OXFORD

INTERNATIONAL
AQA EXAMINATIONS

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INTERNATIONAL A-LEVEL
ECONOMICS

Unit 4 Economic Development and the Global Economy

Thursday 22 June 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.

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

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.

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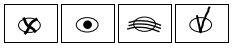
Section A

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 identifies **two** functions of money?

[1 mark]

A Medium of exchange and easily divisible

B Medium of exchange and generally acceptable

C Store of value and limited in supply

D Store of value and measure of value

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0 2 **Table 1** shows the index of export prices and the index of import prices for a country in 2021 and 2022.

Table 1

	Index of export prices	**Index of import prices**
2021	100	80
2022	160	100

Between 2021 and 2022, the country's terms of trade

[1 mark]

A deteriorated by 35 ⬭

B deteriorated by 17.5 ⬭

C improved by 17.5 ⬭

D improved by 35 ⬬

Turn over for the next question

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0 3 Firms can finance investment by issuing shares and by borrowing through issuing bonds.

Which one of the following statements is correct?

[1 mark]

A Individuals who buy shares become owners of the firm. ⬬

B People who own bonds are paid a dividend that depends on the firm's profit. ⬭

C Shareholders receive interest which is a fixed cost for the firm. ⬭

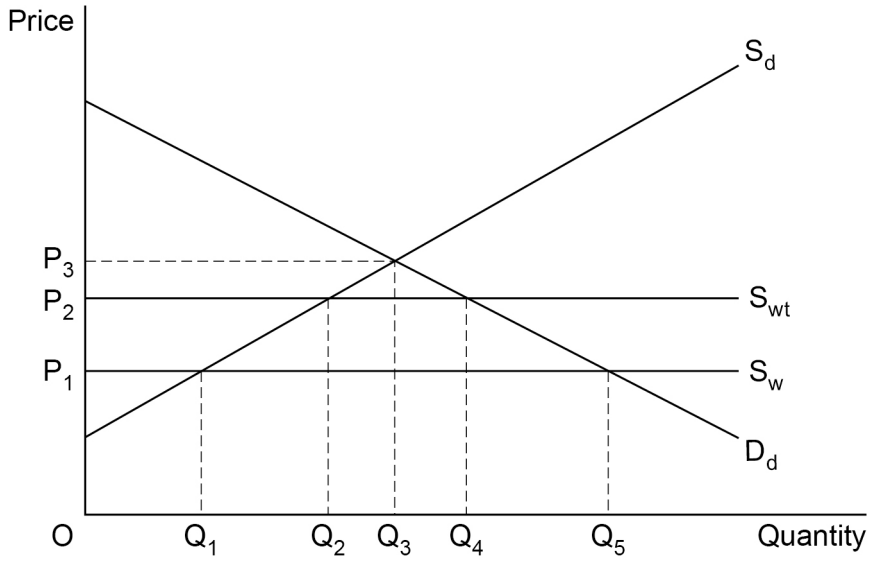
D The market price of bonds does not change after they have been issued. ⬭

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0 4 A country imposes a tariff on a product it imports from the rest of the world.

Figure 1 shows domestic demand (D_d), domestic supply (S_d), the rest of the world supply without a tariff (S_w) and the rest of the world supply with a tariff (S_{wt}).

Figure 1



The amount of government tax revenue raised from the tariff is ($P_2 - P_1$) multiplied by

[1 mark]

A $Q_3 - Q_1$ ⬭

B $Q_3 - Q_2$ ⬭

C $Q_4 - Q_2$ ⬬

D $Q_5 - Q_1$ ⬭

0 5 Which one of the following is a function of a central bank?

[1 mark]

A To accept deposits from individuals ⬭

B To act as lender of last resort ⬬

C To collect taxes for the government ⬭

D To provide loans to firms ⬭

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0 6 **Table 2** shows the exchange rate of four countries against the US dollar in Year 1 and Year 2, and their price elasticity of demand for exports.

Table 2

	Exchange rate in Year 1	Exchange rate in Year 2	Price elasticity of demand for exports
Country W	$0.50	$0.45	–0.6
Country X	$1.00	$0.70	–0.9
Country Y	$1.50	$1.20	–1.2
Country Z	$2.00	$1.80	–1.5

All other things being equal, which one of the countries will have the largest increase in its exports between Year 1 and Year 2?

[1 mark]

A Country W ⬭

B Country X ⬬

C Country Y ⬭

D Country Z ⬭

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0 7 Which one of the following statements about trading blocs is correct?

Members of a

[1 mark]

A customs union impose some restrictions on trade with other members. ⬭

B customs union impose the same restrictions on trade with non-members. ●

C free trade area do not impose restrictions on trade with non-members. ⬭

D free trade area impose their own restrictions on trade with other members. ⬭

0 8 **Table 3** includes items from a country's balance of payments.

Table 3

Item	$ billion
Balance of trade in goods	+400
Net direct investment	–200
Primary income balance	–350
Change in reserve assets	+125
Secondary income balance	+140
Balance of trade in services	–120

The country's balance of payments on current account is a

[1 mark]

A deficit of $130 billion. ⬭

B deficit of $5 billion. ⬭

C surplus of $70 billion. ●

D surplus of $280 billion. ⬭

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0 9 **Table 4** shows the amount of wheat **or** barley two countries can produce with a given amount of resources.

Table 4

	Wheat (tonnes)	Barley (tonnes)
Country X	10	5
Country Y	30	6

Which one of the following is correct?

[1 mark]

A Country X has a comparative advantage in the production of barley and an absolute advantage in the production of barley. ⬭

B Country X has a comparative advantage in the production of wheat and an absolute advantage in the production of both wheat and barley. ⬭

C Country Y has a comparative advantage in the production of both wheat and barley. ⬭

D Country Y has a comparative advantage in the production of wheat and an absolute advantage in the production of barley. ⬬

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1 0 **Table 5** shows the value of exports and imports of goods and services, and gross domestic product (GDP) for four countries in 2021, in US$ billion.

Table 5

	Brazil	France	India	USA
Exports (US$ bn)	317	921	643	2 533
Imports (US$ bn)	298	957	718	3 394
GDP (US$ bn)	1 608	2 935	3 178	22 998

Based on the data in **Table 5**, which country's economy is most dependent on international trade?

[1 mark]

A Brazil ⬭

B France ⬬

C India ⬭

D USA ⬭

10

Turn over for Section B

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Section B

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

1 1 The growth in international trade means that a country's exchange rate has an increasingly important effect on the performance of its economy.

1 1 . 1 Define 'an appreciation in the exchange rate'.

[2 marks]

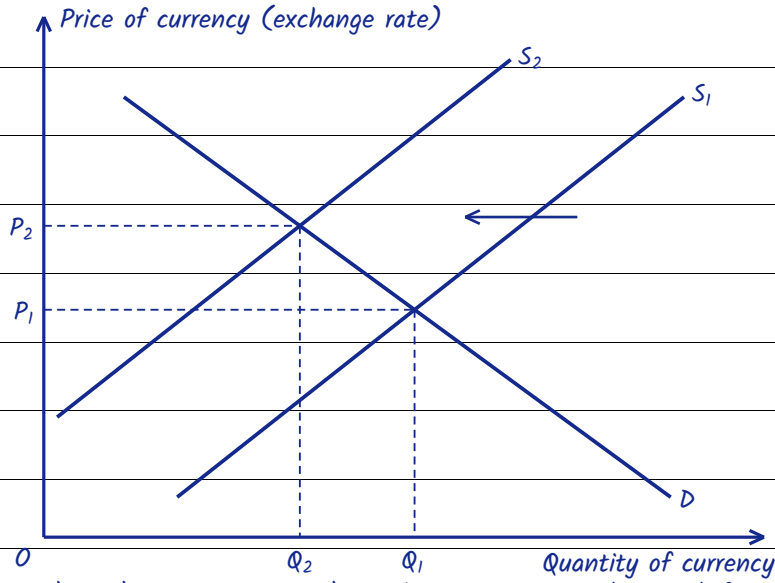
An appreciation is a rise in the value of a currency in terms of other currencies, so that one unit of the domestic currency buys more units of a foreign currency (or basket of currencies) than before.

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1 1 . 2 Explain, using a diagram, the effect of a fall in spending on imports on a country's exchange rate.

[4 marks]

To pay for imports, importers must obtain foreign currency, so they supply (sell) their domestic currency on the foreign exchange market. If spending on imports falls, less domestic currency is supplied, so the supply curve of the currency shifts to the left from S_1 to S_2.



At the original exchange rate P_1 there is now excess demand for the currency, as demand is unchanged but supply has fallen. Buyers of the currency bid its price up until the market clears at the new equilibrium P_2, where the quantity traded falls from Q_1 to Q_2. Therefore, other things being equal, a fall in spending on imports leads to an appreciation of the exchange rate from P_1 to P_2.

Question 11 continues on the next page

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1 1 . 3 **Table 6** shows the price of a computer, imported from the USA, and a country's exchange rate in May 2022 and May 2023. The country's currency is the dinar.

Table 6

	Price of a computer from the USA	Exchange rate
May 2022	$220	$1 = 140 dinars
May 2023	$210	$1 = 170 dinars

Calculate the percentage change, between May 2022 and May 2023, in the amount an importer has to pay, in dinars, for a computer from the USA.

Give your answer to **one decimal place**.

[4 marks]

Price in May 2022 = $220 × 140 = 30 800 dinars

Price in May 2023 = $210 × 170 = 35 700 dinars

Percentage change = (35 700 – 30 800) ÷ 30 800 × 100

= 4900 ÷ 30 800 × 100 = 15.909...%

Answer: the price in dinars increased by 15.9%

10

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Section C

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

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1 2 **Extract A** shows the GDP per capita and the Human Development Index (HDI) in Mexico between 2014 and 2021.

1 2 . 1 Explain why Mexico's GDP per capita is likely to affect the value of its Human Development Index.

[4 marks]

GDP per capita is the total value of goods and services produced in a country in a year divided by its population. The HDI is a composite index of development, between 0 and 1, based on three dimensions: income (GNI per capita at PPP), health (life expectancy at birth) and education (mean and expected years of schooling).

GDP and GNI are both measures of national income and are closely related, so a rise in Mexico's GDP per capita directly raises the income component of its HDI.

Higher GDP per capita also affects the other components indirectly. Households can afford more food, clothing, shelter, energy and private health care, which improves health and raises life expectancy, and can afford to keep children in education for longer. In addition, a higher national income raises tax revenue, so the government can spend more on public health care and schools, increasing life expectancy and mean and expected years of schooling. Therefore, Mexico's HDI is likely to rise when its GDP per capita rises, and fall when it falls.

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1 2 . 2 To what extent do the data suggest that Mexico's GDP per capita has affected the value of its Human Development Index between 2014 and 2021?

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

[4 marks]

The data suggest a strong positive relationship. Between 2014 and 2018, every increase in GDP per capita was matched by a rise in HDI; for example, from 2016 to 2017 GDP per capita rose from US$9752 to US$9842 and HDI rose from 0.772 to 0.775. Between 2019 and 2020, GDP per capita fell sharply from US$9820 to US$8923 and HDI also fell sharply from 0.779 to 0.756, and when GDP per capita recovered to US$9255 in 2021, HDI rose to 0.758. Over the whole period both fell, GDP per capita from US$9426 to US$9255 and HDI from 0.764 to 0.758.

However, the relationship is not exact. Between 2018 and 2019 GDP per capita fell from US$9946 to US$9820 while HDI still rose from 0.777 to 0.779. The strength also varies: from 2014 to 2015 GDP per capita grew by about 2.0% and HDI by 0.52%, but from 2015 to 2016 GDP per capita

Extra space grew by only 1.4% while HDI again rose by a similar 0.52%. This is because HDI also depends on health and education, which are affected by other factors (such as the pandemic in 2020), GDP per capita in US$ is affected by the exchange rate, and HDI uses GNI rather than GDP. Overall, GDP per capita appears to have had a strong, but not the only, effect on Mexico's HDI.

8

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1 3 **Extract B** (line 10) states: 'FDI has contributed to Mexico's economic growth'.

Explain why an increase in foreign direct investment (FDI) is likely to affect Mexico's economic growth.

[12 marks]

Foreign direct investment (FDI) is investment by a firm, usually a multinational (MNC), in productive assets in another country, such as building a factory or buying a controlling stake in a local firm. Economic growth is an increase in real GDP. Short-run growth is an increase in actual output, caused by an increase in aggregate demand (AD) that uses spare capacity, while long-run growth is an increase in the productive potential of the economy, shown by a rightward shift of LRAS.

In the short run, FDI is an injection into the circular flow of income. When a foreign MNC builds a car plant in Mexico, investment (I) rises, so AD = C + I + G + (X − M) shifts to the right from AD_1 to AD_2. The construction firms and suppliers involved receive extra income, and their workers spend part of it on goods and services in Mexico, which become income for others. Through the multiplier, the final rise in real GDP is greater than the initial investment, especially if the marginal propensity to import is low. As incomes and output rise, firms may also need more capacity, so through the accelerator effect domestic investment rises too, adding further to AD and growth.

Much FDI in Mexico is export-oriented, for example manufacturing cars and electronics for the USA under the USMCA trade agreement. This increases exports, while goods produced locally may replace imports (import substitution). Both raise net exports, shifting AD further to the right and increasing short-run growth.

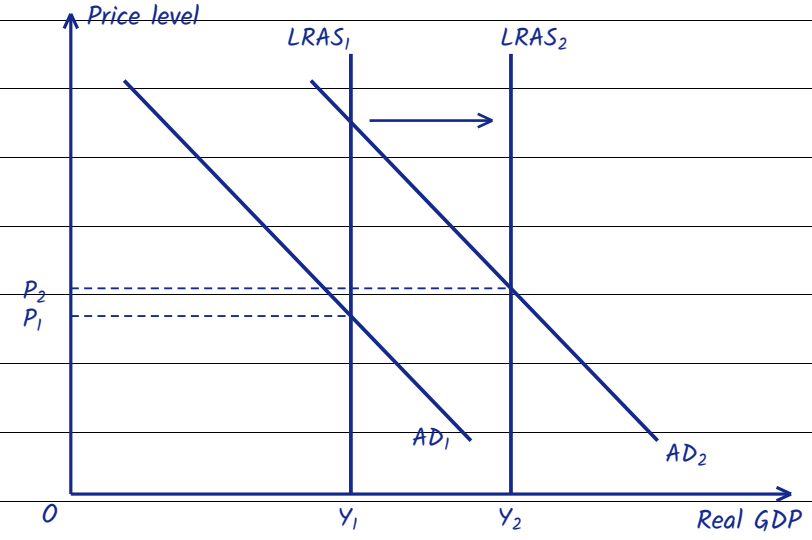
In the long run, FDI increases the quantity and quality of Mexico's capital stock, so productive capacity rises and LRAS shifts right from $LRAS_1$ to

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$LRAS_2$, as shown in the diagram. MNCs bring new technology, management methods and know-how, raising labour productivity. They also invest in human capital by training workers, and these skills spread to the rest of the economy when workers move to Mexican firms. Domestic firms that supply the MNCs must meet higher quality standards, and those that compete with them face more competition, so they become more efficient and innovative. MNCs may also fund infrastructure, such as roads, ports and power supplies, which benefits other industries. Higher productivity and capacity allow sustained non-inflationary growth of real GDP.

However, the effect depends on how much of the income stays in Mexico. If MNCs import components and repatriate profits to their home countries, leakages are high and the multiplier is small. Nevertheless, FDI is still likely to increase both actual and potential output, so it has contributed to Mexico's economic growth.

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1 4 **Extract C** (lines 1–2) states: 'Over the last 30 years, Mexico has not performed as well as similar countries in terms of growth and in reducing poverty.'

Discuss how policies to reduce inequality and poverty could contribute to Mexico's economic development.

[25 marks]

Poverty is a situation where people lack the income to meet basic needs: absolute poverty means living below a minimum level, while relative poverty means having much less than the average income. Inequality refers to an unequal distribution of income or wealth, measured by the Lorenz curve and Gini coefficient. Economic development is an improvement in living standards and welfare, including higher real income per head, better health and education, less poverty and more freedom and choice. Growth is not the same as development, but sustained growth of the right kind contributes to it.

Reducing poverty and inequality contributes to development directly, because development is about the welfare of the whole population. Extract C suggests that Mexico has performed worse than similar countries in reducing poverty, so the benefits of growth have not reached many people, especially in the poorer southern states and the large informal sector.

One policy is government spending on welfare, education and health care, financed by progressive taxes, where the proportion of income paid in tax rises as income rises. Transfers such as conditional cash transfers, paid to poor families if their children attend school and have health checks, raise the incomes of the poor immediately and shift the Lorenz curve towards the line of equality, from L_1 to L_2, reducing the Gini coefficient. As the poor have a higher marginal propensity to consume, redistribution also raises AD. Spending on schools and health care improves health, life expectancy and years of schooling, which are the HDI components.

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Investment in human capital also attacks a cause of poverty. Poor children who leave school early or are malnourished cannot reach their potential, so talent is wasted. Better education raises skills and labour productivity, shifting LRAS to the right and allowing people to move into higher paid jobs, which breaks the poverty cycle and increases long-run growth and development.

A second approach is to raise employment and incomes in poorer regions and in the formal sector. Special economic zones (SEZs) and investment in infrastructure in the south could attract firms and help diversify away from low-productivity subsistence agriculture. Encouraging firms to register in the formal sector gives workers legal protection and pensions and widens the tax base. Raising the national minimum wage increases the income of low-paid workers, and providing access to finance through microfinance allows poor households to start small businesses and invest in their own human capital.

However, these policies have disadvantages. Higher progressive taxes may reduce incentives to work, save, invest and set up businesses, and may encourage tax avoidance or the shift of activity into the informal economy, so growth could slow. A minimum wage set too high could cause unemployment among low-skilled workers or push more workers into informal jobs, where the law is not enforced. Welfare spending has an opportunity cost and may create dependency. Corruption may also mean money does not reach the poor.

How far these policies contribute to development depends on several factors. It depends on the design of the policy: conditional transfers that require school attendance and health checks combine short-run poverty relief with long-run human capital, so they are likely to be more effective than unconditional benefits. It depends on how the spending is financed: if

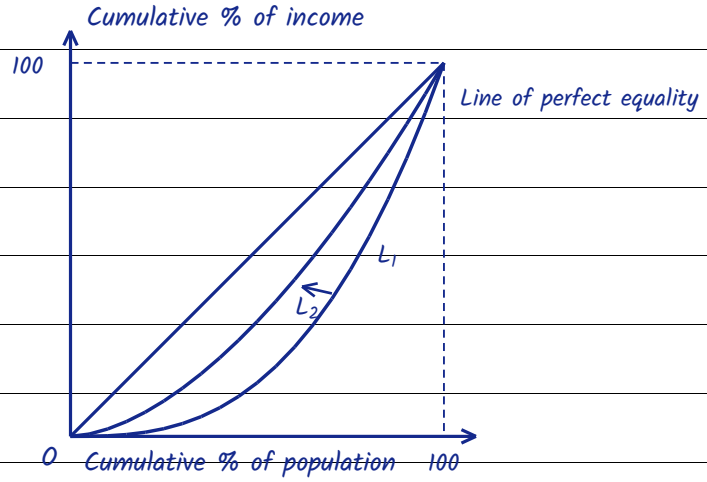
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Mexico can raise tax revenue, which is low compared with other similar countries, without large disincentive effects, the policies are sustainable, but if they are financed by borrowing, they may increase debt. Time scale matters too, as education takes years to raise productivity, while transfers help immediately.

Furthermore, policies to reduce poverty and inequality cannot work alone. Mexico's weak performance in growth, mentioned in Extract C, may also be due to low productivity, crime and insecurity, weak institutions and the rule of law, and limited competition in some industries. In fact, the two support each other: growth provides the tax revenue to fund anti-poverty policies, while a healthier, better educated workforce makes growth more sustainable.

In conclusion, policies to reduce poverty and inequality can make a significant contribution to Mexico's economic development, because they directly improve the living standards of the poorest and, by investing in human capital, raise productivity and long-run growth. The most effective are likely to be those that build human capital, such as conditional cash transfers and education in the poorer south, rather than simply raising taxes or the minimum wage. On balance, they are necessary but not sufficient:



their success depends on good governance and on being combined with policies that raise growth.

25

Turn over ►

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Section D

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

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

Question 15 ○ Question 16 ●

CORRECT METHOD ● WRONG METHODS ⊗ ◉ ≈ ✓

Either

15 The recent rise in global commodity prices has led to an increase in inflation. There is also a risk that this will lead to a recession in the world economy.

Discuss the economic effects of a significant increase in global commodity prices on less economically developed countries (LEDCs).

[25 marks]

or

16 Recent trends in the global economy show that many countries have adopted protectionist policies aimed at restricting international free trade.

Assess the view that the use of protectionist policies by a more economically developed country (MEDC) is likely to reduce the standard of living of its citizens.

[25 marks]

Protectionist policies are measures that restrict international trade to protect domestic producers from foreign competition. They include tariffs (taxes on imports), quotas (limits on the quantity imported), subsidies to domestic producers, import bans or embargoes, exchange controls, and non-tariff barriers such as strict regulations and product standards. An MEDC is a country with high income per head and high levels of development. The standard of living refers to the material welfare of people, usually measured by real income per head, but also including consumption of goods and services, health, leisure and choice.

The case against protection is based on comparative advantage. A country has a comparative advantage in a good when it can produce it at a lower opportunity

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cost than other countries. If each country specialises in what it is relatively best at and trades, total world output rises and all countries can consume beyond their production possibility frontiers. An MEDC typically has a comparative advantage in high-tech manufacturing and services, and gains by importing cheaper labour-intensive goods from LEDCs. Protection prevents this specialisation, so resources stay in less efficient industries and real incomes fall.

The diagram shows the effect of a tariff. Before the tariff, the good is imported at the world price P_w; domestic producers supply Q_1 and consumers buy Q_4, so imports are Q_1Q_4. A tariff raises the domestic price to P_{w+t}. Domestic supply rises to Q_2, demand falls to Q_3 and imports fall to Q_2Q_3. Consumer surplus falls by areas A + B + C + D. Area A is transferred to domestic producers as extra producer surplus and area C is tariff revenue for the government, but areas B and D are deadweight welfare losses: B reflects inefficient domestic production at a higher cost than foreign producers, and D is the lost consumption of people priced out of the market. Society as a whole is therefore worse off.

Higher import prices also raise the cost of living. As import prices rise, domestic producers face less competition and can raise their own prices, so cost-push inflation increases and households' real incomes fall, especially poorer households who spend a larger share of their income on imported food, clothing and electronics. Firms using imported inputs such as steel face higher costs and become less competitive.

In the long run, protection reduces dynamic efficiency. Sheltered from foreign competition, domestic firms have less incentive to cut costs and innovate, so X-inefficiency increases and quality may fall. Protection may create domestic monopolies that exploit consumers through higher prices, and consumers have less variety and choice. Most importantly, other countries may retaliate with their

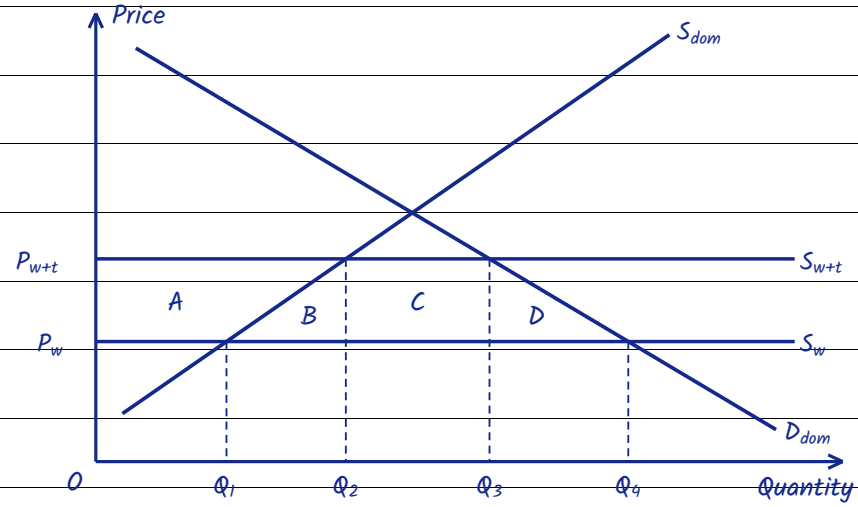
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own tariffs, as happened during the trade war between the USA and China. Exporters in the MEDC then lose markets, output and jobs, world trade shrinks and everyone is made worse off.

On the other hand, there are arguments that protection may raise living standards for some citizens. When imports from low-wage economies cause industries to decline, workers become structurally unemployed, and if they are occupationally or geographically immobile they may stay unemployed for a long time, with whole regions suffering. Protection of these sunset industries can maintain incomes and employment in the short run, slow the decline and give time for retraining. Lower unemployment reduces government spending on welfare benefits, which may allow lower taxes, and tariff revenue can be used to

Extra space support the less well-off.

Protection may also be justified when foreign firms are dumping goods below



cost, which could drive efficient domestic firms out of business and then allow foreign firms to raise prices. Anti-dumping duties protect income and employment in an efficient domestic industry. Protecting infant or sunrise industries, such as green technology, may give them time to invest, gain economies of scale and become internationally competitive. Regulations can prevent the import of unsafe products or goods that harm the environment, such

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as vehicles with high greenhouse gas emissions, which improves welfare in a broader sense. Finally, by reducing imports, protection reduces withdrawals from the circular flow, which raises AD, output and employment, at least in the short run.

Whether protection reduces living standards depends on several factors. It depends on the type of protection: a temporary, well-targeted anti-dumping duty or environmental regulation may raise welfare, while broad tariffs on consumer goods mainly raise prices. It depends on whether other countries retaliate, which in practice is likely, turning a small gain for one industry into a large loss for exporters. It depends on the price elasticities of demand and supply: if domestic supply is inelastic, a tariff mainly raises prices rather than domestic output and jobs. It depends on the time period: protection may save jobs in the short run, but in the long run it reduces efficiency and growth. And it depends on who we consider: workers in protected industries may gain, but the much larger number of consumers and workers in exporting industries usually lose. There is also a risk of government failure, as temporary protection often becomes permanent through lobbying.

In conclusion, I agree with the view that protectionist policies by an MEDC are likely to reduce the standard of living of its citizens overall. The losses to consumers from higher prices, the deadweight losses, reduced efficiency and the risk of retaliation are usually greater than the gains to protected producers and workers. However, protection may improve living standards for particular groups and in specific cases, such as anti-dumping measures or environmental standards. Better ways to help workers in declining industries are retraining, regional policy and welfare support, which protect people rather than inefficient industries.

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END OF QUESTIONS

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