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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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 It is estimated that the marginal propensity to consume in Germany is 0.4.

Which **one** of the following represents the value of the multiplier in Germany?

- ☒ **A** 0.5
- ☒ **B** 0.6
- ☒ **C** 1.7
- ☒ **D** 2.5

(Total for Question 1 = 1 mark)

2 India's central bank, the Reserve Bank of India, has an inflation target and is banker to the Indian Government.

Which **one** of the following is also a role of the central bank?

- ☒ **A** Increasing the trade deficit
- ☒ **B** Acting as the lender of last resort
- ☒ **C** Achieving national happiness
- ☒ **D** Reducing income equality

(Total for Question 2 = 1 mark)

3 In Indonesia it is estimated that approximately 27% of part-time workers are employed for fewer hours than they would be willing to work.

Which **one** of the following may be deduced from this information?

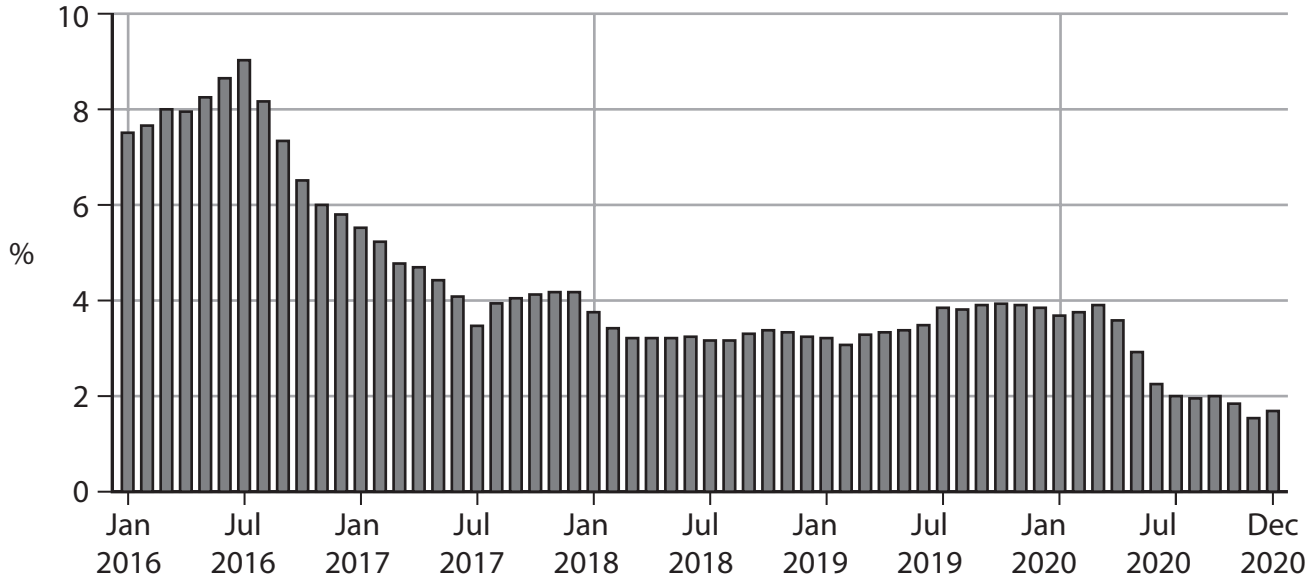
- ☒ **A** There is a high level of underemployment in Indonesia
- ☒ **B** There is a high level of economic inactivity in Indonesia
- ☒ **C** There is a high rate of unemployment in Indonesia
- ☒ **D** There is a high rate of inflation in Indonesia

(Total for Question 3 = 1 mark)

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4 The chart shows the annual rate of inflation in Colombia, measured by the Consumer Price Index (CPI), January 2016 to December 2020.



(Source: https://tradingeconomics.com/colombia/inflation-cpi)

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

- ☒ **A** There was disinflation from January 2016 to July 2016
- ☒ **B** There was deflation from January 2017 to July 2017
- ☒ **C** The average price level was unchanged between January 2019 and July 2019
- ☒ **D** The average price level was lower in January 2020 than in July 2020

(Total for Question 4 = 1 mark)

5 In 2020 the Italian Government spent €945.6 billion and received €789.3 billion in tax revenue.

Which **one** of the following policies could the Italian Government implement to achieve a balanced budget over the following year?

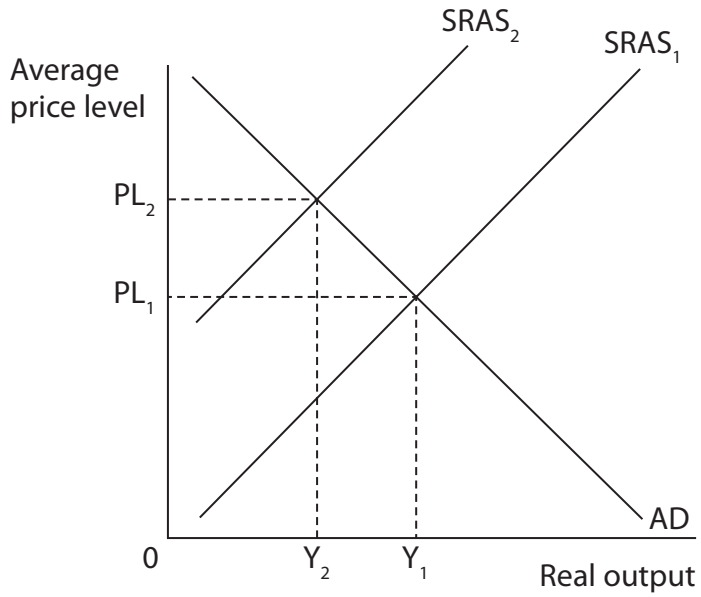
- ☒ **A** Deflationary monetary policy
- ☒ **B** Reflationary monetary policy
- ☒ **C** Deflationary fiscal policy
- ☒ **D** Reflationary fiscal policy

(Total for Question 5 = 1 mark)

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6 The diagram shows the short-run aggregate supply curve and the aggregate demand curve for China's economy.



Which **one** of the following was the most likely cause of the change from $SRAS_1$ to $SRAS_2$?

- ☒ **A** An increase in energy prices
- ☒ **B** A decrease in indirect tax rates
- ☒ **C** An increase in investment in education
- ☒ **D** A decrease in bank lending to consumers

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

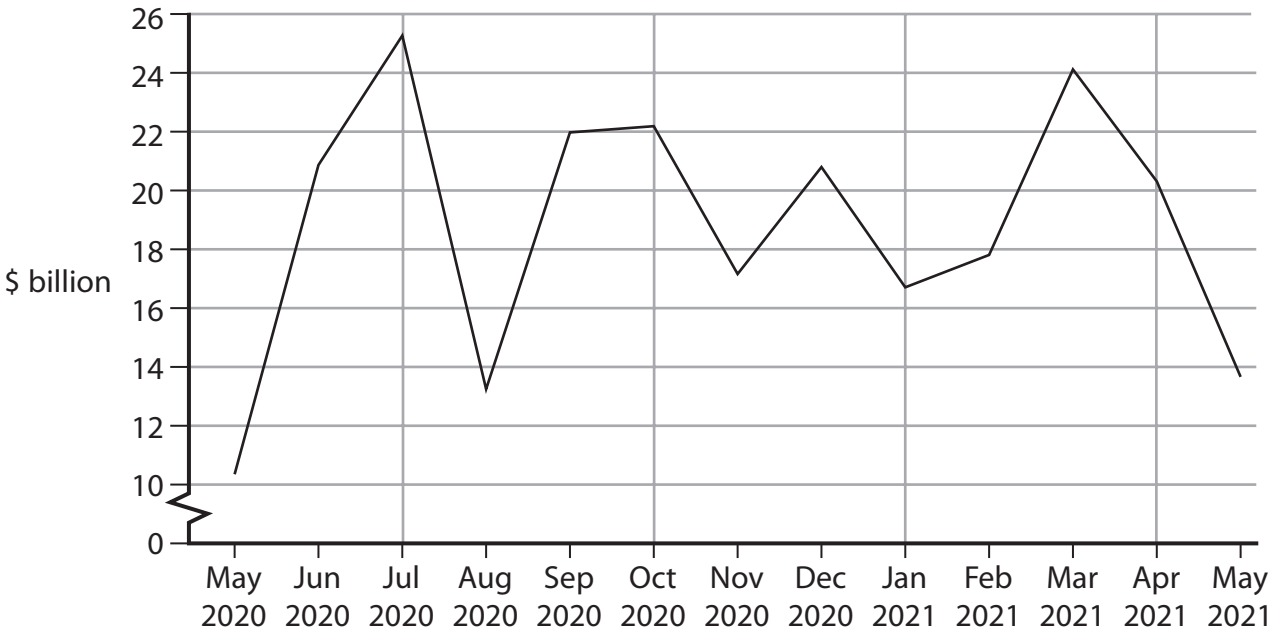
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SECTION B

Answer ALL questions in this section in the space provided.

7 The chart shows Malaysia's net monthly balance of trade in goods and services, May 2020 to May 2021.



(Source: https://tradingeconomics.com/malaysia/balance-of-trade)

With reference to the chart, explain **one** likely reason for the surplus in Malaysia's balance of trade in goods and services.

A trade surplus in goods and services means that the value of exports (X) is greater than the value of imports (M). The chart shows Malaysia had a surplus in every month from May 2020 to May 2021, eg about $25.3 billion in July 2020 and about $13.7 billion in May 2021.

One likely reason is falling real incomes in Malaysia during the Covid-19 pandemic. With lower incomes, households cut spending, and because they have a marginal propensity to import, demand for imports falls. Firms also buy fewer imported raw materials and components as output falls. So M falls by more than X and the trade surplus (X – M) stays large.

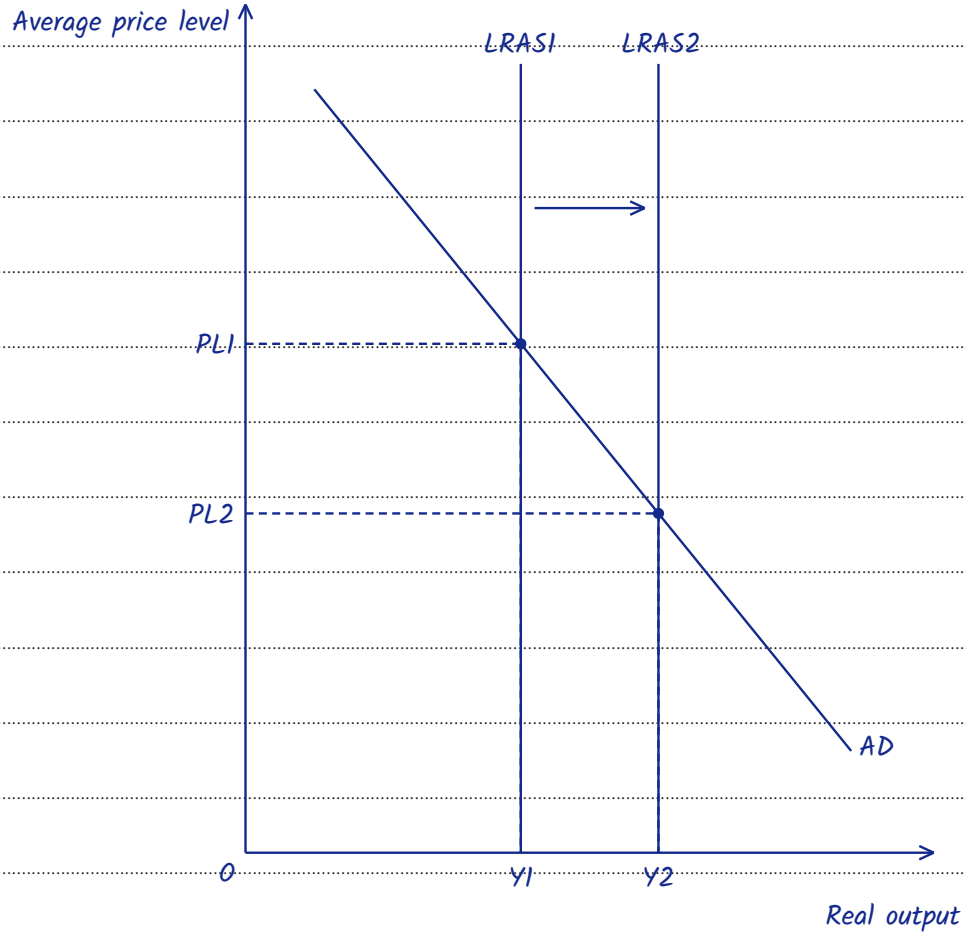
(Total for Question 7 = 4 marks)

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8 For the year ending June 2020, there were 153 900 immigrants arriving in New Zealand and 74 200 emigrants leaving New Zealand.

Draw a LRAS and AD diagram to show the effect of this net migration on the price level **and** real output for New Zealand.



Net migration = 153 900 – 74 200 = 79 700 people. This increases the size of the labour force, so New Zealand's productive capacity rises and LRAS shifts right from LRAS1 to LRAS2. The average price level falls from PL1 to PL2 and real output rises from Y1 to Y2.

(Total for Question 8 = 4 marks)

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9 The table shows the nominal GDP and GDP per capita of Angola in 2019 and 2020.

	GDP ($ billion)	GDP per capita ($)
2019	89.42	2 810
2020	62.31	1 896

(Source: https://data.worldbank.org/country/angola)

Based on this information, calculate the *change* in Angola's population between 2019 and 2020. Show your workings.

GDP per capita = GDP ÷ population, so population = GDP ÷ GDP per capita.

2019: population = $89.42 billion ÷ $2 810 = 31 822 064 ≈ 31.82 million

2020: population = $62.31 billion ÷ $1 896 = 32 863 924 ≈ 32.86 million

Change = 32.86 million − 31.82 million = +1.04 million

(32 863 924 − 31 822 064 = 1 041 860 people)

So Angola's population increased by about 1.04 million between 2019 and 2020.

(Total for Question 9 = 4 marks)

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10 The UK's central bank extended its existing asset purchases (quantitative easing) programme from £645 billion in March 2020 to £895 billion in November 2020.

With reference to this information, explain **one** likely impact of the increase in quantitative easing on aggregate demand.

Quantitative easing (QE) is when the central bank creates new money electronically to buy assets, mainly government bonds, from banks and other financial institutions. The Bank of England increased its asset purchases by £250 billion (£895bn – £645bn), a rise of 38.8% (250 ÷ 645 × 100) between March and November 2020.

One likely impact is an increase in the money supply and liquidity in the banking system. Banks have more reserves, so they are more willing to lend to consumers and firms. The extra demand for bonds also raises bond prices and reduces their yields, which lowers long-term interest rates and the cost of borrowing.

Cheaper and easier credit encourages households to borrow to spend, eg on cars and houses, so consumption (C) rises, and firms borrow to invest in capital, so investment (I) rises. Since AD = C + I + G + (X – M), aggregate demand increases, shifting the AD curve to the right.

(Total for Question 10 = 4 marks)

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11 The table shows the annual percentage change in the real GDP of Japan in 2019 and 2020. The long-term trend rate of growth for the economy is estimated to be 0.5%.

Year	Change in real GDP (annual %)
2019	0.27
2020	–4.83

(Source: https://www.statista.com/statistics/263607/gross-domestic-product-gdp-growth-rate-in-japan/)

With reference to the table, explain what is meant by an output gap.

An output gap is the difference between actual output (real GDP) and potential output, ie the level of output the economy could produce when all resources are fully employed. It is found as actual output minus potential output. A negative output gap (actual below potential) means there is spare capacity; a positive output gap means actual output is above potential.

Japan's trend (potential) growth rate is 0.5%. In 2019 actual growth was only 0.27%, so actual growth was 0.23 percentage points below potential and a negative output gap was opening up. In 2020 real GDP fell by 4.83%, which is 5.33 percentage points (0.5 – (–4.83)) below the trend rate, so the negative output gap widened greatly and there was a lot of spare capacity, eg unemployed workers.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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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 'recession' (Extract A, line 2).

(2)

(b) With reference to Figure 1, explain what is meant by the savings ratio.

(4)

(c) With reference to the second paragraph of Extract A, analyse **two** factors that caused household consumption to increase in quarter 3, 2020.

(6)

(d) With reference to Figure 2 and Extract A, examine **two** likely effects of the substantial increase in the rate of unemployment on the Australian economy.

(8)

(e) With reference to Extract B, discuss interventionist supply-side policies that the Australian Government could implement to increase Australia's productivity.

(14)

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12 (a) Define the term 'recession' (Extract A, line 2).

(2)

A recession is a period of negative economic growth, ie a fall in real GDP, for two consecutive quarters (six months). Australia was in recession because growth was −0.3% in quarter 1 and −6.8% in quarter 2 of 2020.

(b) With reference to Figure 1, explain what is meant by the savings ratio.

(4)

The savings ratio is the proportion of households' total disposable income that is saved rather than spent on consumption:

savings ratio = (total household savings ÷ total disposable income) × 100

Figure 1 shows Australia's savings ratio was fairly stable between 3.6% and 6.1% from Q3 2018 to Q4 2019. It then rose sharply to 7.9% in Q1 2020 and to 22.0% in Q2 2020, meaning households saved 22 cents of every AU$1 of disposable income. In Q3 2020 it fell by 3.3 percentage points to 18.7%, so households were saving less and spending more of their income.

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(c) With reference to the second paragraph of Extract A, analyse **two** factors that caused household consumption to increase in quarter 3, 2020.

(6)

Household consumption is spending by households on goods and services. It fell by 12.5% in quarter 2 of 2020 but rose by 7.9% in quarter 3, helping growth reach 3.3%, well above the predicted 2.5%.

Factor 1, rising house prices: most households hold much of their wealth in their homes. When house prices rise, households feel wealthier (the wealth effect) and more confident about their finances, so they save less of their income and are more willing to borrow against the value of their homes. This increases consumption of goods and services, eg cars and household furniture.

Factor 2, cuts in the base interest rate by Australia's central bank: lower interest rates reduce the reward for saving, so the opportunity cost of spending falls and households save less. They also reduce the cost of borrowing, so more goods are bought on credit, and households with variable-rate mortgages make smaller monthly repayments, which increases their discretionary income. Both effects raise consumption.

Together with higher welfare payments, these factors increased consumer confidence, so the savings ratio fell from 22.0% to 18.7% and consumption rose by 7.9% in quarter 3.

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(d) With reference to Figure 2 and Extract A, examine **two** likely effects of the substantial increase in the rate of unemployment on the Australian economy.

(8)

Unemployment is when people of working age are without a job but are able, willing and available to work. Figure 2 shows Australia's unemployment rate rose from about 5.2% in March 2020 to about 7.5% in July 2020, an increase of about 2.3 percentage points in just four months.

Effect 1, a fall in disposable income: workers who lose their jobs have a large fall in income, since welfare payments are lower than wages, and those still in work lose confidence because they fear losing their own jobs. So consumption falls, and with the multiplier effect, AD and real GDP fall by more than the initial fall in spending, reducing living standards.

However, this effect is likely to be short term. The JobKeeper Payment scheme paid businesses AU$1 200 per employee every two weeks to keep workers employed, and household consumption actually rose by 7.9% in quarter 3. Unemployment also fell back to about 6.8% by August 2020.

Effect 2, worsening public finances: with more people unemployed, the Government receives less income tax and less indirect tax as spending falls, while it pays out more in unemployment benefits. This increases the budget deficit and national debt, which may need to be repaid by higher taxes or spending cuts in the future, and there is an opportunity cost, as the money cannot be spent on education or healthcare.

This is likely to be the more significant effect, as the Government is paying for higher welfare payments and for the JobKeeper scheme at the same time. However, the size of the effect depends on how long unemployment stays high. Unemployment is a lagging indicator, so as the

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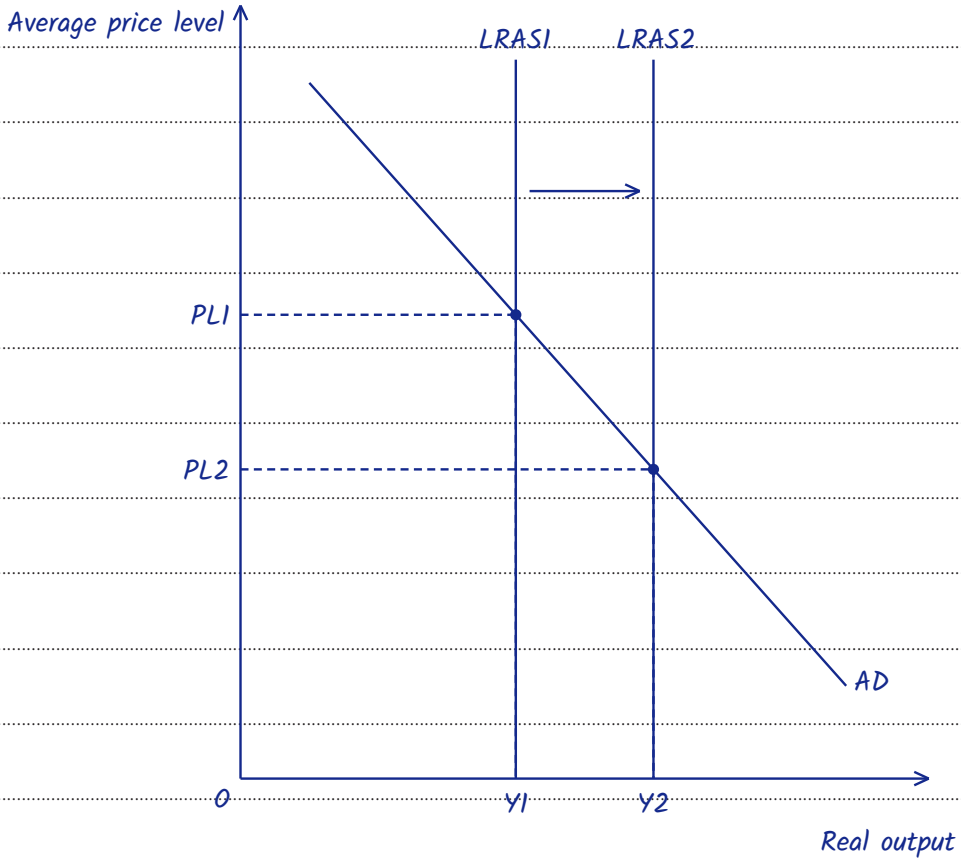
economy recovers with 3.3% growth, unemployment should fall and tax revenues should rise again.

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(e) With reference to Extract B, discuss interventionist supply-side policies that the Australian Government could implement to increase Australia's productivity.

(14)

Productivity is output per worker (or per hour worked). Interventionist supply-side policies are government policies that intervene in markets to increase the quantity and quality of factors of production, so they shift LRAS to the right. Extract B shows that Australia's average annual productivity growth was 1.7% between 2010 and 2020, while growth in GDP per capita was only 0.6%, below the 1% in the USA.



Investment in high-quality education and training schemes, eg apprenticeships and wider access to university, increases workers' skills, so human capital rises. Workers become more productive and more occupationally mobile, so output per worker rises. This is important for the service sector, nearly 70% of Australia's GDP, where output depends mainly on the skills of workers.

Investment in infrastructure improvements, such as faster broadband or better roads and ports,

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reduces firms' transport and communication costs and gives them better access to markets. As shown in the diagram above, productive capacity rises, so LRAS shifts from LRAS1 to LRAS2, real output rises from Y1 to Y2 and the price level falls from PL1 to PL2.

Providing finance for business start-ups, eg government-guaranteed loans, and offering tax incentives and subsidies for investment, reduce the cost of capital. Firms invest more in new machinery, technology and R&D, so each worker has more and better capital to work with. New firms also increase competition, forcing existing firms to innovate and cut costs, which raises productivity.

However, these policies are very costly. The Government is already paying for JobKeeper and higher welfare payments, so it may have to borrow more, increasing the budget deficit and national debt. There is also an opportunity cost: the money cannot be used for healthcare or other public services.

There are also long time lags. A new training scheme or a large infrastructure project may take many years before it raises productivity, so these policies will not quickly close the gap with the USA. Their success also depends on quality: poorly designed courses or badly chosen projects ("white elephants") are a waste of scarce resources, a form of government failure.

Tax incentives and start-up finance may have a deadweight effect, as some firms would have invested anyway, and in a period of low business confidence after the recession firms may not invest even if it is cheaper. Productivity in services, 70% of GDP, is also hard to measure, so the Government may not know how much to spend or which industries to support.

In conclusion, interventionist supply-side policies can raise Australia's productivity and long-run

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growth, but only over the long term. Education and training is likely to be the most effective policy because human capital is the key input in the service sector, but its success depends on the quality of the schemes and on the Government being able to afford them without damaging its public finances.

(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 'Pursuing economic growth at the expense of the environment has resulted in pollution, climate change and the overconsumption of natural resources.'

Evaluate the costs of economic growth. Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 Between June 2020 and June 2021 the rate of inflation in the USA increased from 0.6% to 5.4%.

Evaluate the costs of a high rate of inflation. Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

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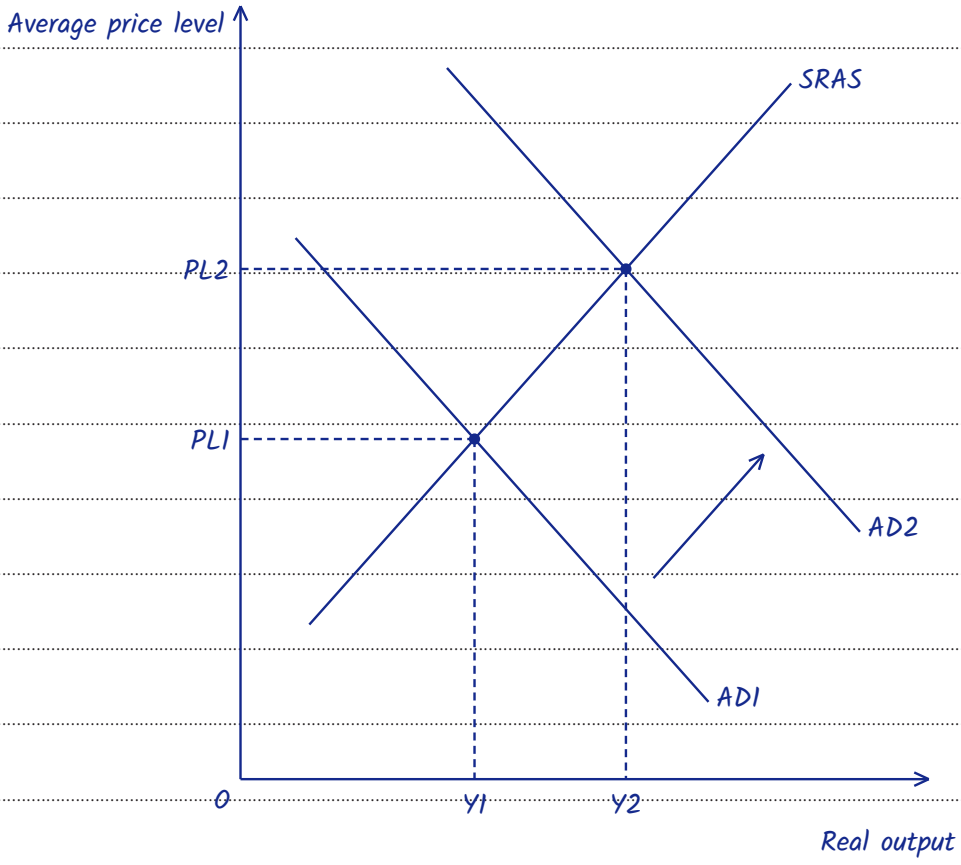
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

Inflation is a sustained rise in the general price level, measured in the USA by the annual percentage change in the Consumer Price Index (CPI). Between June 2020 and June 2021 US inflation rose from 0.6% to 5.4%, an increase of 4.8 percentage points, well above the Federal Reserve's 2% target.

Part of this was demand-pull inflation. Government stimulus payments to households (eg the American Rescue Plan of 2021) and very low interest rates increased consumption, so AD shifted from AD1 to AD2. As the economy approached full capacity and supply chains faced bottlenecks, the price level rose from PL1 to PL2.



The main cost of high inflation is a fall in purchasing power. If prices rise by 5.4% but wages

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rise by less, real incomes fall, so households can afford fewer goods and services and living standards fall. People on fixed incomes, such as pensioners, students and those on welfare benefits, are hit hardest. They are often the poorest, and they spend a large share of income on food, energy and rent, whose prices often rise fastest, so inequality increases.

Second, savers lose out. In 2021 US interest rates were close to zero, so with inflation of 5.4% the real interest rate was about −5%. The real value of savings falls, which particularly hurts retired people who live on interest. This also reduces the incentive to save, so there are fewer funds available for investment in the long run.

Third, high and unpredictable inflation creates uncertainty. Firms cannot predict their future costs and revenues, so they may postpone investment in new capital. This reduces AD in the short run and productive capacity (LRAS) in the long run, lowering economic growth. Firms also face menu costs of changing prices, and price signals become distorted, so resources may be misallocated.

Fourth, if US inflation is higher than in its trading partners, eg the UK, where inflation was about 2.5% in June 2021, US goods become less price competitive. Demand for US exports falls and imports rise, so net exports (X − M) fall and the current account deficit worsens, reducing AD and possibly causing job losses in export industries.

Finally, inflation can become self-reinforcing through expectations. If workers expect prices to keep rising they demand higher wages, which raises firms' costs and shifts SRAS left, causing a wage-price spiral. To stop this, the Federal Reserve may need to raise interest rates sharply, which could cause a recession and higher unemployment.

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However, the size of these costs depends on several factors. First, it depends on the duration of the inflation. The 0.6% in June 2020 was unusually low because of the pandemic, so part of the rise to 5.4% is a base effect. If the inflation is temporary, eg caused by short-term supply bottlenecks, expectations may stay anchored and the costs will be small.

Second, it depends on whether wages keep up. If the labour market is tight and wages rise as fast as prices, real incomes are protected. On the other hand, if workers have weak bargaining power, wages will not rise much, which limits a wage-price spiral but means real incomes fall more.

Third, inflation has some benefits. It reduces the real value of debt, which helps borrowers such as households with mortgages and the US Government, whose debt rose sharply during the pandemic. Firms may gain higher profit margins if prices rise faster than costs. Demand-pull inflation is also linked to a lower rate of unemployment, as shown by the Phillips curve, and moderate inflation is much less damaging than deflation, which causes consumers to delay spending.

Fourth, the effect on competitiveness depends on relative inflation rates and on the exchange rate. If inflation is also rising in the USA's main trading partners, or the dollar depreciates, US exports may not become less competitive at all.

In conclusion, a high rate of inflation imposes real costs on the USA, especially falling real incomes for the poorest households and lower real returns for savers. However, the most important factor is how long it lasts. A short burst of 5.4% inflation caused by recovery from the pandemic is much less costly than persistently high inflation that becomes built into expectations, which would damage investment, competitiveness and long-run growth.

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

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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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Sources for use with Section C

The Australian economy

Figure 1 Savings ratio, Q3 2018 to Q3 2020

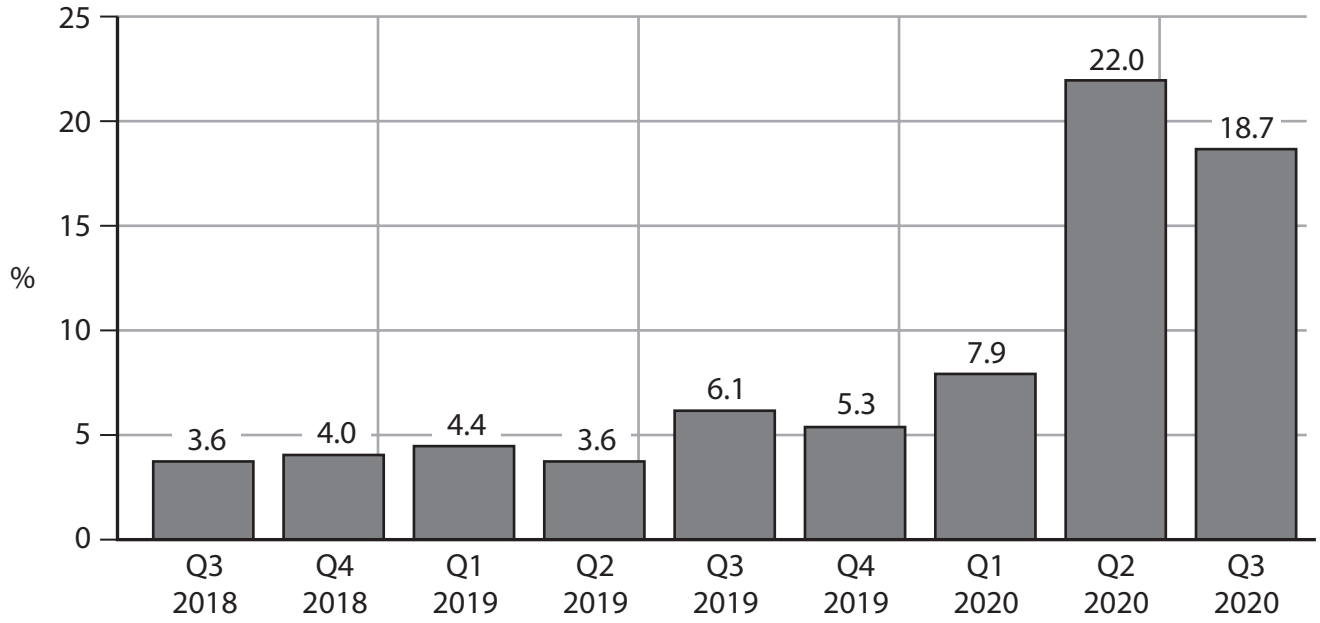
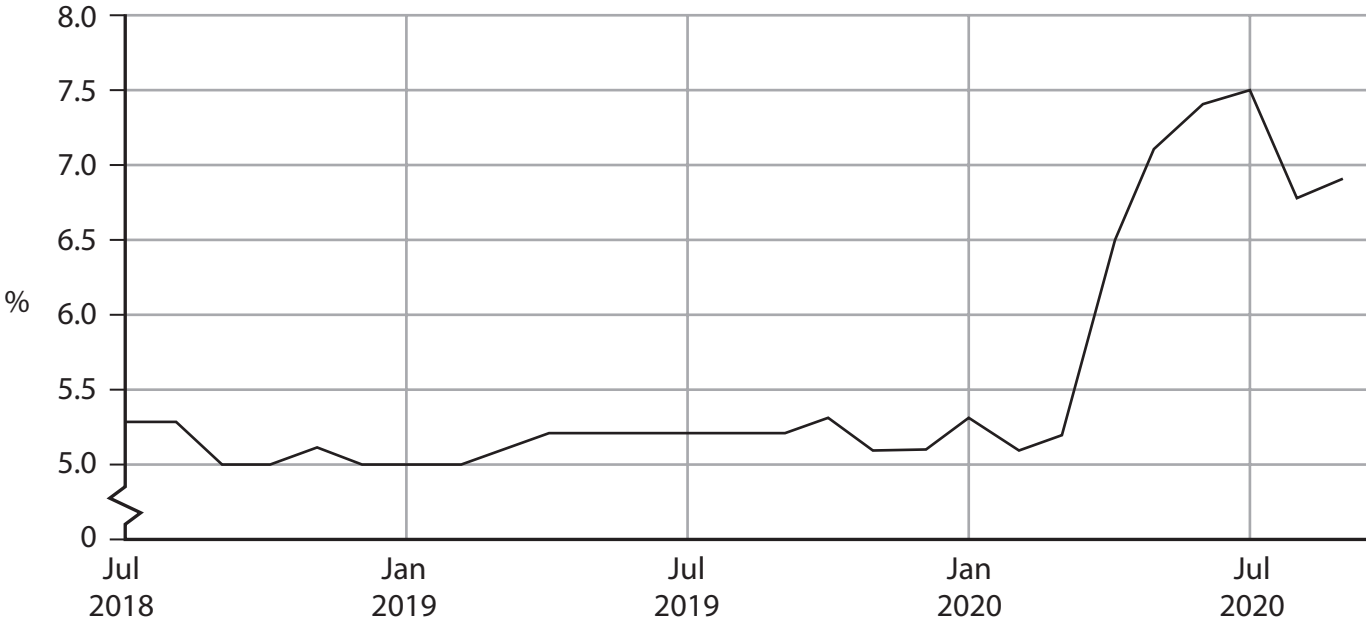


Figure 2 Unemployment rate, July 2018 to September 2020



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Extract A Economic performance

In the first half of 2020 Australia's economy was in recession. In quarter 1 the economic growth rate was −0.3% and it declined further in quarter 2 to −6.8%. Consequently, between March and July 2020 there was a substantial increase in the rate of unemployment.

However, Australia's economy recovered quickly with an economic growth rate of 3.3% in quarter 3 of 2020. This was much higher than predictions of a growth rate of 2.5%. This increase in the growth rate was mainly as a result of a rise in household consumption. Although household consumption decreased by 12.5% in quarter 2 of 2020, it rose by 7.9% in quarter 3. The main reasons for this rise in consumption were:

- rising house prices
- reductions in the base interest rate by Australia's central bank
- higher welfare payments to households.

These factors resulted in an increase in consumer confidence.

While household consumption supported Australia's economic recovery, the rate of unemployment was still relatively high. In response, the Australian Government continued its JobKeeper Payment scheme to keep workers in employment. This scheme supported businesses negatively affected by the economic decline. Businesses were able to claim AU$1 200 (before tax) per employee every two weeks to help cover the cost of wages.

Extract B Supply-side policies

Between 2010 and 2020 Australia's average annual increase in productivity was 1.7%. The country's average annual growth in real GDP per capita was 0.6%. This was below the 1% growth in GDP per capita in the USA. To increase GDP per capita, Australia needs to raise its productivity growth. This applies particularly to the service sector, which accounts for nearly 70% of Australia's GDP.

According to some economists, the Australian Government should consider implementing a range of interventionist supply-side policies to increase the country's productivity. These include:

- providing finance for business start-ups
- investment in infrastructure improvements
- investment in high-quality education and training schemes
- offering tax incentives and subsidies to encourage investment.

Successful implementation of these policies will enable Australia to achieve long-run economic growth.

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Acknowledgements

Figure 1 adapted from https://tradingeconomics.com/australia/personal-savings

Figure 2 adapted from https://tradingeconomics.com/australia/unemployment-rate

Extract A adapted from https://www.marketwatch.com/story/consumer-spending-boosts-australias-economy-2020-12-01; https://www.cnbc.com/2021/04/21/australias-retail-sales-jump-in-march-as-consumer-confidence-soars.html; https://treasury.gov.au/coronavirus/jobkeeper

Extract B adapted from https://www.ampcapital.com/au/en/insights-hub/articles/2021/march/econosights-australian-economic-policy-beyond-covid-19