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 In 2022 Mali was one of the least developed countries in the world with an HDI score of 0.43.

Which **one** of the following interventionist strategies could stimulate economic development in Mali?

- ☒ **A** Promotion of foreign direct investment
- ☒ **B** Development of human capital
- ☒ **C** Removal of government subsidies
- ☒ **D** Privatisation of nationalised industries

(Total for Question 1 = 1 mark)

2 Between January 2021 and November 2021 the eurozone currency, the euro, depreciated against the US dollar from €1 = $1.23 to €1 = $1.13.

Which **one** of the following could have caused the depreciation in the exchange rate of the euro against the US dollar?

- ☒ **A** There was greater economic stability in the eurozone than in the USA
- ☒ **B** The eurozone inflation rate decreased relative to that in the USA
- ☒ **C** There was more capital flight from the eurozone than from the USA
- ☒ **D** The eurozone interest rate increased relative to that in the USA

(Total for Question 2 = 1 mark)

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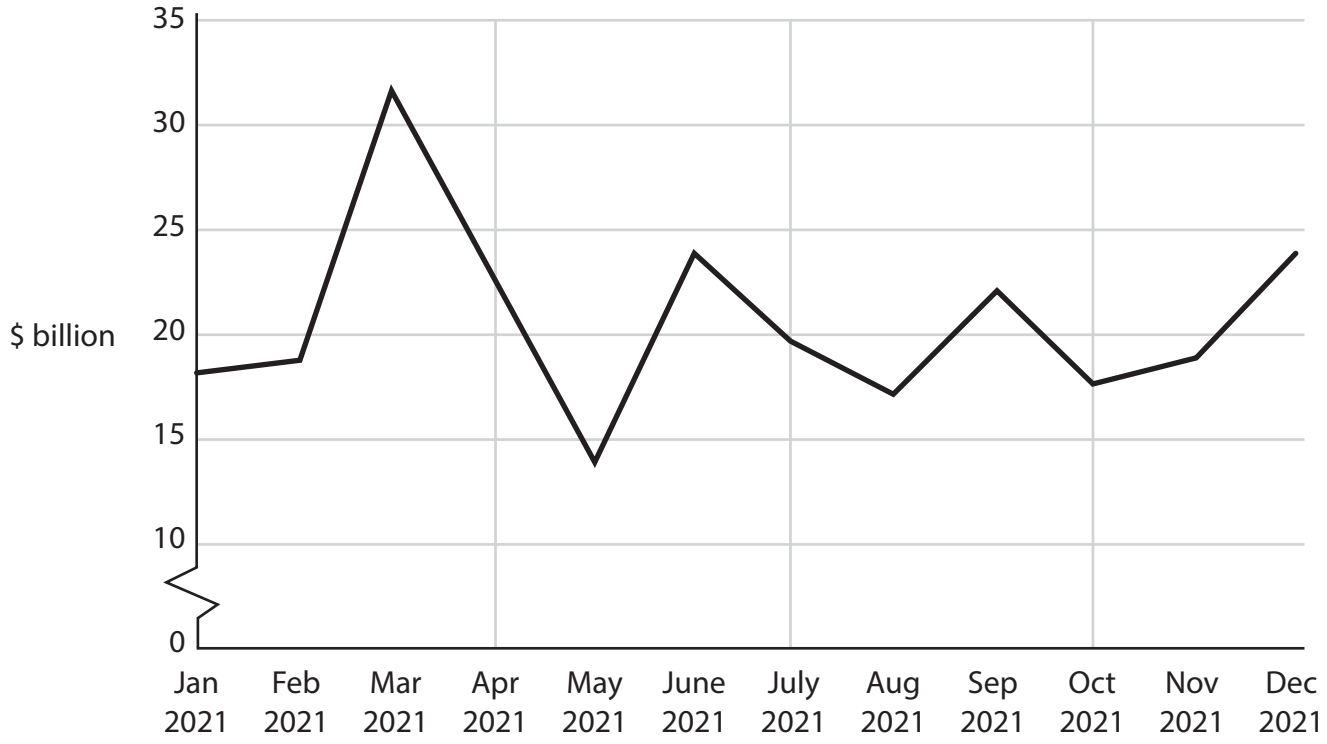
3 Between 2018 and 2019 the Lorenz curve of Peru shifted closer to the line of perfect equality.

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

- ☒ **A** The Gini coefficient for Peru had decreased
- ☐ **B** The Marshall-Lerner condition was not met
- ☐ **C** The rate of unemployment in Peru had increased
- ☐ **D** The Government of Peru had decreased progressive tax rates

(Total for Question 3 = 1 mark)

4 The chart shows Germany's net monthly balance of trade in goods and services, $ billion, January 2021 to December 2021.



(Source: adapted from https://tradingeconomics.com/germany/current-account)

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

- ☐ **A** There was a surplus in the capital and financial accounts
- ☐ **B** There was a fiscal surplus and an increase in the national debt
- ☐ **C** The value of imports was greater than the value of exports
- ☒ **D** The value of exports was greater than the value of imports

(Total for Question 4 = 1 mark)

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5 In May 2021 Canada's central bank aimed to reduce the value of the Canadian dollar against the UK pound sterling.

Which **one** of the following combinations of foreign currency transactions would Canada's central bank use to reduce the value of the Canadian dollar against the UK pound sterling?

	Canadian dollar	UK pound sterling
☒ **A**	Buy	Buy
☒ **B**	Buy	Sell
☒ **C**	Sell	Buy
☒ **D**	Sell	Sell

(Total for Question 5 = 1 mark)

6 Between 2000 and 2020 Pakistan's terms of trade decreased by 43.4%.

Ceteris paribus, which **one** of the following factors is most likely to have caused this decrease in Pakistan's terms of trade?

☒ **A** A higher rate of inflation in Pakistan relative to other countries

☒ **B** The prices of imports into Pakistan increased at a faster rate than the prices of its exports

☒ **C** An appreciation of Pakistan's exchange rate

☒ **D** The prices of Pakistan's exports increased at a faster rate than the prices of its 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 and 2 and Extracts A, B and C in the Source Booklet before answering Question 7.

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

7 (a) With reference to the second and third paragraphs of Extract C, calculate the amount saved by Japanese citizens from the total cash payments made by the Japanese Government. You are advised to show your working.

(2)

(b) With reference to Figure 1 and Extract A, explain what is meant by an 'inflation target' (Extract A, line 5).

(4)

(c) With reference to Figure 1 and Extract A, analyse **two** ways a deflationary monetary policy can 'control the rising rate of inflation'.

(6)

(d) With reference to Figure 2 and Extract B, examine **two** reasons why the demographic changes in Japan may constrain its rate of economic growth.

(8)

(e) With reference to Extract C, discuss policies that the Japanese Government could implement to increase the country's long-term rate of economic growth.

(14)

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(a) With reference to the second and third paragraphs of Extract C, calculate the amount saved by Japanese citizens from the total cash payments made by the Japanese Government. You are advised to show your working.

(2)

Total cash payments = $350 billion; proportion saved = 70%

Amount saved = $350 billion × 0.7

= $245 billion

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(b) With reference to Figure 1 and Extract A, explain what is meant by an 'inflation target' (Extract A, line 5).

(4)

An inflation target is the rate of inflation that the central bank aims to achieve, so that the economy has low and stable inflation. The central bank adjusts monetary policy, such as the base interest rate and quantitative easing, to keep inflation close to the target rate.

Extract A states that the Bank of Japan's inflation target is 2%. Figure 1 shows that the BoJ did not meet the target in any month between January 2020 and December 2021: inflation was negative for most of late 2020 and 2021, falling to −1.2%. Even after inflation started to increase in October 2021, it only reached 0.8% in December 2021, which is 1.2 percentage points below the 2% target.

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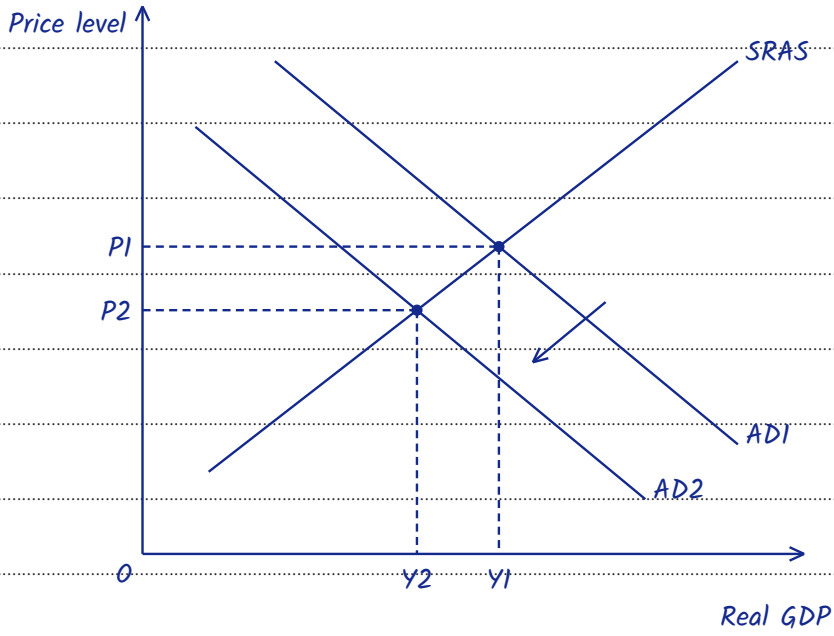
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(c) With reference to Figure 1 and Extract A, analyse **two** ways a deflationary monetary policy can 'control the rising rate of inflation'.

(6)

A deflationary monetary policy reduces aggregate demand (AD) to bring inflation down. Figure 1 shows Japan's inflation rate rose from 0.1% in October 2021 to 0.8% in December 2021, an increase of 0.7 percentage points.

1. Raising the base interest rate, for example from −0.1% to 0% as traders expected (Extract A). This increases the cost of borrowing and the reward for saving, so households borrow less to buy durable goods and save more, and firms postpone investment because fewer projects are profitable. Consumption (C) and investment (I) fall, so AD shifts left from AD1 to AD2, and the price level falls from P1 to P2 compared with what it would otherwise be, reducing demand-pull inflationary pressure.



2. Ending quantitative easing. The BoJ would stop creating money to buy government bonds, which reduces the money supply and the liquidity of commercial banks. Bond prices fall, so long-term interest rates rise, and banks lend less and on stricter criteria. Credit becomes scarcer and more expensive, so C and I fall, AD shifts left as in the diagram and the rising rate of

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inflation is controlled. In fact, in February 2022 the BoJ chose not to pursue a deflationary policy, unlike some other central banks, because inflation was still below target.

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(d) With reference to Figure 2 and Extract B, examine **two** reasons why the demographic changes in Japan may constrain its rate of economic growth.

(8)

Figure 2 shows that the percentage of Japan's population aged 65 and over rose from about 22.5% in 2010 to just over 28% in 2020, a rise of almost 6 percentage points. Extract B shows that the population fell by 630 000 in 2021 and is estimated to fall by a further 16 million between 2022 and 2040.

1. Labour shortages. In 2021 the number of people under 20 was at its lowest level since 1968, so fewer young people will enter the workforce. A smaller working population reduces the quantity of labour available, so the productive capacity of the economy falls and LRAS shifts left, lowering potential output. Shortages of workers also push up wages, raising firms' costs and causing cost-push inflation, which reduces real output and therefore the rate of economic growth.

2. A higher dependency ratio. With a record number of people over 65, the Government must spend more on pensions and healthcare. This has an opportunity cost, as less can be spent on infrastructure and education, which raise productivity. Alternatively, income tax on a shrinking workforce must rise, which reduces the incentive to work and lowers disposable income and consumption, so AD and real GDP grow more slowly.

However, labour shortages are likely to be the more significant reason, as Extract B notes "significant concerns regarding how Japan's economy can continue to function with a smaller workforce". In the short run the impact is small: the fall of 630 000 in 2021 is only about 0.5% of the 125.8 million population. The problem is long term, since the forecast fall of 16 million is about 12.7% of the population. The impact could also be reduced if older people keep working and pass on their skills and experience, or if firms use automation to raise labour productivity.

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(e) With reference to Extract C, discuss policies that the Japanese Government could implement to increase the country's long-term rate of economic growth.

(14)

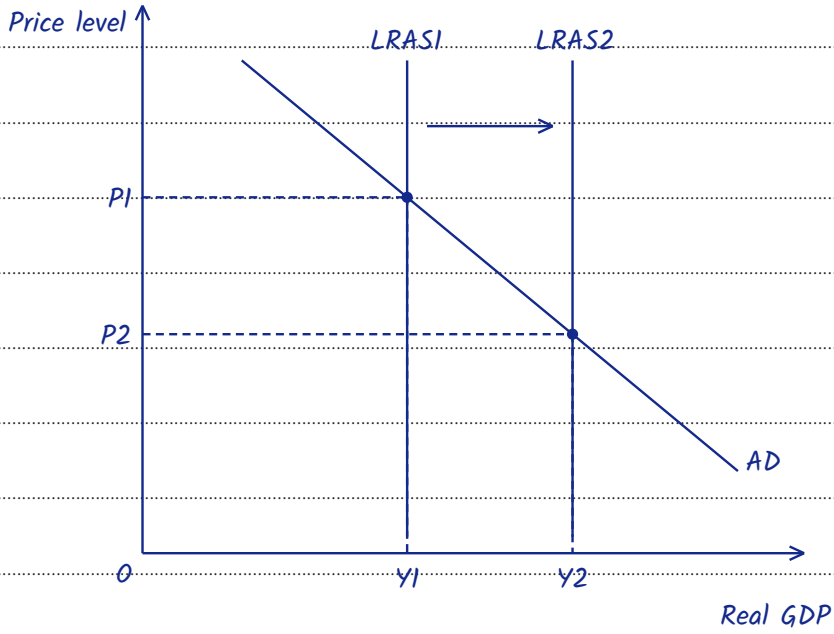
Long-term economic growth is an increase in the productive potential of the economy (potential GDP), shown by a rightward shift of LRAS. Extract C suggests the Government should move away from direct cash payments, since 70% of the $350 billion, $245 billion, is expected to be saved and past payments had little effect on consumption, and should instead invest in the labour force, healthcare and infrastructure.

Investment in the labour force. More spending on education, vocational training and retraining raises the skills of workers and closes skills gaps, increasing human capital. More productive workers raise output per worker, so productive potential increases. With a shrinking workforce (Extract B), raising productivity is the main way Japan can increase output. Policies such as subsidised childcare to bring more women into work would also raise the quantity of labour.

Investment in healthcare. Better healthcare creates a healthier workforce, with fewer working days lost to illness, and allows older people to stay in work for longer. As over 28% of the population is over 65, this increases both the size and the productivity of the labour force, shifting LRAS to the right.

Investment in infrastructure. Better transport links, broadband and energy networks reduce firms' costs and journey times, increasing efficiency and encouraging private investment and trade. In the short run the spending is an injection which raises AD by a multiple through the multiplier effect. In the long run the larger capital stock shifts LRAS1 to LRAS2, so real GDP rises from Y1 to Y2 while the price level falls from P1 to P2, giving non-inflationary growth.

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However, the main constraint is the public finances. Japan's national debt was over 250% of GDP in 2021 and it had already spent $770 billion supporting the recovery. More borrowing has an opportunity cost: debt interest payments would rise, especially if interest rates increase, leaving less for public services, and taxes may have to rise in future. Borrowing could also crowd out private investment, although with a base rate of −0.1% this risk is small at present.

There are also long time lags. Education and training take many years to raise productivity, and large infrastructure projects take years to plan and build, so growth will not rise quickly. The impact depends on the size and quality of the spending: training must match the skills firms need and projects must be well chosen, otherwise there is government failure. Spending on geriatric care improves welfare but adds little to productive capacity, whereas health spending on working-age people raises labour supply. Growth from infrastructure may also conflict with protecting the environment.

Overall, investment in the labour force is likely to be the most effective policy, because Japan's main constraint on growth is its shrinking, ageing workforce. Redirecting money from cash payments, most of which is saved, towards training, healthcare for workers and infrastructure

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would raise long-term growth without adding much to the national debt, provided the spending is well targeted and the Government accepts that the benefits will only appear in the long run.

(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 2021 there was a significant increase in the number of joint ventures between local businesses and transnational companies in many developing countries.

Evaluate the likely benefits to a developing country of joint ventures between local businesses and transnational companies as a means of promoting *economic development*.

(Total for Question 8 = 20 marks)

9 Between 1970 and 2020 growth in international trade, a key measure of globalisation, increased significantly.

Evaluate whether the benefits of globalisation outweigh the costs. Refer to a country of your choice in your answer.

(Total for Question 9 = 20 marks)

10 In 2020 developed countries that were members of the Organisation for Economic Cooperation and Development (OECD) spent $238 billion on agricultural subsidies.

Evaluate the disadvantages of agricultural subsidies paid to farmers in developed countries on developing countries.

(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** ☐

A joint venture is an arrangement in which two or more firms, here a local business and a transnational company (TNC), pool their resources to carry out a project, sharing the costs, risks, control and profits while remaining separate firms. Economic development is an improvement in living standards and welfare, including health, education and income, measured for example by the Human Development Index (HDI). An example is Maruti Suzuki in India, a joint venture between the Indian Government's Maruti Udyog and Suzuki of Japan, which became India's largest car manufacturer.

1. Transfer of technology and skills. The local firm gains access to the TNC's technology, finance, management techniques and brand. Local workers are trained in new skills, which raises human capital and labour productivity. When these workers later move to other local firms, the skills spread through the economy as a positive externality. Higher productivity leads to higher wages, so GNI per capita and living standards rise.

2. Economies of scale and access to markets. Sharing costs allows the venture to produce on a larger scale and gain internal economies of scale, such as technical and purchasing economies, so average costs and prices fall. Combined with the TNC's distribution networks, this gives access to wider export markets. Exports rise, so AD increases and, through the multiplier, more jobs and incomes are created. Export earnings also provide foreign currency to import capital goods, narrowing the foreign exchange gap, while higher incomes increase savings, narrowing the savings gap in the Harrod-Domar model.

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3. Shared risks encourage investment. As the TNC provides part of the capital, the local firm faces a lower financial burden and lower risk of losses if a project fails. More investment therefore takes place in R&D, technology and infrastructure than if the local firm acted alone, increasing the capital stock and the productive potential of the economy. Consumers also benefit from a wider range of higher quality, lower priced goods, increasing consumer surplus and allocative efficiency.

4. Higher tax revenues. Profitable ventures and higher employment raise corporation tax and income tax revenue. Unlike a wholly foreign-owned subsidiary, part of the profit stays in the country with the local partner rather than being repatriated. The government can spend the revenue on healthcare and education, raising life expectancy and years of schooling, so HDI and economic development improve.

However, the size of the benefits depends on the number and size of the joint ventures. The question states there was a significant increase in joint ventures in 2021, so the impact may be large, but if they are concentrated in a few industries, such as mining, which contribute little to GDP and employment, the effect on development will be limited.

If joint ventures use capital-intensive methods, few jobs are created for low-skilled workers, so the gains in incomes and skills go to a small number of workers and inequality may widen. The TNC may also keep its core technology and senior management roles at home, limiting the transfer of skills.

Joint ventures can also fail. Conflicting objectives, as the TNC may aim to maximise global profit while the local firm wants to expand locally, and differences in business culture cause

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communication and coordination problems, a form of diseconomies of scale which raises costs and export prices. Joint ventures are often temporary, and when the agreement ends the TNC may withdraw its investment, so development may not be sustained.

The tax benefits may also be smaller than expected. Governments often offer tax holidays to attract TNCs, and TNCs may use transfer pricing to shift profits to low-tax countries. Even where revenue rises, corruption or spending on defence rather than health and education means it may not improve development. There may also be environmental costs if the ventures are in polluting industries.

Overall, joint ventures are likely to bring significant benefits for development, greater than wholly foreign-owned FDI, because the local partner keeps a share of the profits and gains direct access to technology and skills, as the success of Maruti Suzuki shows. The size of the benefit depends mainly on whether the ventures are labour-intensive and long-lasting, and on whether the government uses the extra tax revenue to invest in health and education, so that local firms can absorb new technology and the gains are spread across the population.

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

An agricultural subsidy is a payment from the government to farmers which lowers their costs of production or raises their income. In 2020 OECD countries spent $238 billion on them, through schemes such as the EU's Common Agricultural Policy and US farm support. They are a form of protectionism, because they give farmers in developed countries an artificial cost advantage over foreign producers.

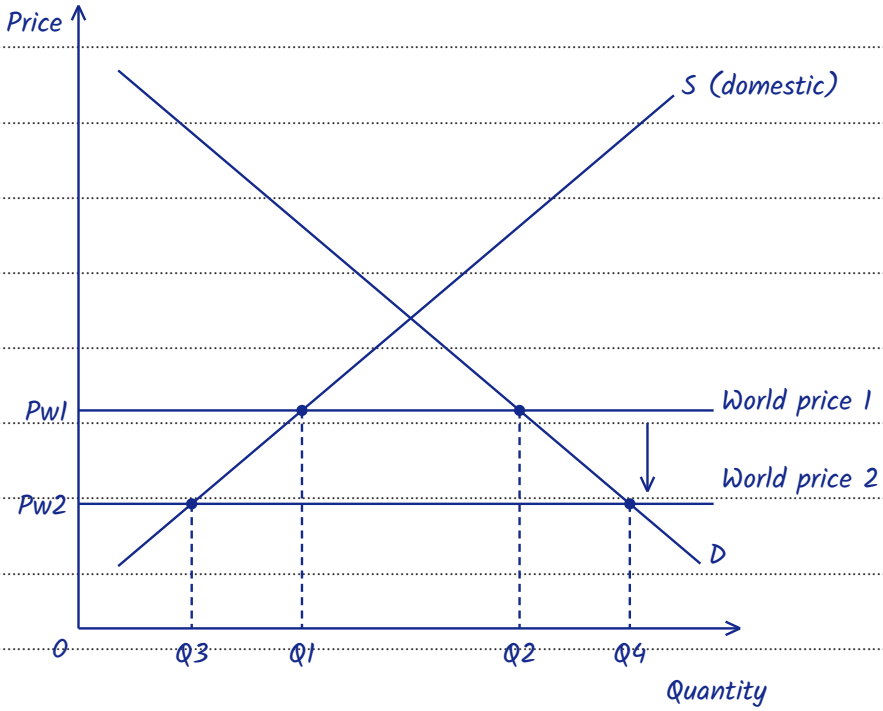
1. Lower world prices and dumping. Subsidies shift the supply curve of developed-country farmers to the right, increasing world supply and reducing the world price. Surpluses are often exported below their cost of production (dumping). The diagram shows a developing country's domestic market: the world price falls from Pw1 to Pw2. Domestic consumption rises from Q2 to Q4, but domestic production falls from Q1 to Q3, so imports rise from Q1Q2 to Q3Q4. Producer surplus of local farmers falls, and many farmers, often among the poorest people, lose income or go out of business.

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2. Loss of comparative advantage and export earnings. Many developing countries have a comparative advantage in agriculture because of low labour costs and a suitable climate. Subsidies divert trade away from these low-cost producers towards high-cost producers in developed countries, so world resources are misallocated. For example, US cotton subsidies are argued to have reduced world cotton prices and the export earnings of West African producers such as Burkina Faso, Benin and Mali. Lower export revenue reduces net exports and AD, so economic growth slows.

3. Balance of payments and terms of trade. Lower export revenue and higher food imports worsen the current account of the balance of payments. Lower prices for primary products also worsen the terms of trade, so more exports are needed to buy the same imports of capital goods, widening the foreign exchange gap and limiting investment.

4. Poverty, unemployment and inequality. Agriculture employs a large share of the workforce in many developing countries, so falling farm incomes increase rural unemployment and absolute poverty, widen inequality between rural and urban areas, and encourage migration to overcrowded

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cities. Lower incomes also mean less saving and investment, holding back economic development and HDI.

However, developing countries that are net importers of food, such as Egypt, which imports large quantities of wheat, may benefit from lower world prices: consumers gain consumer surplus, and lower food prices reduce inflation and poverty among urban households. The overall effect therefore depends on whether the country is a net exporter or a net importer of the subsidised products.

The size of the effect also depends on the type of subsidy and the products affected. Subsidies linked to output, such as guaranteed prices, increase supply the most, whereas many OECD payments are now "decoupled" from production and distort trade less. Subsidies on cereals, dairy and sugar compete with some developing countries, but not with tropical crops such as cocoa and coffee. In addition, WTO members agreed in Nairobi in 2015 to eliminate agricultural export subsidies, which limits dumping.

Furthermore, the farmers of developing countries may be held back more by their own problems, such as poor infrastructure, lack of credit and low productivity, than by subsidies abroad. Some also have preferential access to developed markets, such as the EU's Everything But Arms scheme for least developed countries, which offsets part of the harm.

Overall, agricultural subsidies are most damaging to developing countries which are net exporters of the subsidised products, such as the cotton producers of West Africa, because they lower prices, reduce export earnings and increase rural poverty. For net food importers the short-run effect may be positive, although cheap imports discourage them from developing their own agriculture in the long run. The disadvantages are significant, but their size depends on the type

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of subsidy and the structure of each economy.

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TOTAL FOR PAPER = 80 MARKS

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Economics

International Advanced Level
UNIT 4: Developments in the global economy

Source Booklet

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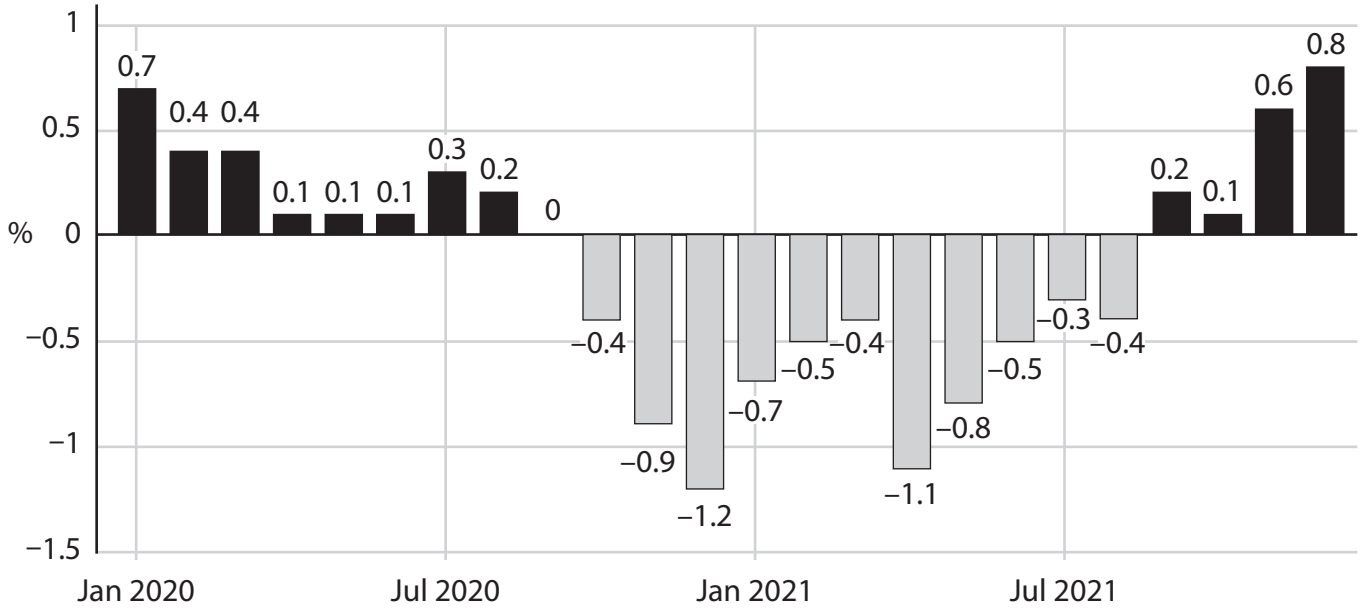
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Sources for use with Section B

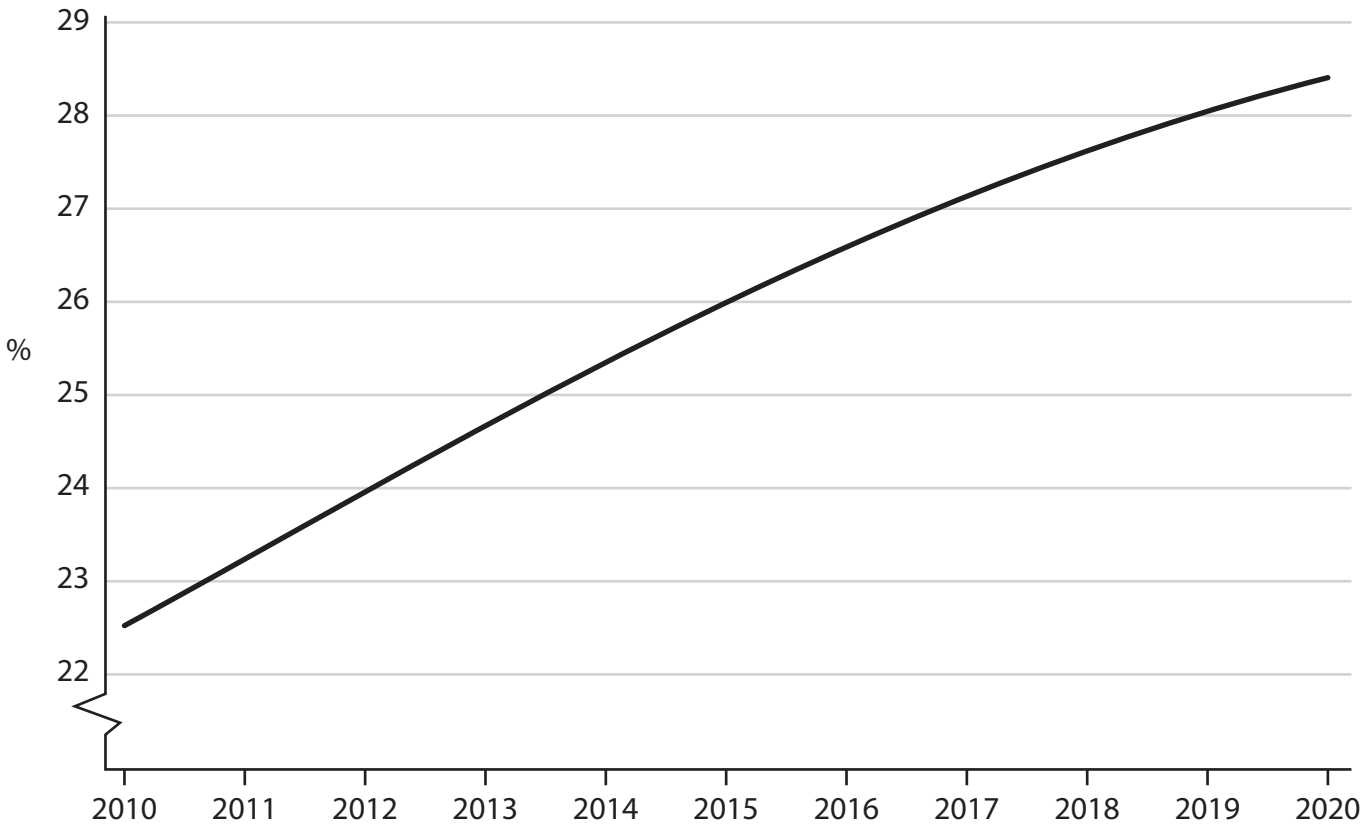
The economy of Japan

Figure 1 Inflation rate*, as measured by the Consumer Price Index (CPI), January 2020 – December 2021



* This is the year-on-year inflation rate calculated monthly

Figure 2 Percentage of the population aged 65 and over, 2010–2020



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Extract A Monetary policy

Japan's rate of inflation started to increase in October 2021. Traders speculated that the Bank of Japan (BoJ) would control the rising rate of inflation by ending quantitative easing or by increasing the base interest rate from –0.1% to 0%. However, Japan's inflation rate was below the BoJ's inflation target of 2%. It was also lower than the rates of inflation experienced in several other advanced economies. Consequently, in February 2022, the BoJ decided not to pursue a deflationary monetary policy, unlike the central banks of some other advanced economies.

Extract B Demographic changes

In 2020 Japan had a population of 125.8 million. In 2021 its population decreased by 630 000 people. Between 2022 and 2040 it is estimated that its population will decrease by a further 16 million. In 2021 the number of people under the age of 20 was at its lowest level since 1968. At the same time, the number of people over the age of 65 had increased to a record level.

There are significant concerns regarding how Japan's economy can continue to function with a smaller workforce.

Extract C Government expenditure

Between March 2020 and November 2021 Japan's Government spent $770 billion in supporting the country's economic recovery.

In early 2022 many governments of advanced economies were recovering from the global health crisis and were planning to reduce their spending. By contrast, the Japanese Government made a direct cash distribution of $872 to each household with children under the age of 18. In addition, the Government announced that cash payments would also be given to low-income households, temporary workers and students. The total cash payments made by the Japanese Government was $350 billion.

However, similar payments distributed in the past have had little effect on the level of consumption and the rate of inflation in Japan. It is unlikely that the outcome will be any different this time. It is estimated that 70% of the total cash payments received by Japanese citizens will be saved.

Some economists suggest that Japan's Government should instead focus its spending on increasing the country's long-term rate of economic growth. They believe that there should be greater investment in the labour force, healthcare and infrastructure. However, there were concerns over additional government spending because Japan's national debt was over 250% of GDP in 2021.

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Acknowledgements

Figure 1 based on data taken from tradingeconomics, https://tradingeconomics.com/japan/inflation-cpi

Figure 2 based on data taken from https://data.worldbank.org/indicator/SP.POP.65UP.TO.ZS?locations=JP

Extract A adapted from FT, https://www.ft.com/content/253df366-707b-4a45-8eb4-f245e08fa370

Extract B adapted from FT, https://www.ft.com/content/980c49e8-e90c-47a6-b892-138a3b83d646

Extract C adapted from FT, https://www.ft.com/content/52216cb9-0505-4fde-824a-58c7778d07e1