Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Pearson Edexcel
International Advanced Level

Centre Number

Candidate Number

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.
- Good luck with your examination.

Turn over ▶

P65833A

©2021 Pearson Education Ltd.

1/1/1/1/1/1

P 6 5 8 3 3 A 0 1 2 8

Pearson

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 ☒.

1 800 000 students graduated from universities in the UK in 2019. 380 000 of these started work in jobs that did not require a degree.

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

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

(Total for Question 1 = 1 mark)

2 Brazil's annual rate of inflation between April 2019 and August 2019 is shown in the table.

Month	Rate of inflation (%)
April	4.94
May	4.66
June	3.37
July	3.22
August	3.43

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

- ☐ **A** There was deflation between April and July
- ☐ **B** The average price level was highest in April
- ☒ **C** There was disinflation between April and July
- ☐ **D** The rate of inflation was lowest in August

(Total for Question 2 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

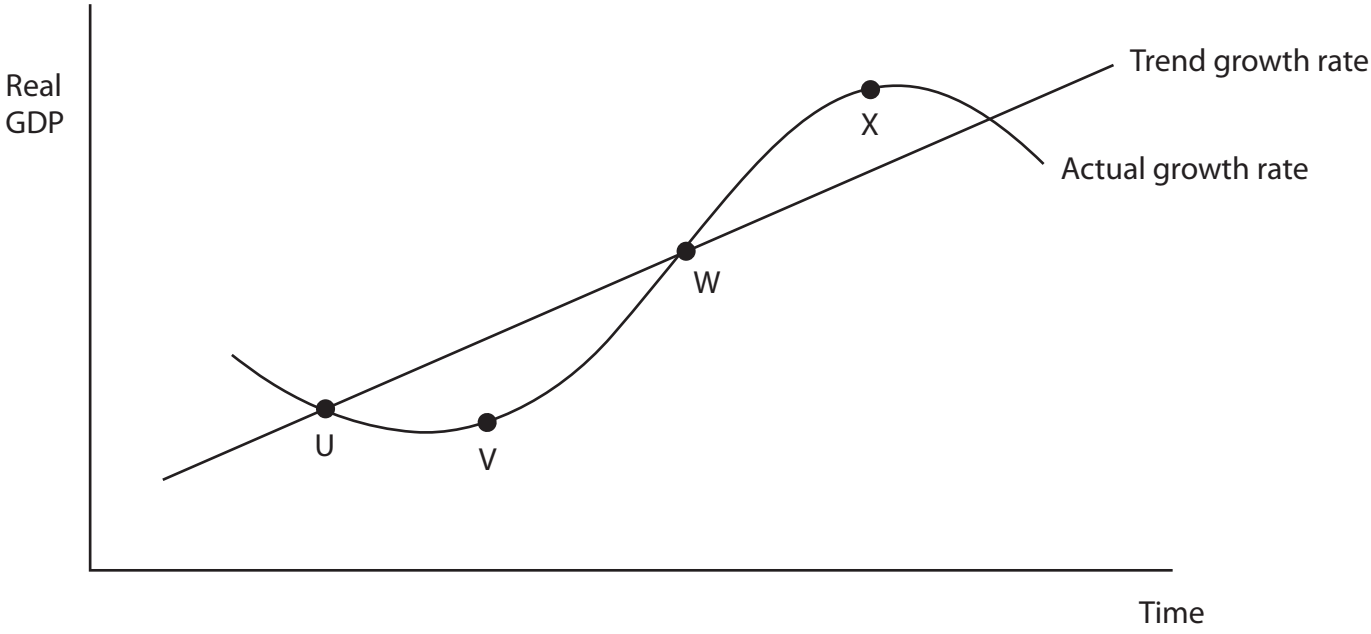
3 South Africa's annual government expenditure as a proportion of GDP increased from 31.4% to 34.6% between 2012 and 2019.

Which **one** of the following is most likely to have contributed to this increase in government expenditure as a proportion of GDP?

- ☒ **A** Lower welfare payments
- ☒ **B** A lower exchange rate
- ☒ **C** Less economic activity
- ☒ **D** Increased business confidence

(Total for Question 3 = 1 mark)

4 The diagram shows an economy's actual growth rate and trend growth rate.



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

- ☒ **A** The economy is in recovery between points U and V
- ☒ **B** A positive output gap exists at point V
- ☒ **C** Unemployment is rising between points W and X
- ☒ **D** A positive output gap exists at point X

(Total for Question 4 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

5 In Japan, private sector investment increased by 1.9% in the second quarter of 2019.

Which **one** of the following was the most likely cause of this increase in investment?

- ☒ **A** A decrease in the rate of economic growth
- ☒ **B** An increase in indirect taxation
- ☒ **C** An increase in the tax on company profits
- ☒ **D** A decrease in interest rates

(Total for Question 5 = 1 mark)

6 In Denmark the marginal propensity to consume is estimated to be 0.49.

Based on this estimate, which **one** of the following is the value of the multiplier for Denmark?

- ☒ **A** 0.51
- ☒ **B** 1.96
- ☒ **C** 2.04
- ☒ **D** 4.90

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

SECTION B

Answer ALL questions in this section in the space provided.

7 The French Government is to offer €5 billion in tax relief for business investment.

Explain **one** likely economic effect of this investment tax relief.

Tax relief on investment means firms pay less tax when they spend on capital goods, such as machinery, factories and equipment.

The €5 billion of relief lowers the cost to French firms of investing, so the expected profit from each investment project rises. More projects become worthwhile, so firms increase their level of investment.

Investment is a component of aggregate demand (AD = C + I + G + (X − M)), so AD shifts to the right. This leads to higher real output in France and, as firms need more workers to produce this output, employment rises and unemployment falls. In the long run the extra capital also raises productive capacity, shifting LRAS to the right.

(Total for Question 7 = 4 marks)

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

8 In the first quarter of 2019 average house prices decreased by 15% in real terms in Sydney, Australia.

Explain **one** possible impact of this change in house prices on the level of consumption.

A fall in house prices reduces household wealth. A house is usually the largest asset a consumer owns, so when average house prices in Sydney fell by 15% in real terms, homeowners became less wealthy (a negative wealth effect).

Feeling less wealthy, consumers become less confident about their finances and are less able to borrow against the value of their homes (less equity release). They therefore save more and reduce their consumption of goods and services.

Since consumption is the largest component of aggregate demand, AD falls, leading to lower real output and a lower price level in the Sydney and Australian economy.

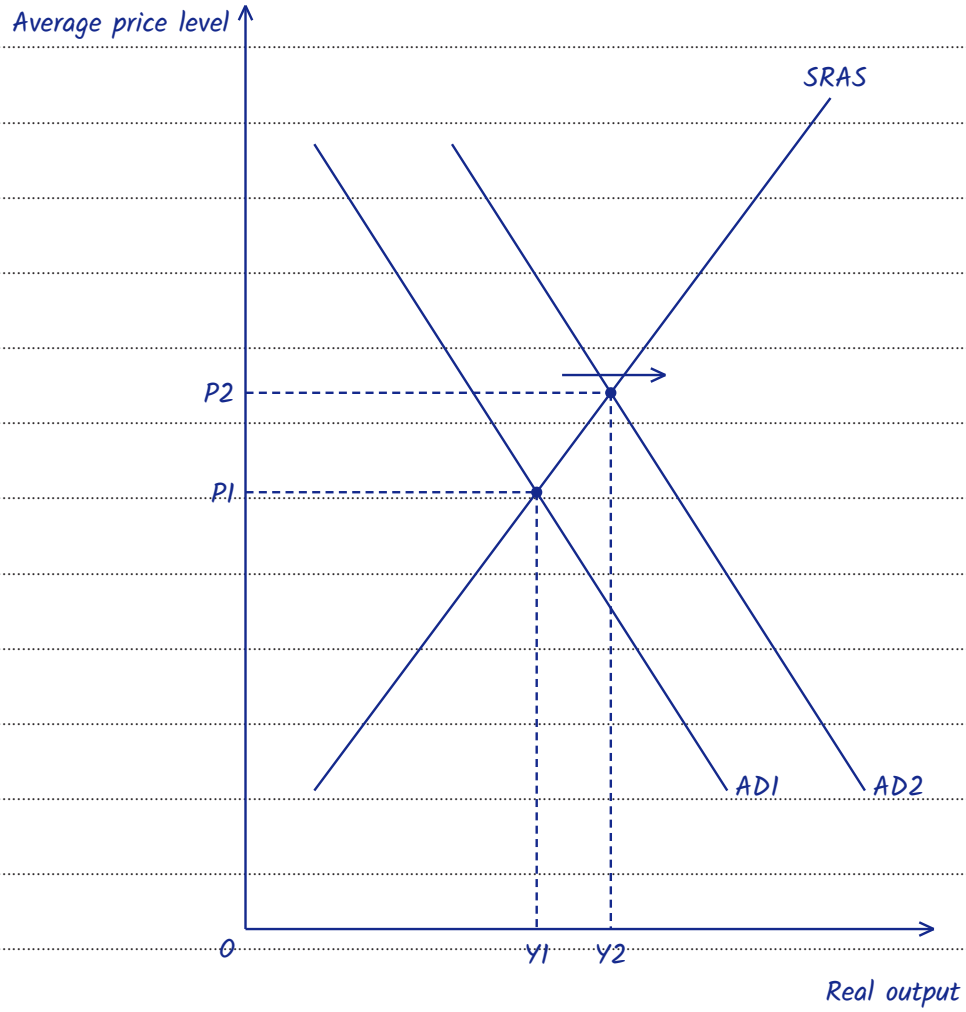
(Total for Question 8 = 4 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

9 In January 2016 the world price of oil was $29.78 per barrel. By May 2019 this had increased to $66.83 per barrel. Saudi Arabia is a net exporter of oil.

Draw a diagram showing the change in AD for Saudi Arabia's economy following the increase in the price of oil. Show the effect on the price level and real output.



The oil price rose from $29.78 to $66.83 per barrel, so the value of Saudi Arabia's exports rises. Net exports (X – M) increase, so AD shifts right from AD1 to AD2. The average price level rises from P1 to P2 and real output rises from Y1 to Y2.

(Total for Question 9 = 4 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

10 The data shows the quarterly percentage growth of real GDP for Belgium between Q1 2019 and Q4 2019.

Quarter	%
Q1	0.0
Q2	0.3
Q3	0.4
Q4	0.4

With reference to the overall trend of the data, explain what is meant by the term 'growth of real GDP'.

Growth of real GDP is an increase in the total value of goods and services produced in an economy (national output) over a period of time, adjusted for inflation, so it measures the change in the volume of output rather than in prices.

For Belgium the overall trend is that the growth rate of real GDP increased during 2019. In Q1 the growth rate was 0.0%, so real GDP did not grow at all. It then rose to 0.3% in Q2 and to 0.4% in Q3, and stayed at 0.4% in Q4.

So from Q2 onwards real output was increasing each quarter, at a faster rate in Q3 and Q4 than in Q2.

(Total for Question 10 = 4 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

11 The table shows values for components of the US economy in 2018.

Component	$ trillion
Consumption	13.95
Investment	3.65
Savings by households	1.25
Government expenditure	3.52
Tax revenue	3.64
Exports	2.50
Imports	3.10

Ceteris paribus, calculate the aggregate demand for the USA in 2018.

Aggregate demand = C + I + G + (X − M)

AD = 13.95 + 3.65 + 3.52 + (2.50 − 3.10)

= 21.12 + (−0.60)

= $20.52 trillion

(Savings and tax revenue are withdrawals, not components of AD, so they are not added.)

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk

SECTION C

Study Figures 1 and 2 and Extracts A and 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 'monetary policy'. (Extract A, line 8)

(2)

(b) With reference to Extract A, explain the term 'foreign direct investment'.

(4)

(c) With reference to Figure 1 and Extract A, examine **two** likely impacts of the annual GDP growth rates on the people living in East African countries.

(8)

(d) With reference to Figure 2, analyse **one** macroeconomic effect of the change in the current account balance as a percentage of GDP on East African economies.

(6)

(e) With reference to Extract A and Extract B, discuss the likely effects of interventionist supply-side policies on East African economies.

(14)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

12 (a) Define the term 'monetary policy'. (Extract A, line 8)

(2)

Monetary policy is the use of interest rates (the base rate), the money supply and the exchange rate by the central bank to influence aggregate demand. It is a demand-side policy often used to meet an inflation target, for example it helped East African inflation fall from 14.4% in 2017 to 8.9% in 2019.

(b) With reference to Extract A, explain the term 'foreign direct investment'.

(4)

Foreign direct investment (FDI) is investment by a firm, usually a transnational company, from one country into productive assets in another country, for example building a new factory or buying an existing business there. It is an injection of funds from abroad into the receiving economy.

Extract A states that higher FDI contributed to economic growth in East Africa. Growth in FDI in 2018 was 67% in Uganda, 27% in Kenya and 18% in Tanzania.

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk

(c) With reference to Figure 1 and Extract A, examine **two** likely impacts of the annual GDP growth rates on the people living in East African countries.

(8)

One impact is rising incomes and living standards. Figure 1 shows real GDP grew by at least 5% every year between 2014 and 2018, peaking at 6.5% in 2015, and Extract A says East Africa was the fastest growing region of Africa in 2018. More output means more jobs and higher real incomes, so people can afford more goods and services, such as better food, housing and healthcare, so their material standard of living rises faster than elsewhere in Africa.

However, Extract A notes that despite rapid growth unemployment remains high and many consumers struggle to meet their basic needs. This suggests the benefits are unevenly shared: growth in agriculture and mining may be capital intensive, so business owners gain more than workers and inequality rises. Also, if population grows faster than real GDP, GDP per capita could still fall.

A second impact is a higher cost of living. Extract A says rapid growth pushed inflation up to 13.1% in 2016 and 14.4% in 2017. As AD grows faster than the economy's capacity, prices rise, so the purchasing power of money falls. People on fixed or low incomes, and those whose savings lose value, see their real incomes fall and may find it harder to buy essentials.

On the other hand, Figure 1 shows real growth figures, already adjusted for inflation, so average incomes are still rising faster than prices, and inflation fell back to 8.9% by 2019. The impacts may also weaken over time: growth slowed from 6.5% in 2015 to 5.7% in 2018 and relies on commodity prices, which are volatile and could fall.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

(d) With reference to Figure 2, analyse **one** macroeconomic effect of the change in the current account balance as a percentage of GDP on East African economies.

(6)

The current account of the balance of payments records trade in goods, trade in services, primary income (investment income) and secondary income (transfers). A deficit means the value of imports and income outflows is greater than the value of exports and inflows.

Figure 2 shows East African economies had a current account deficit throughout, but it narrowed from −6.7% of GDP in 2016 to −5.4% in 2017 and −5.3% in 2018, an improvement of 1.4 percentage points.

One effect is on aggregate demand and real output. Imports are a withdrawal from the circular flow of income and exports are an injection. As the deficit falls as a share of GDP, exports are rising relative to imports, so net exports (X − M) are less negative. This means a smaller net leakage from the circular flow, so AD is higher than it would otherwise be. Through the multiplier effect, the extra export income is spent again, raising real output and employment further, which could help reduce the region's high unemployment.

However, the current account is still in deficit, at 5.3% of GDP, so there is still a net withdrawal from the circular flow, which continues to hold back AD and growth, and the deficit must be financed by borrowing or capital inflows such as FDI.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

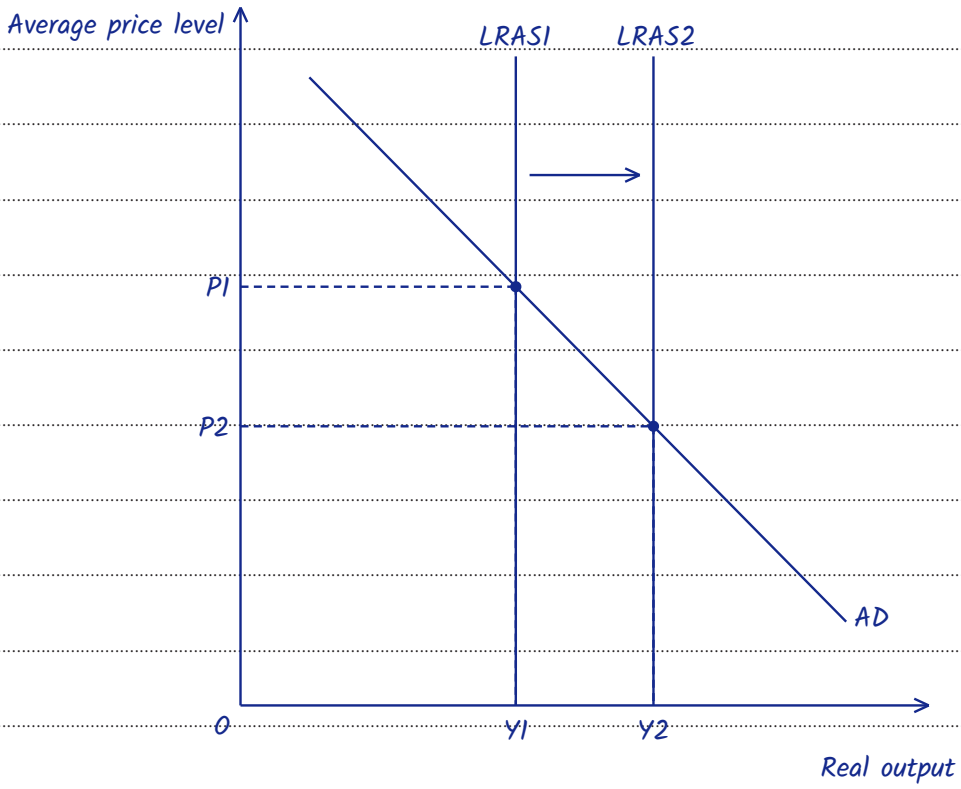
stemup.co.uk

(e) With reference to Extract A and Extract B, discuss the likely effects of interventionist supply-side policies on East African economies.

(14)

Supply-side policies aim to increase the productive capacity of an economy, shifting LRAS to the right. Interventionist supply-side policies involve the government directly intervening, for example by spending on infrastructure, education, healthcare and housing, rather than relying on free markets.

The first policy is investment in infrastructure. Extract B says roads are in poor condition, and low speeds and long distances cause high transport costs, while poor energy supply causes blackouts. Better roads, rail, seaports, energy and telecommunications cut firms' costs and lost production time, so goods and raw materials move more quickly and cheaply. This raises productivity, so productive capacity increases and LRAS shifts right from LRAS1 to LRAS2, as shown below.



Real output rises from Y1 to Y2, so there is long-run economic growth, while the average price

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

P 6 5 8 3 3 A 0 1 6 2 8
stemup.co.uk

level falls from P1 to P2. This would help the region keep inflation, still 8.9% in 2019, under control while growing. Lower costs also make East African exports more internationally competitive, which could reduce the current account deficit.

The second policy is improving the health and skills of the labour force. Spending on healthcare means fewer working days are lost to illness, and spending on education and training raises skills, so labour productivity rises. More skilled workers are more occupationally mobile, so structural unemployment, which Extract A says remains high, should fall. More housing helps people meet their basic needs and improves geographical mobility, so workers can move to where jobs are.

However, the effects depend on several factors. There are long time lags: building roads, rail routes and power stations takes years, and education only raises productivity once students enter work, so in the short run the extra government spending mainly raises AD, which could push inflation back up before LRAS shifts.

There is also an opportunity cost. These are low-income economies where many struggle to meet basic needs, so money spent on infrastructure cannot be spent elsewhere, and funding it may require higher taxes or borrowing. The magnitude of the effect depends on how much is spent: Extract B suggests under-investment is severe, so large sums would be needed.

Government failure is possible too. Governments may lack information and invest in the wrong projects, or in prestige projects with little benefit, and new roads and fossil fuel power may damage the environment. Some investment, such as the Chinese-funded rail routes and private telecommunications spending, is already happening, so free market policies, such as deregulation, might achieve similar results at lower cost to the government.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

Overall, interventionist supply-side policies are likely to raise growth, employment and living standards in East Africa because the infrastructure gaps are so large. Investment in energy supply should come first, as Extract B calls it the biggest problem, but the benefits will mainly come in the long run and depend on spending being well targeted.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

BLANK PAGE

SECTION D BEGINS ON THE NEXT PAGE.

stemup.co.uk

SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 In 2019 the new President of the European Central Bank asked governments of eurozone countries to cut taxation and increase government expenditure to stimulate the rate of economic growth.

Evaluate fiscal policy instruments as a means of increasing the rate of economic growth.

(Total for Question 13 = 20 marks)

OR

14 In quarter 1 2019 the unemployment rate in South Africa was 27.6%. In quarter 2 it increased to 29%. An additional 455 000 workers became unemployed.

Evaluate the likely impact of an increase in the unemployment rate on workers, public finances and resource utilisation.

(Total for Question 14 = 20 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

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:

Economic growth is an increase in real GDP over time. Fiscal policy is the use of government spending and taxation to influence aggregate demand. An expansionary fiscal policy, as requested by the President of the ECB in 2019, involves increasing government expenditure and/or cutting taxes in order to increase AD.

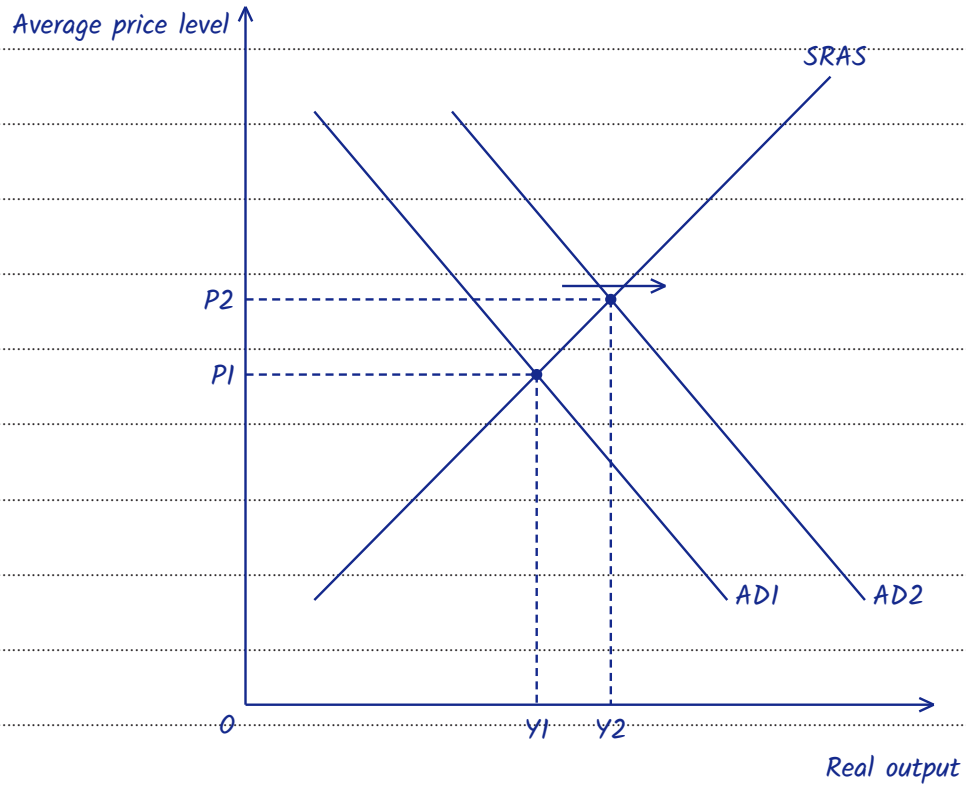
The first instrument is higher government expenditure. Government spending (G) is a component of AD = C + I + G + (X − M), so an increase in G directly shifts AD to the right. For example, if a eurozone government spends more on roads, schools and hospitals, construction firms receive extra orders, hire more workers and pay more wages. These workers then spend part of their income, creating further rounds of spending through the multiplier effect, so the final rise in real GDP is greater than the initial injection.

The second instrument is lower taxation. A cut in income tax raises households' disposable income, so consumption rises, and since consumption is the largest component of AD, AD shifts right. A cut in corporation tax allows firms to keep more of their profits, which increases the funds available for investment and the expected return on it, so investment rises, further increasing AD.

As shown in the diagram, the rise in AD from AD1 to AD2 increases real output from Y1 to Y2, so the economy grows. Firms need more labour to produce the extra output, so employment rises and unemployment falls, closing the negative output gap that existed in many eurozone economies.

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk



Fiscal policy can also raise the long-run rate of growth. If government spending is on infrastructure, education and training, or if tax cuts encourage investment in new capital and make work more rewarding, productive capacity increases and LRAS shifts right, allowing sustainable growth without inflation.

However, the effectiveness of fiscal policy depends on how close the economy is to full capacity. If there is a large negative output gap, as in a recession, the increase in AD mainly raises real output. But if the economy is near full capacity, on the steep part of the AS curve, the increase in AD mainly causes demand-pull inflation, shown by the rise in the price level from P1 to P2, with little extra growth. In the classical view, with a vertical LRAS, there is no long-run growth at all.

Second, expansionary fiscal policy worsens the budget position. Higher spending and lower tax revenue increase the fiscal deficit and national debt. Many eurozone countries, such as Italy,

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

already had high debt, and the EU fiscal rules aim to keep deficits below 3% of GDP, so governments may be unable or unwilling to expand. Higher borrowing could also raise interest rates and crowd out private sector investment, reducing the net effect on growth.

Third, the size of the multiplier may be small. Eurozone economies are very open, so a large share of extra income is spent on imports from other countries, and if households are pessimistic they may save tax cuts rather than spend them. The magnitude also depends on the size of the change; small tax cuts or spending increases will have little effect.

Fourth, there are time lags. Infrastructure projects take time to plan and contracts to agree, and consumers may take time to notice higher disposable income, so the boost to growth may come too late. Government spending also has an opportunity cost, and the government may lack the information to spend efficiently, leading to government failure.

Finally, coordination is difficult because there are 19 eurozone countries with separate governments and budgets, while monetary policy is set for all of them by the ECB. In 2019 interest rates were already close to zero, so monetary policy had little room left, which is why the ECB asked for fiscal support. Alternatively, supply-side policies may raise growth without the same inflationary trade-off, although they take even longer to work.

In conclusion, fiscal policy instruments can increase the rate of economic growth, especially in the short run when there is spare capacity and interest rates are already very low. Government spending on infrastructure is likely to be the most effective instrument, because it raises both AD and LRAS and has a larger multiplier than tax cuts that may be saved. However, the effect depends on the size of the output gap, the fiscal space of each government and how well the spending is targeted, so fiscal policy works best alongside monetary and supply-side policies.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

TOTAL FOR SECTION D = 20 MARKS
TOTAL FOR PAPER = 80 MARKS

stemup.co.uk

BLANK PAGE

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

BLANK PAGE

stemup.co.uk

BLANK PAGE

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

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

Do not return this Booklet with the question paper.

Turn over ▶

P65833A

©2021 Pearson Education Ltd.

1/1/1/1/1/1

P 6 5 8 3 3 A

Pearson

stemup.co.uk

Sources for use with Section C.

East African* economies

* Countries include Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Rwanda, Seychelles, Somalia, South Sudan, Tanzania and Uganda.

Figure 1 Annual real GDP growth, 2014–2018

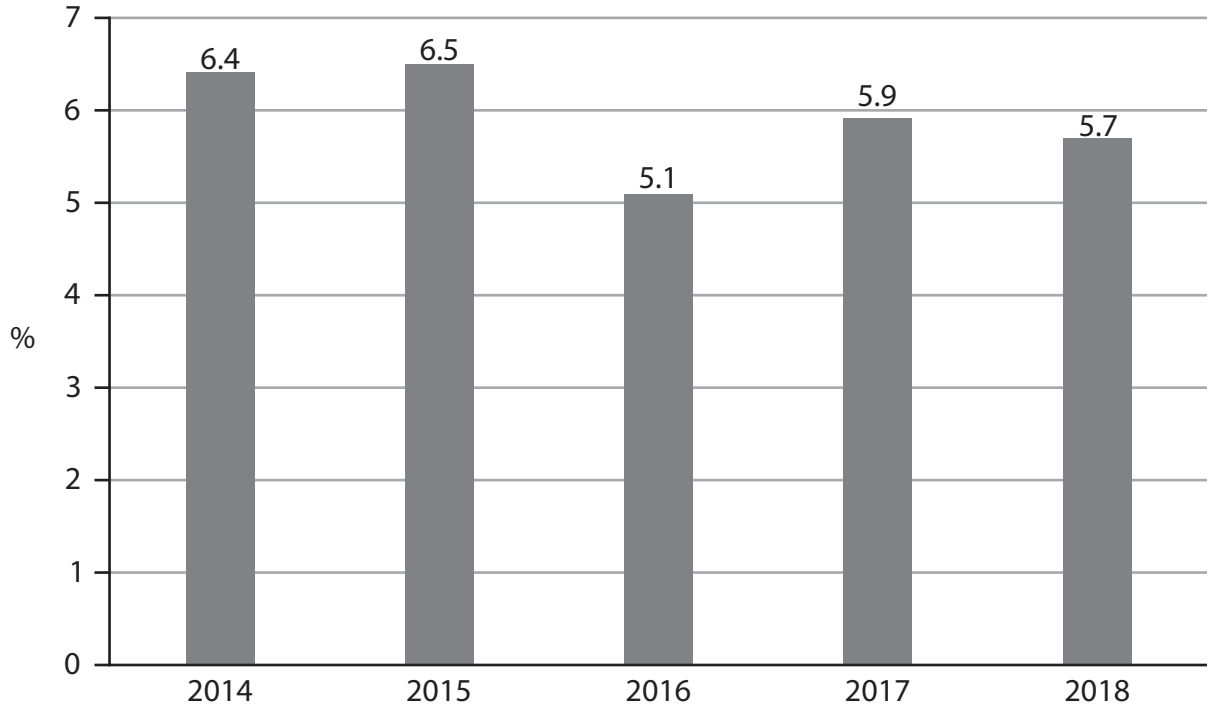


Figure 2 Current account on the balance of payments as a percentage of GDP, 2016–2018

	East African economies
2016	-6.7
2017	-5.4
2018	-5.3

stemup.co.uk

Extract A Rapid growth in East Africa

East Africa was the fastest growing region of Africa in 2018. Increasing commodity prices helped the agricultural and mining sectors contribute most to this growth. Higher foreign direct investment (FDI) in the region also contributed to economic growth. Growth in FDI in 2018 was 67% in Uganda, 27% in Kenya and 18% in Tanzania. Governments in East Africa have been investing in infrastructure, such as roads, seaports and airports.

As a result of rapid economic growth, the rate of inflation increased to 13.1% in 2016 and 14.4% in 2017. Appropriate monetary policy in the region helped the rate of inflation to fall to 8.9% in 2019.

Despite rapid economic growth rates, unemployment remains high. Many consumers struggle to meet their basic needs. The governments of the region have been advised to focus on interventionist supply-side policies. These should include continued investment in infrastructure, improving the health and skills of the labour force and increasing the supply of housing.

Extract B East African infrastructure investment needed

East African economies have under-invested in infrastructure. The roads in East Africa are in a poor condition. The combination of low speeds and long distances causes high transport costs. Rail transport is poor, which means most goods have to be transported on a congested road system. Funds from China are being used to build two rail routes in the region.

Inadequate energy supply is the biggest infrastructure problem. East Africa has the lowest energy generating capacity per capita on the continent. Poor energy supply causes blackouts. However, the region has the potential to develop hydro, wind and fossil fuel resources that could increase energy supply.

The region has the smallest proportion of their population with telephone lines and access to mobile phone networks in Africa. However, recently there has been a high level of investment in telecommunications infrastructure. This will result in significant improvements in communications.

stemup.co.uk

BLANK PAGE

Acknowledgements

Figure 1, Figure 2 and Extract A and Extract B adapted from 'East Africa Economic Outlook', African Development Bank Group, 2018, https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/2018AEO/African-Economic-Outlook-2018-East-Africa.pdf

'East Africa stays at the top, with foreign inflows at $4bn, report shows', Njiraini Muchira, 19 June 2019, https://www.theeastafrican.co.ke/business/East-Africa-foreign-inflows/2560-5163074-emgbyy/index.html