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

Wednesday 15 May 2024

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.

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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 Economists predicted that Canada was likely to experience a recession in 2023.

Which **one** of the following is most likely to occur when an economy is in a recession?

- ☐ **A** A rise in investment and a rise in the profits of firms
- ☐ **B** A fall in government expenditure and a rise in real income
- ☐ **C** A rise in consumer confidence and a fall in the unemployment rate
- ☒ **D** A fall in government tax revenues and a fall in real output

(Total for Question 1 = 1 mark)

2 Between July 2021 and December 2021, the rate of inflation in Rwanda was negative.

Which **one** of the following is most likely to account for this decrease in the average price level in Rwanda?

- ☐ **A** A decrease in the savings ratio
- ☒ **B** A decrease in the costs of raw materials
- ☐ **C** An increase in the level of welfare payments
- ☐ **D** An increase in the availability of credit

(Total for Question 2 = 1 mark)

3 In 2022 Bahrain's GDP was $44 billion and its population was 1.5 million.

Which **one** of the following is the GDP per capita for Bahrain in 2022?

- ☐ **A** $29.33
- ☐ **B** $66.00
- ☒ **C** $29 333.33
- ☐ **D** $66 000.00

(Total for Question 3 = 1 mark)

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4 The net monthly balance of trade deficit in goods and services for Honduras increased from $475.8 million in April 2022 to $647.9 million in April 2023.

Which **one** of the following is the most likely reason for this increase in the balance of trade deficit for Honduras?

- ☒ **A** A decrease in its rate of inflation relative to its trading partners
- ☒ **B** An increase in the external value of its currency
- ☒ **C** A decrease in the real incomes of its citizens
- ☒ **D** An increase in the quality of its goods and services

(Total for Question 4 = 1 mark)

5 The unemployment rate in Sri Lanka increased from 5.2% in 2021 to 6.7% in 2022.

Which **one** of the following is the most likely effect of this increase in the unemployment rate?

- ☒ **A** An increase in national happiness in Sri Lanka
- ☒ **B** An increase in the level of profits for firms in Sri Lanka
- ☒ **C** A decrease in tax revenues for Sri Lanka's Government
- ☒ **D** A decrease in welfare payments by Sri Lanka's Government

(Total for Question 5 = 1 mark)

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6 The table shows average UK house prices between November 2022 and January 2023.

Month and year	Average house price (£)
November 2022	294 693
December 2022	293 162
January 2023	289 818

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

- ☒ **A** Existing homeowners experienced negative wealth effects
- ☒ **B** Existing homeowners experienced an increase in consumer confidence
- ☒ **C** Between November 2022 and January 2023 average house prices fell by 0.52%
- ☒ **D** There will be a greater incentive for construction companies to build new houses

(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 In 2021 net migration in Nepal was approximately 300 000.

Explain **one** impact of this net migration on *employment* in Nepal.

(4)

Net migration is immigration minus emigration, ie the number of people entering a country to live minus the number leaving. In 2021 net migration in Nepal was about 300 000, so its population rose.

One impact is higher employment. Positive net migration increases the size of the labour force, so the supply of labour rises and more people are available for work. Many migrants are of working age and can fill job vacancies that firms in Nepal were unable to fill, so employment increases.

In addition, a larger population means more household consumption of goods and services. Firms need to raise output to meet this demand, and because labour is a derived demand, they employ more workers, which increases employment further.

(Total for Question 7 = 4 marks)

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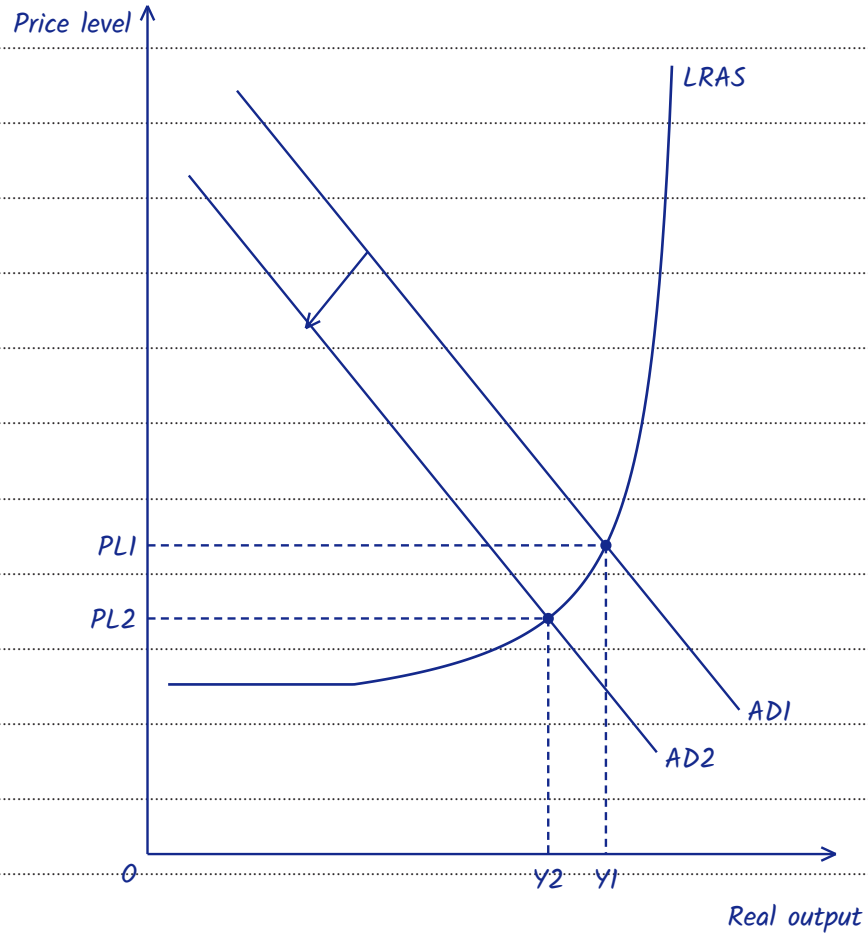
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8 Between May 2022 and April 2023 the central bank of Nigeria increased the country's base rate of interest by six percentage points.

Draw an AD and LRAS diagram to show the effect of this increase in the base rate of interest on *consumption*, the price level and real output.

(4)



The six percentage point rise in Nigeria's base rate increases the cost of borrowing and the reward for saving, so consumption falls. AD shifts left from AD1 to AD2, so the price level falls from PL1 to PL2 and real output falls from Y1 to Y2.

(Total for Question 8 = 4 marks)

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9 The table shows the value of exports and imports of goods and services, $ billion, for Thailand in 2020 and 2021.

	Exports ($ billion)	Imports ($ billion)
2020	208	187
2021	257	230

Calculate the *change* in Thailand's balance of trade between 2020 and 2021.
Show your workings.

(4)

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

2020: $208 billion – $187 billion = $21 billion surplus

2021: $257 billion – $230 billion = $27 billion surplus

Change = $27 billion – $21 billion = +$6 billion

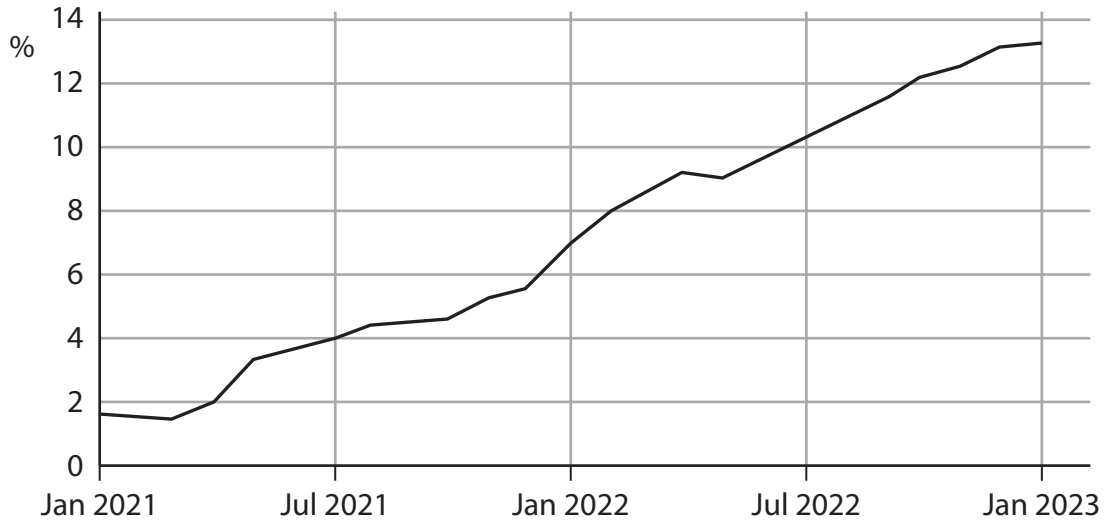
So Thailand's trade surplus increased by $6 billion between 2020 and 2021 (a rise of ($6bn ÷ $21bn) × 100 = 28.6%).

(Total for Question 9 = 4 marks)

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10 The chart shows the annual rate of inflation* in Colombia, as measured by the consumer price index (CPI), January 2021 to January 2023.



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

With reference to the chart, explain **one** likely effect of this trend in the rate of inflation.

(4)

Inflation is a sustained increase in the general price level. The chart shows Colombia's inflation rate rose from about 1.6% in January 2021 to about 13% in January 2023, a rise of over 11 percentage points.

One likely effect is a fall in real incomes. If prices rise by about 13% a year but money wages rise more slowly, each peso buys fewer goods and services, so households' purchasing power falls. People on fixed incomes, such as pensioners and students, are hit hardest. As a result consumption falls and consumer confidence weakens, so living standards in Colombia are likely to fall.

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11 Between 2015 and 2023 the European Central Bank increased its asset purchases (quantitative easing) programme by approximately €3.5 trillion.

With reference to the data, explain what is meant by quantitative easing.

(4)

Quantitative easing (QE) is a monetary policy instrument in which the central bank creates new 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 injects liquidity into financial markets, because banks now hold more cash deposits. It is a reflationary policy: buying bonds raises their price and lowers their yield, so interest rates and the cost of borrowing fall. This encourages consumption and investment, which increases AD.

Between 2015 and 2023 the European Central Bank increased its asset purchases by about €3.5 trillion, which shows the very large scale of the money it created to stimulate demand in the euro area.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

Study Figure 1, Figure 2 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 'corporation tax' (Extract A, lines 4 and 5).

(2)

(b) Explain what is meant by Gross National Income (Extract A, line 24).

(4)

(c) With reference to Extract A, analyse **two** reasons for the improvement in living standards in Ireland between 2015 and 2022.

(6)

(d) With reference to Figure 1 and Extract A, examine **two** reasons why Ireland's rate of economic growth was expected to decrease in 2023.

(8)

(e) With reference to Figure 2, Extract A and your own knowledge, discuss the limitations of using GDP to compare living standards between countries.

(14)

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12 (a) Define the term 'corporation tax' (Extract A, lines 4 and 5).

(2)

Corporation tax is a direct tax charged by the government on the profits of companies (firms). In Ireland the rate is 12.5% of profits.

(b) Explain what is meant by Gross National Income (Extract A, line 24).

(4)

Gross National Income (GNI) is GDP plus net income from abroad, ie GDP plus income earned by the country's residents from overseas assets and work, minus income (eg profits) paid to foreign owners of assets in the country.

In Ireland's case GNI is used as an alternative measure of economic growth, because it removes the impact of international companies whose profits flow back to their owners abroad. It gives a better understanding of domestic demand. On the GNI measure, Ireland's growth in 2022 was much lower, at 5.9%, compared with GDP growth of 12.2%.

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(c) With reference to Extract A, analyse **two** reasons for the improvement in living standards in Ireland between 2015 and 2022.

(6)

Living standards refer to the material welfare of people, often measured by real income per head.

Reason 1, higher employment. Ireland's low corporation tax rate of 12.5% has attracted over 1,500 international companies, such as Apple Inc., which moved its European base to Ireland in 2015. These firms have a derived demand for Irish workers, so employment increased from 2.06 million to 2.55 million between 2015 and 2022, a rise of 0.49 million. More people in work means more households earn wages rather than relying on benefits, so their real disposable incomes rise. They can therefore buy more goods and services, which raises material living standards.

Reason 2, higher government tax revenue. With more people employed, the Government receives more income tax, and the profits of international companies increase corporation tax receipts, which reached an all-time high of €22.6 billion in 2022. The Government can use this revenue to spend more on public services such as healthcare, education and housing, without raising tax rates. Better health and education improve the quality of life of Irish citizens, so living standards improve.

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(d) With reference to Figure 1 and Extract A, examine **two** reasons why Ireland's rate of economic growth was expected to decrease in 2023.

(8)

Figure 1 shows Ireland's real GDP growth rate was 12.2% in 2022, but Extract A says it was expected to fall to just 4% in 2023, a decrease of 8.2 percentage points.

Reason 1, a high rate of inflation. Inflation reduces real incomes if wages do not rise as quickly as prices, so households can afford fewer goods and services and consumption falls. Higher Irish prices also make Ireland's exports less price competitive, so net exports fall. Since C and (X – M) are components of AD, AD shifts left and the rate of growth of real output slows.

Reason 2, rising interest rates. Higher interest rates increase the cost of borrowing and the reward for saving. Households borrow less to buy cars and houses, and firms postpone investment projects as fewer are profitable at the higher cost of borrowing. Consumption and investment fall, so AD grows more slowly and economic growth decreases.

However, these are only forecasts and may not happen. If inflation falls faster than expected, real incomes recover and the European Central Bank may stop raising rates, so growth could be higher than 4%. Also, the fall is from an unusually high 12.2%, partly caused by international companies, so a growth rate of 4% is still positive and high compared with the euro area. Forecasts suggest GDP will still grow by an average of 3.5% a year between 2024 and 2027, so the slowdown is not a recession.

Interest rates are likely to be the more significant reason, because Ireland is in the euro area, so rates are set by the European Central Bank for the whole area and Ireland cannot lower them. However, the record corporation tax receipts of €22.6 billion give the Irish Government room to increase its spending, which could offset part of the fall in AD. In reality, it is a

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combination of these reasons, together with a weaker global economy, that lowers growth.

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(e) With reference to Figure 2, Extract A and your own knowledge, discuss the limitations of using GDP to compare living standards between countries.

(14)

Gross Domestic Product (GDP) is the total value of goods and services produced within a country in a year. Living standards are the level of welfare of the population, including income, health, education and the environment.

First, comparing GDP growth rates can be misleading. Figure 2 shows Ireland grew by about 12% in 2022, compared with only about 2% in Germany and the USA. This does not mean living standards in Ireland improved six times faster, because growth rates say nothing about the level of GDP or GDP per capita: the USA has a far larger economy. Population growth also differs; India grew by about 6.6%, but its population is also rising, so real GDP per capita grows by much less.

Second, the composition of GDP differs. Much of Ireland's GDP is produced by over 1,500 international companies attracted by the 12.5% corporation tax rate. Some are so large that GDP may be overstated: in 2018 global sales of Apple iPhones accounted for 25% of Ireland's GDP growth. Most of these profits flow abroad to foreign shareholders, so they do not raise the incomes of Irish residents. This is why GNI growth was only 5.9% in 2022, less than half of GDP growth.

Third, GDP does not show how income is distributed or its effect on the environment. Extract A says GDP can mislead analysis of income inequality and the environment. A country with high GDP but very unequal income, or high pollution from manufacturing, may have lower living standards than GDP suggests.

Fourth, data may be unreliable and calculated differently between countries. Ireland's industrial

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production rose or fell by more than 10% from one month to the next, so the central bank had to review its seasonal adjustments. Countries such as India also have large informal and subsistence sectors whose output is not recorded, so GDP understates their output. GDP also ignores unpaid work and leisure.

Finally, GDP is measured in different currencies. Converting at market exchange rates ignores differences in the cost of living, so GDP must be adjusted using purchasing power parity (PPP) to compare what incomes can actually buy.

However, GDP is still very useful. It is calculated in a standard way by almost all countries, so data is widely available, up to date and easy to compare over time. Many limitations can be reduced by using real GDP per capita at PPP, which allows for population size and the cost of living, or GNI, as Ireland's central bank does. Income is also a key determinant of living standards: the activities of international companies helped raise Irish employment from 2.06 million to 2.55 million, which did improve living standards.

Alternative measures such as the Human Development Index (HDI) include health and education, but they have their own problems, as weighting and measuring these is subjective. In addition, the limitations matter more for some countries than others: they are extreme for a small, open economy like Ireland, but much smaller when comparing similar large economies such as Germany and the USA.

In conclusion, GDP on its own, especially GDP growth rates, is a weak measure for comparing living standards, as Ireland's 12.2% shows. It is most useful as a starting point when converted to real GDP or GNI per capita at PPP and used alongside indicators such as HDI.

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(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 2022 many countries experienced low rates of economic growth and high rates of inflation.

Evaluate supply-side policies that a government could use to increase the rate of economic growth and to decrease the rate of inflation. Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 In February 2023 government expenditure exceeded tax revenue by approximately $1 billion in Argentina.

Evaluate the likely macroeconomic effects of a government using deflationary policies to achieve a balanced budget. Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

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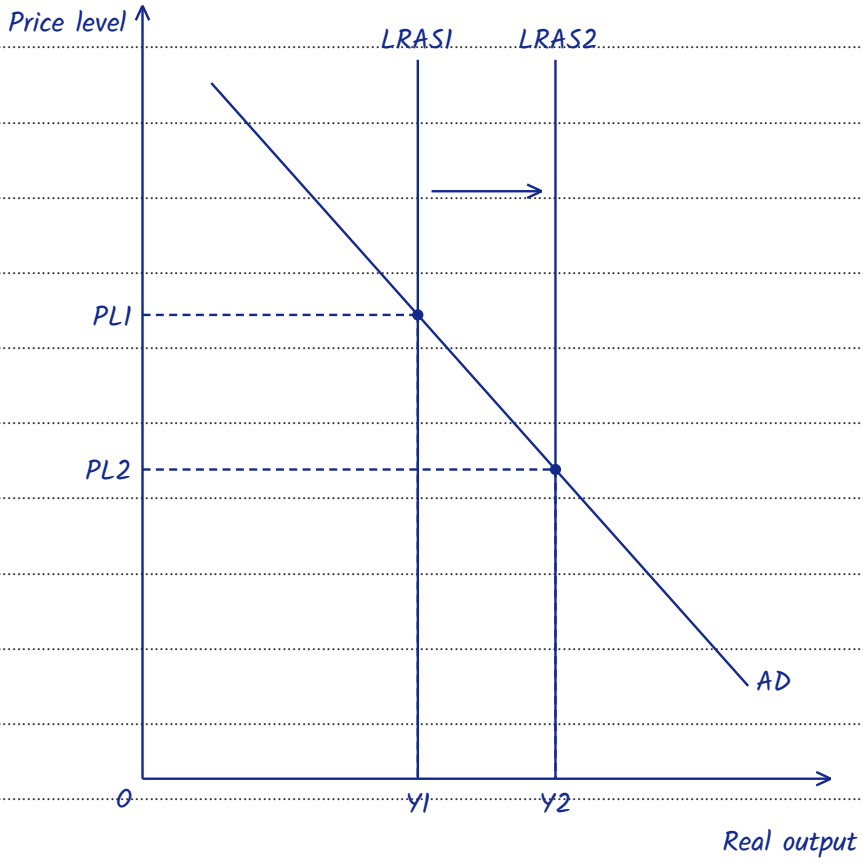
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Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

Supply-side policies are government policies that aim to increase the productive capacity of the economy by improving productivity, competition and incentives. I will refer to the UK, where in 2022 CPI inflation reached 11.1% in October, the highest for about 40 years, while growth was weak.



As the diagram shows, successful supply-side policies shift LRAS right from LRAS1 to LRAS2. Real output rises from Y1 to Y2 and the price level falls from PL1 to PL2. So, unlike demand-side policies, they can increase growth and reduce inflation at the same time, with no trade-off.

First, the UK Government could spend more on education and training, eg apprenticeships

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funded by the apprenticeship levy introduced in 2017. This raises human capital, so output per worker rises. Higher labour productivity lowers unit labour costs, so firms can supply more at lower prices, reducing cost-push inflation. A more skilled workforce also reduces occupational immobility and structural unemployment, increasing the size of the effective labour force and potential growth.

However, there are long time lags: a training programme may take several years before workers are more productive, so it does little to reduce inflation in 2022 and 2023. Its success also depends on the quality of training, and there is an opportunity cost, as the money could have been spent on healthcare instead.

Second, the Government could invest in infrastructure such as transport (eg HS2) and full fibre broadband. Faster and more reliable networks reduce firms' transport and communication costs and give them access to wider markets, so productivity and productive capacity increase and LRAS shifts right.

However, infrastructure projects are very expensive and often over budget; HS2's costs rose so much that its northern leg was cancelled in 2023. In the short run, government spending also increases AD, which could add to demand-pull inflation before the extra capacity is available. With UK government debt already high after the pandemic, it may also need higher taxes or borrowing.

Third, the Government could cut corporation tax or give investment allowances, such as the full expensing of investment introduced in 2023. This raises the post-tax return on investment, so firms buy more capital and new technology and spend more on research and development. The capital stock grows and technology improves, so potential output increases.

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However, this may be ineffective if firms are uncertain about future profits; with high inflation and rising interest rates in 2022, business confidence was low. There may also be a deadweight loss, as some firms would have invested anyway, and lower tax revenue reduces the money available for public services. In fact the UK raised its main corporation tax rate from 19% to 25% in 2023.

Fourth, market-based policies such as cutting income tax or reducing welfare benefits could increase incentives to work. This is important in the UK, where economic inactivity rose after the pandemic. If more people join the labour force, labour supply rises, which reduces wage pressure and inflation and increases potential output.

However, a lower income tax rate may lead some workers to take more leisure, as the income effect may outweigh the substitution effect. Cutting benefits may increase poverty and inequality, and it will not help if people are inactive because of long-term illness rather than low incentives.

Overall, the effectiveness of supply-side policies depends on the cause of the problem. UK inflation in 2022 was mainly cost-push, caused by higher energy and food prices after Russia's invasion of Ukraine. Supply-side policies cannot reduce world energy prices quickly, so in the short run the Bank of England had to raise Bank Rate, from 0.1% in November 2021 to 3.5% by December 2022. Also, if there is spare capacity, shifting LRAS creates only potential growth, not actual growth, unless AD also rises.

In conclusion, supply-side policies are the best long-run solution for the UK, because they are the only policies that can raise growth and lower inflation together. Education and training and

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infrastructure are likely to be most effective, as they tackle the UK's weak productivity directly, but because of time lags they should be combined with monetary policy to control inflation in the short run.

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

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Pearson Edexcel International Advanced Level

Wednesday 15 May 2024

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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Sources for use with Section C

The economy of Ireland

Figure 1 Annual real GDP growth rate (%), 2013 to 2022

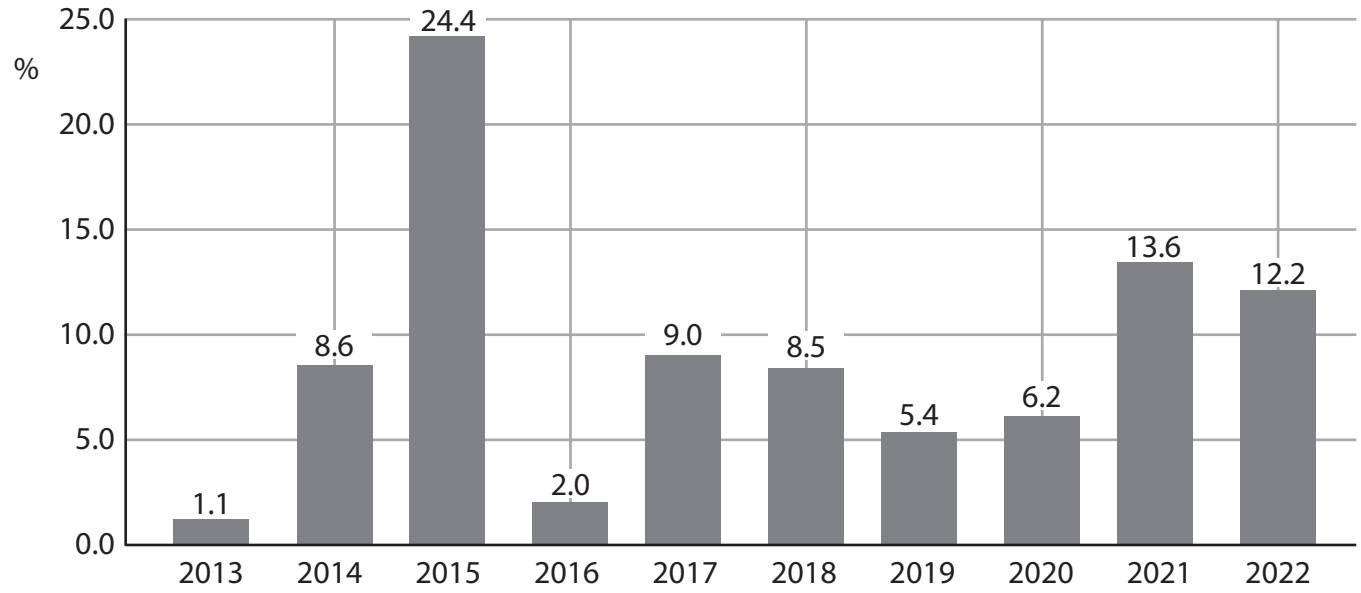
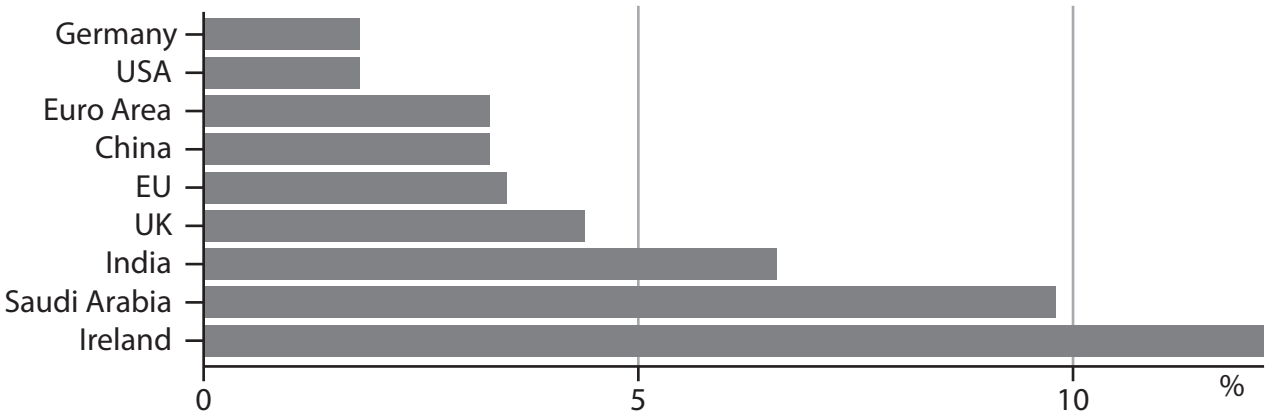


Figure 2 Annual real GDP growth rate (%) for selected countries, 2022



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Extract A Limitations of using GDP

Many economists argue that Ireland's high rate of economic growth for 2022 is not accurate. They claim that Ireland only experiences high rates of economic growth because international companies take advantage of the country's low corporation tax rate of 12.5%. This tax rate is lower than the corporation tax rates of many other European countries and has attracted over 1 500 international companies.

Some of these companies are so large that the country's GDP figures may be overstated. For example, Apple Inc., the world's largest technology company, moved its European base to Ireland in 2015. This resulted in a significant increase in the country's rate of economic growth. In 2018 the global sales of Apple iPhones accounted for 25% of the GDP growth rate in Ireland.

In 2022 there were large fluctuations in Ireland's industrial production data. It rose or fell by more than 10% from one month to the next. This led to Ireland's central bank reviewing how it calculated seasonal adjustments when measuring the country's GDP.

Economists suggested that Ireland's GDP data was meaningless as a guide to how the economy is performing. For example, they argued that using GDP can mislead analysis of matters related to income inequality and the environment.

However, Ireland's central bank defended this measurement of the country's rate of economic growth for 2022. It indicated that the activities of international companies had a positive impact on living standards in Ireland. Between 2015 and 2022 employment increased from 2.06 million to 2.55 million. This contributed to a significant increase in government revenues from income tax and corporation tax. In 2022 the country's corporation tax receipts rose to an all-time high of €22.6 billion.

Ireland's central bank also uses Gross National Income (GNI) as an alternative measure of economic growth. This measure removes the impact of international companies and provides a better understanding of domestic demand. According to the GNI measure, Ireland's rate of economic growth was much lower at 5.9% in 2022.

In 2023 Ireland's rate of economic growth was expected to decrease to just 4%, as measured by GDP. This is as a result of a high rate of inflation, rising interest rates and the weakening state of the global economy. Forecasts also suggest that between 2024 and 2027, GDP is likely to grow by an average of 3.5% per year.

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Acknowledgements

Figure 1 adapted from tradingeconomics,
https://tradingeconomics.com/ireland/gdp-growth-annual

Figure 2 adapted from FT,
https://www.ft.com/content/e1cfecd4-e429-4151-963e-0d172ed0e028

Extract A adapted from FT,
https://www.ft.com/content/e1cfecd4-e429-4151-963e-0d172ed0e028
https://www.politico.eu/article/ireland-gdp-growth-multinationals-misleading/