

Relationship between countries at different levels of development

A2

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Read first: [Economic development](#), [Characteristics of countries at different levels of development](#), [Current account of the balance of payments](#)

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What you need to know

Economic development showed how to measure development, and **Characteristics of countries at different levels of development** showed what low-income, emerging and high-income countries look like. This topic is about the **links between them**: the money, goods, firms and people that flow from one kind of country to another, and the two international institutions that lend to them. By the end you should be able to explain:

1. International aid:

- its **forms**: bilateral or multilateral, tied or untied, grants or soft loans, project aid, technical assistance, food and emergency aid;
- the **reasons** donors give it;
- its **effects** on the receiving country, good and bad;
- how **important** it is compared with other flows such as trade, FDI and remittances.

2. Trade and investment between countries at different levels of development.

3. Multinational companies (MNCs): what an MNC is, what MNCs do, and the consequences of their activities for host and home countries.

4. Foreign direct investment (FDI): what it is and its consequences.

5. External debt: its causes and its consequences.

6. The role of the International Monetary Fund (IMF).

7. The role of the World Bank.

Understand it

Four flows that link countries

Low-income and high-income countries are linked by four main flows:

Flow	From whom	What it is
Trade	firms	exports and imports of goods and services
Investment	firms and investors	FDI (building or buying firms abroad) and portfolio investment (shares and bonds)
Aid	governments and official institutions	help given on better than market terms
Borrowing	banks, governments, institutions	loans that must be repaid with interest, building up external debt

Add **migration**: workers who move from low-income to high-income countries, and the **remittances** they send home. Each flow can help development, and each has costs. The exam keeps asking the same question in different forms: **under what conditions** does this flow raise living standards in the low-income country?

International aid: its forms

Aid is a transfer of money, goods, services or skills to a country, on terms better than it could get in the market, from a **government** or an **official international institution**, to help its development or welfare. Money from charities and other **non-governmental organisations (NGOs)** helps, but it is not **official** aid, because no government supplies it. FDI and portfolio investment are not aid either: they are private flows made for profit.

Aid is classified in several ways at once, so one gift can be, say, bilateral, tied, project aid and a grant all together:

- **By donor**: **bilateral** aid goes directly from one government to another; **multilateral** aid is pooled by an international body funded by many governments (the World Bank, United Nations agencies, regional development banks) and then given out.
- **By conditions on spending**: **tied** aid must be spent on goods or services from a named source, usually the donor's own firms (sometimes another named supplier); **untied** aid can be spent anywhere, so the receiver can buy the cheapest supplies.
- **By repayment**: a **grant** need not be repaid; a **soft (concessional) loan** must be repaid, but at a low interest rate, over a long period, often after a grace period.
- **By purpose**: **project aid** pays for a particular scheme (a dam, a road, a school); **programme aid** supports a government's budget or a whole sector; **technical assistance** sends skilled people or training; **food aid** and **emergency (humanitarian) aid** respond to famine, war or disaster.

Aid that brings the biggest **long-term** benefit is a **grant** (nothing to repay, so no debt) spent on **capital** that raises productive capacity (machinery, infrastructure, training), not on consumption such as food subsidies, which helps only while it lasts.

Why donors give aid

- **Humanitarian**: to relieve poverty, hunger and disease, and respond to disasters.

- **Economic development:** to fill the **savings gap** (low incomes mean low saving, so too little investment) and the **foreign exchange gap** (too little foreign currency to import capital goods).
- **Self-interest of the donor:** tied aid creates orders and jobs for the donor's firms; aid opens markets for its exports and secures supplies of raw materials.
- **Political and strategic:** to win allies, influence and votes in international bodies, and to reward or encourage policies the donor favours.
- **Global problems:** to slow migration pressures, fight disease that crosses borders and protect the environment.

Effects of aid

Benefits for the receiver

- **More investment** in infrastructure, health and education raises productivity, output and incomes (LRAS shifts right). Higher incomes bring more tax revenue to spend on health, housing and schools.
- **Foreign exchange:** aid adds to the country's **foreign currency reserves**, lets it import capital goods, and raises demand for its currency, so its **exchange rate** tends to rise. Grants are recorded in the **current account** (secondary income, as transfers), or in the capital account for some capital grants, not as investment in the financial account.
- **Short-term spending:** aid spent in the economy adds to aggregate demand, with a multiplier effect on income and jobs.
- **Emergency aid** saves lives and stops a disaster turning into long-term poverty.
- **Technical assistance** transfers skills and technology.
- **Political relations** between donor and receiver usually improve.

Problems

- **Tied aid** forces the receiver to buy from the donor, often at higher prices than elsewhere, and the extra demand and jobs go partly to the donor.
- **Loans create debt:** interest and repayments drain foreign exchange later.
- **Dependency:** long-term reliance on aid, or on foreign experts, can weaken local enterprise, initiative and innovation, and reduce the pressure on governments to raise their own taxes.
- **It may not reach the poor:** corruption, waste, spending on prestige projects or on the capital city, or conditions that suit the donor.
- **Food aid** given free can lower the prices local farmers get and harm domestic agriculture.
- **Conditions** attached by donors or institutions (cuts in government spending, free trade) can hurt the poor in the short run.

How important is aid?

Aid can matter a great deal for the poorest countries, and in emergencies. But for most low- and middle-income countries it is a smaller flow than **export earnings, FDI and remittances**. That is behind the slogan "**trade not aid**": opening rich countries' markets to low-income countries' exports, and ending the **agricultural**

subsidies that let rich countries' farmers undercut them, can raise incomes more than aid, and without dependency. Aid works best where it is untied, given as grants, spent on investment, and matched by good government; it helps least where it is tied, wasted or replaces local effort.

Trade and investment between countries at different levels of development

From the topic before, low-income countries mostly **export primary products** and **import manufactures and capital goods**. Trade with high-income countries lets them:

- **specialise** in goods where they have a **comparative advantage**, gain economies of scale and earn foreign exchange to buy capital goods;
- give consumers **cheaper imports and more choice**, so real incomes rise;
- grow through **export-led growth**: exports are an injection, so AD and output rise.

But the terms are uneven:

- prices of primary products are **unstable**, and their low income elasticity of demand weakens the **terms of trade** over time;
- rich countries' **tariffs** on processed goods and **subsidies** for their own farmers keep low-income countries' exports out or push down world prices;
- **free trade** exposes infant industries to competition before they can survive, which can cause **structural unemployment**; foreign firms may **dump** goods below cost;
- extracting natural resources for export can **degrade the environment**.

Investment flows the other way: capital moves from high-income to low-income countries as **FDI** by MNCs, **portfolio investment** in shares and bonds, and **loans**. Low-income countries need it because their own saving is too low to finance the investment that growth needs.

Multinational companies (MNCs)

A **multinational company (MNC)**, also called a multinational or transnational corporation, is a firm that **owns or controls production in more than one country**: it has its headquarters in a **home country** and operations (factories, mines, offices, plantations) in one or more **host countries**. A firm that only **trades** internationally, exporting from its own country, is not an MNC.

What MNCs do

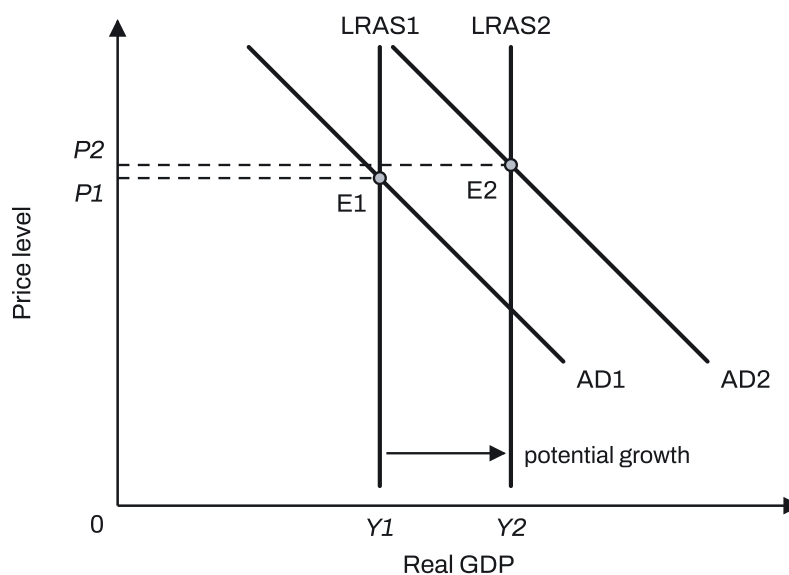
- set up or buy factories, mines, plantations and service centres abroad, to be close to **raw materials** or to **markets**, to use **cheap labour** and land, or to get round **trade barriers** by producing inside the market;
- spread production across countries to gain **economies of scale**, sourcing components wherever they are cheapest (global supply chains);
- move profits through their subsidiaries and choose a home base where **corporation tax** is low (transfer pricing);
- use their size and market power, sometimes approaching monopoly in a host market.

Why MNCs choose a country: low wages and land costs only attract an MNC if the country also has good **infrastructure** (roads, ports, power, communications), political **stability**, a skilled enough workforce and freedom to send profits home. A government that wants FDI does best to **invest in infrastructure** and education; extra regulation, minimum wages and import quotas tend to put investors off.

Foreign direct investment (FDI)

Foreign direct investment is investment by a firm in one country to **set up, buy or expand a business in another country that it controls** (by convention, owning at least 10% of it). It is long-term and gives control. **Portfolio investment** (buying shares or bonds without control) and short-term "hot money" are not FDI.

Consequences of FDI and MNCs for the host (usually low-income) country



The diagram shows the two effects together, from E1 to E2. It draws LRAS as vertical for simplicity; where the host has unemployed resources, the first rise in AD lifts output towards capacity before the new capacity is added.

Benefits:

- **Actual growth:** building the factory is an injection of investment, so **AD shifts right**; with unemployed resources the **investment multiplier** raises income and employment by more than the first spending.
- **Potential growth:** new capital, **technology** and **training** raise productivity, and new mines and infrastructure add to capacity, so **LRAS shifts right** (the PPC shifts out).
- **Jobs and incomes:** direct jobs in the MNC, and indirect ones in local suppliers; wages in MNCs are often above local levels.
- **Tax revenue** from profits, wages and spending pays for public services.
- **Balance of payments:** the inflow of capital is a credit in the **financial account**; later, **exports** from the factory and fewer imports (if it makes goods once imported) improve the **current account**; both add to demand for the currency.

- **Diversification** away from a few primary products, and **more choice** and lower prices for consumers.

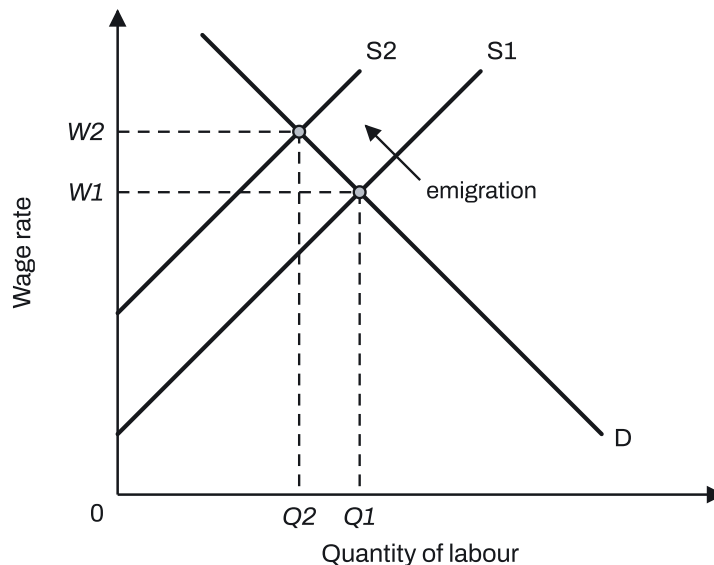
Costs:

- **Profits are sent home** (repatriated): a debit in the **primary income** part of the current account, so the host's net investment income **falls**.
- **Imports** of machinery, components and raw materials: in the **short run** the current account usually **worsens**, even while employment and investment rise. The current account gains most when the MNC uses **local** materials and sells **exports** whose demand is **income elastic** (it grows quickly as world incomes rise).
- **Competition** from the MNC may drive local firms out of business; skilled jobs may go to managers brought from the home country while local workers get low-paid jobs.
- **Capital-intensive** methods create fewer jobs than expected; jobs may be lost later if the MNC moves on.
- **Environmental damage** and over-use of natural resources (deforestation, pollution), external costs the MNC does not pay.
- **Tax concessions** offered to attract MNCs cut government revenue; transfer pricing moves profits to low-tax countries.
- **Power and corruption**: a large MNC may bribe officials or press the government for favourable rules; **cultural** and working practices may change.
- **"Dutch disease"**: big exports of minerals raise the exchange rate, making the country's other exports dearer and causing structural unemployment in them.
- **Volatility**: an MNC may pull investment out quickly in a global crisis.
- Some one-off benefits do not last: buying local building materials for the factory helps only while it is built; new technology, training and diversification last.

For the MNC's home country: profits flow back as primary income; consumers get cheaper goods; but jobs move abroad (structural unemployment in the home country), and the home country loses tax if profits are booked in low-tax countries.

Migration and remittances

When workers move from low-income to high-income countries:



- **In the home country:** the supply of labour falls, so wages tend to **rise** and unemployment falls. Migrants send **remittances**: money from abroad that is a **credit in the current account**, adds to demand like exports, and raises household spending on food, schooling and health. But if the skilled leave, there is a **brain drain**: fewer doctors, engineers and teachers, which is why removing restrictions on the emigration of skilled labour is **not** good for a developing country.
- **In the host country:** a larger labour force, more tax revenue, younger workers who help support pensions, more demand and new businesses; but more pressure on housing, health and school places, possible downward pressure on wages in some jobs, and costs of training and integration.

External debt

External debt is the money a country's government, firms and households owe to lenders **abroad**: foreign governments, banks, bondholders and international institutions. It usually has to be repaid in **foreign currency** (often US dollars).

Causes of debt

- **Low saving:** income is too low to finance investment at home, so the government borrows abroad for infrastructure and development.
- **Current account deficits:** importing more than is exported, often because of reliance on a few primary exports with falling or unstable prices.
- **Cheap credit:** when world interest rates are low, borrowing looks cheap, as in 2010–2020.
- **Poor use of loans:** projects that never earn enough to repay them ("vanity projects", corruption, capital flight).
- **Shocks:** a slump in commodity prices, natural disasters, war, or a rise in oil prices for an importer.
- **Rising interest rates and depreciation:** the debt grows in local currency even with no new borrowing.

Consequences of debt

- **Debt service** (interest plus repayments of principal) uses scarce foreign exchange that could have bought capital goods; interest paid abroad is a **debit in the primary income** part of the current account.
- The **opportunity cost**: money for debt service is not spent on health, education and infrastructure, so development slows.
- **Higher interest rates abroad** raise the cost of servicing the debt. A **depreciation** of the borrower's currency raises the local-currency cost of every dollar owed: a \$1 billion payment costs 8 billion in local currency at 8 per dollar, but 10 billion at 10 per dollar, 25% more.
- To earn foreign currency, governments may push more primary exports, which can lower world prices and damage the environment.
- A **debt crisis**: the country cannot pay, loses access to new loans, its currency falls and it must turn to the IMF, accepting conditions.
- **Debt relief** (cancelling or rescheduling debts, such as the IMF and World Bank's scheme for heavily indebted poor countries) frees money for development and helps a country overcome foreign exchange shortages, but may encourage new borrowing.

The key ratio is the **debt service ratio**: debt service as a percentage of export earnings. If a country owes \$10 billion at 5% interest and repays \$0.6 billion of principal a year, debt service is $0.05 \times 10 + 0.6 = 1.1$ billion dollars; with exports of \$4 billion that is $\frac{1.1}{4} \times 100 = 27.5\%$ of everything it earns abroad.

Is borrowing for growth a good idea? A loan-financed project pays for itself only if its **rate of return is higher than the interest rate**: a project returning 9% a year on a loan at 6% adds to income after debt service; one returning 4% does not. So borrowing works when the money goes into productive projects (power, ports, education) whose returns, ideally in exports, cover the debt service, and when interest and exchange rates stay stable.

The International Monetary Fund (IMF)

The IMF is an international institution of about 190 member countries, set up in 1944. Its role is the **stability of the international monetary system**:

- it promotes **international monetary cooperation** and **exchange rate stability**;
- it gives **short-term loans to countries with balance of payments problems**, including those whose policies have failed and those hit by a natural disaster or other shock;
- it carries out **surveillance**: it monitors economies and gives **policy advice**, including on fiscal and monetary policy;
- it gives **technical assistance** (for example on running a central bank or a tax system).

IMF loans usually come with **conditions**, known in the past as **structural adjustment programmes (SAPs)**: policies to move towards a free-market economy, such as **free trade** (removing import restrictions), **deregulation** (for example of farming markets), **privatisation** of state enterprises, **cuts in the budget deficit** (contractionary fiscal policy, ending subsidies), **controlling inflation**, and **devaluation** of the currency.

- **For the conditions**: they tackle the causes of the crisis, restore confidence so other lenders return, and can raise efficiency.

- **Against:** cuts in spending and subsidies hit the poor; free trade conflicts with the **infant industry argument** for protecting new firms; a focus on primary exports leaves income unstable; devaluation raises import prices, causing **cost-push inflation**; privatisation can replace a state monopoly with a private one; one set of policies may not fit every country.

The IMF does **not** pay for capital projects such as water plants, dams or roads. That is the World Bank's job.

The World Bank

The World Bank, set up alongside the IMF, is a multilateral development institution. Its role is **long-term development and the reduction of poverty**:

- it gives **long-term, low-interest loans and grants to governments of low- and middle-income countries** for **capital projects**: infrastructure (roads, power, ports, clean water), education, health and farming;
- its arm for the poorest countries lends on very soft terms (interest-free or close to it, over decades) and gives grants;
- it gives **advice and technical help** on development policy, and with the IMF has run **debt relief** for heavily indebted poor countries;
- like the IMF, it often attaches conditions such as **privatisation** or market reforms.

	IMF	World Bank
Main aim	stable international monetary system	long-term development, less poverty
Lends for	balance of payments problems	projects: infrastructure, water, schools, health
Term of loans	short to medium term	long term, low interest, also grants
Both	policy advice, technical help, conditions on loans	policy advice, technical help, conditions on loans

Key facts and formulas

There is no formula list in the 9708 exam, so everything here is "Learn it".

Formula	Status
Aid: a transfer from a government or official institution on better than market terms (grants, soft loans, goods, skills); NGO money, FDI and portfolio investment are not official aid	Learn it
Tied aid: aid that must be spent on goods or services from a named source, usually the donor	Learn it
Bilateral aid: from one government to another; multilateral aid: through an international body funded by many governments	Learn it

Formula	Status
MNC: a firm that owns or controls production in more than one country	Learn it
FDI: investment by a firm to set up, buy or expand a business it controls in another country	Learn it
Debt service = interest payments + repayments of principal	Learn it
Debt service ratio = $\frac{\text{debt service}}{\text{export earnings}} \times 100$	Learn it
Local-currency cost of a foreign debt payment = payment in foreign currency $\times$ exchange rate (local currency per unit of foreign currency)	Learn it
A loan-financed project adds to income only if its rate of return $>$ the interest rate	Learn it
FDI in the balance of payments: capital inflow is a financial account credit; repatriated profits are a primary income debit	Learn it

How to do it

We tagged 50 questions for this topic, from March 2021 to March 2026 (46 different; 4 are repeats across paper variants): 37 Paper 3 multiple choice and 13 Paper 4 essays and data-response questions. Each question is counted under one type.

Question type	Questions
MNCs and FDI: benefits, costs, balance of payments, what attracts them (MCQ)	17
Forms and effects of aid (MCQ)	10
Roles of the IMF and the World Bank (MCQ)	8
Evaluate MNCs or FDI in low-income countries (essay)	4
Evaluate aid, trade or globalisation for low-income countries (essay)	3
Evaluate borrowing, debt and IMF or World Bank conditions (essay)	3
Links between countries in a data response	3
Which policy of richer countries helps developing countries (MCQ)	2

1. MNCs and FDI (17 questions)

- Definition:** an MNC **operates (owns production) in more than one country**. Trading internationally is not enough ([9708/31/O/N/25 Q26](#)).

2. **Benefit or not?** Benefits to the host: technology, training, jobs, tax revenue, exports, diversification. **Not** a benefit: more competition that drives out **small domestic producers** (9708/34/O/N/25 Q28). But in "least valid **criticism**" questions, "it encourages competition and lowers prices, forcing out inefficient firms" is the odd one out, because that describes a gain in efficiency (9708/34/O/N/25 Q30). Real criticisms: low-paid jobs while managers come from abroad, quick withdrawal in a crisis, environmental damage.
3. **Lasting or one-off?** Technology, training and diversification last; buying local building materials for the factory ends when it is built (9708/31/O/N/22 Q27).
4. **Balance of payments**, by account:
 - FDI inflow (buying or building a firm) → **financial account improves**;
 - imports of machinery and raw materials → **current account worsens**; exports → it improves;
 - profits sent home → **net investment income falls** (primary income debit). An MNC that buys a local firm, sells at home and imports its inputs: current account worse, financial account better (9708/32/M/J/24 Q28). In the **short run** a new factory raises employment and investment but does **not** improve the current account (9708/33/M/J/23 Q26). The **most likely** result of FDI in general: a better **trade balance** from exports, not more net investment income or less tax (9708/33/O/N/24 Q28). The current account gains most with a **high share of local raw materials** and **income elastic** demand for the product abroad (9708/32/O/N/24 Q28). More MNCs means more **exports** (9708/33/M/J/24 Q27).
5. **Multiplier**: with **unemployed resources**, low inflation and a stable currency, FDI boosts AD through the **investment multiplier** (9708/32/O/N/22 Q28).
6. **What attracts FDI**: infrastructure. Cheap labour and land do **not** attract manufacturing if infrastructure is poor (9708/33/O/N/23 Q30); spending on infrastructure is the best way to attract it (9708/32/F/M/22 Q20).
7. **Harder future growth** from a foreign mining firm: exchange rate appreciation (Dutch disease), profits sent abroad, tax cuts that cause problems. Training local workers does **not** support that view (9708/32/O/N/22 Q18).
8. **MNC objectives**: monopoly power, a low-tax home base and subsidiaries abroad for economies of scale all help an MNC cut costs and raise profits. Operating in a **cartel with production quotas** helps least, because a quota limits its output and so its economies of scale (9708/31/O/N/21 Q9).
9. **Reading data**: if FDI and GDP growth do not rise and fall together across the years, the relationship is **weak**; do not claim a link the figures do not show (9708/33/O/N/23 Q23).

2. Forms and effects of aid (10 questions)

1. **Classify on every axis**: who gives it (one government = bilateral; an international body such as the UN or World Bank = multilateral), whether spending is tied, grant or loan, project or programme.
2. **Tied** = must buy from a named source. United Nations money that must buy vaccines made in India is **multilateral and tied** (9708/32/O/N/25 Q26). US government money that must buy American drugs is **tied aid** (9708/31/O/N/21 Q28). UK aid for a school in Uganda, with UK materials, is bilateral, project and tied, but **not multilateral** (9708/32/M/J/21 Q27).
3. **Restrictive aid** = **tied** grants (9708/31/O/N/24 Q28); emergency food aid, soft loans and technical help are not restrictive in that sense.

4. **What counts as official aid:** official development assistance only; FDI and portfolio flows are private (9708/33/M/J/22 Q27). Disaster relief from an **NGO** is not official aid because it is **not supplied by a government** (9708/32/O/N/22 Q20).
5. **Biggest long-term benefit:** a **grant** (no debt) for **capital** such as farm machinery (9708/33/O/N/25 Q27).
6. **Effects of more aid:** the exchange rate, foreign currency reserves and political relations improve; the **financial account** is least likely to, because aid is not investment (9708/34/M/J/25 Q30).
7. **Evidence aid fails: over-reliance** on technical assistance that weakens local initiative and innovation. Better communications, ports and training are evidence aid **works** (9708/32/F/M/25 Q30).

3. Roles of the IMF and the World Bank (8 questions)

1. **World Bank** = long-term loans and grants to governments of low- and middle-income countries for **capital projects** and infrastructure (9708/32/F/M/26 Q27, 9708/31/O/N/25 Q28).
2. **IMF** = exchange rate stability and **short-term help with balance of payments problems** (9708/33/O/N/23 Q28), including countries with failed policies and after natural disasters.
3. **Not the IMF:** funding a water plant or other project (9708/33/M/J/25 Q28). The role done by the World Bank **but not** the IMF is money to **build infrastructure**; free trade, fiscal policy advice and support with external accounts are things both do (9708/32/F/M/25 Q29).
4. **Conditions (SAPs)** are free-market policies: deregulation of farming (9708/31/O/N/21 Q23), privatisation, free trade, cutting deficits. Food subsidies, nationalisation and capital controls are the opposite.
5. **Conflicts:** the condition that clashes with the **infant industry** argument is **free trade**, because infant industries need protection (9708/32/M/J/25 Q29).

4. Evaluate MNCs or FDI in low-income countries (4 questions)

Paper 4 essays: 20 marks since 2023 (Table A, knowledge, understanding and analysis, 14 marks, Level 3 is 11–14; Table B, evaluation, 6 marks, Level 2 is 4–6); 25 marks in 2021–2022, marked in levels. Examples: whether MNCs in low-income countries are "always beneficial" (9708/42/O/N/25 Q5) or "always promote growth" (9708/42/O/N/23 Q4), MNCs and living standards in home **and** host countries (9708/42/O/N/22 Q7), and a chain of claims from FDI to GDP to living standards (9708/41/O/N/21 Q6).

1. **Define:** MNC, FDI, low-income country, and the outcome in the question (economic growth as a rise in real GDP; standard of living, material and non-material).
2. **Analyse 3–4 developed chains of benefit:** investment → AD right → multiplier → actual growth and jobs (AD/AS diagram); capital, technology, training and infrastructure → LRAS right or PPC out → potential growth; tax revenue → spending on health and education; exports and capital inflow → balance of payments and exchange rate.
3. **Evaluate with 3+ developed costs:** local firms displaced; capital-intensive methods so few jobs, or structural unemployment; profits repatriated and imported inputs; environmental damage (externalities); corruption and changes in working and cultural life; Dutch disease from mineral exports; tax concessions; the MNC may leave.

4. **Use "always" or "both countries"**: it depends on the type of MNC (extracting minerals or making exports), the share of local inputs, government regulation and how the tax revenue is used. If the question names the home **and** host countries, keep them apart and cover both.
5. **Conclude**: not always beneficial; say under which conditions the benefits outweigh the costs.

5. Evaluate aid, trade or globalisation for low-income countries (3 questions)

Essays such as how far aid **and** trade can contribute to development ([9708/42/F/M/26 Q5](#)), the impact of aid on living standards ([9708/43/O/N/23 Q5](#)), or whether globalisation helps high-income countries at the expense of low-income ones ([9708/41/O/N/23 Q5](#)).

1. **Define** aid (with its forms), trade, development or living standards.
2. **Aid chains**: investment and technology → productivity, output, jobs → incomes and tax revenue → health, housing, education.
3. **Trade chains**: comparative advantage and economies of scale → lower costs and prices, more choice → higher real incomes; exports → AD and jobs.
4. **Evaluate both**: aid may reach only a few, tied aid raises costs, dependency cuts innovation, loans create debt; trade can cause structural unemployment, supply shocks, resource degradation and dumping; rich-country protection limits the gains.
5. **Give each part the same weight**, then judge their **relative** importance. A conclusion that only repeats earlier points earns little.

6. Evaluate borrowing, debt and IMF or World Bank conditions (3 questions)

Essays on borrowing abroad at low interest rates to finance long-term growth ([9708/42/O/N/24 Q5](#)), whether to keep borrowing from the IMF given its conditions ([9708/43/O/N/21 Q7](#)), and privatisation required by the IMF and World Bank ([9708/42/O/N/24 Q3](#), where the privatisation analysis belongs to the market failure topic).

1. **Define** long-term growth (a rise in productive capacity, PPC or LRAS shifting out; measured by real GDP) and external debt.
2. **Analyse why borrow**: low incomes mean low saving; funds from foreign governments (for example China's Belt and Road loans), international agencies (the World Bank) and MNCs finance infrastructure and capital; investment raises AD now and LRAS later; borrowing pays when the **return on the project exceeds the interest rate**, which was easy when rates were very low.
3. **Evaluate**: how much funding comes from abroad and whether domestic funds exist; the **quality of projects** (vanity projects earn nothing); lenders that insist on their own firms and materials, so little extra AD at home and more imports; **rising interest rates** in high-income countries raise the cost of borrowing, and a **depreciation** (often after a commodity price slump cuts export earnings) raises the local cost of dollar debt; debt service worsens the current account.
4. **IMF conditions**: take each condition in turn (free trade, primary exports, devaluation, spending cuts, privatisation), give its benefit and its cost, then weigh the loan against the conditions.

5. **Conclude:** borrowing works if it funds productive, export-earning projects and the debt stays affordable; say what would make it fail.

7. Links between countries in a data response (3 questions)

Point-marked parts, 4–8 marks, all based on the extract: migration and remittances ([9708/41/O/N/25 Q1](#)), China's Belt and Road loans and infrastructure in Pakistan ([9708/42/M/J/23 Q1](#)), IMF advice and an MNC in the palm oil industry ([9708/43/O/N/22 Q1](#)).

- **Remittances benefit the home economy** (6): they are income from abroad, a credit in the current account (1), like exports in the $(X - M)$ part of AD (1), so AD shifts right (1) and real GDP rises (1); an AD/AS diagram earns more.
- **Migration and wages at home** with a diagram (5): axes wage and labour (1), D and S (1), first equilibrium (1), supply shifts **left** (1), new higher wage and lower quantity (1).
- **Foreign-funded infrastructure** and growth with a diagram (4): actual growth (AD right, or a move to the PPC) and potential growth (LRAS right, or the PPC shifting out), and the difference between them.
- **"Consider" or "to what extent"** (7–8): up to 3 marks for each side from the extract (benefits, then costs or missing information; up to 4 a side when the part is worth 8 and the scheme says so), and 1 for a justified conclusion. Find evidence for **both** sides: answers that only list disadvantages are capped.

8. Which policy of richer countries helps developing countries (2 questions)

1. **Helps:** removing rich countries' **agricultural subsidies**, writing off debt (it eases foreign exchange shortages), aid for capital projects such as clean water, hiring migrant workers (remittances).
2. **Does not help:** restricting investment or exploration by global firms, **letting skilled workers leave** (brain drain), cutting exports of fuel that low-income countries need for production.

Examples: [9708/32/F/M/21 Q28](#) (withdrawing agricultural subsidies is most beneficial), [9708/32/M/J/23 Q19](#) (cutting fuel exports is least likely to help growth).

Worked examples

Example 1

In one year Country R receives four inflows:

1. A United Nations agency pays for engineers to spend a year training R's water technicians.
2. The government of Country S lends R money at 1% interest over 30 years, on condition that it is spent on trains made in Country S.
3. An international charity pays for village wells.
4. A carmaker based in Country S builds a factory in R.

Which flows are official aid, and which of those is tied?

A 1 and 2 are official aid; only 2 is tied **B** 1, 2 and 3 are official aid; only 2 is tied **C** 1 and 2 are official aid; both are tied **D** 2 and 4 are official aid; only 2 is tied **[1]**

Flow 1 is multilateral technical assistance, given free and not tied to a supplier. Flow 2 is a bilateral soft loan (low interest, long term), tied to the donor's trains. Flow 3 comes from an NGO, not a government, so it is not official aid; flow 4 is FDI, a private investment for profit. **A** (1).

B counts the charity as official aid; C treats the training as tied; D counts FDI as aid and leaves out the UN training.

Example 2

A multinational car maker builds a factory in Country N. In year 1 it brings in \$800 million of foreign investment and imports \$500 million of machinery. From year 2, each year the factory exports cars worth \$300 million, imports components worth \$120 million and sends \$90 million of profit to its home country.

Calculate the effect on Country N's financial account in year 1, and on its current account in year 1 and in each year from year 2. Comment on the result. **[3]**

Year 1: financial account **+\$800 million** (the FDI inflow), current account **−\$500 million** (imported machinery) (1).

From year 2: current account = $300 - 120 - 90 = +90$, a gain of \$90 million a year (1).

The current account worsens at first and improves only once exports start, and the gain is reduced by imported components and repatriated profits; using more local components would raise it (1).

Marks: $1 + 1 + 1 = 3/3$.

Example 3

Extract: Country Z has external debt of \$24 billion and earns \$8 billion a year from exports. After interest rates rose in high-income countries, the average interest rate on its debt rose from 4% to 7%. Over the same period a fall in commodity prices led its currency to depreciate from 10 to 12.5 zeds per US dollar.

(a) Calculate Country Z's annual interest payments as a percentage of export earnings, before and after the rise in interest rates. **[2]**

(b) Using the extract, analyse two consequences of these changes for Country Z's economy. **[4]**

(a) Before: $0.04 \times 24 = 0.96$, so \$0.96 billion, $\frac{0.96}{8} \times 100 = 12\%$ of export earnings (1). After: $0.07 \times 24 = 1.68$, so \$1.68 billion, $\frac{1.68}{8} \times 100 = 21\%$ (1).

(b) The interest is paid in dollars, and the depreciation means each dollar costs more zeds: the interest bill rises from $0.96 \times 10 = 9.6$ billion zeds to $1.68 \times 12.5 = 21$ billion zeds, more than double (about 119% higher) (1). The government must find this from taxes or by cutting other spending, so less is spent on schools, health and infrastructure, which slows development and long-term growth (1).

Interest paid abroad is a debit in the primary income part of the current account, so the current account deficit widens (1). With 21% of export earnings going on interest, less foreign currency is left to import capital goods, so investment and growth fall, and the country may have to turn to the IMF and accept conditions such as spending cuts (1).

Marks: (a) 2 + (b) 2 + 2 = **6/6**.

Example 4

"Foreign direct investment does more than official aid to raise living standards in low-income countries." Evaluate this view. [20]

Model answer (paragraph plan):

1. **Definitions:** FDI (a firm setting up, buying or expanding a business it controls abroad, usually an MNC); official aid (transfers from governments or institutions on better than market terms: grants, soft loans, tied or untied, bilateral or multilateral); standard of living (material: real income per head; non-material: health, education, environment). (AO1)
2. **How FDI raises living standards:** building the factory is an injection, so AD shifts right and, with unemployed resources, the multiplier raises income and jobs; new capital, technology and training shift LRAS right, so potential output grows (AD/AS diagram); wages and tax revenue rise, paying for public services; exports improve the current account. FDI is often larger than aid and brings management skills as well as money. (AO2)
3. **How aid raises living standards:** it fills the savings and foreign exchange gaps; it can go straight to what markets underprovide, such as clinics, schools, clean water and rural roads, which raise the non-material standard of living directly; emergency aid saves lives; grants add no debt. (AO2)
4. **Limits of FDI:** profits are repatriated and inputs imported; MNCs may use capital-intensive methods, pay low wages to local staff and displace local firms; they invest where there is already infrastructure and stability, so the poorest countries get little; tax concessions, pollution and resource depletion reduce the net gain; FDI can be withdrawn in a crisis. (AO3)
5. **Limits of aid:** tied aid raises costs and benefits the donor; soft loans add to debt; aid may be lost to corruption or spent on prestige projects; long-term dependence weakens local enterprise; free food aid can harm local farmers. (AO3)
6. **Weighing them:** they work best together: aid-funded infrastructure and schooling are what attract FDI; FDI does more for income and jobs where a country is already stable and connected; aid does more for health and education in the poorest or crisis-hit countries. (AO3)
7. **Conclusion:** for middle-income countries with good infrastructure, the view is largely right, because FDI brings more money, technology and jobs; for the least developed, aid matters more, since FDI will not come until basic infrastructure and skills exist. Neither raises living standards unless the gains are spread and taxed to fund public services. (AO3)

Table A Level 3 (11–14): accurate definitions, developed chains for both FDI and aid with a correct AD/AS diagram, and the link to living standards made each time. Table B Level 2 (4–6): both sides weighed with developed points, and a justified conclusion that answers "does more", saying for which countries. **20/20**.

Common mistakes

- **Mixing up the IMF and the World Bank.** In March 2025 ([9708/32/F/M/25 Q29](#)) the right answer, money to build infrastructure, was the **least** popular choice; each of the other options, roles both bodies perform, drew about a quarter of candidates. In March 2026 ([9708/32/F/M/26 Q27](#)) the IMF was a common wrong answer for an organisation lending to governments for capital projects. Remember: World Bank = projects and development; IMF = balance of payments and exchange rate stability.
- **Counting private flows as aid.** In June 2022 ([9708/33/M/J/22 Q27](#), also Paper 31) only 22% were right, and 59% counted one of the private investment flows as foreign aid as well as official development assistance. Aid comes from governments and official institutions; FDI and portfolio investment are private.
- **Getting the direction of migration wrong.** In March 2021 ([9708/32/F/M/21 Q28](#)) 49% were right; 27% chose removing restrictions on the emigration of skilled labour, which makes it easier for skilled workers to **leave** the developing country.
- **Unbalanced aid and trade essays.** In March 2026 ([9708/42/F/M/26 Q5](#)) weaker answers did not give aid and trade similar weight, explained the types of aid only briefly, and wrote conclusions that summarised instead of judging the relative importance of each.
- **Losing the home country in MNC essays.** In November 2022 ([9708/42/O/N/22 Q7](#)) good answers defined an MNC with an example and kept the **home** country and the **host** countries separate throughout; using the multiplier to analyse the effect of investment abroad was rewarded. A significant number lacked analysis, and only the best evaluated and concluded.
- **Treating a list of claims as one claim.** In November 2021 ([9708/41/O/N/21 Q6](#)) the statement had three linked parts (GDP and living standards, FDI and GDP, and the policy); each needed explaining and discussing, then a conclusion on how far to agree.
- **Not taking IMF conditions one by one.** In November 2021 ([9708/43/O/N/21 Q7](#)) good answers weighed each of the three IMF requirements against the benefit of the loan: removing import restrictions could cause balance of payments problems, relying on primary exports could mean unstable income and low productivity, and devaluation could cause cost-push inflation.
- **Arguing only one side from an extract.** In November 2022 ([9708/43/O/N/22 Q1\(d\)](#)) answers tended to focus on the disadvantages of following the IMF's advice, because they were easier to find in the text; up to half the marks were available for each side, plus one for a reasoned conclusion. In June 2023 ([9708/42/M/J/23 Q1\(d\)](#)) the best answers saw that the Belt and Road investment had limits as well as benefits.

How to get the marks

- **Multiple choice:** classify aid on every axis (donor, tied, grant or loan, purpose); place FDI flows in the right account (financial account inflow, current account imports and exports, primary income for profits); separate the IMF (balance of payments) from the World Bank (projects). Read "not", "least" and "most likely" carefully.
- **Definitions earn the first marks:** aid and its forms, tied aid, bilateral and multilateral aid, MNC, FDI, external debt, debt service, the roles of the IMF and World Bank, standard of living and economic growth.

- **Diagrams:** AD/AS with AD shifting right for the short-run effect of investment and LRAS shifting right for the long-run effect (or a PPC shifting out) supports essays on FDI, aid and borrowing; a labour market diagram shows migration. Label the axes, curves and equilibria, and refer to the diagram in the text.
- **"Analyse"** needs chains: flow → investment, jobs or exports → output and income → tax revenue and spending → living standards.
- **"Evaluate", "assess", "to what extent", "consider"** need both sides with developed points, then a judgement. Good evaluation says **what it depends on**: tied or untied, grant or loan, how the money is used, local inputs, government regulation and corruption, the type of country.
- **Cover every part of the question:** both flows (aid **and** trade), both countries (home **and** host), every condition the IMF sets, every link in a quoted statement.
- **Essays (20 marks since 2023):** Table A (14) rewards accurate definitions, relevant labelled diagrams and developed analysis of every part of the question; Table B (6) rewards developed evaluation and a conclusion that answers the question's own words ("always", "does more", "should continue"), not a summary. In 2021–2022 essays were worth 25 marks and marked in levels; the top level needed both sides and a conclusion.
- **Data response:** quote and use the extract on both sides; say what information is missing.

Quick check

1. A regional development bank, funded by 40 member governments, lends Country P money for 30 years at 1% interest to build a power station. Country P can buy the turbines from any supplier. Classify this aid in four ways.
2. A country has external debt of \$15 billion at 6% interest, and repays \$1.2 billion of principal a year. Its exports earn \$7 billion. Find its debt service and its debt service ratio. What would the ratio be if a commodity price slump cut export earnings to \$6 billion?
3. Which of these is a role of the World Bank but not of the IMF: (i) short-term loans to correct a balance of payments deficit, (ii) advice on fiscal policy, (iii) long-term loans to build water supply systems, (iv) monitoring exchange rates?
4. An MNC's factory in a low-income country exports goods worth \$240 million a year, imports components worth \$90 million, pays local workers \$60 million and sends \$45 million of profit home. Find the yearly effect on the host country's current account, and explain why the wages are not included.
5. Explain two reasons why a high-income country might give aid to a low-income country. **[4]**

Answers

1. Multilateral (a body funded by many governments); a soft (concessional) loan (it must be repaid, but at a low rate over a long time); project aid (one power station); untied (the turbines can be bought anywhere).
2. Debt service = $0.06 \times 15 + 1.2 = 0.9 + 1.2 = 2.1$, so \$2.1 billion. Debt service ratio = $\frac{2.1}{7} \times 100 = 30\%$. With exports of \$6 billion: $\frac{2.1}{6} \times 100 = 35\%$, so more of every dollar earned goes on debt.
3. (iii). Short-term balance of payments loans and monitoring exchange rates are the IMF's role; both bodies give policy advice.
4. $240 - 90 - 45 = +105$: the current account gains \$105 million a year. The wages are paid by a firm located in the country to workers living there, so no money crosses the border; they raise local incomes and AD but are not in the balance of payments.
5. Humanitarian reasons: to reduce poverty and disease in the receiving country (1), because low incomes there mean people lack food, clean water and health care that aid can pay for (1). Self-interest: tied aid must be spent on the donor's goods (1), so it creates orders, jobs and new export markets for the donor's firms (1). (Other valid reasons: political influence or allies; securing raw materials; tackling global problems such as disease or migration pressures.)

Past questions to try

- 9708/31/O/N/25 Q28: the main role of the World Bank.
- 9708/32/M/J/24 Q28: FDI and the current and financial accounts of the balance of payments.
- 9708/33/O/N/25 Q27: which form of aid gives the biggest long-term benefit.
- 9708/42/F/M/26 Q5: a 20-mark essay on how far aid and trade contribute to economic development.