

Please write clearly in block capitals.

Centre number

Candidate number

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

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	



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

In 2020, the Central Bank of Nigeria decided to change the fixed exchange rate of its currency, the naira (₦), to the US\$ from ₦307:\$1 to ₦360:\$1.

This is known as

[1 mark]

A appreciation.

☐

B depreciation.

☐

C devaluation.

☒

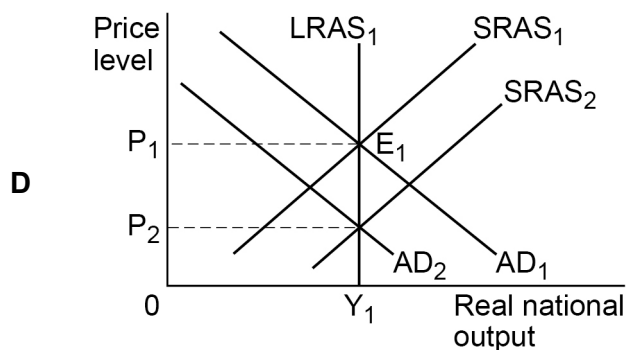
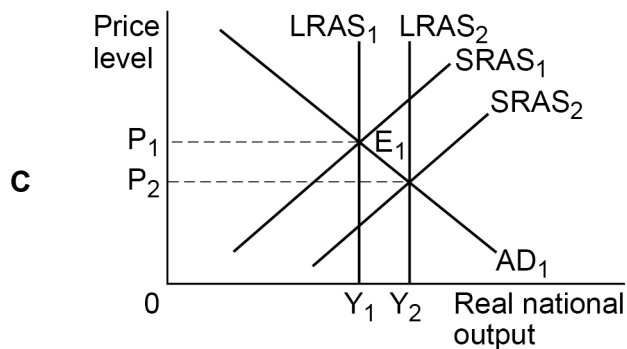
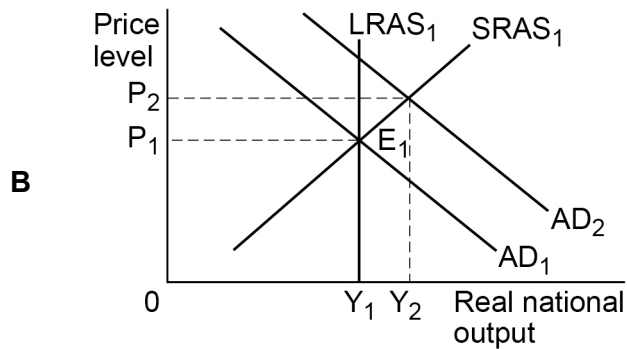
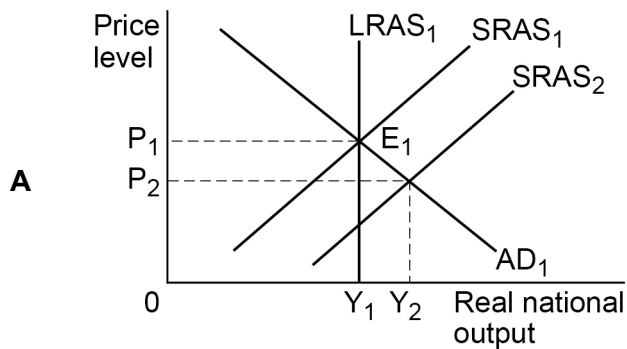
D revaluation.

☐


0 2

The diagrams below show the aggregate demand (AD), short-run aggregate supply (SRAS) and long-run aggregate supply (LRAS) curves of an economy. The economy is initially in equilibrium at E_1 .

All other things being equal, which one of the following diagrams is most likely to show export-led growth?

[1 mark]**Turn over ►**

0 3**Table 1** shows remittances into Pakistan from 2015 to 2019 in index number form.**Table 1**

Year	2015	2016	2017	2018	2019
Index of remittances	100	102.5	102.4	109.3	114.9

If the monetary value of remittances in 2016 was US\$19 734 million, what was the monetary value of remittances in 2019 to the nearest US\$ million?

[1 mark]**A** \$17 604m☐**B** \$21 043m☐**C** \$22 121m☒**D** \$22 674m☐**0 4**

An economy's exchange rate falls.

Which one of the following combinations of changes to macroeconomic indicators is most likely to result from the lower exchange rate?

[1 mark]

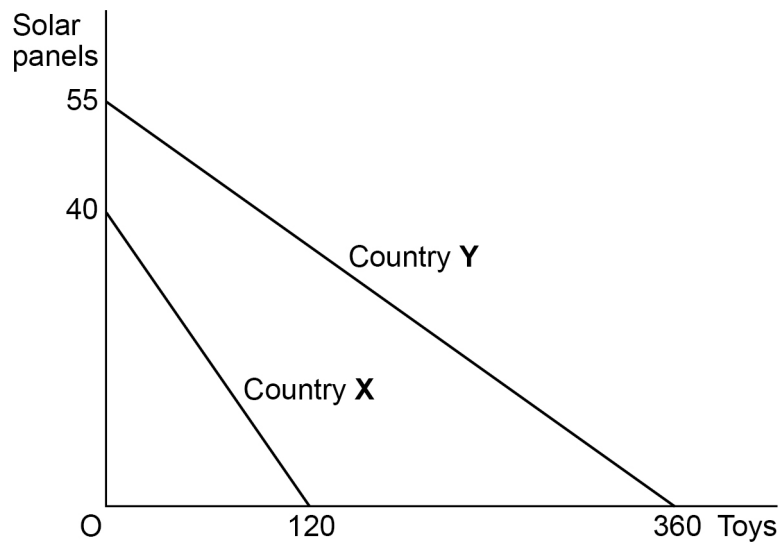
	Unemployment	Inflation	Balance of trade	
A	Falls	Falls	Worsens	☐
B	Falls	Rises	Improves	☒
C	Rises	Falls	Improves	☐
D	Rises	Rises	Worsens	☐



0 5

Figure 1 shows the production possibility boundaries (PPBs) for two countries, Country X and Country Y, producing two goods, toys and solar panels.

Figure 1



All other things being equal, which one of the following can be concluded from the diagram?

[1 mark]

- A** Country X has a comparative advantage in solar panels.
- B** Country X has an absolute advantage in solar panels.
- C** Country X should not engage in trade with Country Y.
- D** Country Y has a comparative advantage in solar panels.

☒
☐
☐
☐

Turn over for the next question

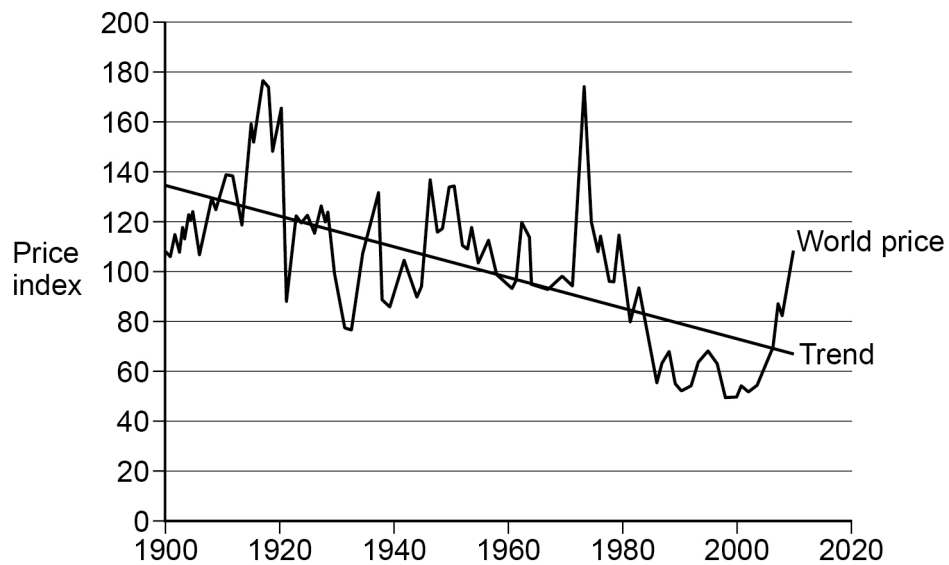
Turn over ►



0 6

Figure 2 shows the world price index and the trend line for a category of goods or services from 1900 to 2010.

Figure 2



According to the Prebisch–Singer hypothesis, which one of the following categories of goods or services is most likely to have experienced the price changes in **Figure 2**?

[1 mark]

A Books

☐

B Financial services

☐

C Food

☒

D Tourism

☐


0 7

Which one of the following is most likely to slow down the process of globalisation?

[1 mark]

A A move from multilateral to bilateral free trade agreements

☒

B A removal of limits on capital movements between countries

☐

C A rise in the number of countries in the World Trade Organization

☐

D An increase in the capacity of ports and container ships

☐

0 8

Which barrier to development in less economically developed countries (LEDs) does microfinance aim to solve?

[1 mark]

A High levels of corruption

☐

B High savings ratio

☐

C Lack of available credit

☒

D Limited supply of entrepreneurs

☐

Turn over for the next question

Turn over ►



0 9

Table 2 shows development indicators for three countries, Namibia, Cambodia and Honduras in 2020.

Table 2

	Namibia	Cambodia	Honduras
Life expectancy at birth (years)	63.7	69.8	75.3
Expected years of schooling (years)	12.6	11.5	10.1
HDI ranking	130	144	132
Inequality-adjusted HDI value	0.418	0.475	0.472

Which one of the following can be concluded from the data?

[1 mark]

- A** All three countries have high levels of human development. ☐
- B** Cambodia is the poorest country in terms of GDP per capita. ☐
- C** Honduras has the lowest child literacy rate. ☐
- D** The impact of inequality on living standards is higher in Namibia than Honduras. ☒

1 0

A spot market is used to

[1 mark]

- A** agree a price for shares in a company to be exchanged in five years' time. ☐
- B** assess the ability of a bank to withstand economic instability. ☐
- C** protect buyers of foreign currency against future falls in the market price. ☐
- D** trade commodities at a current price for immediate delivery. ☒

10

Section B

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

1 1 . 1 A tariff is a protectionist policy.

Identify **two** other protectionist policies.

[2 marks]

1. Import quotas (a physical limit on the quantity of a good that can be imported).

2. Subsidies to domestic producers, such as export subsidies.

Question 11 continues on the next page

Turn over ►

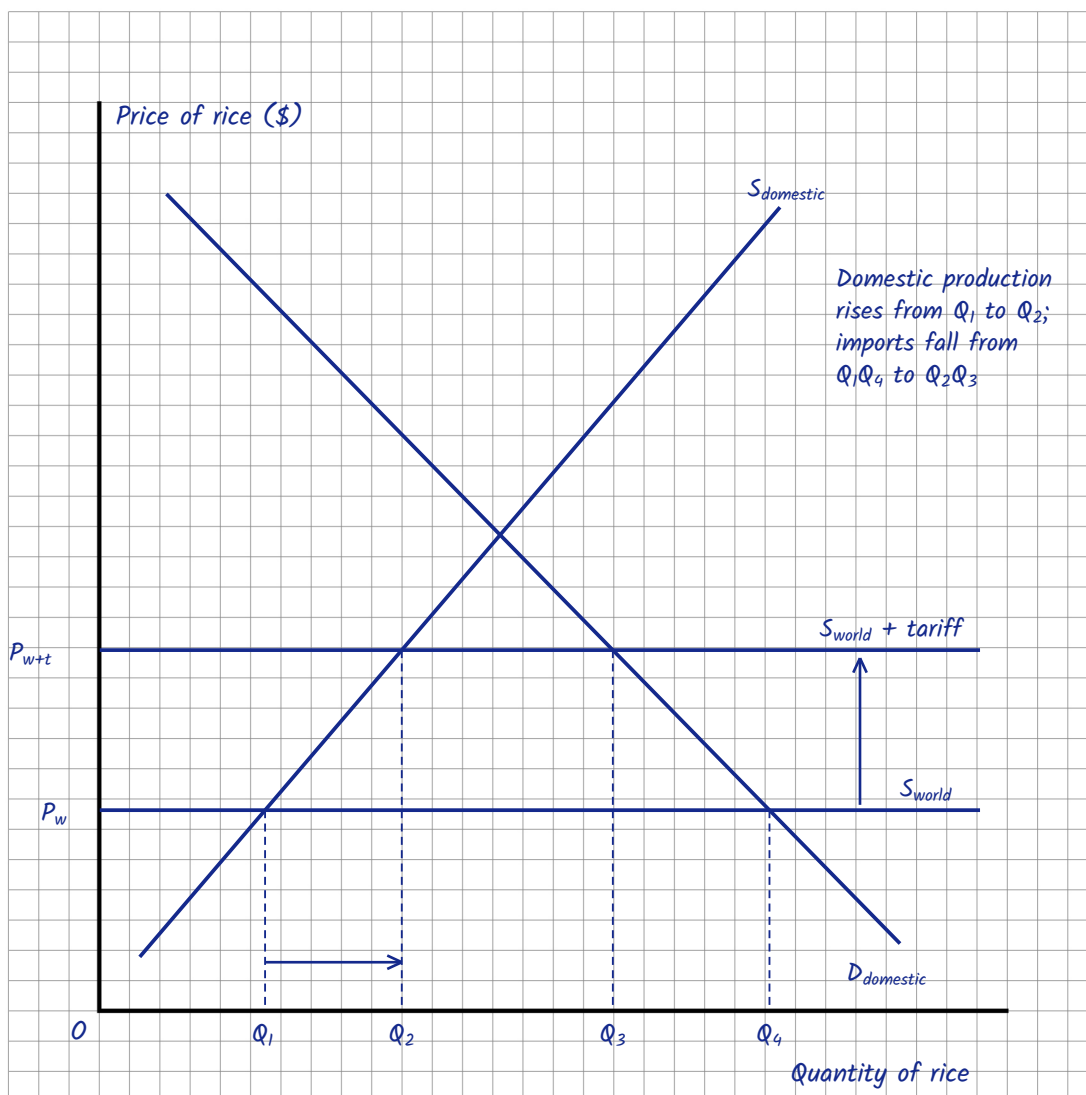


1 1 . 2

The price of rice is fixed by the world market. Country A is one of many buyers of rice. Country A decides to place a tariff on the rice.

Draw a diagram showing the tariff on rice imports **and** the change in the quantity of rice sold by producers in Country A.

[4 marks]



1 1 . 3

Table 3 shows the price of imported rice before and after a tariff is placed on rice imports into Country A. It also shows the quantity demanded by Country A consumers before the tariff is imposed.

Table 3

	Price of 1 kg of imported rice	Quantity demanded by Country A consumers (kg per week)
Before tariff	\$3.40	11 000
After tariff	\$3.91	

Country A estimates the price elasticity of demand for imported rice is -1.5

Use **Table 3** to calculate the total weekly government revenue from the tariff placed on imported rice.

Assume that the price increase is only due to the introduction of the tariff.

Give your answer to the **nearest dollar**.

You are advised to show your working.

[4 marks]

$$\text{Tariff per kg} = \$3.91 - \$3.40 = \$0.51$$

$$\% \text{ change in price} = 0.51 \div 3.40 \times 100 = +15\%$$

$$\% \text{ change in } Q_d = PED \times \% \text{ change in price} = -1.5 \times 15 = -22.5\%$$

$$\text{New quantity demanded} = 11\,000 \times (1 - 0.225) = 11\,000 \times 0.775 = 8525 \text{ kg per week}$$

$$\text{Tariff revenue} = \text{tariff per kg} \times \text{quantity imported} = \$0.51 \times 8525 = \$4347.75$$

$$\text{Answer: } \$4348 \text{ per week}$$



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 B (lines 13–14) states: ‘Bad governance, poor infrastructure and low adult literacy rates also harm growth and foreign direct investment’.

1 2 . 1

Explain why adult literacy rates are likely to affect the level of foreign direct investment (FDI) into low income countries (LICs).

[4 marks]

The adult literacy rate is the percentage of people aged 15 and over who can read and write. FDI is investment by a multinational company (MNC) in productive assets, such as factories, in another country. LICs are countries with a very low GNI per capita.

Low adult literacy means low human capital, so workers are harder to train, make more mistakes and have low labour productivity. For an MNC this raises unit labour costs and training costs, and makes it harder to recruit supervisors and skilled staff, so output per worker and the expected rate of return on the investment fall. Since MNCs compare profitability across locations, and many LICs compete for FDI in globalised supply chains, an LIC with low literacy is less attractive and receives less FDI. Conversely, rising adult literacy raises productivity and expected profits, attracting more FDI.

Extra space



1 2 . 2

To what extent do the data suggest that adult literacy rates have affected the level of foreign direct investment (FDI) into low income countries (LICs) between 2006 and 2019?

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

[4 marks]

There is some evidence of a positive link. Between 2006 and 2019 the adult literacy rate in LICs rose from 51.5% to 61.0% (an 18% rise), while FDI rose from \$6804m to \$11 982m (a 76% rise). When literacy rose by its largest amount, 1.9 percentage points between 2010 and 2011, FDI also rose by \$3342m, the second largest increase.

However, the link is weak. Literacy rose in every year, but FDI fluctuated: it peaked at \$20 379m in 2012 and then fell to \$11 982m by 2019, even though literacy rose from 56.6% to 61.0%. Also, the largest rise in FDI, \$4264m between 2009 and 2010, came when literacy rose by only 0.5 percentage points. The causation could also run the other way, from FDI to literacy.

The data are averages for all LICs, hiding big differences between countries, and FDI also depends on other factors such as corporation tax rates,

Extra space governance, infrastructure, natural resources and global conditions.

Overall, the data suggest that rising literacy has supported higher FDI over the period, but only to a limited extent, as it is clearly not the main driver of the year-to-year changes.



1 3

Extract B (lines 1–3) states: ‘Public sector debt (as a % of GDP) has risen in recent years in low income countries (LICs). Half of LICs are judged to be at high risk of debt problems by the International Monetary Fund (IMF)’.

Explain the likely effects of rising public sector debt in low income countries (LICs).

[12 marks]

Public sector debt is the total accumulated amount owed by the government (and other public bodies) as a result of past borrowing to finance budget deficits. Low income countries (LICs), such as Mozambique, Malawi or Chad, have a very low GNI per capita. Measuring debt as a percentage of GDP shows the size of the debt relative to the ability of the economy to generate the income and tax revenue needed to repay it, so a rising ratio suggests the debt is becoming harder to service. Extract B notes that half of LICs are judged by the IMF to be at high risk of debt problems.

Rising debt need not be harmful. If the borrowing finances investment in infrastructure, such as roads, ports, power and water, or in education and health care, it raises government spending (G) and aggregate demand in the short run, and through the multiplier real GDP and employment rise. In the long run, this investment increases productive capacity, shifting LRAS to the right, raising labour productivity and making the country more attractive to FDI. If the resulting growth raises GDP and tax revenue faster than the debt grows, the debt to GDP ratio can later fall and development is improved.

The effects also depend on who the debt is owed to. Loans from multilateral institutions such as the IMF and World Bank, or from other governments, are often concessional, with low interest rates and long repayment periods, so the burden is manageable. However, debt borrowed on international financial markets, often in US dollars, carries higher, market interest rates, and if the LIC's currency depreciates, the cost of servicing it in local currency rises sharply.



The main negative effect is the rising cost of debt servicing. As interest payments take a larger share of tax revenue, there is an opportunity cost: less can be spent on schools, hospitals, infrastructure and welfare payments. Cuts in

Extra space public services reduce human capital and living standards, and lower government spending reduces aggregate demand, so growth slows and unemployment rises. Because GDP grows more slowly, the debt to GDP ratio may rise even further, creating a debt trap.

High debt also damages confidence. Credit rating agencies may downgrade the country, so lenders demand higher interest rates on new borrowing, which raises servicing costs further. Foreign investors may fear default, higher future taxes or inflation if the debt is financed by creating money, so FDI falls and there are capital outflows. This puts downward pressure on the exchange rate, raising the local cost of foreign currency debt and of imports, adding to cost-push inflation. Lower private sector confidence also reduces domestic investment, so macroeconomic stability worsens.

Finally, if steps are not taken to control the debt, an LIC may lose access to further support from international institutions, or may have to accept strict conditions, such as austerity, in return for a bailout or debt relief. Austerity may further reduce spending on public services and increase poverty in the short run. Therefore, whether rising public sector debt helps or harms an LIC depends mainly on what the money is spent on, the terms of the debt and whether it can be serviced, but given that half of LICs are at high risk, the likely overall effect is a slower rate of growth and development.



1 4

Extract C (lines 5–6) states: ‘the IMF plays a major role in promoting good economic governance in LICs.’

Assess the role of international organisations such as the IMF and World Bank in promoting economic development in low income countries (LICs).

[25 marks]

Economic development is an improvement in the economic welfare and quality of life of a population, including higher real incomes, better health and education, less poverty and greater freedom of choice. It is broader than economic growth, which is only an increase in real GDP. Low income countries (LICs), such as Ethiopia, Niger or Haiti, have a very low GNI per capita. The IMF aims to promote global financial stability: it monitors economies, gives policy advice and provides short-term loans to countries with balance of payments problems. The World Bank provides long-term loans, grants and technical advice to fund specific development projects such as dams, roads, schools and health programmes.

One role of these organisations is to provide finance where it is scarce. LICs suffer from a savings gap: low incomes mean low savings, so there are too few funds for investment, and private lenders see LICs as too risky. World Bank loans, often concessional through the International Development Association, fund infrastructure and human capital. Better roads and electricity lower firms' costs, and better education and health raise labour productivity, so LRAS shifts to the right and long-run growth rises. Higher incomes and improved services directly raise development, breaking the poverty cycle.

The IMF supports development by providing stability. When an LIC faces a sudden shock, such as a fall in the price of its main commodity export, a currency crisis or a pandemic, IMF loans allow it to keep paying for essential imports such as food, medicine and fuel without making drastic cuts. Stable inflation, a sustainable exchange rate and sound public finances increase



confidence, encouraging both domestic investment and FDI.

Both organisations also give technical advice and, as Extract C states, the IMF plays a major role in promoting good economic governance. Holding governments to account through monitoring, transparency requirements and conditions on loans can reduce corruption and improve tax collection and the management of public finances. As corruption diverts resources from productive uses and deters investors, better governance raises the efficiency of government spending and attracts FDI, promoting development. Debt relief schemes, such as the Heavily Indebted Poor Countries initiative, have also freed resources for health and education spending.

However, there are important criticisms. Loans add to the debt burden, and if they are not used productively, interest payments divert tax revenue from public services, as rising public debt in LICs shows. In the past, IMF and World Bank structural adjustment programmes required conditions such as privatisation, trade liberalisation, removal of subsidies and austerity. Cuts to spending on health, education and food subsidies harmed the poorest in the short run, and privatisation sometimes raised the prices of water and electricity and widened inequality. Rapid liberalisation exposed infant industries to competition before they were able to compete.

Conditionality also reduces policy independence, and critics argue that the "one size fits all" free market approach reflects the interests of high income countries that control voting at these institutions. This can be a form of government failure at the international level: officials may lack local knowledge, so projects may be badly designed, such as large dams that displace communities. At the domestic level, funds may be lost to corruption or used for projects with political rather than economic benefits.

The extent to which these organisations promote development depends on

Turn over ►



Extra space *several factors. Firstly, it depends on the quality of domestic governance and political stability: aid and loans are most effective in countries with strong institutions and little corruption, and largely wasted in countries in conflict. Secondly, global economic conditions matter: if commodity prices fall or world demand slumps, even well-designed programmes will struggle. Thirdly, it depends on the time period: restructuring programmes may cause short-run hardship but may lay the foundations for long-run growth if they create stable public finances and efficient markets.*

It also depends on the alternatives. LICs could borrow on private financial markets or sell government bonds, but at much higher interest rates; broaden the tax base, which is difficult when the informal economy is large; agree bilateral loans, for example from China, which may have fewer conditions but less transparency; or receive overseas development aid. Private sector FDI, trade through the WTO and NGOs may often contribute more to development than the IMF and World Bank, which are only one part of the picture. Moreover, all LICs are not the same: a resource-rich country with a large debt problem has different needs from a landlocked country with poor infrastructure.

In conclusion, international organisations such as the IMF and World Bank play an important, but not decisive, role in promoting development in LICs. They provide finance, stability and advice that LICs could not otherwise obtain, and their focus on good governance, as noted in Extract C, can raise the effectiveness of all other spending. However, their success is limited by the risk of rising debt, the harm caused by inappropriate conditions in the past and the importance of domestic factors. Their role is most effective when programmes are designed for each country's circumstances, focus on poverty reduction and human capital, and are supported by stable, well-governed domestic institutions.



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

Argentina is one of a number of economies that has suffered from currency fluctuations over the years. It has tried both fixed and floating exchange rate systems to try to control inflation and prevent rapid depreciations.

Evaluate the effectiveness of a fixed exchange rate as a method of improving the macroeconomic performance of an economy.

[25 marks]**or**

1 6

Financial markets in high income countries have been deregulated since the 1980s.

Deregulation has been blamed for the financial crisis in 2007 because of the high levels of lending and systemic risk.

Assess the case for and against greater regulation of financial markets.

[25 marks]

A fixed exchange rate is a system in which the government or central bank sets

the value of its currency against another currency, such as the US dollar, or a

basket of currencies, and intervenes to keep it there. Under a floating system the

rate is determined only by the demand for and supply of the currency, while a

managed float allows market forces to operate with occasional intervention.

Macroeconomic performance is judged by the main objectives: stable low inflation,

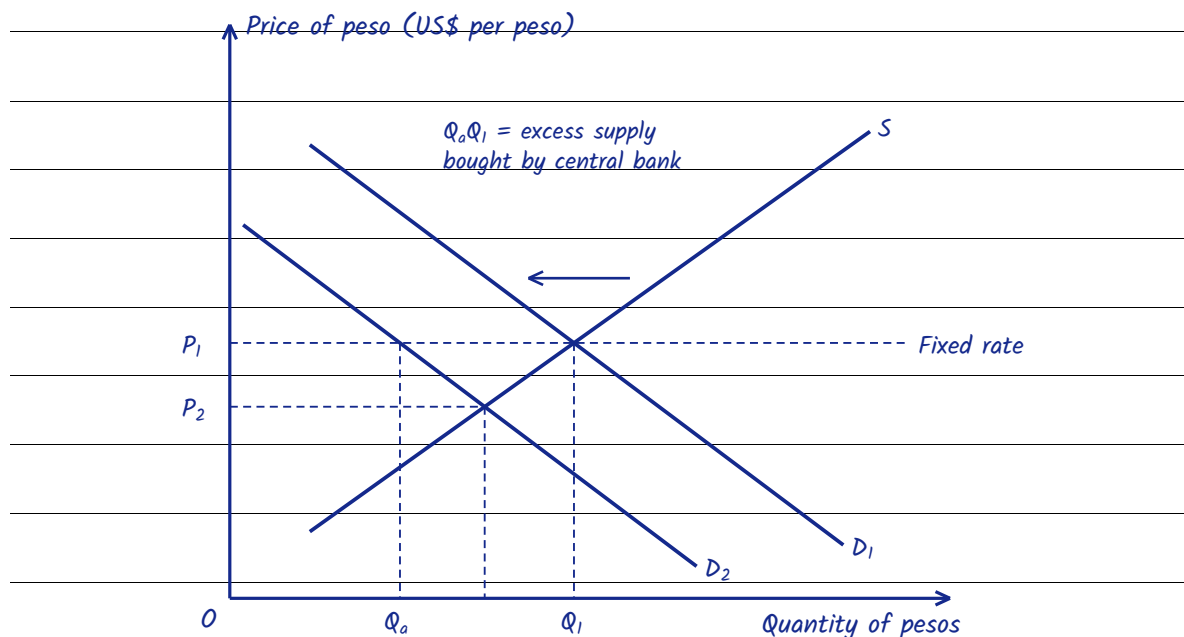
sustained economic growth, low unemployment and a satisfactory balance of

payments on current account.

To maintain the peg, the central bank buys or sells its currency using foreign

currency reserves and adjusts interest rates. In the diagram, if confidence falls and

Turn over ►



demand for pesos shifts from D_1 to D_2 , the free market rate would fall to P_2 . To hold the fixed rate P_1 , the central bank must buy the excess supply Q_aQ_1 with its dollar reserves, and may raise interest rates to attract hot money inflows, increasing demand for the currency.

The main benefit is lower inflation. Pegging to a low-inflation currency imports credibility: import prices are stable, so cost-push inflation from imported raw materials, fuel and food is controlled, and firms and workers expect lower inflation, so wage demands moderate. Argentina's 1991 Convertibility Plan, which fixed the peso at one to one with the US dollar, reduced inflation from hyperinflation levels to low single digits within a few years. Stable import prices of food and fuel also protect the real incomes of the poorest households.

A fixed rate also reduces uncertainty for traders and investors. Exporters know the price their goods will sell for abroad and importers know their costs, so there is less need to hedge, transaction costs fall and trade increases. Multinationals are more willing to invest when the value of their profits is not at risk from depreciation. If the rate is set at a competitive level, exports remain price



competitive, contributing to export-led growth, more jobs in export industries and an improvement in the balance of trade. The peg also imposes discipline on government, which cannot rely on depreciation to restore competitiveness, so it must control costs and improve productivity.

However, there are significant drawbacks. The government loses monetary policy independence, because interest rates must be used to defend the currency rather than to manage domestic demand. If the currency comes under pressure during a recession, interest rates may have to rise, reducing consumption and investment, so growth falls and unemployment rises. Using reserves to defend the peg also has an opportunity cost, as these funds cannot be used for imports of capital goods or other spending.

Extra space A fixed rate also makes it harder to deal with economic shocks. If the rate is overvalued, for example because domestic inflation remains above that of the anchor country, exports become uncompetitive and imports cheaper, so the current account deficit widens and domestic industries decline. This happened in Argentina in the late 1990s: when the dollar strengthened and Brazil devalued, Argentina could not adjust its exchange rate, so the economy fell into a deep recession with high unemployment.

The credibility of the peg is crucial. Speculators who believe a currency is overvalued sell it, so the central bank must spend large amounts of reserves. LICs and middle income countries often have limited reserves, so a speculative attack can force a sudden devaluation or abandonment of the peg, as in Argentina in 2002, when the peso lost around 70% of its value. This damages the country's credit rating, raises the cost of foreign currency debt and undermines future stability, leaving the economy worse off than if it had floated.

How effective a fixed exchange rate is depends on several factors. It depends on whether the rate is set at the right level: an undervalued rate supports exports and

Turn over ►



growth, but can cause inflation, while an overvalued rate harms competitiveness, and governments may lack the information to choose correctly. It depends on the size of reserves and supporting policies: a peg is only credible if fiscal policy is disciplined, government debt is sustainable and capital flows or speculation are controlled. It depends on the structure of the economy: a country that trades mainly with the anchor country, or one highly dependent on a single commodity export that would otherwise push up the exchange rate and harm other exports, may gain more from a peg, as the Gulf states do with the dollar. Finally, it depends on the alternatives: inflation targeting by an independent central bank with a floating rate, supply-side policies to raise productivity and fiscal discipline may achieve the same objectives without the risks.

In conclusion, a fixed exchange rate can be effective in the short run, particularly for controlling high inflation and providing stability for trade, as Argentina's early experience shows. However, it is less effective at improving overall macroeconomic performance in the long run, because it removes the ability to use monetary policy and the exchange rate to respond to shocks, and it can collapse if reserves and credibility are insufficient. It is most likely to succeed when set at a realistic level, backed by large reserves and supported by sound fiscal policy, but for most economies, especially those with limited reserves like Argentina, a managed float combined with credible inflation targeting is likely to be a better long-term choice.

END OF QUESTIONS



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2 8



2 2 6 X E C 0 4