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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

Wednesday 15 January 2025

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 5 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

Which one of the following best describes how transnational corporations (TNCs) operate? **[1 mark]**

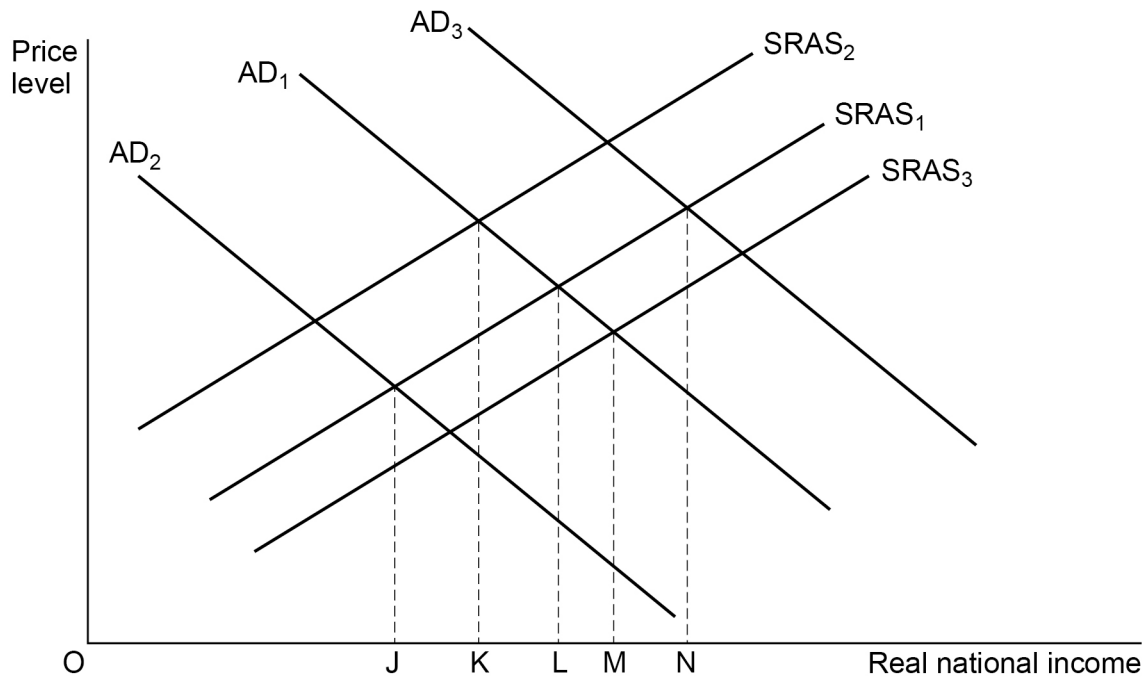
- A** TNCs import products from other countries and sell them in their home market. 
- B** TNCs invest all their profits in the countries in which they are earned. 
- C** TNCs produce and sell their products in a number of different countries. 
- D** TNCs produce in one country and export their products to other countries. 



0 2

Figure 1 shows the initial aggregate demand (AD_1) and short-run aggregate supply ($SRAS_1$) curves for a country.

Figure 1



The surplus on the country's balance of trade in goods and services increases.

All other things being equal, how is this most likely to affect the country's equilibrium level of real national income?

[1 mark]

A Real national income falls from L to J

☐

B Real national income falls from L to K

☐

C Real national income rises from L to M

☐

D Real national income rises from L to N

☒

Turn over for the next question

Turn over ►



0 3

The control of inflation is an important role of a central bank.

If inflation in a country is too high, its central bank may

[1 mark]

A increase taxes.

☐

B lower the exchange rate.

☐

C reduce interest rates.

☐

D sell government bonds.

☒
0 4

Speculation and herding behaviour may cause large fluctuations in an exchange rate.

This can happen when

[1 mark]

A speculators buy a currency that is appreciating because they believe that the exchange rate will continue to rise.

☒

B speculators buy a currency when the demand for the country's imports and exports are both price elastic.

☐

C speculators sell a currency that is depreciating because they believe that the exchange rate will start to appreciate.

☐

D speculators sell a currency when the demand for the country's imports and exports are both price inelastic.

☐
0 5

Moral hazard is most likely to increase when

[1 mark]

A a commercial bank increases the amount of cash it has deposited with the country's central bank.

☐

B a firm agrees to pay for the insurance on cars owned by workers that are sometimes used on company business.

☒

C the central bank increases the liquidity and capital ratios the commercial banks are required to maintain.

☐

D the government refuses to rescue a financial institution that has made a large loss.

☐


0 6

A firm buys a new van for \$35 000. To help pay for the van, the firm borrows \$15 000 from a bank for a period of 4 years. The interest on the loan is paid at the end of each year and the amount borrowed is paid back at the end of the period.

A rise in market interest rates means that the annual rate of interest charged by the bank increases from 4.5% to 7%.

How much **extra** interest, in total, will the firm have to pay as a result of the rise in the rate of interest?

[1 mark]**A** \$375☐**B** \$1050☐**C** \$1500☒**D** \$4200☐**0 7**

In a country whose currency is the pound (£), the nominal exchange rate appreciated from £1 = \$0.60 to £1 = \$0.75 in a year. In the same year, the country's annual inflation rate was 10% higher than in other countries.

What was the approximate change in the purchasing power of the country's currency?

[1 mark]**A** Decreased by 15%☐**B** Decreased by 35%☐**C** Increased by 15%☒**D** Increased by 35%☐

Turn over for the next question

Turn over ►



0 8

Table 1 shows the annual net inflow of foreign direct investment (FDI) for Egypt between 2016 and 2022.

Table 1

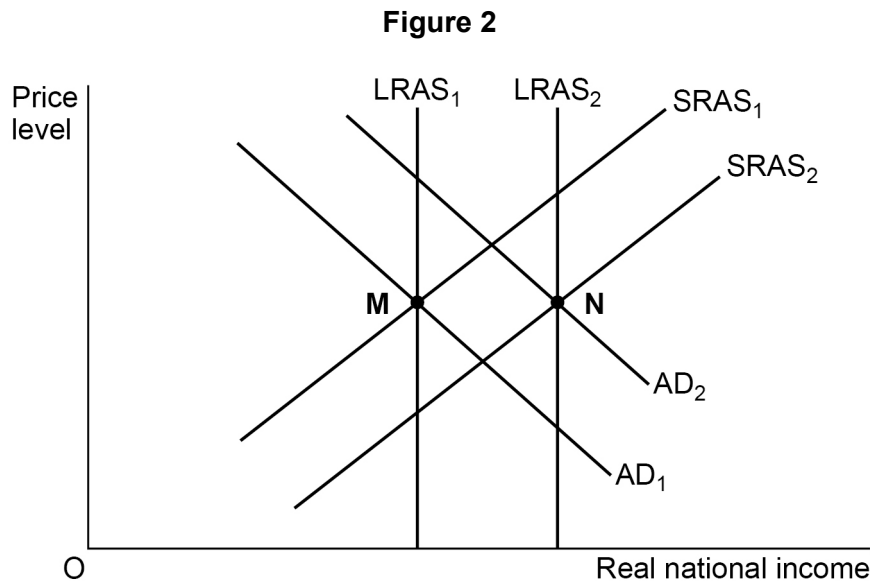
Year	2016	2017	2018	2019	2020	2021	2022
FDI (\$ billion)	8107	7409	8141	9010	5852	5122	11400

For the period 2016 to 2022, the median value of the annual net inflow of FDI for Egypt was

[1 mark]**A** \$6278 billion.☐**B** \$7863 billion.☐**C** \$8107 billion.☒**D** \$9010 billion.☐

0 9

Figure 2 shows the aggregate demand (AD), short-run aggregate supply (SRAS) and long-run aggregate supply (LRAS) curves for an economy.



All other things being equal, which one of the following economic policies is most likely to cause the country's macroeconomic equilibrium to move from point **M** to point **N**?

[1 mark]

- A** A rise in government spending on education and training
- B** An increase in the benefits given to workers who are unemployed
- C** An increase in the marginal rate of tax on company profits
- D** The introduction of a buffer stock scheme to stabilise commodity prices

☒
☐
☐
☐

Turn over for the next question

Turn over ►



1 0

A French importer buys boxes of soap from a firm in the United Kingdom. The French currency is the euro (€) and the currency of the United Kingdom is the pound (£).

Table 2 shows the price of a box of soap, in pounds, in 2023 and 2024 and the pound/euro exchange rate in 2023 and 2024.

Table 2

Price of a box of soap		Pound/euro exchange rate	
2023	2024	2023	2024
£20	£24	£1.00 = €1.00	£1.00 = €1.20

What is the percentage change in the price, in euros, that the French importer has to pay for each box of soap, between 2023 and 2024?

[1 mark]

A 0%

☐

B 20%

☐

C 40%

☐

D 44%

☒

10



Section B

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

1	1
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Governments use fiscal policy to help them achieve their economic policy objectives. Fiscal policy can influence economic activity and a country's economic development through changes in taxation and government spending.

1	1	.	1
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What is the difference between a direct tax and an indirect tax?

[2 marks]

A direct tax is a tax on income and wealth (eg income tax), paid directly to the government by the taxpayer, whereas an indirect tax is a tax on spending (eg VAT) which can be passed on to the consumer.

Question 11 continues on the next page

Turn over ►



1 1 . 2 Table 3 shows a selection of economic data for a country in Year 1 and Year 2.

Table 3

	Year 1	Year 2
National income	\$500bn	\$600bn
Government spending	\$100bn	\$120bn
Taxation	\$80bn	?

The country's marginal propensity to tax is 0.15.

All other things being equal, calculate the country's budget balance in Year 2, as a percentage of its national income.

Give your answer to **two** decimal places.

[4 marks]

$$\text{Change in national income} = \$600\text{bn} - \$500\text{bn} = \$100\text{bn}$$

$$\text{Change in tax} = \text{MPT} \times \text{change in income} = 0.15 \times \$100\text{bn} = \$15\text{bn}$$

$$\text{Tax in Year 2} = \$80\text{bn} + \$15\text{bn} = \$95\text{bn}$$

$$\text{Budget balance} = \text{tax} - \text{government spending} = \$95\text{bn} - \$120\text{bn} = -\$25\text{bn}$$

(a deficit of \$25bn)

$$\text{As a \% of national income} = (25 \div 600) \times 100 = 4.1666...\%$$

Answer: a budget deficit of 4.17% of national income (-4.17%)

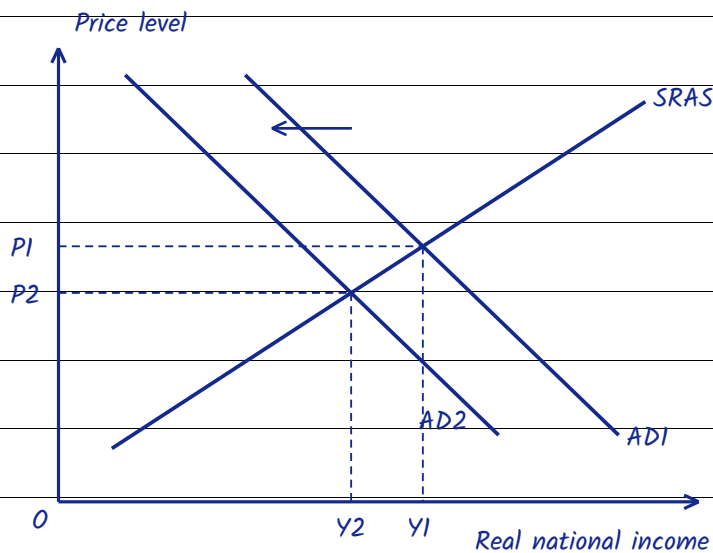


1 1 3

Explain, using a diagram, how a reduction in a government's budget deficit is likely to affect a country's national income in the short run.

[4 marks]

A budget deficit occurs when government spending is greater than tax revenue, so it is a net injection into the circular flow of income. A reduction in the deficit, through a cut in government spending (G) or a rise in taxes that reduces consumption (C), means the net injection from the government sector falls.



Since G is a component of aggregate demand ($AD = C + I + G + X - M$), AD falls and shifts left from $AD1$ to $AD2$. The initial fall is made bigger by the multiplier effect, as lower incomes lead to further falls in spending.

In the short run, with the $SRAS$ curve unchanged, firms cut output, so real national income falls from $Y1$ to $Y2$ and the price level falls from $P1$ to $P2$. Employment and incomes are likely to fall too.

10

Turn over for the next section

Turn over ►



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 output gap and the change in consumer prices (an indicator of inflation), in Indonesia between 2015 and 2023.

1 2 . 1

Explain why Indonesia's output gap is likely to affect the change in its consumer prices.

[4 marks]

The output gap is the difference between a country's actual real GDP and its potential (trend) real GDP, measured as a % of potential GDP. A positive output gap means the economy is producing above its potential, while a negative output gap means there is spare capacity. The % change in consumer prices is a measure of inflation.

With a positive output gap, aggregate demand is high relative to productive capacity, so there is excess demand in the goods market and firms raise prices (demand-pull inflation). Firms also compete for scarce labour, so wages and costs rise, adding cost-push pressure. Strong demand also sucks in imports, which may weaken the rupiah and raise import prices. Inflation is likely to rise.

With a negative output gap, as in Indonesia for most of the period, there is Extra space spare capacity and unemployment, so wage growth is weak and firms hold down prices to attract customers. The rate of increase in consumer prices is therefore likely to fall (disinflation), and the bigger the negative gap, the weaker the inflationary pressure.



1 2 . 2

To what extent do the data suggest that Indonesia's output gap affected the change in its consumer prices between 2015 to 2023?

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

[4 marks]

The data give fairly strong support. In 2015, the only year with a positive output gap (+0.3% of GDP), consumer prices rose fastest, by 6.4%, whereas in 2023 there was a negative gap (−0.2% of GDP) and inflation was lower at 4.4%.

Between 2016 and 2020 the negative output gap widened from −0.1% to −3.4% of GDP and inflation fell from 3.5% to 2.0% (disinflation). In 2020, when the negative gap was largest, inflation was the second lowest. Between 2020 and 2023 the negative gap narrowed from −3.4% to −0.2% and inflation rose from 2.0% to 4.4%.

However, there are anomalies. From 2016 to 2017 the negative gap widened from −0.1% to −0.5% of GDP yet inflation rose from 3.5% to 3.8%, and the lowest inflation (1.6%) was in 2021 when the negative gap had narrowed to Extra space −2.8%, suggesting a time lag. In some other years the gap

narrowed but inflation still fell. Other factors also mattered, such as world commodity prices, changes in the exchange rate and the pandemic.

Overall, the data strongly suggest that a larger negative output gap is generally linked to lower inflation, but the relationship is not exact and may work with a lag.



1 3

Extract B (lines 3–5) states: ‘Since 2000, Indonesia’s economic growth has been high and stable, with an average annual rate of growth in real GDP of more than 5%.’

Explain how high and stable economic growth since 2000 is likely to have contributed to the economic development of Indonesia.

[12 marks]

Economic growth is an increase in a country's real GDP, its output of goods and services, while economic development is a broader improvement in people's welfare, including higher real incomes, less poverty, better health and education and more freedom of choice. It is often measured by the Human Development Index (HDI).

First, growth of more than 5% a year means that real GDP roughly doubles every 14 years, so far more goods and services are available to consume and material living standards rise. Growth also creates jobs: as firms expand output, the derived demand for labour rises, so unemployment falls and workers move from low-productivity farming into higher-paid jobs in manufacturing and services. Rising employment and incomes reduce absolute poverty, and Table 4 shows that the proportion of people living on less than \$2.15 a day fell from 43.6% in 2000 to only 3.5% in 2021.

Second, growth raises government tax revenue without the need for higher tax rates, because incomes, profits and spending all rise. This allows the government to spend more on merit goods and public goods. Spending on education increases human capital, and Table 4 shows mean years of schooling rose from 6 to 8.6 years. A more skilled workforce is more productive and earns higher wages, which in turn raises future growth. Spending on health care improves health and life expectancy, which Table 4 shows rose from 66.43 to 67.57 years.

Third, there is a cumulative, virtuous circle. Higher incomes raise saving, which provides funds for investment, and firms invest more when they expect demand



to keep growing. Investment in capital and infrastructure such as roads, ports, electricity and clean water raises productivity, shifts the LRAS curve to the right and improves people's access to basic services, so development can be sustained. Growth also attracts foreign direct investment, bringing technology and management skills.

Extra space The fact that growth has been stable as well as high is important.

Stable growth, without booms and recessions, reduces uncertainty, so households and firms are more confident and willing to make long-term investment decisions. It avoids the rises in unemployment and poverty that happen in recessions and keeps inflation low, protecting the real incomes of the poor. Stable tax revenues also allow the government to plan long-term spending on schools, hospitals and infrastructure.

These effects are reflected in Table 4, where Indonesia's HDI rose from 0.595 to 0.705, showing that high and stable growth has very probably contributed to its economic development. The impact is greatest where the benefits of growth are widely shared and the extra tax revenue is spent on education, health and infrastructure.



1 4

Extract C (lines 17–19) states: ‘In June 2023, Indonesia imposed a ban on the export of bauxite, which is used to make aluminium. It is likely that export bans will soon be imposed on other minerals, such as copper.’

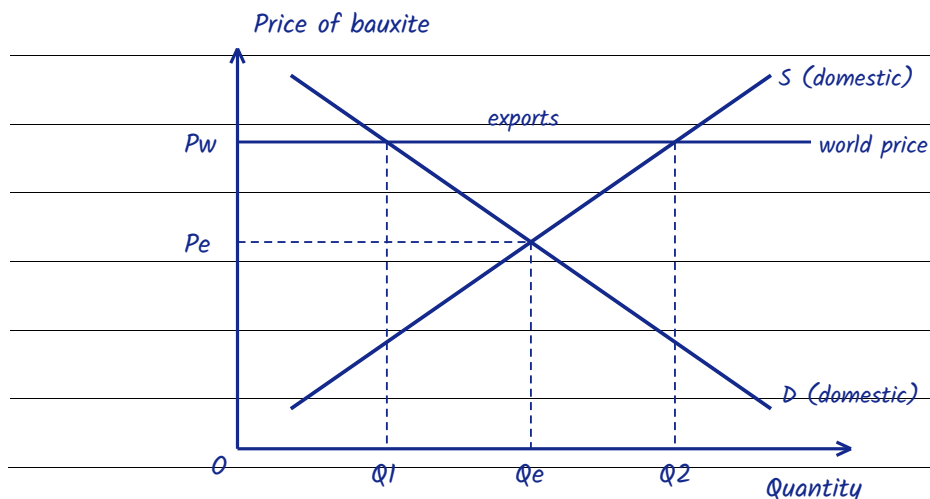
Assess the likely effects of an increase in the use of protectionist policies by Indonesia on its economic performance.

[25 marks]

Economic performance is how well an economy achieves the main macroeconomic objectives: strong and sustainable economic growth, low unemployment, low and stable inflation and a sustainable balance of payments.

Protectionist policies are measures that restrict free trade to protect domestic industries, such as tariffs, quotas, export subsidies and export bans. Extract C shows that Indonesia has banned the export of nickel ore and, from June 2023, bauxite, and is likely to ban copper exports too.

The main aim of the export bans is to make Indonesia move up the value chain. Instead of exporting cheap raw ore, firms must process it in Indonesia, smelting bauxite into aluminium and nickel into inputs for batteries. In the diagram, with free trade bauxite producers sell at the world price P_w : domestic firms buy Q_1 and $Q_2 - Q_1$ is exported. The ban removes exports, so the domestic price falls to P_e and domestic users, such as smelters, buy more at a lower cost.



This can improve economic performance. It encourages inward FDI in smelters and processing plants, as foreign firms that want access to the minerals must invest in Indonesia. Investment is an injection that raises AD with a multiplier effect, and it raises productive capacity, shifting LRAS right. Jobs are created in processing and in industries that use the minerals, such as the manufacture of batteries and electric vehicles, reducing unemployment. Exports of processed goods have much higher value added than raw ore, so in the long run export revenue and the current account may improve and the economy becomes more diversified and less dependent on volatile primary commodity prices. The Prebisch-Singer hypothesis suggests that the terms of trade of primary producers tend to worsen over time, which supports this strategy. New industries may also be protected as infant industries until they grow, benefit from economies of scale and become internationally competitive.

However, protectionism also has costs. In the short run, banning the sale of bauxite and copper means a loss of export revenue, worsening the current account and possibly weakening the rupiah, until processing capacity is built. Mining firms lose revenue and may cut jobs. If Indonesia also uses tariffs and quotas on imports, domestic prices rise, adding to inflation and reducing consumers' real incomes, and firms that rely on imported components face higher costs, making them less competitive.

More importantly, the theory of comparative advantage shows that world output and living standards are highest when countries specialise in what they produce at the lowest opportunity cost and trade freely. Protection causes resources to be misallocated to industries where Indonesia may not have a comparative advantage. Reduced competition allows inefficient firms to survive and reduces the incentive to cut costs and invest in research and development, so productive and dynamic efficiency suffer, and growth could be lower in the

Turn over ►



Extra space *long run. Infant industries may never grow up and may rely on protection for ever.*

There is also the risk of retaliation and conflict with trade rules. Indonesia is a member of the WTO and the EU has challenged the nickel export ban. If trading partners respond with their own tariffs or restrictions, Indonesia's other exports, such as palm oil and manufactured goods, could fall, making everyone worse off and harming growth and employment.

The overall effect depends on several factors. First, it depends on the type of policy: export bans on minerals where Indonesia has market power are very different from tariffs on consumer goods, which mainly raise prices. Indonesia has some of the world's largest reserves of nickel and bauxite, so buyers cannot easily switch to other suppliers and foreign firms have a strong incentive to invest. Second, it depends on the time period: the costs, such as lost export revenue, come in the short run, while the benefits of higher value added and diversification may only appear in the long run. Third, it depends on whether Indonesia has the infrastructure, energy supply and skilled labour needed to build efficient smelters, and on whether the policies are temporary and well targeted or permanent and widespread. Fourth, it depends on how trading partners react.

In conclusion, a targeted increase in protection, especially export bans on minerals where Indonesia has a strong market position, is likely to improve its economic performance in the long run by attracting investment, creating jobs and raising export values, as the nickel ban appears to have done. However, a general increase in protectionism, including tariffs and quotas on imports, is likely to worsen performance by raising inflation, reducing efficiency and provoking retaliation. On balance, the effect will be positive only if protection is limited, temporary and supported by investment in infrastructure and skills.



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**

The governments of many countries have introduced policies to attract visitors from abroad. While tourism may support the local economy, there are disadvantages for people who live in areas that are visited by large numbers of tourists.

Evaluate the view that the promotion of tourism by governments of less economically developed countries (LEDCs) will improve the living standards of their citizens.

[25 marks]**or****1 6**

In 2022, Türkiye had a deficit on its balance of payments on current account equal to 5.4% of its GDP. In the same year, Kenya's current account deficit was 4.7% of its GDP.

Evaluate the view that a deficit on a country's balance of payments on current account is likely to harm its economic development.

[25 marks]

The current account of the balance of payments records a country's trade in goods and services, primary income (such as profits, interest and dividends) and secondary income (transfers such as remittances and aid). A deficit means that the value of money flowing out for imports and income payments is greater than the value flowing in. Economic development is an improvement in people's welfare and quality of life, including higher real incomes, less poverty, and better health, education and life expectancy.

A deficit may harm development in several ways. First, a deficit is a net withdrawal from the circular flow of income, since spending on imports leaks out of the economy. Lower net exports reduce aggregate demand, so with the multiplier

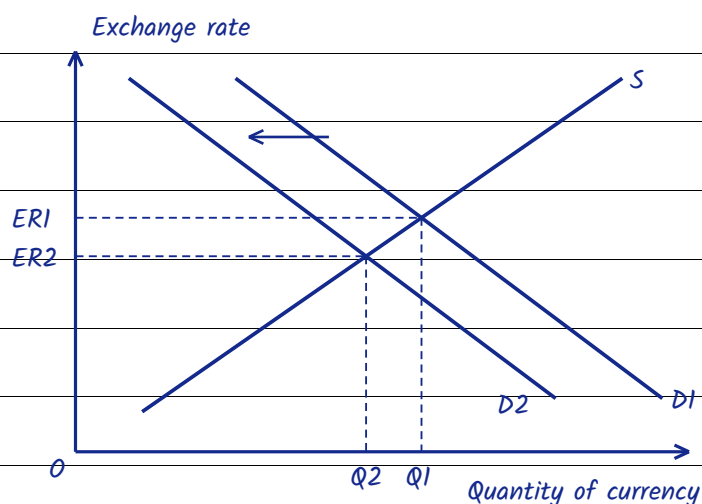
Turn over ►

effect output, incomes and employment are lower than they would otherwise be. If the deficit is caused by a loss of competitiveness, domestic firms lose market share to foreign producers, causing job losses and structural unemployment, which increases poverty.

Second, a deficit must be financed by a surplus on the financial account, either by borrowing from abroad, selling assets or using foreign exchange reserves. A persistent deficit financed by borrowing increases overseas debt, and interest payments on that debt are an outflow on primary income that makes the deficit worse. Paying the debt diverts money that could have been spent on schools, health care and infrastructure. If the debt is in US dollars, a fall in the exchange rate makes it more expensive to repay.

Third, the deficit means the demand for the currency is weak relative to its supply, so the exchange rate is likely to fall, as shown in the diagram where demand falls from D_1 to D_2 and the exchange rate falls from ER_1 to ER_2 .

Türkiye's deficit of 5.4% of GDP in 2022 was accompanied by a sharp fall in the value of the lira. A depreciation raises the price of imported food, fuel and medicines, causing cost-push inflation that reduces real incomes and hurts the poor most.



Fourth, a large deficit may cause a loss of confidence, leading to capital flight and speculative attacks on the currency, as investors fear devaluation or default. To defend the currency or reduce the deficit, the government may have to raise interest rates or cut spending, sometimes as a condition of an IMF loan. These deflationary policies reduce growth, raise unemployment and may lead to cuts in spending on health and education, directly harming development.

However, a deficit is not always harmful. It allows residents to consume more goods and services than the country produces, raising living standards in the short run. For many LEDCs such as Kenya, a deficit of 4.7% of GDP may reflect imports of capital goods, such as machinery, technology and materials for infrastructure, that cannot be produced domestically. This investment raises

Extra space productivity and productive capacity, shifting LRAS to the right, and can lead to export-led growth in the future, so the deficit may help development rather than harm it.

Much depends on how the deficit is financed. If it is financed by long-term FDI, foreign firms bring capital, jobs, technology and skills, and there is no debt to repay. If it is financed by short-term hot money flows attracted by high interest rates, these can quickly be withdrawn, causing a currency crisis, so the deficit is far more risky.

It also depends on the cause. A deficit caused by a boom in domestic demand or an overvalued exchange rate is likely to be temporary and may correct itself as the economy slows or the currency falls. A deficit caused by a contraction in export markets, such as a world recession, may also be short term. In contrast, a fundamental deficit caused by poor non-price competitiveness, low productivity and dependence on a narrow range of primary exports is more harmful because it is persistent and reflects weaknesses in the economy. A deficit caused by a sudden rise in world energy prices, as in 2022 for oil importers like Türkiye and Kenya,

Turn over ►



harms development because it reduces real incomes without adding to productive capacity.

The size and duration of the deficit also matter. A small deficit of 1 to 2% of GDP is usually sustainable, especially in a fast-growing economy, while deficits of around 5% of GDP, like Türkiye's, that persist for many years are more likely to lead to rising debt and a currency crisis. The ability of the country to finance the deficit, including its stock of foreign exchange reserves and its credit rating, is also important.

Finally, the policies used to correct the deficit matter. Expenditure-reducing policies lower imports by reducing incomes and can harm development, while supply-side policies that improve education, infrastructure and productivity reduce the deficit in the long run by making exports more competitive and support development at the same time.

In conclusion, I only partly agree with the view. A short-run deficit that is financed by FDI and used to import capital goods, as is often the case in LEDCs such as Kenya, can support economic development. However, a large and persistent deficit that reflects a lack of competitiveness, is spent on consumer goods and is financed by short-term borrowing, as appears more likely in Türkiye, is likely to harm development by causing currency depreciation, inflation, rising foreign debt and eventually painful deflationary policies. Whether a deficit is harmful therefore depends mainly on its cause, its size and duration and how it is financed.

END OF QUESTIONS



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ANSWER IN THE SPACES PROVIDED**



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