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

Friday 10 January 2025

Afternoon (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.

Turn over ▶

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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 Which **one** of the following statements about the classical long-run aggregate supply (LRAS) curve is correct?

- ☒ **A** It is perfectly inelastic when there is a high level of spare capacity
- ☒ **B** It is relatively elastic at the full employment level of real output
- ☒ **C** It is relatively inelastic at high levels of spare capacity
- ☒ **D** It is perfectly inelastic at the full employment level of real output

(Total for Question 1 = 1 mark)

2 In 2022 the Government of Brazil announced that it was introducing measures to cut the costs of bureaucracy for firms.

This policy is an example of which **one** of the following?

- ☒ **A** Free market supply-side policy
- ☒ **B** Interventionist supply-side policy
- ☒ **C** Reflationary fiscal policy
- ☒ **D** Deflationary fiscal policy

(Total for Question 2 = 1 mark)

3 Between January 2022 and January 2023 Turkey's unemployment rate fell from 11.2% to 9.8%.

Which **one** of the following is the percentage change in the unemployment rate for Turkey between January 2022 and January 2023?

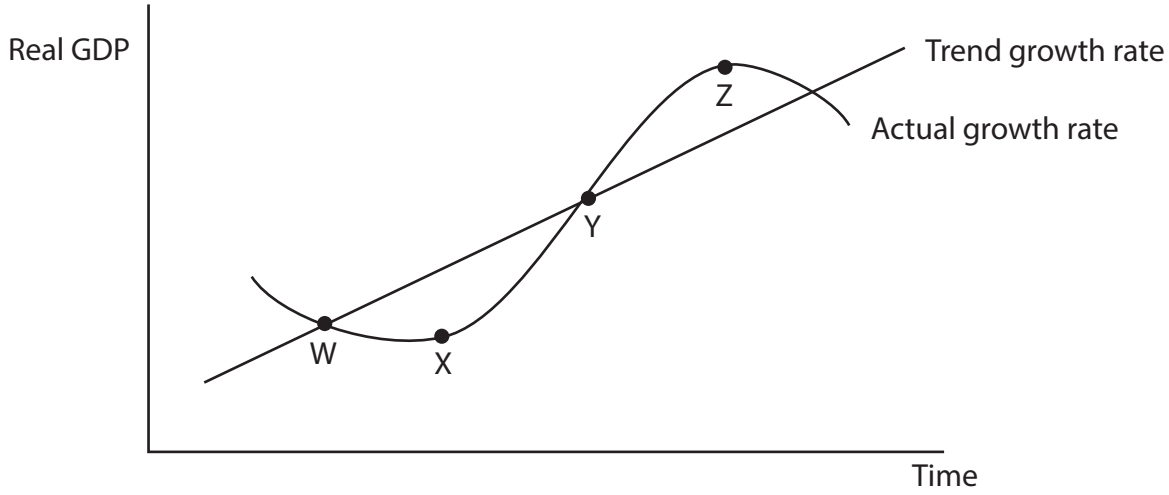
- ☒ **A** –1.4
- ☒ **B** –12.5
- ☒ **C** –14.3
- ☒ **D** –21.0

(Total for Question 3 = 1 mark)

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4 The diagram shows a country's trend growth rate and its actual growth rate.



With reference to the diagram, which **one** of the following is most likely to be associated with a movement from point Y to point Z?

- ☒ **A** A decrease in government tax revenue
- ☒ **B** An increase in profits for firms
- ☒ **C** An increase in the rate of unemployment
- ☒ **D** A decrease in business confidence

(Total for Question 4 = 1 mark)

5 In Austria investment was $98 billion in 2012 and it increased to $129 billion in 2022.

Which **one** of the following is most likely to have caused this increase in investment?

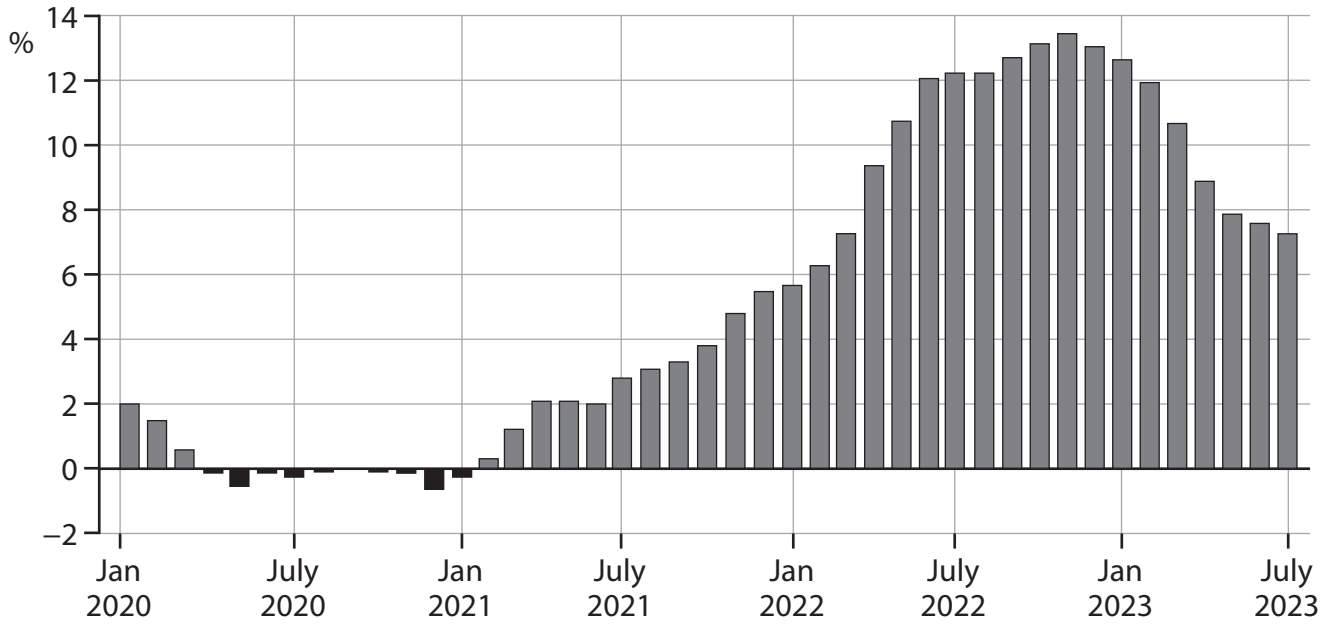
- ☒ **A** An increase in the availability of credit
- ☒ **B** An increase in the rate of tax on company profits
- ☒ **C** An increase in the base rate of interest
- ☒ **D** An increase in commodity prices

(Total for Question 5 = 1 mark)

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6 The chart shows the annual rate of inflation* in Croatia, as measured by the consumer price index (CPI), January 2020 to July 2023.



*This is the year-on-year inflation rate calculated monthly.

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

- ☒ **A** The rate of inflation was highest in July 2023
- ☒ **B** The average price level was highest in November 2022
- ☒ **C** There was deflation between April 2020 and July 2020
- ☒ **D** There was disinflation between June 2021 and June 2022

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B BEGINS ON THE NEXT PAGE.

SECTION B

Answer ALL questions in this section in the space provided.

7 In 2022 Guyana's rate of economic growth was the highest in the world. Its annual percentage increase in real GDP was 62.3%.

With reference to this information, explain **one** cost of economic growth.

One cost of economic growth is more pollution and environmental degradation. In 2022 Guyana had the highest rate of economic growth in the world, with real GDP rising by 62.3% in one year.

Because output rose so quickly, firms needed far more resources, such as energy and raw materials, and much of the growth came from extracting and burning fossil fuels such as oil. This produces more carbon emissions, air pollution and toxic waste, and uses up non-renewable resources.

This creates negative externalities: third parties suffer from poorer health and damage to the environment, so living standards may not rise as much as the 62.3% increase in real GDP suggests, and growth may not be sustainable for future generations.

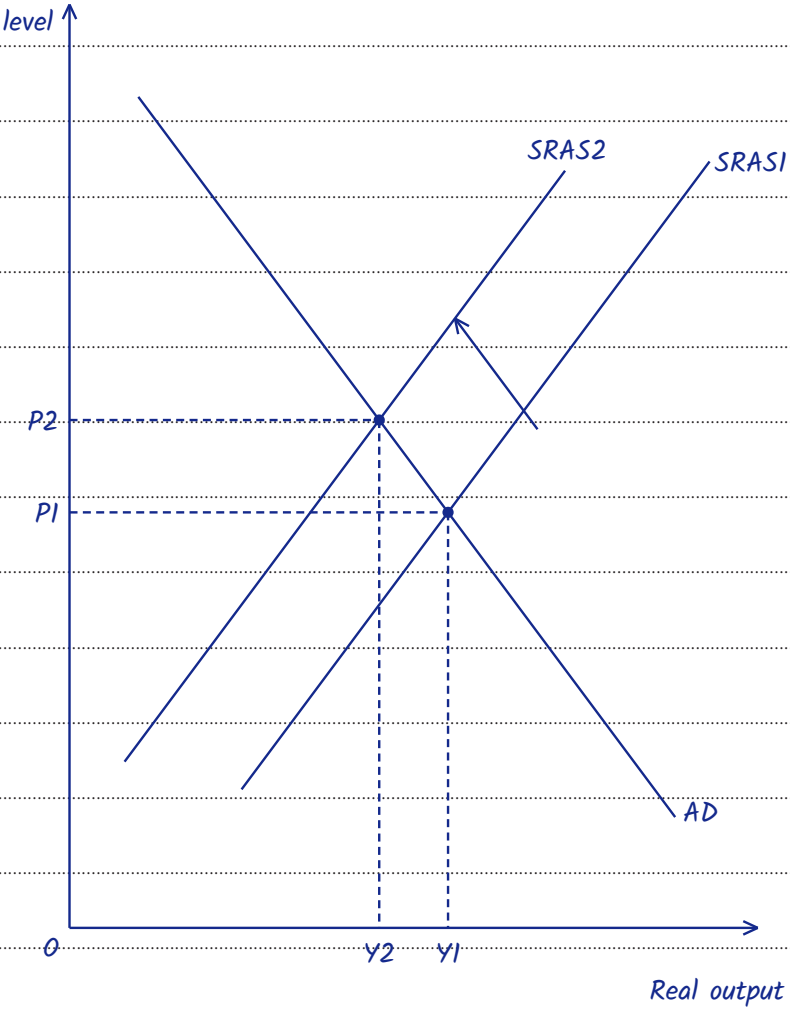
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8 Between January 2020 and December 2022 the global price of coal per tonne increased from $64.25 to $172.30. Japan is a net importer of coal.

Draw a SRAS and AD diagram to show the effect of this increase in the price of coal on the price level **and** real output for Japan.



Coal is an imported raw material for Japanese firms, so its price rising from $64.25 to $172.30 per tonne increases costs of production. SRAS shifts left from SRAS1 to SRAS2, so the price level rises from P1 to P2 (cost-push inflation) and real output falls from Y1 to Y2.

(Total for Question 8 = 4 marks)

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9 The table shows marginal propensities to withdraw for an economy.

Marginal propensity to save (MPS)	0.4
Marginal propensity to tax (MPT)	0.3
Marginal propensity to import (MPM)	0.1

With reference to the table, calculate the value of the multiplier for this economy.
Show your workings.

The multiplier = 1 ÷ MPW, where the marginal propensity to withdraw MPW = MPS + MPT + MPM.

MPW = 0.4 + 0.3 + 0.1

= 0.8

Multiplier = 1 ÷ MPW = 1 ÷ 0.8

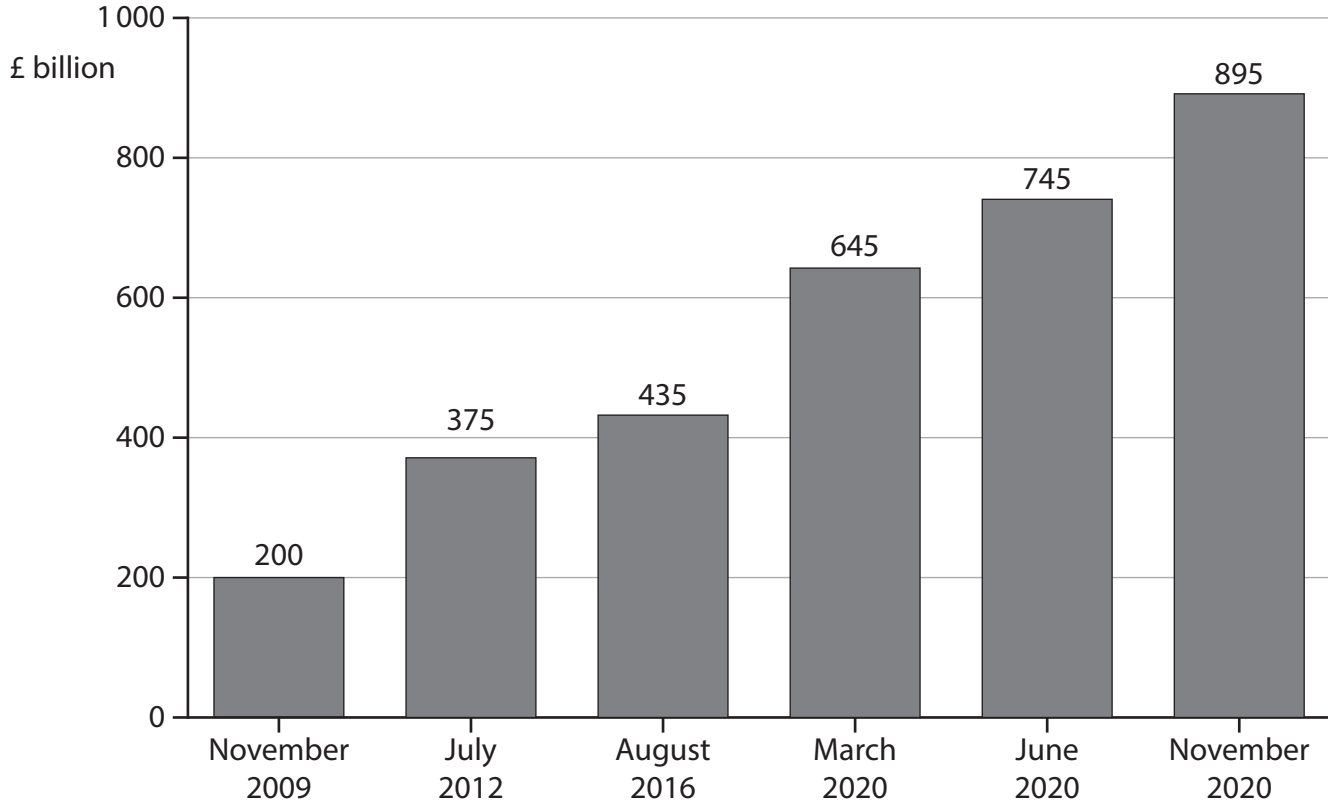
= 1.25

So the value of the multiplier is 1.25: an initial injection of 100 into the circular flow raises national income by 125 in total.

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10 The chart shows quantitative easing in the UK between November 2009 and November 2020, £ billion.



With reference to the chart, explain the term 'quantitative easing'.

Quantitative easing (QE) is a form of expansionary (reflationary) monetary policy in which the central bank creates money electronically and uses it to buy assets, mainly government bonds and corporate bonds, from commercial banks and other financial institutions.

This increases the money supply and the liquidity of banks, lowers long-term interest rates and encourages lending and borrowing, raising consumption, investment and AD. The chart shows QE in the UK increased from £200 billion in November 2009 to £895 billion in November 2020, a rise of £695 billion or 347.5%.

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11 Kuwait's GDP per capita and average world happiness score for 2013 and 2022 are shown in the table. This score gives a value between 0 and 10, where 10 is the highest level of subjective happiness.

	GDP per capita ($)	World happiness score
2013	31 082	6.52
2022	26 788	6.11

With reference to Kuwait, explain **one** likely impact of lower real incomes on subjective happiness.

Lower real incomes are likely to reduce subjective happiness. Between 2013 and 2022 Kuwait's GDP per capita fell from $31 082 to $26 788, a fall of $4 294 or 13.8%, while its world happiness score fell from 6.52 to 6.11, a fall of 0.41.

With lower real incomes, people can afford to buy fewer goods and services, so they must reduce their consumption and material living standards fall. Lower incomes may also be linked to a weaker economy or a recession, so people become more anxious about job security and their future prospects. Both of these reduce how satisfied people feel with their lives, so subjective happiness falls.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C BEGINS ON THE NEXT PAGE.

SECTION C

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

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

12 (a) Define the term 'recession'.

(2)

(b) With reference to the third paragraph of Extract A, explain the term 'exchange rate'.

(4)

(c) Analyse **one** likely effect of the 'increase in the number of overseas visitors' (Extract A, lines 8 and 9) on Japan's circular flow of income.

Illustrate your answer with a circular flow diagram.

(6)

(d) With reference to Extract A, examine the likely impact on Japan's real output of the fall in domestic consumption.

(8)

(e) With reference to the information provided and your own knowledge, discuss factors that the BoJ might consider when setting the base interest rate.

(14)

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12 (a) Define the term 'recession'.

(2)

A recession is a fall in real GDP (negative economic growth) for two or more consecutive quarters, ie at least six months.

(b) With reference to the third paragraph of Extract A, explain the term 'exchange rate'.

(4)

An exchange rate is the price (value) of one country's currency in terms of another currency, for example the number of US dollars that one Japanese yen can buy.

Extract A states that Japan's weak exchange rate was mainly responsible for the fall in domestic consumption. A weak yen means that each yen buys less foreign currency, so imports become more expensive in yen. As a result Japan's imports decreased by 4.3% between Q1 and Q2 2023, one of the largest reductions ever recorded, and domestic consumption fell by 0.5%.

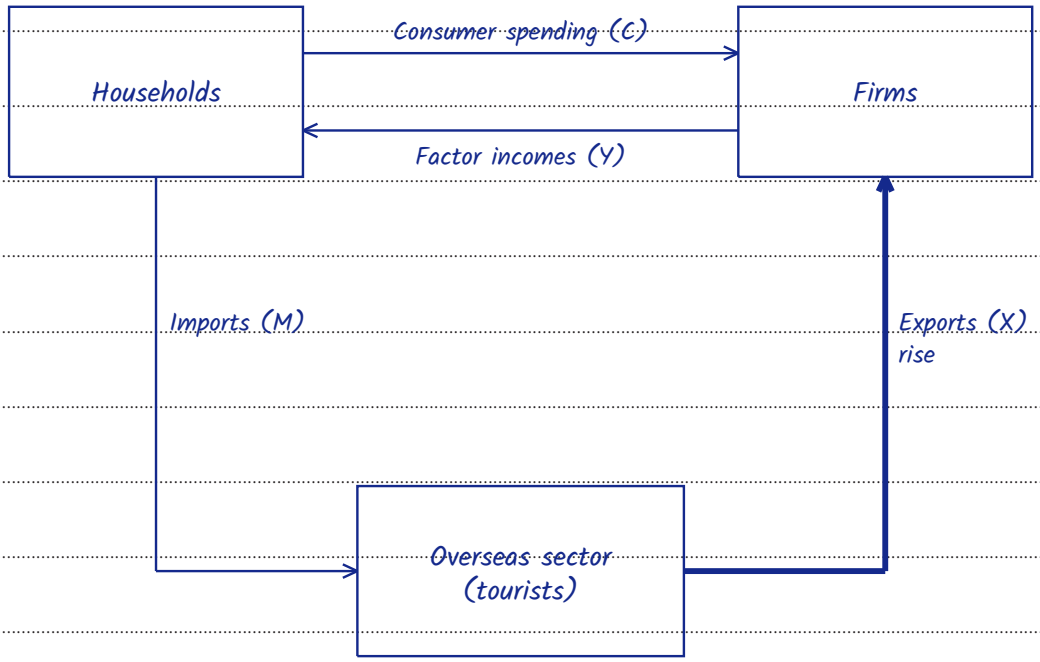
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(c) Analyse **one** likely effect of the 'increase in the number of overseas visitors' (Extract A, lines 8 and 9) on Japan's circular flow of income.

Illustrate your answer with a circular flow diagram.

(6)

The circular flow of income shows the flows of income and spending between households and firms, with injections (I, G, X) adding to the flow and withdrawals (S, T, M) leaking out of it.



One likely effect is an increase in the size of Japan's circular flow of income. Spending by overseas visitors in Japan, for example on hotels, restaurants and transport, counts as exports. Extract A says the contribution of tourism to GDP is included in net trade figures and has returned to more than two-thirds of pre-global health crisis levels, and the number of tourists was expected to grow further after China ended restrictions on group tours to Japan.

Because exports are an injection, the money flowing into Japanese firms from the overseas sector rises, as shown by the thicker X arrow in the diagram. Firms earn more revenue, so they

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employ more workers and pay more factor incomes to households. Households then spend part of this extra income, creating further rounds of spending (the multiplier effect). Therefore the flow of national income increases by more than the initial rise in tourist spending, increasing Japan's real GDP.

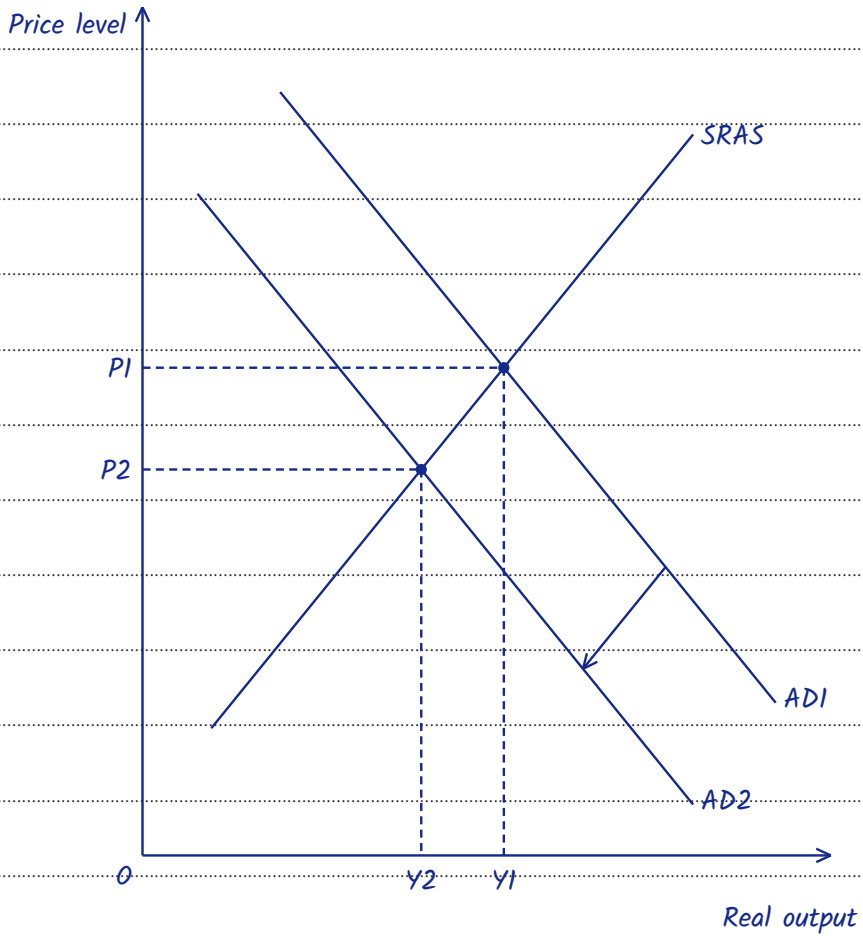
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(d) With reference to Extract A, examine the likely impact on Japan's real output of the fall in domestic consumption.

(8)

Real output is the value of goods and services produced in an economy adjusted for inflation, so it measures the volume of output. The fall in domestic consumption is likely to reduce Japan's real output.

Consumption is a component of aggregate demand (AD = C + I + G + (X − M)). Extract A shows that domestic consumption makes up more than half of Japan's economy, and it fell by 0.5% between Q1 and Q2 2023 because consumers faced significant increases in the prices of goods and services. As shown in the diagram, AD shifts left from AD1 to AD2, so real output falls from Y1 to Y2.



Lower consumption also means households save more of their income, so withdrawals from the

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circular flow rise. Firms sell less, so they cut output and employment, which reduces incomes and leads to further falls in spending through the negative multiplier effect.

However, the magnitude of the fall is small: a 0.5% fall in consumption is only about 0.25% of GDP, so the impact on real output is likely to be insignificant. In fact Japan's growth rate rose from 0.9% to 1.5% over the same period, because exports rose by 3.2%, offsetting the fall in C.

Also, part of the fall in spending was on imports, which fell by 4.3%, so less of the fall reduces demand for Japanese output. In the long run, if the yen strengthens, imports become cheaper, real incomes rise and consumption may recover. The effect also depends on spare capacity: if the economy is near full capacity, the fall in AD mainly lowers the price level rather than real output.

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(e) With reference to the information provided and your own knowledge, discuss factors that the BoJ might consider when setting the base interest rate.

(14)

The base interest rate is the rate at which the central bank lends to commercial banks, and it influences all other interest rates in the economy. Figure 1 shows that the BoJ has kept the base rate very low for twenty years, and negative at −0.1% since 2016.

The most important factor is the rate of inflation compared with the 2% target. In Q2 2023 inflation averaged 3.3%, 1.3 percentage points above target. If inflation is above target, the BoJ should raise the base rate: borrowing becomes more expensive and saving more attractive, so consumption and investment fall, AD grows more slowly and inflationary pressure is reduced. Extract B says the low rate was introduced when inflation was below target, so there is no longer a case for it.

Second, the BoJ will consider forecasts and inflationary expectations. Workers are demanding higher wages because of rising prices, which raises firms' costs and could cause a wage-price spiral. The Government expects inflation of 2.6% in 2023, against the BoJ's forecast of 1.8%. If expectations rise, inflation may become permanent rather than temporary, which supports raising the base rate.

Third, the BoJ must consider economic growth and the output gap. Growth rose from 0.9% to 1.5% and real GDP growth was double the original forecast, and the probability of a global recession had diminished. This suggests that AD is strong enough to cope with a higher interest rate. On the other hand, domestic consumption, more than half of the economy, fell by 0.5%, and uncertainty has reduced business investment. Raising interest rates could reduce C and I further and risk a recession, which is why the BoJ may keep rates low.

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Fourth, the exchange rate. Japan's weak exchange rate has raised the price of imported raw materials and energy, causing cost-push inflation. A higher base rate would attract hot money flows into Japan, increasing demand for the yen, so it would appreciate. Imports would become cheaper, reducing inflation and helping consumers. However, a stronger yen makes Japanese exports, such as cars and tourism, less price competitive, and exports were the main reason for the rise in real GDP.

However, the BoJ has to prioritise these factors and consider them in combination. The BoJ argues that the rise in inflation is temporary; if it is caused by volatile commodity prices and a weak yen, it is cost-push inflation, and raising interest rates would be ineffective at removing it while reducing growth. Using the current inflation rate to guide policy could then be a mistake.

There are also time lags: a change in interest rates may take 18 to 24 months to have its full effect, so the BoJ must act on forecasts, which are uncertain; the Government and the BoJ disagree by 0.8 percentage points. Data such as real GDP and consumption are often revised later, and the size of the output gap is difficult to estimate, so the BoJ could misjudge the amount of spare capacity.

Finally, after decades of deflation and no wage growth, the BoJ may fear that raising rates too soon could push Japan back into deflation, and external shocks could change the global outlook.

In conclusion, the most important factor is whether inflation above the 2% target is temporary or persistent. Rising wage demands and the Government's 2.6% forecast suggest it is becoming persistent, so a small, gradual rise in the base rate is justified, but the BoJ should watch consumption and the exchange rate closely, because rising too fast could cause a recession.

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TOTAL FOR SECTION C = 34 MARKS

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SECTION D BEGINS ON THE NEXT PAGE.

SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 In 2022 the Government of China decided to invest 1.48 trillion yuan in many new transportation, energy and telecommunication infrastructure projects.

Evaluate the likely benefits of an increase in government expenditure on infrastructure.

Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 Between 2012 and 2022 the productivity rate in Turkey increased by 39.2%.

Evaluate the likely benefits of an increase in the productivity rate.

Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

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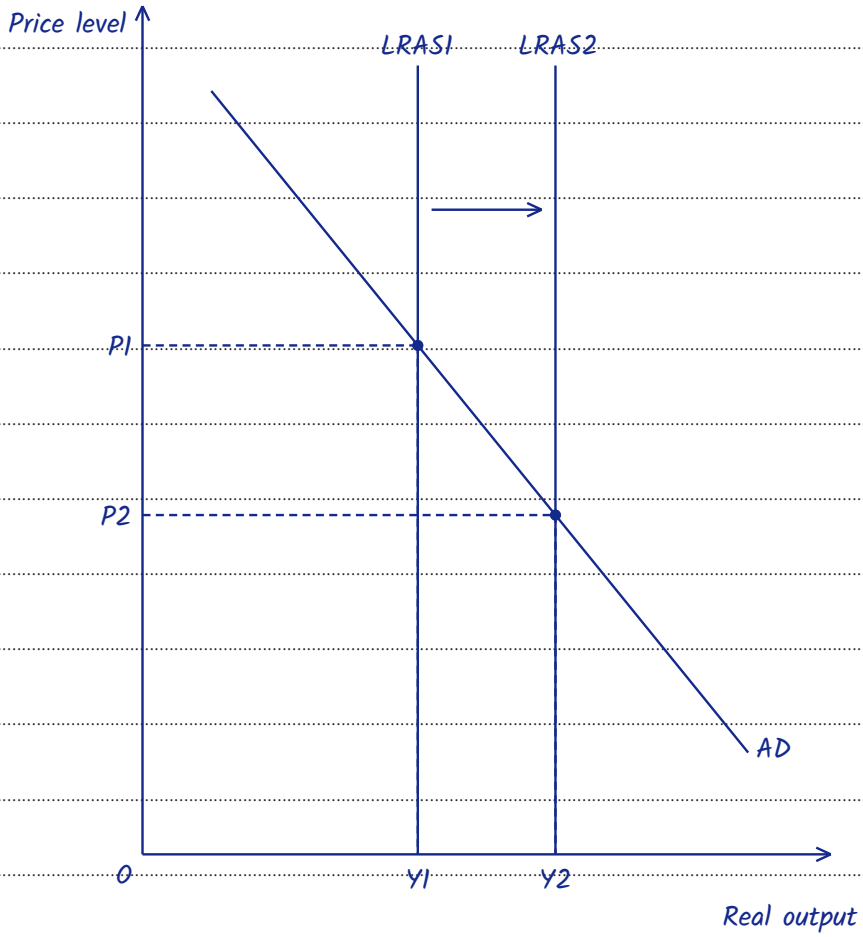
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

Productivity is the output per unit of input, usually measured as output per worker or output per hour worked. It measures the efficiency of production. In Turkey the productivity rate increased by 39.2% between 2012 and 2022, about 3.4% a year on average.

The main benefit of higher productivity is an increase in the productive potential of the economy. Each worker produces more, so the economy can produce more with the same resources. As shown in the diagram, LRAS shifts right from LRAS1 to LRAS2, so real output rises from Y1 to Y2. This is economic growth, which can raise living standards in Turkey through higher real incomes.



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The diagram also shows that the price level falls from P1 to P2. Higher productivity lowers unit labour costs, so firms can produce at lower cost, reducing inflationary pressure. This is especially important for Turkey, which had inflation of over 70% in 2022; productivity growth allows sustained, non-inflationary growth.

Lower unit costs also make Turkish goods, such as cars, textiles and machinery, more price competitive in international markets. Demand for Turkish exports increases and imports become relatively less attractive, so net exports rise. This improves the current account of the balance of payments, which matters for Turkey because it has often had a current account deficit. Higher exports also add to AD, so through the multiplier effect real output increases further and unemployment falls.

Higher productivity also raises firms' profits. Firms have more retained profit to fund investment and a greater incentive to invest, which is an injection into the circular flow and increases both AD and future productive capacity. Workers who are more productive are in greater demand, so real wages can rise, increasing consumption. Higher incomes and profits increase tax revenue, so the Government can spend more on education, healthcare or infrastructure, or reduce its budget deficit.

However, these benefits depend on several factors. First, the magnitude of the increase is limited: 39.2% over ten years is only about 3.4% a year, and what matters for competitiveness is relative productivity. If productivity in Turkey's trading partners, such as Germany or China, has risen faster, Turkish exports will not become more competitive. The current account is also affected by other factors, such as the exchange rate, inflation and the level of world income.

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Second, higher productivity may come from capital investment, for example automation, which replaces workers. This can cause structural unemployment, especially among low-skilled workers, who may need to be retrained before they can move into other sectors. In the short run this could reduce incomes and consumption and increase inequality, so not everyone shares the benefits.

Third, the benefits take time. Productivity gains from training or new technology happen mainly in the long run, so they are unlikely to have an immediate effect on real output. In the short run, economic growth may depend more on AD, for example high consumption through demand-side policies. Business investment may also depend more on confidence and interest rates than on productivity.

Fourth, the effect on prices and output depends on the position of AD and the elasticity of LRAS. If the economy has a lot of spare capacity, a rightward shift in LRAS increases potential output but has little effect on actual output unless AD also rises. Turkey's very high inflation in 2022 was mainly caused by a weak lira and low interest rates, so productivity growth alone cannot solve it.

Finally, faster growth in output may conflict with environmental objectives, increasing pollution and the use of non-renewable resources. Productivity is also difficult to measure accurately, especially in the service sector, so the 39.2% figure may over- or under-state the true change.

In conclusion, an increase in the productivity rate brings significant benefits: it shifts LRAS to the right, allowing economic growth with lower inflation and improving international competitiveness. The most important benefit is long-run, non-inflationary growth in living standards. However, the size of the benefits depends on how quickly productivity rises relative

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to other countries and on whether the gains are shared through higher wages rather than lost through structural unemployment. For Turkey, productivity growth is beneficial but must be combined with policies to control inflation.

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TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Friday 10 January 2025

Afternoon (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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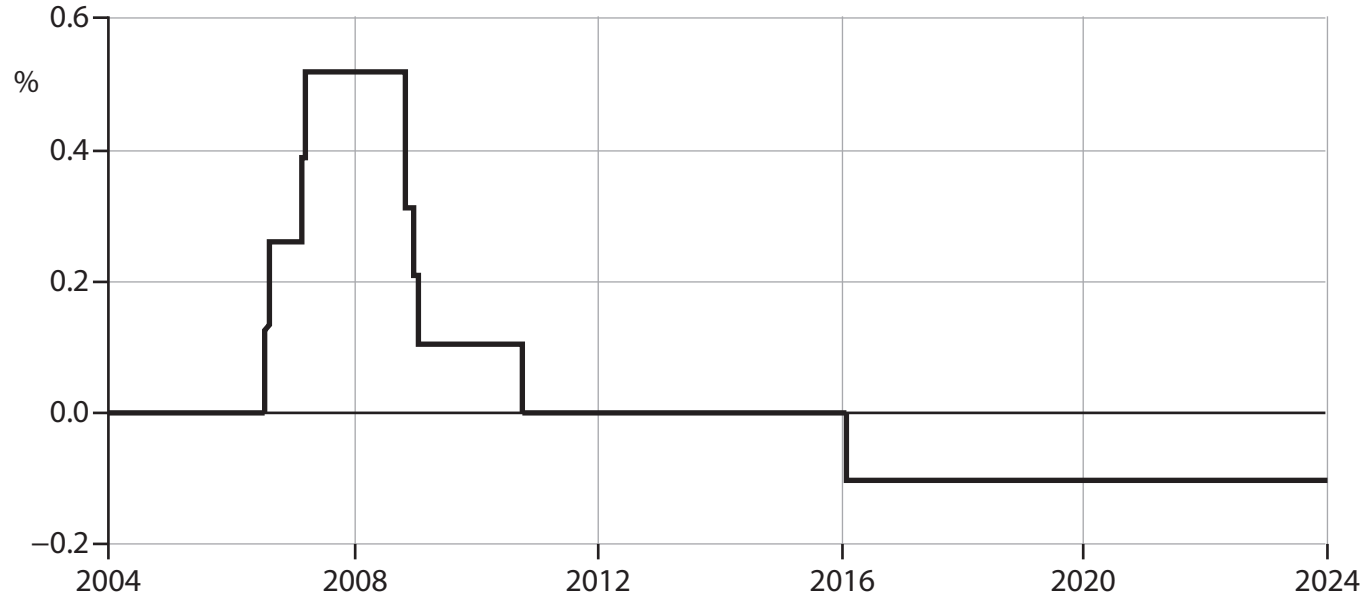
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Sources for use with Section C

The Japanese economy

Figure 1 Base interest rate, January 2004 to December 2023



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Extract A Economic growth

Between quarter 1 (Q1) 2023 and quarter 2 (Q2) 2023, the rate of economic growth in Japan increased from 0.9% to 1.5%. This increase in Japan's real Gross Domestic Product (GDP) was double the original forecast. Therefore, concerns that the country was exposed to a recession were eased.

The main reason for the increase in real GDP was an increase in exports that rose by 3.2% in Q2 2023. This was mainly as a result of higher exports of cars caused by an improvement in supply chains. There was also an increase in the number of overseas visitors to Japan. The contribution of tourism to GDP is included in net trade figures and returned to more than two-thirds of pre-global health crisis levels. The number of tourists was expected to grow in the second half of 2023 after China ended restrictions on group tours to a number of countries including Japan.

However, economists warned that the fall in domestic consumption, following the global health crisis, remained a concern. They suggested that this was mainly the result of Japan's weak exchange rate. Domestic consumption, which makes up more than half of Japan's economy, fell by 0.5% between Q1 2023 and Q2 2023. During the same period, Japan's imports decreased by 4.3%, which was one of the largest reductions ever recorded. This indicated that the rising rate of inflation was having a significant impact on consumer expenditure.

Until the end of 2022 Japan had faced several years of deflation and no wage growth. However, in 2023 consumers experienced significant increases in the prices of goods and services. Japan's weak exchange rate resulted in an increase in the price of raw materials and energy for businesses. It also created greater uncertainty that had an impact on business investment.

Extract B Monetary policy

The aim of Japan's central bank, the Bank of Japan (BoJ), is to achieve a 2% inflation target. In Q2 2023 the annual rate of inflation averaged 3.3%. Upward pressure on prices caused workers to demand higher wages, resulting in a rise in inflationary expectations.

The BoJ argued that this increase in the rate of inflation was temporary. Therefore, it continued to maintain the base interest rate at a low level.

Economists claimed that the BoJ's argument was weak. They stated that even the Government of Japan expected the annual rate of inflation to be 2.6% in 2023 against the BoJ's forecast of 1.8%. Therefore, there would no longer be a case for maintaining a low base interest rate, that was introduced at a time when the rate of inflation was below the inflation target. Moreover, the probability of a global recession, considered to be a significant risk to Japan's economy, had diminished. To achieve the inflation target of 2% an increase in the base interest rate would be necessary.

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Acknowledgements

Figure 1 adapted from https://tradingeconomics.com/japan/interest-rate

Extract A adapted from FT, https://www.ft.com/content/7b384d9c-ae10-4baf-bc85-34ba8ff5b15c

Extract B adapted from FT, https://www.ft.com/content/9d27719e-2802-413a-b6b7-ba8644de6d8f; https://www.ft.com/content/8d20355f-ddb9-4d11-afe1-7d5456cb2f86