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Centre number

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Candidate number

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Surname *StemUp Model Solution*

Forename(s)

Candidate signature

I declare this is my own work.

INTERNATIONAL A-LEVEL ECONOMICS

Unit 4 Economic Development and the Global Economy

Monday 9 January 2023

07:00 GMT

Time allowed: 2 hours

Materials

For this paper you must have:

- the Source Booklet, provided as an insert (enclosed)
- a calculator, which you are expected to use where appropriate.

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Fill in the boxes at the top of this page.
- Answer **all** questions in **Sections A, B and C**.
- Answer **EITHER** Question 15 or Question 16 in **Section D**.
- You must answer the questions in the spaces provided. Do **not** write outside the box around each page or on blank pages.
- Do **not** write in the Source Booklet.
- If you need extra space for your answer(s), use the lined pages at the end of this book. Write the question number against your answer(s).
- Do all rough work in this book. Cross through any work you do not want to be marked.

Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 90.
- You may use a bilingual dictionary for this exam.
- You may **not** use an English dictionary.

For Examiner's Use	
Question	Mark
1–10	
11	
12	
13	
14	
15	
16	
TOTAL	



J A N 2 3 E C O 4 0 1

Section A

Answer **all** questions in the spaces provided.

Only **one** answer per question is allowed.

For each question completely fill in the circle alongside the appropriate answer.

CORRECT METHOD



WRONG METHODS



If you want to change your answer you must cross out your original answer as shown.



If you wish to return to an answer previously crossed out, ring the answer you now wish to select as shown.



0 1

Transnational companies (TNCs) may deliberately reduce the profits they make in some countries to reduce the tax they pay. This involves one part of a business charging another part of the same business for goods and services received.

This strategy is known as

[1 mark]

A deferred payment.

☐

B dumping.

☐

C tax evasion.

☐

D transfer pricing.

☒


0 2

Table 1 shows labour market statistics for a more economically developed country (MEDC).

Table 1

Number of individuals employed	12 600 000
Number of individuals out of work but actively seeking employment	636 000
Number of 16–24 year olds in full-time education	2 000 000

What is the unemployment rate to one decimal place?

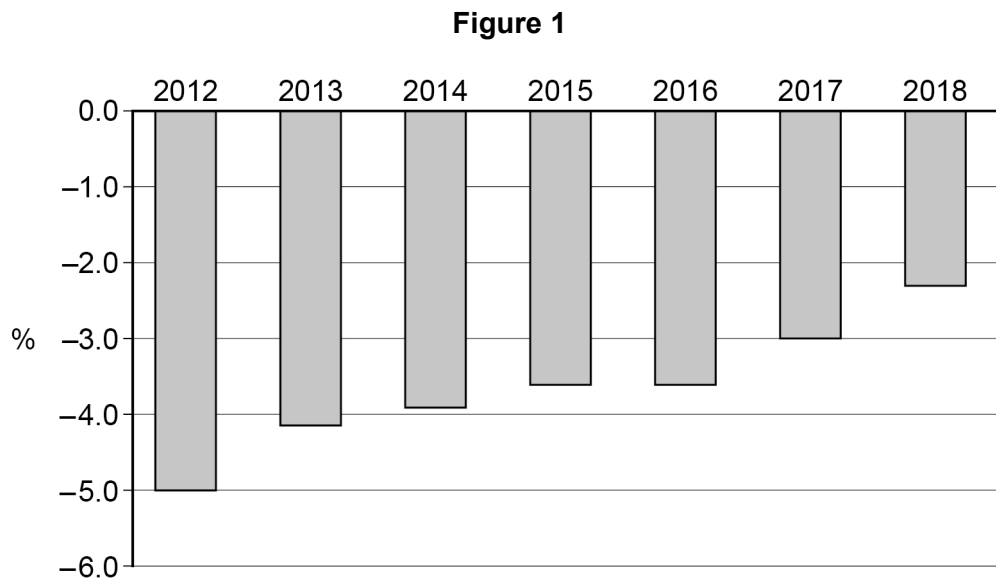
[1 mark]**A** 4.4%☐**B** 4.8%☒**C** 4.9%☐**D** 5.0%☐

Turn over for the next question

Turn over ►

0 3

Figure 1 shows the budget balance for France as a percentage of GDP in 2012–2018.



All other things being equal, what can be concluded about the size of the public sector debt for France?

[1 mark]

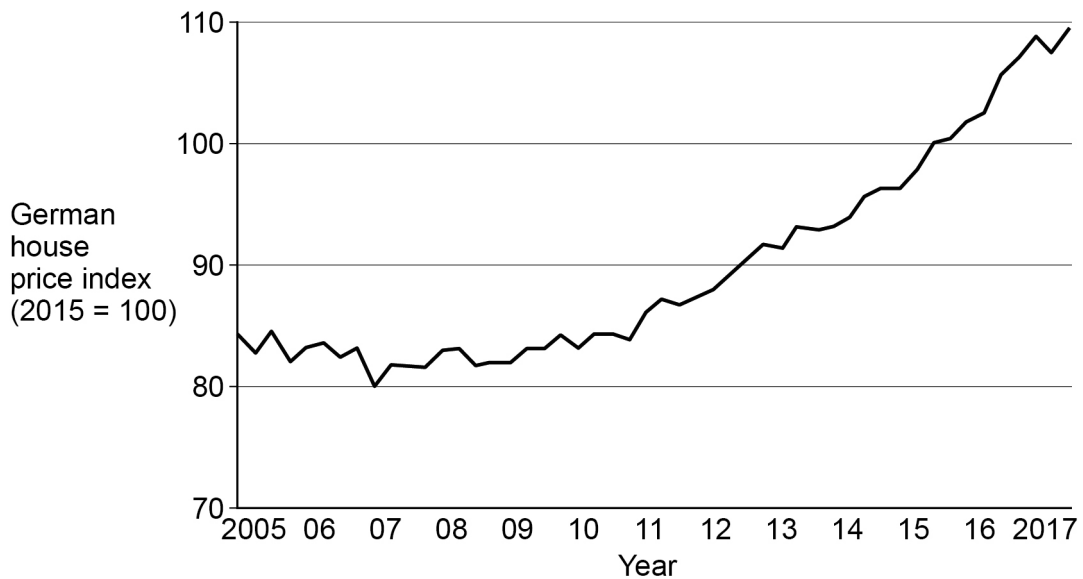
- A** Public sector debt fell in all years except 2016.
- B** Public sector debt was highest in 2018.
- C** Public sector debt was lower in 2013 than 2012.
- D** Public sector debt was unchanged between 2015 and 2016.

☐
☒
☐
☐


0 4

Figure 2 shows the index of house prices in Germany from 2005 to 2017.

Figure 2



As a result of the changing house prices, a commercial bank in Germany increased its mortgage lending. This raised the ratio of its long-term lending to customer deposits.

Which one of the following combinations shows the most likely impact on the bank's liquidity and profitability?

[1 mark]

	Liquidity	Profitability	
A	Falls	Falls	☐
B	Falls	Rises	☒
C	Rises	Falls	☐
D	Rises	Rises	☐

Turn over for the next question

Turn over ►



0 5

In 2008, the UK Government spent £500bn to support banks that held too many risky assets.

Which one of the following best describes why banks may engage in risky lending due to this financial support?

[1 mark]

A Asymmetric information

☐

B Herding

☐

C Moral hazard

☒

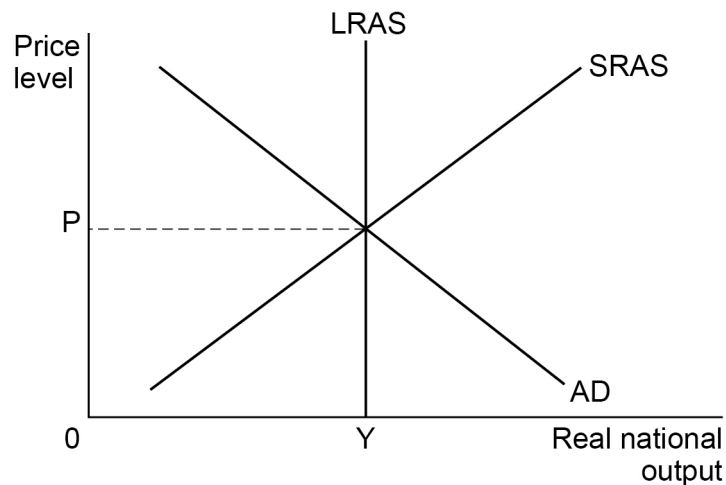
D Speculation

☐

0 6

Figure 3 shows the aggregate demand (AD) curve, short-run aggregate supply (SRAS) curve and long-run aggregate supply (LRAS) curve for an emerging economy. The economy is in equilibrium at output Y.

Figure 3



In order to maintain growth rates, the government increases its spending.

Which one of the following indicators is most likely to **decrease** as a result of this change in spending?

[1 mark]

A International competitiveness

☒

B Nominal wages

☐

C The budget deficit

☐

D The current account deficit

☐


0 7

Table 2 shows a selection of items from the balance of payments account of a country over two years.

Table 2

	Year 1	Year 2
	\$ billion	\$ billion
Balance of trade in goods	–75	–60
Balance of trade in services	120	100
Net FDI	90	80
Net portfolio investment	107	117
Payments to the IMF	–5	–4
Overseas development aid	–10	–10

All other things being equal, which one of the following is true?

[1 mark]

- A** The capital account has improved.
- B** The deficit in goods and services has fallen.
- C** The financial account has improved.
- D** The secondary income balance has improved.

☐
☐
☐
☒

Turn over for the next question

Turn over ►



0 8

Table 3 shows the average values for the price elasticity of demand for an economy's exports and imports.

Table 3

	Price elasticity of demand
Exports	−0.65
Imports	−1.20

The economy devalues its currency.

All other things being equal, which one of the following is the most likely impact of this devaluation?

[1 mark]

A The balance of trade worsens.

☐

B The demand for exports rises.

☒

C The value of exports rises.

☐

D The value of imports rises.

☐
0 9

A fall in which one of the following development indicators would indicate an improvement in the standard of living in an economy?

[1 mark]

A Human Development Index

☐

B Life expectancy

☐

C Literacy rate

☐

D Multidimensional Poverty Index

☒


1 0

Which one of the following changes is most likely to cause a country's currency to appreciate?

[1 mark]

- A** Hot money leaves the country after a fall in economic growth.
- B** The base interest rate of its major trading partner is raised.
- C** The country's central bank buys large amounts of foreign currency.
- D** The fall in outward FDI is greater than the fall in inward FDI.

☐☐☐☒**10**

Turn over for Section B

Turn over ►



Section B

Answer **all** questions in the spaces provided.

1	1
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Governments can use a variety of policies to promote economic growth and development. This may involve changing the tax system to finance increased government spending.

1	1	.	1
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Define 'progressive tax'.

[2 marks]

A progressive tax is a tax where the proportion (percentage) of income paid in tax rises as income rises, so higher income earners pay a larger share of their income in tax than lower income earners.

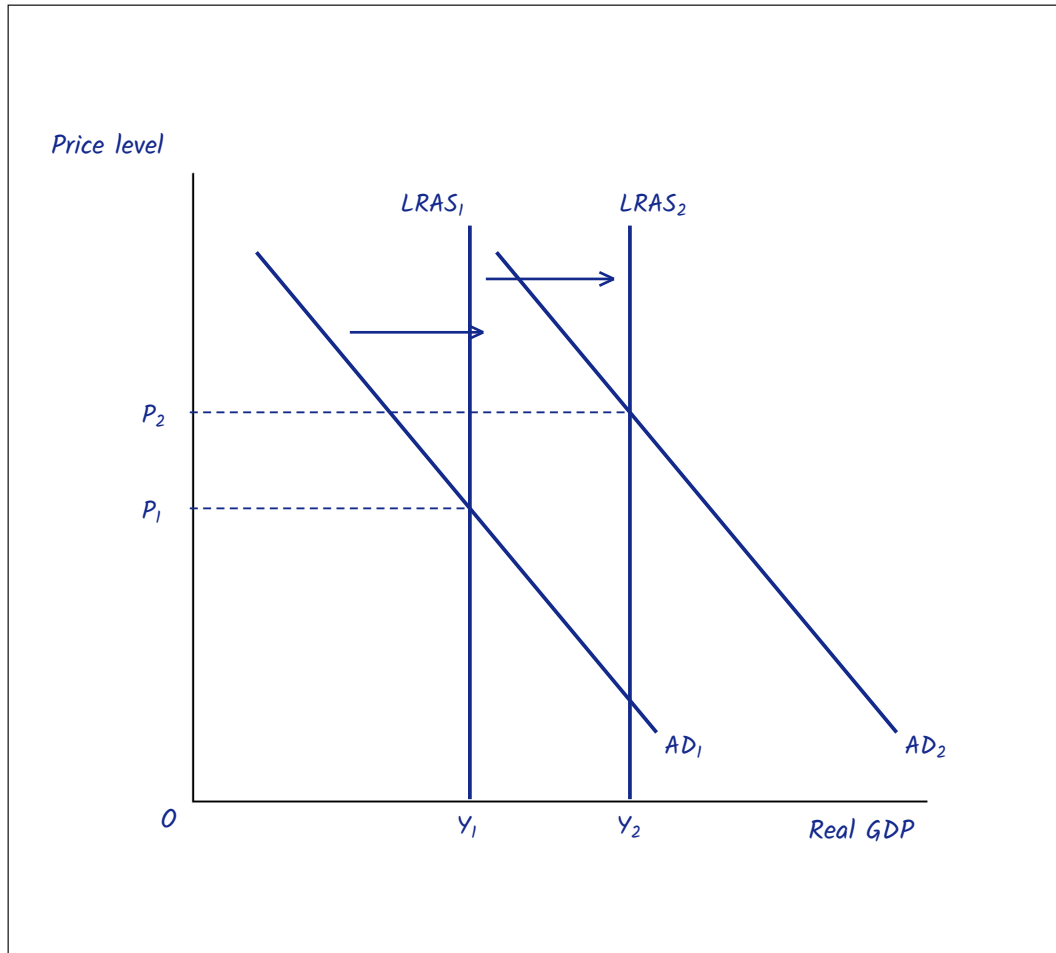


1 1 . 2

A government decides to build a new high-speed rail link to raise the rate of economic growth in the economy and increase its productive capacity.

Draw an AD/AS diagram to show how increased government spending on infrastructure will affect an economy.

[4 marks]



Question 11 continues on the next page

Turn over ►



1 1 . 3

A government attempts to increase economic growth by increasing government spending by \$70bn.

The government has the following information:

- 20% of household income is taxed
- 30% of income is spent on imports
- on average, \$0.15 of an additional \$1 of income is saved by households.

Calculate the total change in national income due to the increase in government spending.

Give your answer to the **nearest billion dollars**.

You are advised to show your working.

[4 marks]

$$MPW = MPT + MPM + MPS = 0.2 + 0.3 + 0.15 = 0.65$$

$$MPC = 1 - 0.65 = 0.35$$

$$\text{Multiplier} = 1 \div (1 - MPC) = 1 \div 0.65 = 1.538...$$

$$\text{Change in national income} = 1.538... \times \$70bn = \$107.69...bn$$

$$\text{Answer: } \$108bn$$



Section C

Look at the Source Booklet and answer **all** questions in the spaces provided.

Do **not** write in the Source Booklet.

1 2

Extract A shows the value of world exports and the growth of world real GDP (%), from 2004 to 2020.

1 2 . 1

Explain why changes in the value of world exports are likely to affect the growth of world real GDP.

[4 marks]

World exports are the total value of goods and services sold across borders by all countries, and world real GDP is the total output of the world economy adjusted for inflation. Exports (X) are an injection and a component of aggregate demand, $AD = C + I + G + (X - M)$, so when the value of a country's exports rises, AD shifts to the right and real output rises.

The extra export earnings become income for firms and workers, who spend part of it, so through the multiplier real GDP rises by more than the initial rise in exports.

Firms need more capacity to meet export orders, so through the accelerator investment rises, and more workers are employed. As one country's exports are another country's imports, rising world trade also allows countries to specialise according to comparative advantage, gain economies of scale and access cheaper inputs, which lowers costs, increases competition and productivity and shifts

Extra space aggregate supply to the right. Export-led growth in large economies such as China also raises their imports, which spreads growth to the rest of the world. A fall in the value of world exports has the opposite effect, reducing world real GDP growth.

Turn over ►



1 2 . 2

To what extent do the data suggest that changes in the value of world exports have affected growth of world real GDP between 2004 and 2020?

Use the data in **Extract A** to support your answer.

[4 marks]

There is some evidence of a positive link. From 2004 to 2008 the index of the value of world exports rose from 55.7 to 97.6 (75.2%), and world real GDP growth was at its highest, 4.4% in both 2004 and 2006. From 2016 to 2018 the index rose by 21.3 points (22%) and growth increased to 3% in 2018. When the index fell by 11.8 points between 2018 and 2020, growth turned negative at -3.6% in 2020. Over the whole period the index rose from 55.7 to 106.4 (91%) and world real GDP grew every year except 2020.

However, the link is not always strong. Between 2008 and 2010 growth rose from 1.9% to 4.3%, the largest increase, while the index fell from 97.6 to 92.5. The fall in the index between 2014 and 2016 did not cause negative growth, which was 2.6% in 2016 and 3% in 2018. There may be a time lag: the slowdown in export growth between 2012 and 2014 (21.1% to 2.6%) was followed by slower GDP

Extra space growth from 2014 to 2016 (2.9% to 2.6%).

The data only cover alternate years and are global aggregates, and causation may run both ways. Consumption, investment and government spending are a larger share of GDP in most countries. Overall, exports appear to have had some effect, but other factors also matter.



1 3

Extract B (lines 1–2) states: ‘There is growing evidence that the world economy has reached the end of a long period of lower tariffs and reduced protectionism.’

Explain why a country may decide to adopt protectionist policies.

[12 marks]

Protectionism is the use of policies to restrict imports and protect domestic producers from foreign competition. Examples include tariffs (taxes on imports), quotas (limits on the quantity of imports), subsidies to domestic producers, embargoes and non-tariff barriers such as strict product standards and complex customs rules. Extract B suggests that, after a long period of trade liberalisation, many countries are now turning back towards protection.

A tariff raises the price of imports, so domestic consumers switch to domestically produced goods. Domestic producers increase output along their supply curve and imports fall. A quota or a subsidy has a similar effect, while a subsidy lowers domestic firms' costs so that they can compete on price with foreign firms.

One reason for protection is to protect employment. Free trade is often blamed for the decline of industries such as steel and manufacturing in MEDCs, as cheaper imports from low-wage economies take market share. Workers become structurally unemployed and, if they are occupationally and geographically immobile, whole regions suffer. By reducing imports, protection raises demand for domestic output, so the derived demand for labour rises and jobs are saved. Protecting a declining (sunset) industry slows its decline and gives workers time to retrain.

A second reason is to reduce a current account deficit. Imports are a withdrawal from the circular flow, so lower imports increase net exports and aggregate demand, raising real GDP through the multiplier. A smaller deficit also reduces the need to borrow from abroad or sell assets to foreigners.

A third reason is the infant industry argument. New industries, such as electric vehicles in an emerging economy, have high average costs because they have not yet gained economies of scale or experience. Temporary protection allows them to

Turn over ►



grow, reduce costs and eventually compete internationally, which helps the economy diversify away from dependence on a few primary products, reducing its vulnerability to falling world prices.

Extra space Countries also use protection against dumping, which is when foreign firms sell goods below cost in another market. This could drive efficient domestic firms out of business, so anti-dumping duties restore fair competition. Tariffs also raise government revenue, which is especially important in LEDCs with a small tax base.

Recent events have added further reasons. The global recession and the pandemic disrupted global supply chains, so countries want to reduce their reliance on imports whose supply may fluctuate. Strategic industries such as food, energy, defence, medicines and semiconductors may be protected so that the country is not dependent on foreign suppliers that could be cut off for political reasons. Finally, a country may impose tariffs in retaliation against another country's protectionist policies, as in the trade war between the USA and China, to put pressure on it to remove its own barriers.



1 4

Extract C (lines 9–10) states: ‘Governments have taken action to correct balance of payments problems due to concerns over unemployment and economic growth.’

Assess the effectiveness of different policies that may be used to solve balance of payments problems.

[25 marks]

The balance of payments is a record of all financial transactions between the residents of one country and the rest of the world over a period. It consists of the current account, the capital account and the financial account. Balance of payments problems usually mean a large and persistent current account deficit, but they can also include a large surplus, volatile flows of speculative hot money, a lack of FDI, or high external debt. As Extract C suggests, these problems matter because a deficit is a withdrawal of demand, reducing growth and raising unemployment, and it must be financed by borrowing or selling assets abroad, which may not be sustainable.

Policies can be grouped into expenditure-switching policies, which switch spending from imports to domestic goods, expenditure-reducing policies, which reduce total spending and so spending on imports, and supply-side policies, which improve competitiveness.

A devaluation or depreciation of the exchange rate is an expenditure-switching policy. It makes exports cheaper in foreign currency and imports dearer in domestic currency, so the volume of exports rises and the volume of imports falls. However, its effectiveness depends on the price elasticities of demand for exports and imports. By the Marshall-Lerner condition, the current account only improves if the sum of the PEDs is greater than one. In the short run demand is inelastic because contracts are fixed and buyers take time to switch, so the deficit first worsens before improving, which is the J-curve effect shown in the diagram. In addition, dearer imported raw materials and food cause cost-push inflation, which erodes the gain in competitiveness over time, and other countries may retaliate.

Turn over ►



Protectionism is another expenditure-switching policy. Tariffs and quotas raise the price of imports, so consumers switch to domestic goods and the deficit falls. This acts quickly, but it causes a deadweight welfare loss, raises prices for consumers, protects inefficient firms, and is likely to provoke retaliation, which reduces exports. It may also break WTO rules, and the IMF promotes liberalisation instead.

Expenditure-reducing policies include contractionary fiscal policy, such as higher income tax or lower government spending, and contractionary monetary policy, such as higher interest rates. Lower disposable income reduces consumption, and as part of consumption is spent on imports, imports fall, especially if the marginal propensity to import is high. However, this comes at a high cost: AD shifts left, so growth falls and unemployment rises, which is exactly the concern in Extract C. Higher interest rates may also attract hot money, causing the exchange rate to appreciate, which makes exports less competitive and offsets some of the improvement.

Supply-side policies aim to tackle the cause of the deficit, which is often low productivity and poor non-price competitiveness. Investment in education, training, infrastructure and research raises productivity, lowers unit labour costs and improves quality, so exports grow and domestic firms compete better with imports. Countries such as Singapore and Malaysia used investment in human capital and infrastructure to achieve export-led growth. Lower corporation tax and deregulation can attract inward FDI, which brings inflows on the financial account and builds export industries. These policies improve the current account without reducing growth, and may even raise it by shifting LRAS to the right. However, they take a long time to work, have an opportunity cost and uncertain results.

The effectiveness of each policy depends on the cause of the problem. If a deficit is caused by excessive consumer spending in a boom, expenditure-reducing policies are appropriate, but if it is caused by a lack of competitiveness, only supply-side

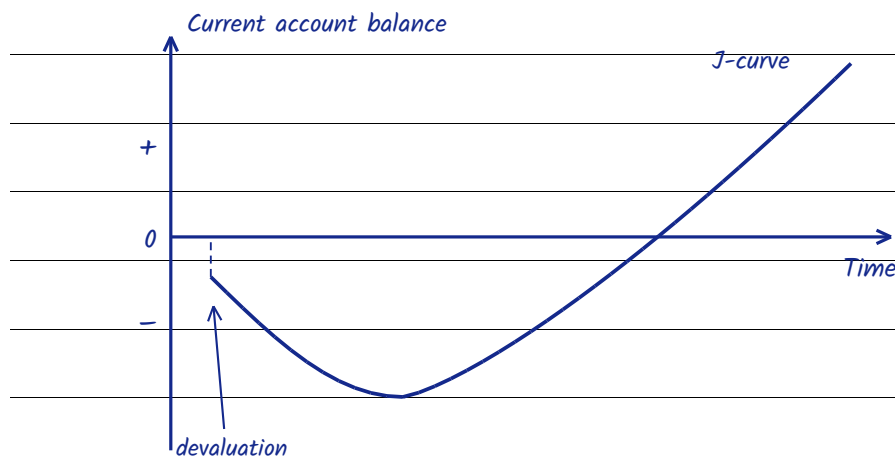


Extra space

policies give a lasting solution. It also depends on the context: an economy with spare capacity can respond to a devaluation by increasing output, while one at full capacity will mainly experience inflation. The PEDs of exports and imports matter for both devaluation and tariffs, and the time period is important, as most policies involve a trade-off between short-run costs and long-run benefits.

It is also questionable whether a deficit is always a problem that needs a policy response. The USA and the UK have run current account deficits for many years, financed by surpluses on the financial account as foreign investors buy their assets. Persistent surpluses, as in Germany, can also be a problem, reflecting weak domestic demand.

In conclusion, no single policy is fully effective. Expenditure-switching and expenditure-reducing policies can reduce a deficit in the short run, but they often harm growth, employment and consumers, or are offset by inflation and retaliation. Supply-side policies are the most effective in the long run because they address the underlying cause, low competitiveness, and support growth rather than reducing



it. The best approach is likely to be a combination, with supply-side reforms supported by a managed exchange rate, chosen according to the cause of the problem and the country's other objectives.



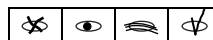
Section D

Answer **EITHER** Question 15 **OR** Question 16.

Shade the circle below to indicate which optional question you have answered.

Question 1 5 ☐Question 1 6 ☒CORRECT METHOD ☒

WRONG METHODS

**Either**

1 5

In 2018, the Organisation for Economic Co-operation and Development (OECD) launched an initiative about economic growth. This initiative encourages economies to consider environmental factors and quality of life when working towards economic growth, instead of just focusing on GDP.

Evaluate whether economic growth should be the main economic objective for all economies.

[25 marks]**or**

1 6

According to the United Nations (UN), 'Education... is a key to escaping poverty. Education helps reduce inequalities and reach gender equality... In 2018, some 773 million adults – two-thirds of whom are women – were illiterate'.

Assess whether poor education is likely to be the most significant factor limiting economic development.

[25 marks]

Economic development is an improvement in the living standards and welfare of the population, including higher real income per head, better health and education, less poverty and more freedom and choice. It is measured by indicators such as the Human Development Index (HDI), which combines GNI per capita, life expectancy and years of schooling, or the Multidimensional Poverty Index. Limited development is most common in LEDCs, for example in sub-Saharan Africa and South Asia. Poor education can be measured by low literacy rates, few mean years of schooling or low scores in international tests, although the quality of education is harder to measure than the quantity.

Poor education limits development in several ways. Education builds human capital, the



skills and knowledge of the workforce. Where, as the UN states, 773 million adults are illiterate, labour productivity is low, so output per worker and wages are low and people remain trapped in poverty and low-productivity subsistence farming. Better education raises productivity, lowers unit costs of production and shifts the PPF and LRAS outwards, allowing sustained growth in real income per head, as shown in the diagram. Education also has positive externalities. An educated population is healthier, as people understand nutrition and hygiene, has smaller families and better educated children, and is more likely to take part in democracy and hold governments to account. A skilled workforce attracts FDI from multinationals, encourages domestic business investment and allows innovation and the adoption of new technology. More workers in formal, higher paid jobs means higher tax revenues, which can fund further spending on health care and infrastructure.

The UN quote highlights gender inequality: two-thirds of illiterate adults are women. Educating girls increases the formal economic activity of women, effectively increasing the size of the labour force, and educated mothers are more likely to keep their own children in school and healthy. This breaks the cycle of poverty across generations and reduces inequality.

However, there are reasons to doubt that poor education is the most significant factor. Poor education is often a symptom of other problems. Absolute poverty means families need children to work rather than attend school, poor health care and malnutrition reduce children's ability to learn, and conflict destroys schools. Corruption may mean education budgets do not reach schools, and attitudes to women may keep girls at home. These causes must be tackled first, otherwise spending on education will have little effect.

Many other factors limit development. Poor infrastructure, such as unreliable electricity, roads and ports, raises costs and prevents firms from reaching markets. Corruption and weak institutions, including insecure property rights, discourage investment. A savings gap

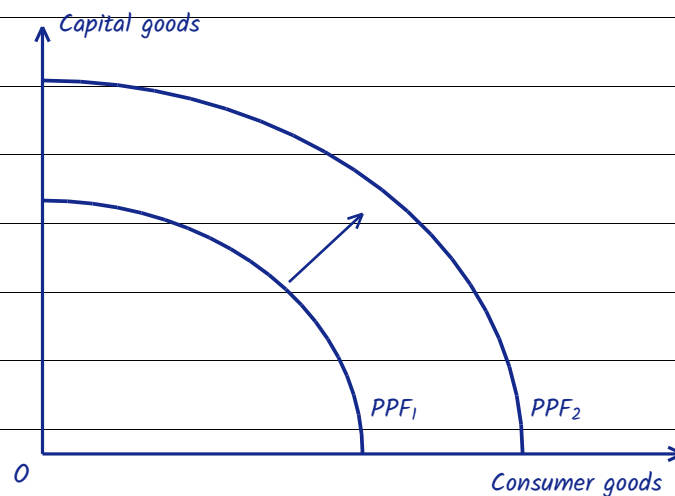
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and a lack of available credit, as described by the Harrod-Domar model, mean too little investment in physical capital. Dependence on primary products leaves countries exposed to volatile world prices and the natural resource curse. High external debt diverts funds to interest payments, and protectionism in MEDCs, such as agricultural subsidies, limits access to export markets.

Furthermore, some argue that a poorly educated population can bring benefits in the early stages of development, as a large supply of unskilled labour at low wages lowers costs of production and attracts labour-intensive manufacturing, as in Bangladesh's clothing industry. Education alone may also be ineffective if there are no skilled jobs available, causing graduate unemployment or a brain drain to MEDCs. The type of education matters: basic primary education and literacy may give the highest returns in

Extra space the poorest countries, while vocational training may be more useful than university education in others.



How significant poor education is depends on the country context. In a country suffering from civil war, such as Yemen, conflict is clearly the most significant constraint, and in a resource-rich economy with poor governance, corruption may be more important. Some factors, such as a lack of education, infrastructure and corruption, are within a country's control, while others, such as falling commodity prices, debt and trade barriers in MEDCs, are not and require action from international organisations such



as the World Bank and the IMF. Countries also have different goals, which affects how much they prioritise education. It also depends on the time period: education takes many years to raise productivity, so other policies may matter more in the short run. In conclusion, poor education is a very significant factor limiting economic development, because human capital is needed to raise productivity, attract investment, reduce gender inequality and escape poverty, and the successful economies of East Asia, such as South Korea, invested heavily in education. However, it is unlikely to be the single most significant factor in every economy, since poor education is often the result of poverty, poor health, conflict and corruption, and education is less effective without infrastructure, good governance and jobs. On balance, the factors are interdependent, and poor education is best seen as one of the most important constraints, which must be tackled alongside the others.

END OF QUESTIONS



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