Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Centre Number | Candidate Number

Pearson Edexcel International Advanced Level

Time 1 hour 45 minutes

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary
UNIT 2: Macroeconomic performance and policy

You must have:
Source Booklet (enclosed)

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **ALL** questions in Sections A, B and C.
- Answer **ONE** question in Section D.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

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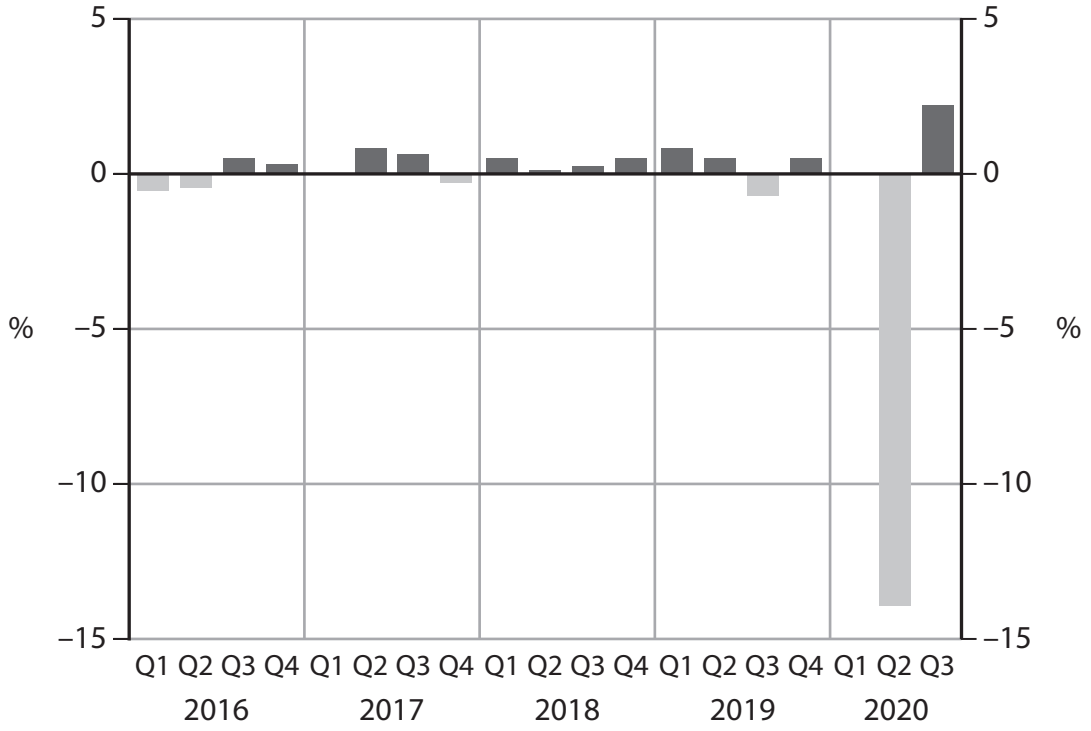
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SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 The chart shows the quarterly real GDP growth rate for Greece from Quarter 1 2016 to Quarter 3 2020.



Which **one** of the following can be deduced from the chart?

☒ **A** Greece experienced a recession in Quarters 1 and 2 of 2016

☒ **B** Greece experienced negative economic growth throughout 2017

☒ **C** Greece experienced positive economic growth in Quarter 3 of 2019

☒ **D** Greece experienced a recession in Quarter 2 of 2020

(Total for Question 1 = 1 mark)

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2 In the USA, in 2020, research showed that 33.8% of university graduates were working in jobs that did not require a university degree.

Which **one** of the following best describes this situation?

- ☒ **A** Real wage inflexibility
- ☒ **B** Economic inactivity
- ☒ **C** Unemployment
- ☒ **D** Underemployment

(Total for Question 2 = 1 mark)

3 In Quarter 3 of 2020 labour productivity improved by 9.8% in Ireland compared to the same quarter in 2019.

Ceteris paribus, what was the most likely impact of this change in labour productivity?

- ☒ **A** The aggregate demand curve shifted to the left
- ☒ **B** The aggregate demand curve shifted to the right
- ☒ **C** The long-run aggregate supply curve shifted to the right
- ☒ **D** The short-run aggregate supply curve shifted to the left

(Total for Question 3 = 1 mark)

4 In 2019 the German Government's tax revenue exceeded its expenditure by €45.35 billion.

Ceteris paribus, which **one** of the following can be deduced from this information?

- ☒ **A** Germany had a net withdrawal from the circular flow of income
- ☒ **B** Germany had a net injection into the circular flow of income
- ☒ **C** Germany had a deficit on the current account of the balance of payments
- ☒ **D** Germany had a surplus on the current account of the balance of payments

(Total for Question 4 = 1 mark)

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5 The short-run Phillips curve shows the relationship between which of the following?

- ☒ **A** The rate of economic growth and protection of the environment
- ☒ **B** The rate of inflation and the unemployment rate
- ☒ **C** The rate of inflation and equilibrium on the current account of the balance of payments
- ☒ **D** The rate of economic growth and income inequality

(Total for Question 5 = 1 mark)

6 The Indian Government planned to spend $19 billion on a high-speed rail link between Mumbai and Ahmedabad.
The multiplier is estimated to be 2.45 in India.

Which **one** of the following shows the potential increase in real GDP caused by this government injection?

- ☒ **A** $7.76 billion
- ☒ **B** $21.45 billion
- ☒ **C** $46.55 billion
- ☒ **D** $65.55 billion

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

Answer ALL questions in this section in the space provided.

7 The table shows the five countries with the highest percentage growth in GDP in 2019.

Country	Percentage growth in GDP
Syria	9.9%
Bangladesh	7.9%
Bhutan	7.4%
India	7.4%
Rwanda	7.3%

With reference to the table, explain **one** likely cost of economic growth.

Economic growth is an increase in real GDP. One likely cost is environmental degradation. As output rises, firms need more raw materials and energy, so more fossil fuels are burned to generate electricity and more resources such as forests are used up. This causes more air pollution and carbon emissions, which are negative externalities that harm third parties, eg through respiratory illness, and reduce the quality of life.

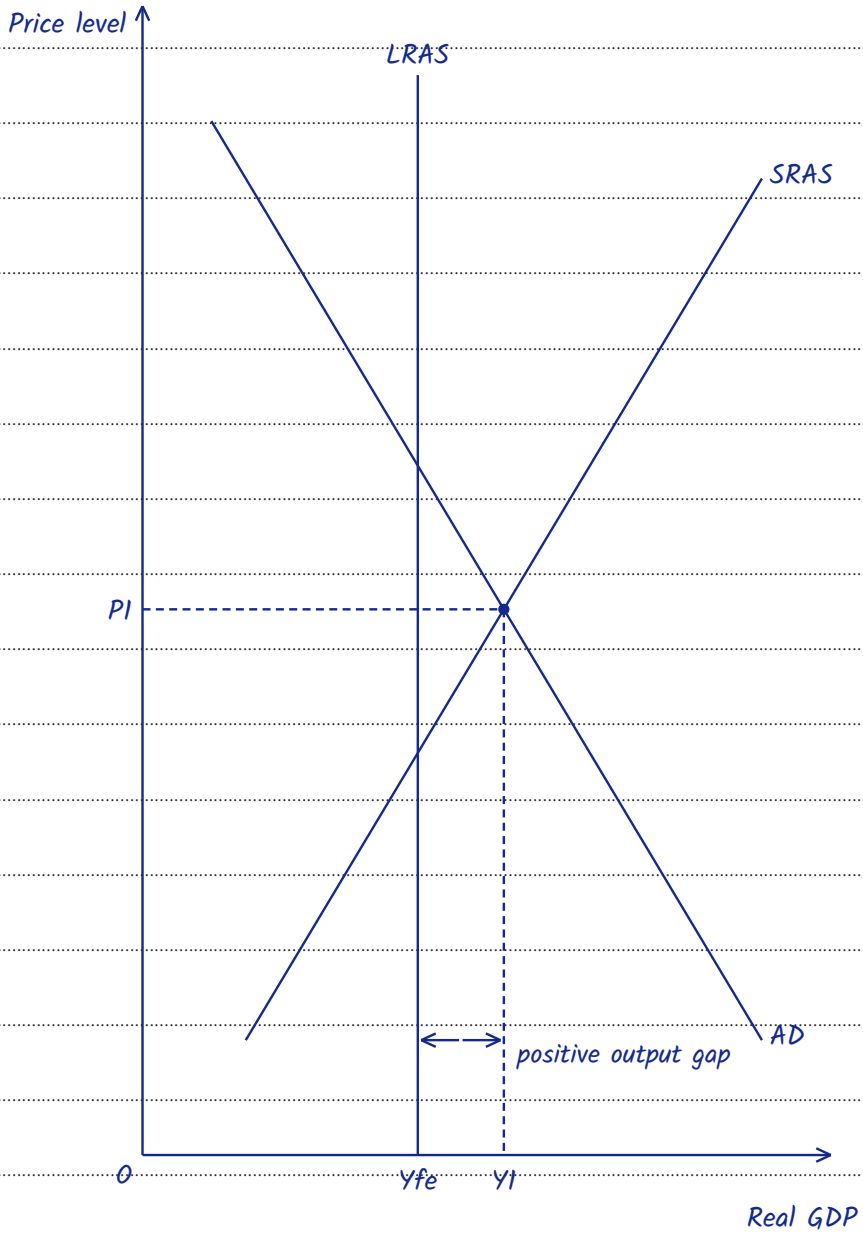
The table shows that this cost is likely to be greatest in the fastest-growing economies: Syria's GDP grew by 9.9% and Bangladesh's by 7.9% in 2019, while India grew by 7.4%. Such rapid growth in output could lead to rising pollution in their cities, so growth may not be sustainable.

(Total for Question 7 = 4 marks)

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8 In Scotland there was a positive output gap in 2018. The economy was growing at 1% faster than the trend rate of economic growth.

Draw a diagram to show a positive output gap.



LRAS shows the full employment (potential) level of output, Yfe. The short-run equilibrium, where AD = SRAS, is at YI, to the right of LRAS. Because actual real GDP (YI) is greater than potential output (Yfe), the gap Yfe to YI is a positive output gap, as in Scotland in 2018.

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9 The table shows the value of exports and imports of goods and services, $ billion, for Saudi Arabia in 2018 and 2019.

	2018	**2019**
Exports of goods and services ($ billion)	294.5	251.8
Imports of goods and services ($ billion)	135.2	144.3

Based on this information, calculate the change in the balance of trade for Saudi Arabia between 2018 and 2019. Show your workings.

Balance of trade = value of exports – value of imports (X – M)

2018: 294.5 – 135.2 = $159.3 billion (surplus)

2019: 251.8 – 144.3 = $107.5 billion (surplus)

Change = 107.5 – 159.3 = –$51.8 billion

So Saudi Arabia's trade surplus fell by $51.8 billion between 2018 and 2019, because exports fell while imports rose.

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10 In 2020 Turkey had 1.4 million more immigrants than emigrants.

Explain **one** way by which this net migration could increase employment.

Net migration is the number of immigrants minus the number of emigrants. In 2020 Turkey had 1.4 million more immigrants than emigrants, so net migration was positive and its population rose.

This larger population increases household consumption, because the immigrants need to buy food, housing, clothing and other goods and services. Firms respond to the higher demand by increasing output. Since labour is a derived demand, firms must employ more workers to produce this extra output, so employment rises.

In addition, many immigrants may come to fill job vacancies that Turkish workers are unable or unwilling to fill, eg in agriculture or construction, which also directly increases employment.

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11 The table shows income, measured by GDP per capita at PPP, and the World Happiness Score, in 2019 for selected countries. The World Happiness Score gives a value between 0 and 10, where 10 is the highest level of subjective happiness.

Country	GDP per capita at PPP ($)	World Happiness Score
Singapore	101 458	6.377
Malaysia	28 911	5.384
China	16 709	5.124
India	6 977	3.573

With reference to the data, explain the likely relationship between income and subjective happiness.

The data suggest a positive relationship between income and subjective happiness: as GDP per capita at PPP rises, the World Happiness Score also rises. This is because people with higher incomes can afford more goods and services, such as better housing, healthcare and education, which raises their living standards and so they tend to feel happier.

Singapore has the highest income, $101 458 per capita, and the highest happiness score of 6.377, whereas India has the lowest income, $6 977, and the lowest score of 3.573. Malaysia ($28 911, 5.384) and China ($16 709, 5.124) lie in between. However, the relationship is not proportional: Singapore's income is about 3.5 times Malaysia's but its score is only about 1 point higher.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

Study Figure 1 and Extract A in the Source Booklet before answering Question 12.

Write your answers in the space provided on the following pages.

12 (a) Define the term 'fiscal policy' (Extract A, line 12).

(2)

(b) With reference to Figure 1, explain how the ILO unemployment rate is measured.

(4)

(c) With reference to Figure 1 and Extract A, examine **two** likely economic effects of the increase in unemployment experienced in New Zealand between Quarter 2 and Quarter 3 2020.

(8)

(d) With reference to Extract A, analyse **one** likely effect of the reduction in tourist visitors on the circular flow of income.

Illustrate your answer with a circular flow diagram.

(6)

(e) With reference to Extract A and your own knowledge, discuss the likely effects of reflationary monetary policy on the New Zealand economy.

(14)

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12 (a) Define the term 'fiscal policy' (Extract A, line 12).

(2)

Fiscal policy is the use of changes in government spending and taxation (and so the budget balance) to influence the level of aggregate demand in the economy, eg New Zealand's reflationary fiscal policy of NZ$62 billion of extra government spending in 2020.

(b) With reference to Figure 1, explain how the ILO unemployment rate is measured.

(4)

The ILO unemployment rate is measured using the Labour Force Survey, a questionnaire of a sample of households. A person is counted as unemployed if they are without a job, have actively looked for work in the last 4 weeks and are available to start work in the next 2 weeks.

The rate is the number of ILO unemployed as a percentage of the labour force (the economically active: employed + unemployed). Figure 1 shows that in New Zealand it was 4.2% in Q1 2020 and 4.0% in Q2, then rose to 5.3% in Q3 before falling to 4.9% in Q4 2020.

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(c) With reference to Figure 1 and Extract A, examine **two** likely economic effects of the increase in unemployment experienced in New Zealand between Quarter 2 and Quarter 3 2020.

(8)

Between Q2 and Q3 2020 New Zealand's ILO unemployment rate rose from 4.0% to 5.3%, an increase of 1.3 percentage points, largely due to redundancies in the tourism industry after the borders closed.

One effect is a loss of income for those who become unemployed. Workers made redundant in tourism lose their wages, so they are less able to buy goods and services. Consumption, the largest component of AD, falls, and through the negative multiplier effect real GDP falls further, which may cause more job losses in other industries.

However, the size of this effect may be limited. Unemployment benefits act as an automatic stabiliser, partly replacing lost incomes and supporting consumption and AD. In addition, the rise in tourism unemployment may be temporary: when foreign visitors are allowed back, demand for tourism should rise and many of these workers could be re-employed.

A second effect is that the government's public finances worsen. With fewer people in work, the government receives less income tax and, as spending falls, less indirect tax revenue, while it must pay out more in unemployment benefits. This increases the budget deficit and government borrowing, adding to the pressure from the NZ$62 billion increase in spending in 2020, and there is an opportunity cost as the money could have been spent on healthcare or education.

The significance of this depends on how long unemployment lasts. A 1.3 percentage point rise in just one quarter is large, so spending on benefits would rise significantly. If unemployment becomes long term, workers lose skills and find it harder to get jobs in future, so the cost to

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the public finances and to the economy's productive capacity would be much greater. But Figure 1 shows the rate fell back to 4.9% in Q4, which suggests the effects may be short-lived.

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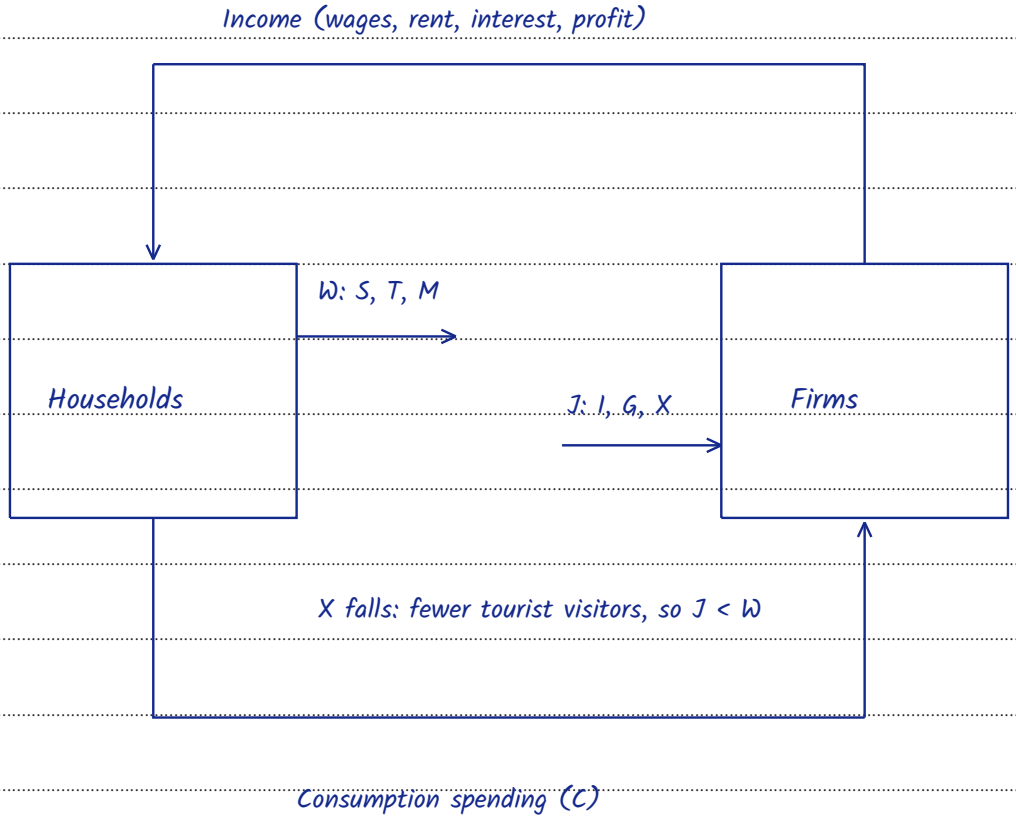
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(d) With reference to Extract A, analyse **one** likely effect of the reduction in tourist visitors on the circular flow of income.

Illustrate your answer with a circular flow diagram.

(6)

In the circular flow of income, households receive income from firms and spend it on goods and services, while exports (X) are an injection into the flow, along with investment (I) and government spending (G), and savings, taxes and imports are withdrawals.



The Government closed New Zealand's borders to all foreigners in March 2020 and this continued well into 2021. Spending by foreign tourists counts as an export of services, and tourism accounted for 20% of New Zealand's exports in 2019. So the fall in tourist visitors causes exports, an injection, to fall.

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With injections now less than withdrawals, less money flows into firms, so the circular flow of income shrinks. Tourism firms earn less revenue: 33% were temporarily closing, 40% were reducing operations and 21% might not survive. They pay out less in wages and profits, so household incomes fall, consumption falls and there are further rounds of reduced spending through the multiplier, reducing national income (real GDP).

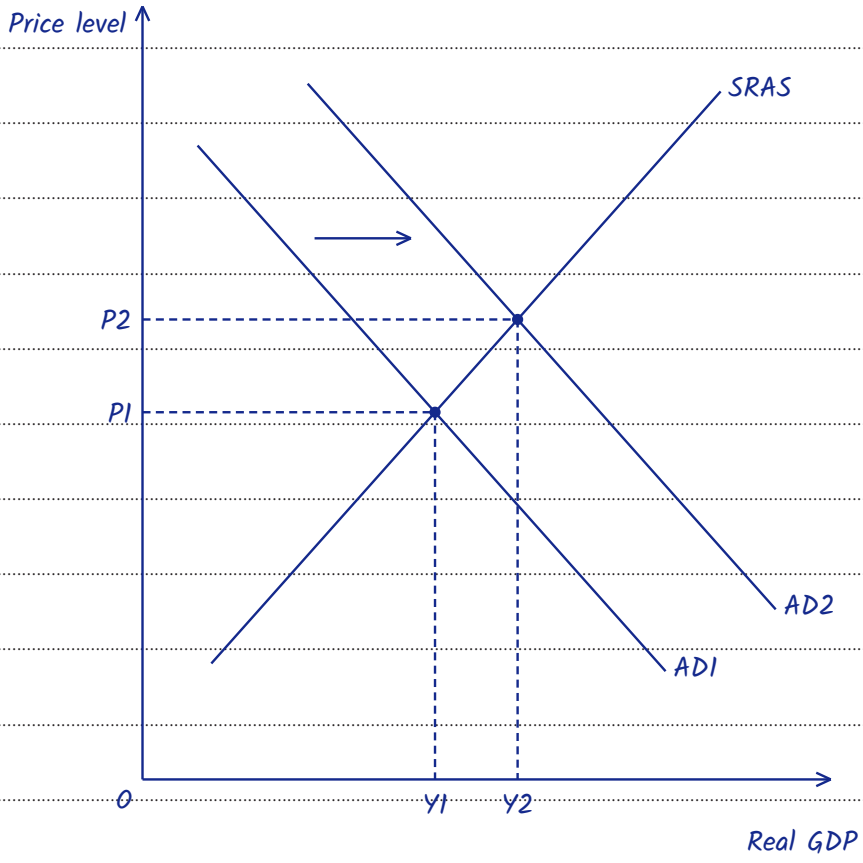
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(e) With reference to Extract A and your own knowledge, discuss the likely effects of reflationary monetary policy on the New Zealand economy.

(14)

Reflationary monetary policy is the use of lower interest rates and an increase in the money supply by the central bank to increase aggregate demand. In March 2020 New Zealand's central bank cut the base rate from 1% to 0.25% and introduced NZ$60 billion of quantitative easing (QE), increased to NZ$100 billion in August 2020.

Lower interest rates reduce the cost of borrowing and the reward for saving, so households borrow more and save less, increasing consumption. Those with variable rate mortgages see their monthly repayments fall, increasing their discretionary income. Firms also find it cheaper to borrow to finance investment. Lower rates may also lead to a depreciation of the NZ$, making exports cheaper and imports dearer, so net exports rise.



QE, where the central bank buys bonds with newly created money, injects liquidity into the

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banking system, so banks are more willing to lend, and lowers bond yields and borrowing costs for firms. It also raises asset prices, creating a positive wealth effect. The extract shows cheaper mortgages increased demand for housing, so the average house price rose 2.6% to a record NZ$788 967. Higher house prices raise household wealth and confidence, so consumption rises further.

As C, I and net exports rise, AD shifts right from AD1 to AD2 (see diagram), so real GDP rises from Y1 to Y2, with a multiplier effect. The extract shows consumer spending grew by 14.8% in Q3 2020 and growth recovered from −12.2% in Q2 to +14% in Q3. Higher output means firms employ more workers, reducing unemployment (from 5.3% in Q3 to 4.9% in Q4). The price level rises from P1 to P2, so there is some demand-pull inflationary pressure.

However, the effect may be limited. Interest rates were already very low at 1%, so a cut to 0.25% may make little difference to borrowing, and rates cannot fall much further. After the sharp fall in output in Q2, consumer and business confidence may be low, so people may save rather than spend, and banks may be risk averse and refuse to lend if they doubt borrowers can repay. Monetary policy also works with a time lag of around 18 to 24 months.

Also, it is hard to separate the effect of monetary policy from other factors. The 14% recovery in Q3 was largely due to people no longer having to stay at home, and the NZ$62 billion fiscal stimulus also raised AD. The gains may be offset by lost tourism exports (20% of exports) while the borders stay closed. There are also costs: the record house prices may create an asset bubble and make housing less affordable, widening wealth inequality.

Nevertheless, the size of the QE programme, NZ$100 billion, is very large, and the 14.8% rise in consumption and record house prices suggest the policy did have a significant effect. Overall,

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reflationary monetary policy is likely to have helped New Zealand recover by boosting consumption, but its effect was strengthened by the reopening of the economy and fiscal policy, and it is less effective in the tourism sector, which depends on the borders reopening.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

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SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 In 2020 Japan's rate of inflation was –0.6% compared with 2019. Between 2019 and 2020 household consumption fell and the savings ratio increased from 33% to 44% of disposable income. Falling world oil prices also contributed to deflation.

Evaluate possible causes of deflation.

Illustrate your answer with an appropriate diagram.

(Total for Question 13 = 20 marks)

OR

14 The Government of the Philippines increased expenditure on infrastructure from ₱681 billion in 2020 to ₱1 200 billion in 2021.

Evaluate the possible effects of an increase in government expenditure on infrastructure on a country's economy.

Illustrate your answer with an appropriate diagram.

(Total for Question 14 = 20 marks)

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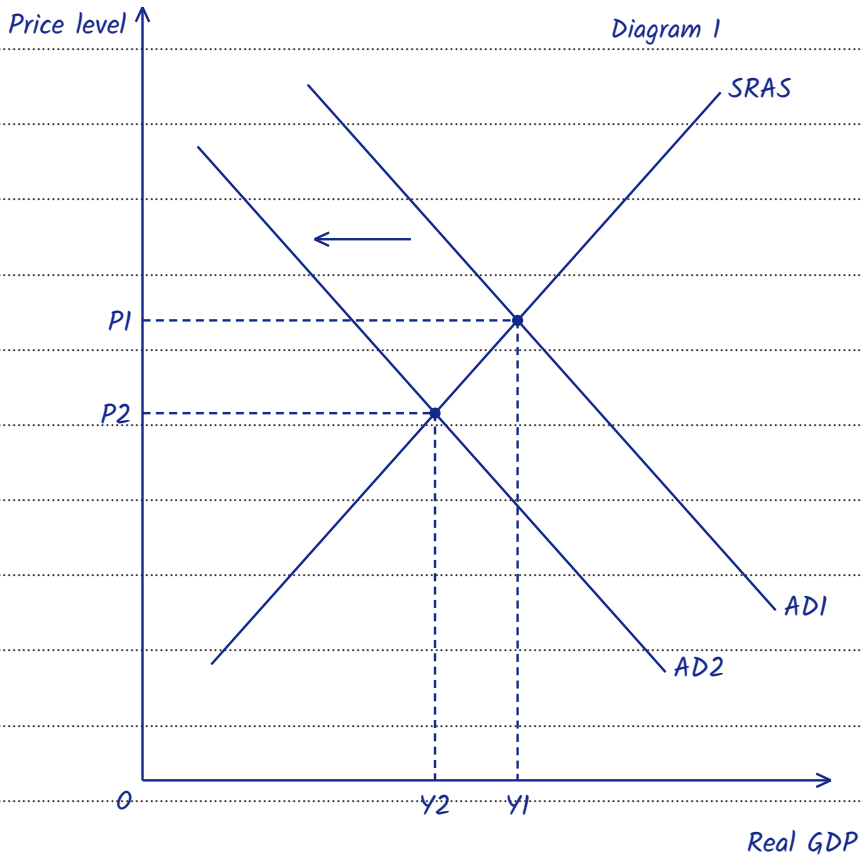
Chosen question number: **Question 13** ☒ **Question 14** ☐

Write your answer here:

Deflation is a sustained fall in the general (average) price level, so the inflation rate is negative. In 2020 Japan's inflation rate was −0.6%. Deflation can be caused by a fall in aggregate demand (demand-side) or by an increase in aggregate supply (supply-side).

One cause is a fall in consumption. In Japan the savings ratio rose from 33% to 44% of disposable income between 2019 and 2020, so households spent a smaller share of their income and household consumption fell. Since consumption is the largest component of AD (C + I + G + X − M), AD shifts left from AD1 to AD2, as shown in Diagram 1. There is a contraction along SRAS and, with the negative multiplier effect, the price level falls from P1 to P2 and real GDP falls from Y1 to Y2.

Diagram 1



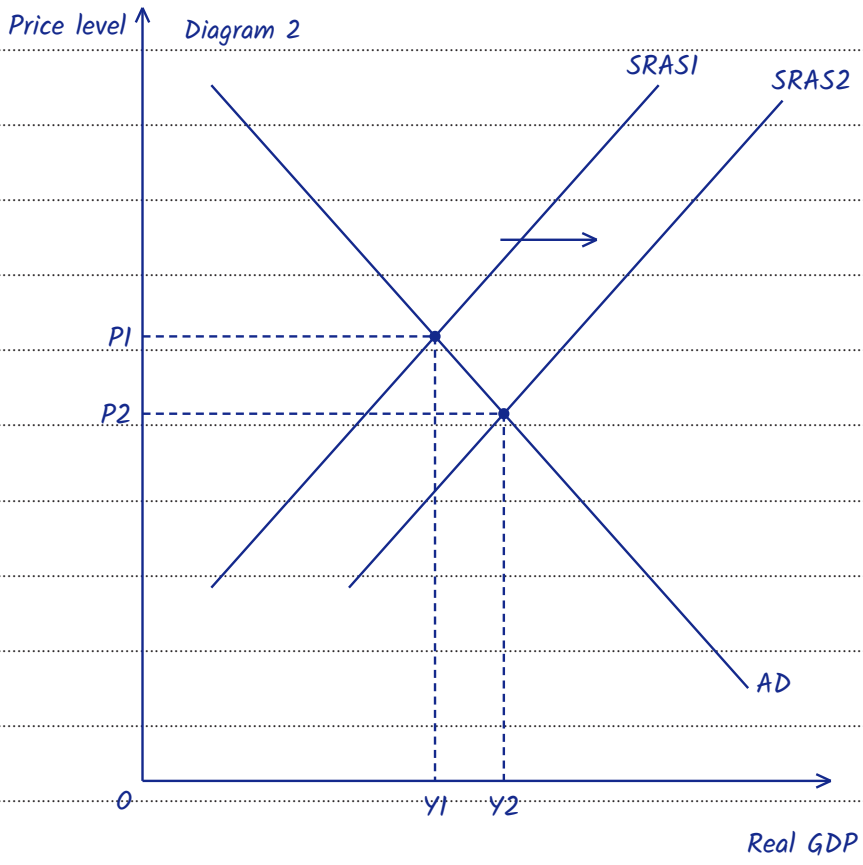
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Other demand-side causes include a fall in investment, eg if business confidence is low during the global health crisis, a fall in exports or rise in imports, and contractionary fiscal or monetary policy such as higher interest rates or cuts in government spending. Once deflation starts, consumers may expect prices to keep falling and delay purchases, so AD falls further and a deflationary spiral can develop. This appears to apply in Japan, where saving rose sharply.

A second cause is a fall in costs of production. The question states that falling world oil prices contributed to Japan's deflation. Japan imports almost all of its oil, so cheaper oil reduces firms' energy and transport costs. As shown in Diagram 2, SRAS shifts right from SRAS1 to SRAS2; there is an extension along AD, the price level falls from P1 to P2 and real GDP rises from Y1 to Y2.

Diagram 2



Similarly, falling prices of other raw materials and an appreciation of the yen, which makes

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imported goods and raw materials cheaper, reduce costs. In the long run, supply-side improvements such as better technology, education and skills, or more competition, shift LRAS right and push down the price level.

However, the causes have very different effects. Deflation caused by falling AD (demand-side, or "bad" deflation) comes with falling output and rising unemployment, while deflation caused by lower costs (supply-side, or "good" deflation) comes with higher real GDP and employment. So the cause matters more than the size of the price fall.

In Japan, both causes are likely to have operated at the same time, but the fall in AD is likely to be the more important. An 11 percentage point rise in the savings ratio is very large, so it would have caused a big fall in consumption, whereas the fall in oil prices mainly affects energy and transport costs. Supply-side causes such as new technology also only lower prices after a long time lag, so they are unlikely to explain a sudden fall in prices in a single year.

The magnitude of the deflation depends on the size of the shifts in AD and AS and on the slope of SRAS. With spare capacity, a fall in AD mainly reduces output rather than prices, so the fall in consumption may explain only part of the −0.6%. Also, −0.6% is a small fall and may be temporary.

Some causes are likely to reverse. Oil and raw material prices tend to rise again as the world economy recovers and demand increases, and floating exchange rates can depreciate, making imports more expensive again, so cost-push deflation may be short-lived. Equally, the higher savings ratio may partly reflect people being unable to spend during the health crisis, so consumption could recover once restrictions end, although Japan's ageing population and long history of weak demand suggest low consumption may persist.

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Policy also plays a role: contractionary policy can cause deflation, but monetary policy takes time to affect AD, and in Japan interest rates were already close to zero, so the central bank had little room to cut rates to prevent the fall in AD.

In conclusion, deflation can be caused by both demand-side and supply-side factors. In Japan in 2020, the main cause is likely to have been the sharp fall in consumption shown by the rise in the savings ratio from 33% to 44%, with falling oil prices adding to it. Since the demand-side cause reduces output and employment, this is the more harmful type of deflation, and it is likely to last longer than the effect of cheaper oil.

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Pearson Edexcel International Advanced Level

Time 1 hour 45 minutes

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary
UNIT 2: Macroeconomic performance and policy

Source Booklet

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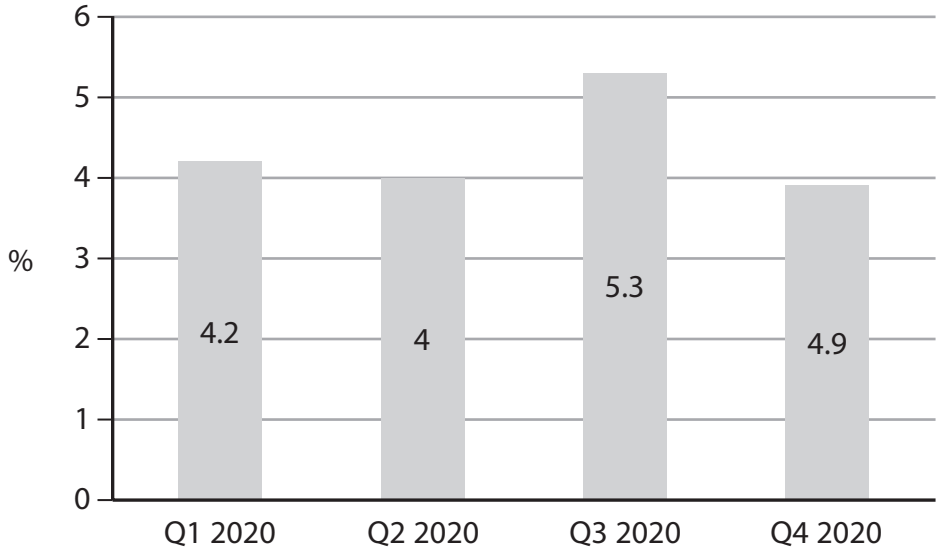
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Sources for use with Section C

The New Zealand economy

Figure 1 ILO unemployment rate, Quarter 1 to Quarter 4 2020



Extract A The impact of the global health crisis

In Quarter 2 2020 a global health crisis resulted in a reduction in economic activity in many countries. Significant declines in manufacturing, construction and services contributed to an average decrease in economic growth of 9.8% in 36 developed countries.

In response to the global health crisis New Zealand's Government instructed most people to stay at home from March 25 to May 13. This led to a substantial reduction in the country's GDP and to an increase in unemployment. Its economic growth rate fell by 12.2% in Quarter 2 2020 compared with Quarter 1 2020. However, in Quarter 3 2020, when New Zealanders no longer had to stay at home, economic growth recovered strongly and increased by 14% compared with Quarter 2 2020.

The economic recovery was also helped by reflationary fiscal policy by the New Zealand Government and reflationary monetary policy by New Zealand's central bank. In 2020 the Government increased its spending by NZ$62 billion. In March 2020 New Zealand's central bank reduced the base interest rate from 1% to 0.25%. At the same time, it introduced NZ$60 billion of quantitative easing, which was increased to NZ$100 billion in August 2020. This helped to stimulate consumer spending that grew by 14.8% in Quarter 3 2020.

The reflationary policy helped to increase the demand for housing. Consequently, the average price of a house rose to NZ$788 967, the highest on record. This was an increase of 2.6% in 2020 compared with 2019.

One problem for New Zealand's economy was that, in response to the global health crisis, the Government closed its borders to all foreigners in March 2020. This policy continued well into 2021. This significantly affected the tourism industry and exports of services. The results of a survey of firms in the tourism industry indicated that:

- 33% of businesses were temporarily closing
- 40% of businesses were significantly reducing operations
- 21% of businesses might not survive.

In 2019 tourism accounted for 20% of exports, 10% of GDP and employed 400 000 people. By the end of 2020 a significant number of workers in the tourism industry were made redundant.

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Acknowledgements

Figure 1 adapted from https://www.stats.govt.nz/indicators/unemployment-rate

Extract A adapted from 'New Zealand Economy Surges Out of Recession In V-Shaped Recovery', Tracy Withers, 16 December 2020, Bloomberg, https://www.bloomberg.com/news/articles/2020-12-16/new-zealand-economy-surges-out-of-recession-amid-spending-spree and 'New Zealand's housing market soars, with record prices for second month in a row', Elle Hunt, Guardian, 7 Jan 2021, https://www.theguardian.com/world/2021/jan/07/new-zealands-housing-market-soars-with-record-prices-for-second-month-in-a-row and 'Alarming Impact Of COVID-19 On Tourism Industry Revealed', 5 May 2020, https://www.scoop.co.nz/stories/BU2005/S00085/alarming-impact-of-covid-19-on-tourism-industry-revealed.htm