, then fell to about $2.20 by 2020. Because demand and supply of copper are price inelastic, small shifts in global demand cause large price changes. When trade tensions between the USA and China reduced the global demand for copper, the price fell, so export revenue and the current account worsened. Lower exports reduce aggregate demand and, through the multiplier, real output, so real GDP growth fell from 4% in 2018 to 2% in 2019. Volatility also makes it difficult for mining firms to plan output, employment and investment.

A second problem is a deterioration in the public finances. Copper provides more than 25% of Zambia's tax revenues, so when the copper price falls, tax revenue from mining companies falls sharply. The government's budget deficit widens, so it must borrow more or cut spending on education, healthcare and infrastructure, which are already weak. Falling copper production also reduced foreign currency reserves while debt still had to be serviced, so the kwacha depreciated by 30% against the US dollar between January and May 2020, raising the burden of foreign debt.

However, the significance of these problems depends on the time period. When copper prices are high, as in 2017 to 2018, export earnings and tax revenues rise, improving the trade balance and allowing more spending on public services. Indeed, despite its copper dependence, Zambia grew by an average of 7.5% per year between 2004 and 2014 and reached middle-income status. A weaker kwacha may also give an incentive to diversify into tourism and ICT. Even so, because copper is such a large share of GDP, tax and exports, the overall impact of a price fall is large.

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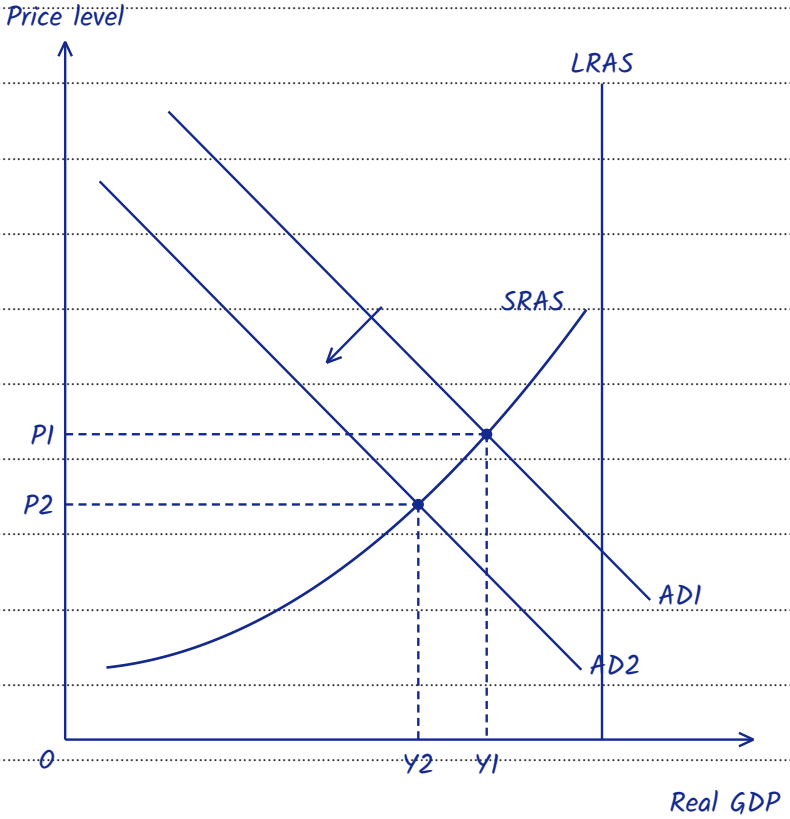
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(e) Discuss economic factors, apart from primary product dependency, that may constrain Zambia's economic growth.

(14)

Economic growth is an increase in real GDP. Between 2004 and 2014 Zambia's real GDP grew by an average of 7.5% per year, but growth slowed to just 2% in 2019. Apart from copper dependence, several economic factors constrain growth.

Firstly, high inflation and high interest rates. Inflation rose from 7.5% in 2018 to 9.2% in 2019, which creates uncertainty for firms and makes Zambian exports less price competitive. To control it, the Bank of Zambia raised the base rate to 11.5%. This increases the cost of borrowing, so firms cut investment and households reduce spending on credit, while the reward for saving rises. As consumption and investment are components of AD, AD shifts left from AD1 to AD2, so real output falls from Y1 to Y2, as shown in the diagram. The higher rate may also appreciate the kwacha against the rand, reducing net exports with South Africa and lowering AD further.



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Secondly, poor human capital and infrastructure. The extract states that the quality of education, healthcare and infrastructure is weak. Poorly educated and less healthy workers have low labour productivity, and poor roads and power supplies in a landlocked country raise transport costs and unit costs for firms. This limits the productive potential of the economy, so LRAS cannot shift right and long-run growth is constrained. It also discourages inward FDI.

Thirdly, the foreign exchange gap and debt. Foreign currency reserves fell because of debt servicing, and the kwacha depreciated by 30% against the US dollar in 2020. Without foreign currency, Zambia cannot import the capital goods and technology needed for investment, and the depreciation raises the kwacha cost of repaying dollar debts. Money spent on debt servicing has an opportunity cost, as it cannot be spent on education or infrastructure. High income inequality, with a Gini coefficient of 0.50, also means much of the population is too poor to save, so the savings gap limits investment.

However, the impact of these factors may be limited. The effect of higher inflation depends on inflation rates in trading partners: if South Africa's inflation is similar, competitiveness is not lost. The 11.5% base rate may succeed in controlling inflation, which creates a more stable environment for long-term investment. The effect of the exchange rate depends on the price elasticities of demand for exports and imports and whether the Marshall-Lerner condition holds. Low wages, lower than in most middle-income countries, keep unit labour costs low, which can attract TNCs, and TNCs seeking copper may invest in infrastructure. The foreign exchange gap could be reduced through debt relief from the IMF or World Bank.

Overall, poor human capital and infrastructure are the most significant constraints because they limit long-run productive capacity, while high interest rates and inflation are mainly short-run constraints. In the long run, the government's plans to diversify into tourism, infrastructure and

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ICT should raise real GDP, but only if the debt and foreign currency shortages are resolved to fund them.

(Total for Question 7 = 34 marks)

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SECTION C

Answer TWO questions from this section.

8 In 2019 the rate of economic growth was over 6% in both India and China.

Evaluate the likely impact of rapid economic growth in emerging economies on world trade patterns. Refer to countries of your choice in your answer.

(Total for Question 8 = 20 marks)

9 The share of GDP accounted for by the service sector is much higher in the UK and the USA than in Italy and Canada.

Evaluate the possible benefits of specialisation and trade to a developed country of your choice.

(Total for Question 9 = 20 marks)

10 In 2019 the current account deficit on the balance of payments in Turkey was US$47.4 billion and in Argentina it was US$31.3 billion.

Evaluate the disadvantages of a current account deficit to 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** ☐

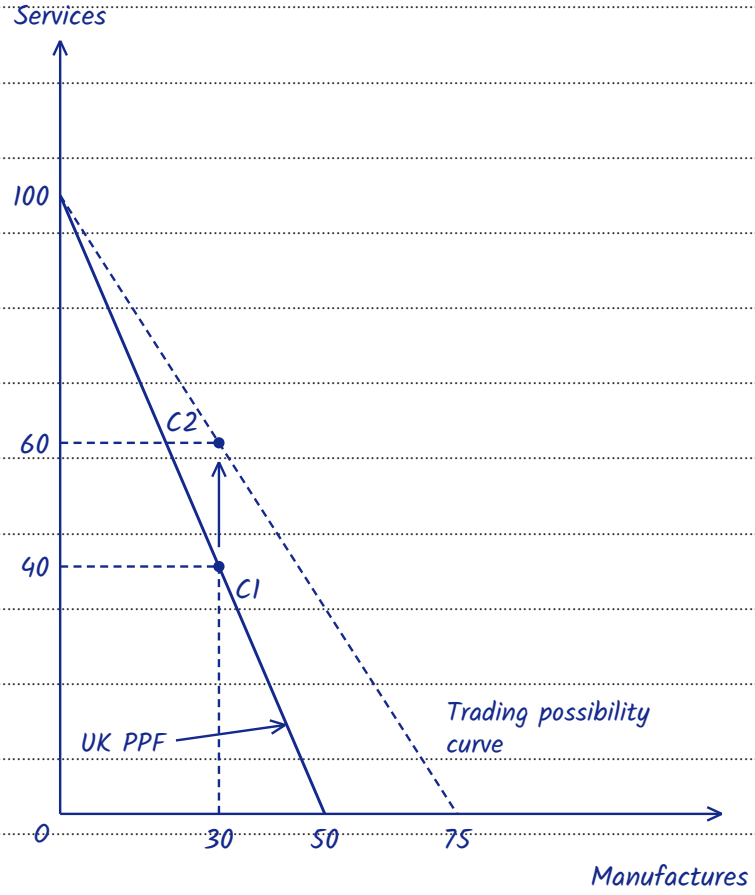
Specialisation is when a country concentrates on producing the goods or services in which it is most efficient, then trades its surplus for other products. In the UK the service sector accounts for around 80% of GDP, and the UK specialises in financial, legal, business and education services, with the City of London as a global financial centre.

The main benefit comes from the law of comparative advantage: a country should specialise in the good it can produce at the lowest opportunity cost. Suppose with all resources the UK and Italy can produce:

	Services	Manufactures	Opp. cost of 1 service
UK	100	50	0.5 manufactures
Italy	40	40	1 manufacture

The UK has a lower opportunity cost of services (0.5 compared with 1), so it has a comparative advantage in services, while Italy has a comparative advantage in manufactures. If the UK specialises in services and trades at terms of trade between the two opportunity cost ratios, for example 1 service for 0.75 manufactures, it can consume beyond its PPF. As shown in the diagram, before trade the UK consumes at C1 (40 services and 30 manufactures). By producing 100 services and exporting 40 in exchange for 30 manufactures, it consumes at C2 (60 services and 30 manufactures), outside its PPF, a gain of 20 services. World output rises, so both countries gain.

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Secondly, specialisation allows UK service firms to serve a global market, so they can exploit economies of scale. As output rises, long-run average costs fall, for example through spreading the high fixed costs of IT systems and expertise over more customers. Lower costs allow lower prices for UK financial and business services, making them more internationally competitive, so service exports rise. The UK runs a large trade in services surplus, which helps to offset its deficit on trade in goods.

Thirdly, higher exports are an injection into the circular flow, so aggregate demand rises and, through the multiplier effect, real GDP increases by more than the initial rise in exports. Growing service industries increase the derived demand for labour, creating well-paid skilled jobs and encouraging investment, including inward FDI into London. Consumers also benefit, because importing manufactured goods from lower-cost producers such as China and Italy gives lower prices and more choice. This raises real incomes and living standards and reduces inflationary

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pressure, as competition forces firms to be more efficient, improving allocative and productive efficiency.

However, these benefits must be evaluated. The comparative advantage model rests on unrealistic assumptions: it ignores transport costs, assumes constant costs and perfect factor mobility, and trade only benefits both countries if the terms of trade lie between the two opportunity cost ratios. In practice, trade barriers, such as new barriers to trade in services between the UK and the EU after Brexit, can reduce the gains.

Specialisation also increases vulnerability to external shocks. The UK's dependence on financial services meant that the 2008 global financial crisis hit the UK economy very hard, causing a deep recession. Heavy reliance on imported goods and long global supply chains can cause shortages and higher prices when supply is disrupted, as seen during the COVID-19 pandemic. In addition, the shift towards services caused deindustrialisation in regions such as the North of England, where workers in declining manufacturing industries faced structural unemployment because of occupational and geographical immobility of labour. This widened regional inequality.

The size of the benefit also depends on which services a country specialises in. High value services such as finance, consultancy and higher education generate high incomes, but the gains are concentrated among skilled workers in London and the South East, so inequality may increase. Increased trade also raises external costs, such as pollution and carbon emissions from transporting imported goods.

In conclusion, the UK has gained significantly from specialisation and trade, as its comparative advantage in services has generated economies of scale, export earnings, high-paid jobs and cheaper imports. The most important benefit is the rise in living standards from consuming

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beyond its PPF. However, the gains are unevenly distributed and depend on open access to foreign markets, so the benefits are greatest when the UK keeps strong trade agreements and supports workers to retrain.

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

The current account of the balance of payments records trade in goods, trade in services, primary income and secondary income. A current account deficit occurs when the total outflows of money exceed the inflows, mainly because the value of imports exceeds the value of exports. In 2019 Turkey, a developing country, had a current account deficit of US$47.4 billion.

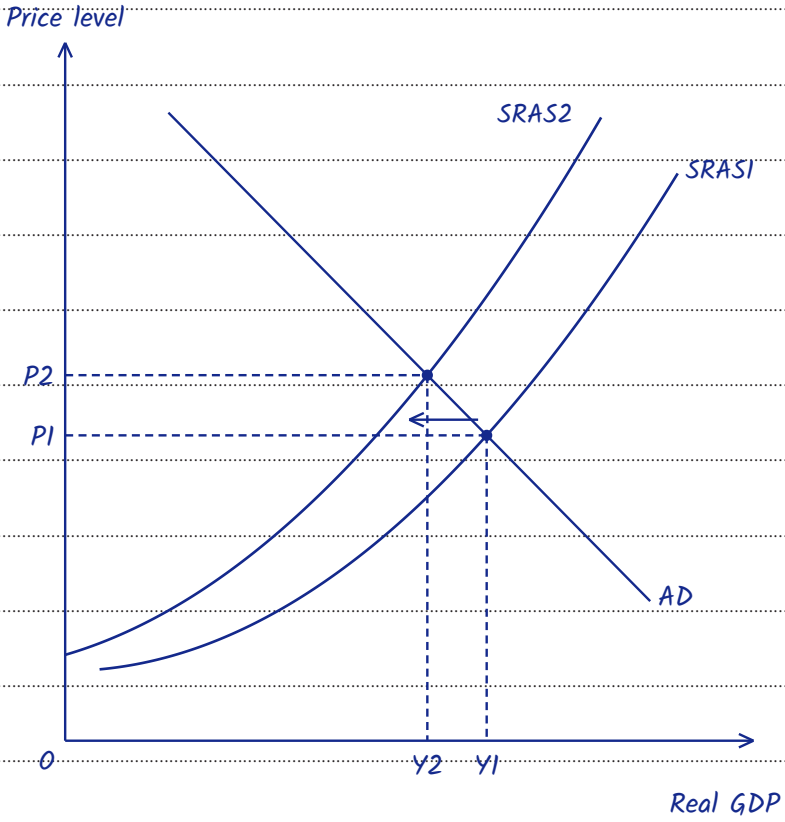
The first disadvantage is that the deficit must be financed. A deficit on the current account must be matched by a surplus on the capital and financial account, through borrowing from abroad, running down foreign currency reserves, selling assets to foreign owners or attracting hot money. To attract hot money the central bank may have to keep interest rates high, which raises the cost of borrowing for domestic firms, reducing investment and growth. Hot money can also leave quickly if confidence falls. If reserves run out, the country may need a loan from the IMF with strict conditions attached, such as cuts in government spending.

Secondly, a large deficit is likely to cause a depreciation of the currency, because the supply of the currency to buy imports exceeds the demand for it from exports. In 2018 the Turkish lira lost around 30% of its value against the US dollar. A depreciation raises the price of imported raw materials, energy and components, so firms' costs of production rise and SRAS shifts left from SRAS1 to SRAS2, as shown in the diagram. This causes cost-push inflation, with the price level rising from P1 to P2 and real output falling from Y1 to Y2. Turkey's inflation rose above 20% in late 2018, which reduced real incomes, especially of the poor.

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Thirdly, a depreciation increases the burden of foreign debt. Many Turkish firms and banks borrowed heavily in US dollars and euros to finance the deficit. When the lira falls, the lira cost of repaying this debt rises, so firms face higher debt repayments, some go bankrupt and banks make losses. This reduces investment and confidence, and the outflow of capital can turn into a currency crisis, as happened in Turkey in 2018.

Fourthly, imports are a withdrawal from the circular flow of income. When imports exceed exports, net exports (X – M) are negative, so aggregate demand is lower than it otherwise would be. Through the negative multiplier effect, output, employment and incomes are lower. A persistent deficit may also show a structural weakness: a lack of international competitiveness, with domestic producers losing market share to imports, which leads to job losses in manufacturing and structural unemployment. The country may then turn to protectionist policies such as tariffs, which distort comparative advantage, provoke retaliation and reduce allocative efficiency.

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However, the disadvantages depend on the size, cause and length of the deficit. Turkey's deficit of US$47.4 billion is large in absolute terms, but its significance depends on its size as a percentage of GDP: a deficit of 2% to 3% of GDP is usually manageable for a growing developing economy. It also depends on how it is financed. If it is financed by long-term inward FDI rather than short-term hot money or debt, it is sustainable, because FDI brings capital, technology and jobs and does not need to be repaid.

The cause also matters. If the deficit is caused by imports of capital goods, such as machinery for new factories and infrastructure, it will increase productive capacity, shift LRAS right and raise future exports, so it may correct itself in the long run. A deficit caused by a consumer boom in imported luxury goods is more harmful. A depreciation is not always harmful either: if the Marshall-Lerner condition holds, the lower lira makes exports cheaper and imports dearer, so after the J-curve effect the deficit narrows, helped by cheaper tourism in Turkey. Argentina, with a smaller deficit of US$31.3 billion, suffered more severely because it relied on short-term foreign borrowing and already had high inflation, showing that the context of each country matters.

In conclusion, a current account deficit is a serious problem for a developing country such as Turkey when it is large, persistent and financed by short-term borrowing in foreign currency, because it leads to currency depreciation, inflation and a debt crisis. The most significant disadvantage is the risk of a sudden loss of confidence. However, a modest deficit that finances investment in capital goods and is funded by FDI can support long-run development.

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Time 2 hours

Paper reference **WEC14/01**

Economics

International Advanced Level
Unit 4: Developments in the global economy

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Total Marks

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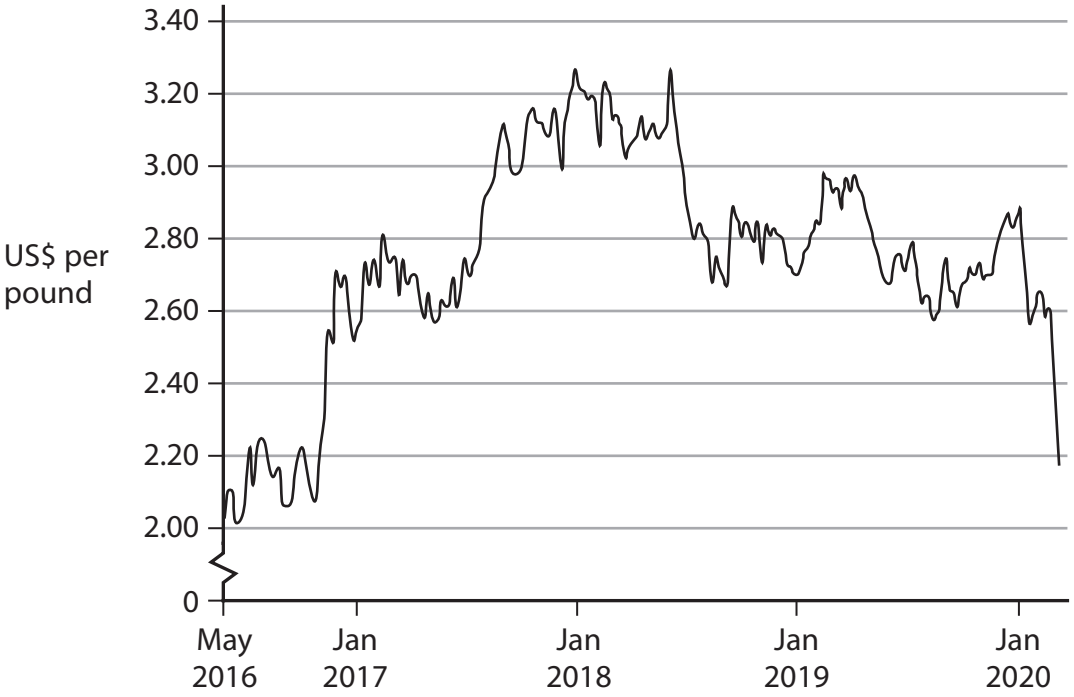
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Sources for use with Section B.

Zambia's economy

Figure 1 World copper prices, US$ per pound, 2016–2020



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Extract A Economic outlook

Zambia is a landlocked country of 17 million people. It achieved middle-income country status in 2011. Zambia had been one of the fastest growing economies in Africa. Between 2004 and 2014, real GDP grew by an average of 7.5% per year. Between 2014 and 2018, Zambia's economy continued to grow but at a slower rate.

In 2019 uncertainty in global markets, and a slower pace of economic recovery in many advanced countries, were major constraints on Zambia's economic growth prospects. This was mainly because of the country's heavy reliance on copper exports. Zambia is the world's seventh-largest copper producer. Copper contributes to 30% of Zambia's GDP, 70% of its export earnings and more than 25% of its tax revenues.

Zambia's rate of inflation rose from 7.5% in 2018 to 9.2% in 2019. The inflation rate was forecast to remain high. This prompted the Bank of Zambia to raise the base interest rate by 1.75 percentage points to 11.5% between April and November 2019. This change in the interest rate affected Zambia's exchange rate. Consequently, this had a considerable impact on Zambia's balance of trade with South Africa, a major trading partner of Zambia. Over 55% of Zambia's imports are from South Africa.

Zambia has low human development indicators. Poverty and income inequality are very high by international standards. The Gini coefficient in 2018 was 0.50. The quality of education, healthcare and infrastructure was also weak. Wages in Zambia were lower than in most middle-income countries.

Increased trade tensions between the USA and China led to a decline in the global demand for copper. The subsequent fall in the price of copper decreased Zambia's real GDP growth rate from 4% in 2018 to 2% in 2019.

Between January and May 2020 Zambia's currency, the *kwacha*, depreciated by 30% against the US dollar. This was as a result of falling foreign currency reserves caused by debt servicing and low production in the copper mining sector.

To reduce the impact of such external shocks it would be beneficial for Zambia to move away from its dependence on copper mining. The Government identified developments in tourism, infrastructure, and information and communication technology as the areas for economic diversification. These developments would help to increase Zambia's real GDP in the long-term.

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Acknowledgements

Figure 1 based on data taken from https://www.macrotrends.net/1476/copper-prices-historical-chart-data

Extract A adapted from
https://tradingeconomics.com/zambia/
https://www.afdb.org/en/countries/southern-africa/zambia
https://www.worldbank.org/en/country/zambia/overview#1
https://www.tralac.org/resources/our-resources/13594-zambia-intra-africa-trade-and-tariff-profile.html