Exercise walk-through

8.2
Poverty, public finance and development

Pearson Edexcel · International A-Level · Economics

Growth and development (3)

- **primary product dependency** : copper earns about 70% of Zambia's export revenue, so a price fall cuts its income. By the **Prebisch–Singer hypothesis** - , prices of primary products tend to fall over time compared with prices of manufactures, so the terms of trade of commodity exporters worsen;
- **volatile commodity prices**, which make incomes and tax revenue unpredictable;
- the **savings gap** : by the **Harrod–Domar model** - , growth = savings ratio ÷ capital–output ratio, and poor households save little;

Data-response practice (Section B style)

- (a) Bangladesh's GDP is about US\$450 billion and its population about 173 million. Calculate GDP per head. [2]
- (b) Explain **two** limitations of GDP per head as a measure of development, using the extract. [4]
- (c) Explain, with reference to the **Lewis dual-sector model**, how the growth of the garment industry has helped to reduce poverty. [6]

Sources for this lesson (2)

- S. Kuznets, "Economic Growth and **Income Inequality**", *American Economic Review* 45 (1955); W. A. Lewis, "**Economic Development** with Unlimited Supplies of Labour" (1954).
- OECD, statement on the two-pillar solution to the tax challenges of the digitalisation of the economy (October 2021).
- IMF, World Economic Outlook and Fiscal Monitor databases (government spending and debt).
- Pearson Edexcel International A Level Economics specification (WEC14), Issue 2, sections 4.3.4–4.3.6.

Exercise 2.1

2.1 Distinguish between absolute and relative poverty, and explain why a country can reduce one while the other rises. [4]

absolute poverty relative poverty

Exercise 2.1

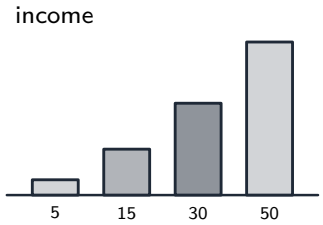
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absolute poverty relative poverty

2.1 Absolute poverty: below a fixed minimum standard such as the international extreme-poverty line; relative poverty: below a set share (often 60%) of the median income of the society. Growth can lift the poorest above the fixed line while the median rises faster, so relative poverty rises even as absolute poverty falls. Authored marking guidance (original, not an official scheme): B1 per distinction, B1 + B1 for the explained scenario.

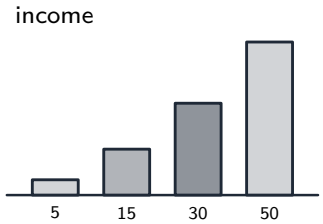
Exercise 2.2

2.2 A four-person economy has incomes 5, 15, 30, 50 (total 100). Compute the cumulative income shares, sketch the Lorenz points, and state the income share of the richest 25% and the poorest 50%. [6]



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2.2 Cumulative income shares, poorest first: 5%, 20%, 50%, 100%. Points at (25%, 5%), (50%, 20%), (75%, 50%), (100%, 100%). Richest 25% receive 50% of income; the poorest 50% receive 20%. Authored marking guidance (original): M1 method, A1 values, B1 points, A1 readings.

Exercise 2.3

2.3 Explain the difference between a cyclical and a structural fiscal deficit, and why the difference matters for policy. [6]

cyclical deficit

structural deficit

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cyclical deficit structural deficit

2.3 A cyclical deficit appears because of the downturn itself: tax revenue falls and benefit spending rises through the automatic stabilisers. A structural deficit persists even at full employment, because spending commitments exceed normal revenue. It matters because a cyclical deficit self-corrects with recovery, while a structural one needs lasting tax or spending changes; treating a structural gap as cyclical delays the repair. Authored marking guidance (original): identification plus development for each, plus policy significance.

Exercise 3.1

3.1 The fictional country of Soravia exports 85% of its foreign earnings as unprocessed cocoa. Cocoa prices fell 40% in two years; government revenue collapsed and skilled nurses emigrated. Evaluate the economic factors that constrain Soravia's growth and development. Refer to Soravia in your answer. [20]



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3.1 Model response (original; official WEC14 essays are marked 12 for knowledge, application and analysis plus 8 for evaluation; "refer to a country" is required).

Growth means rising real output; development means broader improvement in living standards. Soravia's first constraint is primary-product dependency: 85% of foreign earnings come from one unprocessed crop. The Prebisch-Singer hypothesis holds that primary exporters' terms of trade worsen over time, because demand for raw materials grows slowly with world income; Soravia's 40% price fall shows the volatility directly – export earnings, the tax base and the government's budget all collapsed together.

Full solution on next slide

Full solution 3.1 (1/2)

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Second, the savings gap of the Harrod-Domar model: with incomes hit, domestic saving is too low to fund investment, so capital accumulation and growth stall. Third, a foreign-currency gap: export earnings no longer cover the capital imports that diversification

Full solution 3.1 (2/2)

needs. Fourth, the emigration of nurses – a human-capital drain – weakens health services and future productivity; remittances only partly offset the loss. Weak state capacity after the revenue collapse adds a governance constraint.

Evaluation: cocoa dependence could be reduced by processing cocoa domestically or developing tourism, but both need capital Soravia lacks – which argues for debt relief or aid with conditions. Microfinance could widen credit access. Yet if governance is weak, aid may be diverted; and commodity buffer stocks have historically been hard to sustain. The binding constraint looks like the foreign-currency gap, since even good projects cannot be imported without earnings.

Judgement: Soravia's priority is export diversification supported by debt relief, because no domestic strategy escapes the savings and currency gaps quickly enough on its own. (≈330 words; allow supported alternative judgements with conditions.)