Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Centre Number | Candidate Number

Pearson Edexcel International Advanced Level

Wednesday 14 May 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.

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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 is a withdrawal from the circular flow of income?

- ☒ **A** Exports
- ☒ **B** Savings
- ☒ **C** Investment
- ☒ **D** Consumption

(Total for Question 1 = 1 mark)

2 Between November 2023 and December 2023, Thailand's private sector investment decreased by 10.2%.

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

- ☒ **A** An increase in the availability of credit
- ☒ **B** A decrease in the tax on company profits
- ☒ **C** A decrease in business confidence
- ☒ **D** An increase in the rate of economic growth

(Total for Question 2 = 1 mark)

3 In France the marginal propensity to consume was estimated to be 0.21 in January 2023.

Based on this estimate, which **one** of the following was the value of the multiplier for France?

- ☒ **A** 0.04
- ☒ **B** 0.79
- ☒ **C** 1.27
- ☒ **D** 4.76

(Total for Question 3 = 1 mark)

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4 In 2023 the European Central Bank decided to end its quantitative easing programme.

Ceteris paribus, which **one** of the following is the most likely effect of this decision?

- ☒ **A** An increase in the rate of corporation tax
- ☒ **B** A decrease in the rate of unemployment
- ☒ **C** An increase in the rate of economic growth
- ☒ **D** A decrease in the rate of inflation

(Total for Question 4 = 1 mark)

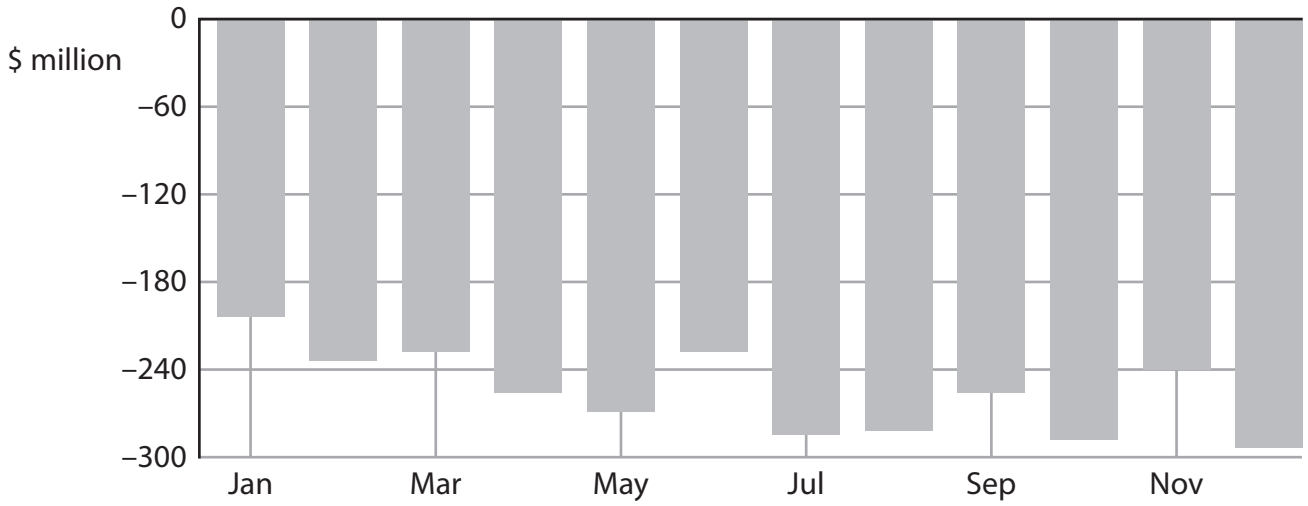
5 Which **one** of the following describes how unemployment is measured using the International Labour Organization (ILO) definition?

- ☒ **A** When a person has been actively seeking work in the past four weeks and is available to start work in the next two weeks
- ☒ **B** When a person has been actively seeking work in the past four months and is available to start work in the next two months
- ☒ **C** When a person has been actively seeking work in the past two months and is available to start work in the next four months
- ☒ **D** When a person has been actively seeking work in the past two weeks and is available to start work in the next four weeks

(Total for Question 5 = 1 mark)

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6 The chart shows Maldives' net monthly balance of trade in goods and services, January 2023 to December 2023.



Which **one** of the following is the most likely cause of the worsening in Maldives' balance of trade in goods and services?

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

(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 spaces provided.

7 In 2023 Macau's rate of economic growth was the highest in the world. Its annual percentage increase in real GDP was 80.5%.

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

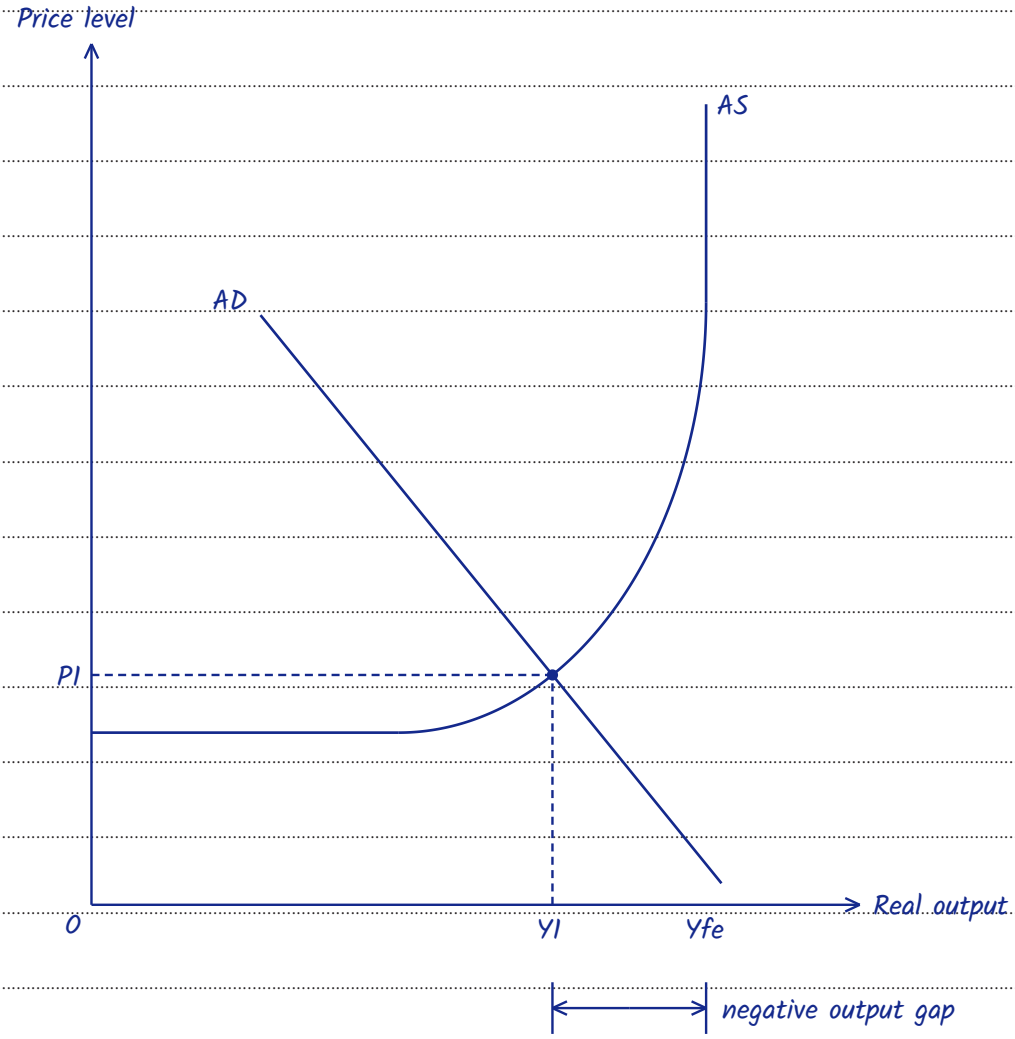
One benefit of economic growth is more employment, so unemployment falls. In 2023 Macau had the highest rate of economic growth in the world, with real GDP rising by 80.5%. This means firms were producing far more goods and services to meet higher consumer demand, for example from tourism. Because the demand for labour is a derived demand, firms need to hire more workers to produce this extra output, so more jobs are created and unemployment falls. Households then earn higher incomes, which raises their living standards and their spending, creating further jobs through the multiplier effect.

(Total for Question 7 = 4 marks)

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8 In 2023 Ghana experienced a negative output gap.

Draw a Keynesian AS/AD diagram to illustrate a negative output gap.



Equilibrium is where AD = AS, at real output YI and price level PI. YI is below the full employment level of output Yfe, so actual output is below potential output. The distance YI to Yfe is the negative output gap, so there is spare capacity and unemployment in Ghana.

(Total for Question 8 = 4 marks)

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9 The table shows the population and GDP per capita of Nepal in 2013 and 2023.

	Population (millions)	GDP per capita ($)
2013	27.4	809.4
2023	30.9	1 350.0

Based on this information, calculate the *change* in Nepal's GDP between 2013 and 2023. Show your workings.

GDP = GDP per capita × population

2013: $809.4 × 27.4 million = $22 177.56 million = $22.18 billion

2023: $1 350.0 × 30.9 million = $41 715 million = $41.72 billion

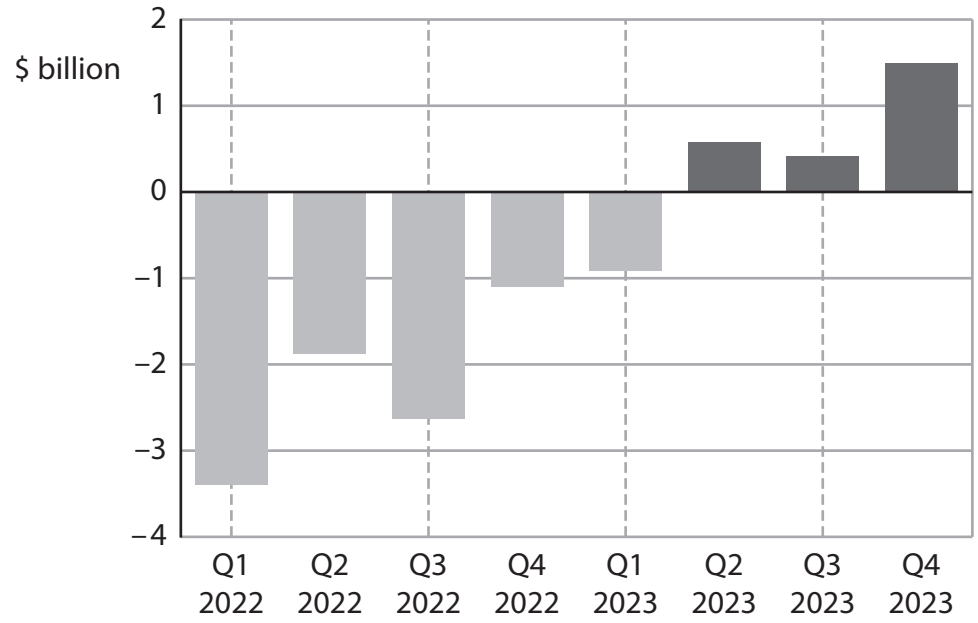
Change in GDP = $41.72 billion − $22.18 billion

= an increase of $19.54 billion (about +88.1%)

(Total for Question 9 = 4 marks)

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10 The chart shows Peru's current account of the balance of payments between quarter 1 (Q1) 2022 and quarter 4 (Q4) 2023.



With reference to the chart, explain the difference between a current account deficit and a current account surplus.

A current account deficit is when the sum of the balances on trade in goods, trade in services, primary income and secondary income is negative, so more money flows out of the country than flows in (for example the value of imports is greater than the value of exports). Peru had a deficit in every quarter from Q1 2022 to Q1 2023, for example about −$3.4 billion in Q1 2022 and about −$0.9 billion in Q1 2023.

A current account surplus is when this sum is positive, so inflows are greater than outflows (exports greater than imports). Peru had a surplus from Q2 2023 to Q4 2023, reaching about +$1.5 billion in Q4 2023.

(Total for Question 10 = 4 marks)

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11 In 2024 air fryers and rice cakes were added to the UK's consumer price index (CPI) basket of goods and services. At the same time, hand hygiene gel and sofa beds were removed from this basket.

Explain **one** reason why it is necessary to regularly update the CPI basket of goods and services.

The CPI basket must be updated regularly so that inflation is measured accurately. The CPI measures the change in the price of a basket of goods and services that represents what a typical household buys, weighted by the share of spending on each item. Consumer tastes and spending patterns change over time, and new products are introduced because of technological advances. For example, air fryers and rice cakes were added because UK households now spend more on them, while hand hygiene gel was removed because spending on it fell after the global health crisis, and sofa beds were removed as spending on them became less significant.

If the basket were not updated, the CPI would track the prices of goods people no longer buy and the weights would not reflect actual spending, so the measured rate of inflation would not reflect the true change in the cost of living. This could lead to wrong policy decisions, for example on interest rates.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

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

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

12 (a) Define the term 'inflation'.

(2)

(b) With reference to Figure 1 and the first paragraph of Extract A, examine **two** causes of the relatively high rate of inflation in the USA.

(8)

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

(4)

(d) With reference to the first paragraph of Extract B, analyse **two** reasons why the USA's rate of economic growth increased in 2023.

(6)

(e) With reference to the information provided and your own knowledge, discuss the likely macroeconomic effects of the increase in the base rate of interest on the US economy.

(14)

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12 (a) Define the term 'inflation'.

(2)

Inflation is a sustained rise in the general (average) price level of goods and services in an economy over a period of time, usually measured by the annual percentage change in the consumer price index (CPI).

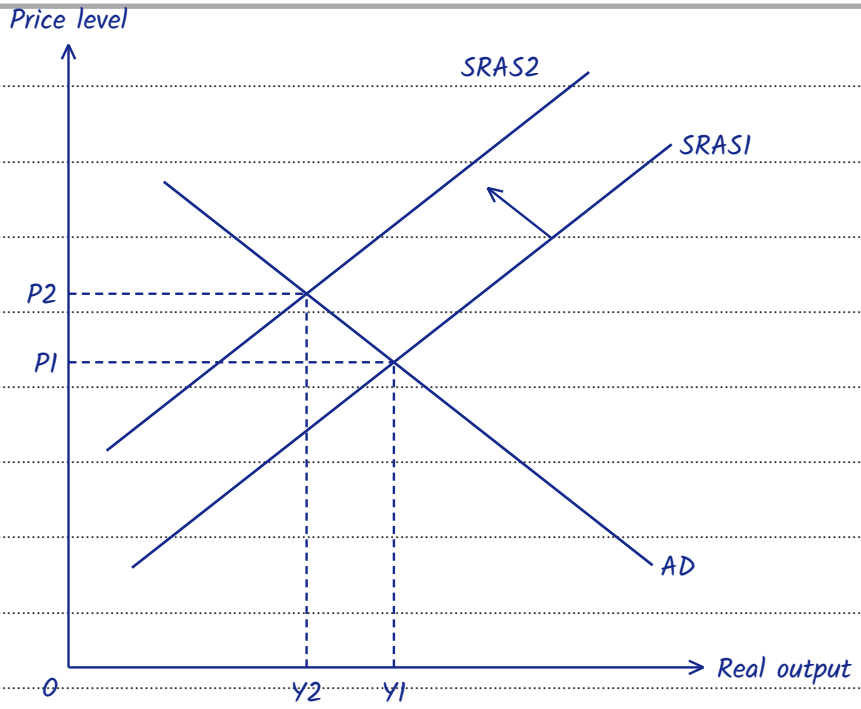
(b) With reference to Figure 1 and the first paragraph of Extract A, examine **two** causes of the relatively high rate of inflation in the USA.

(8)

Figure 1 shows that the US rate of inflation rose from about 1.4% in January 2021 to about 6% in January 2022, an increase of 4.6 percentage points, and it peaked at about 6.5% in 2022, well above the Fed's 2% target.

1. Disruptions to the supply chain. The global health crisis of 2020–2022 disrupted supply chains, creating shortages of raw materials, components and finished goods. Firms had to pay more for scarce inputs and transport, so their costs of production rose. This shifts the SRAS curve to the left from SRAS1 to SRAS2, so the price level rises from P1 to P2 (see diagram). This is cost-push inflation.

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2. Rising global prices of energy and food in 2021–2022. Energy is an input for almost every firm, so higher oil and gas prices raise production and transport costs and shift SRAS further left. Energy and food are also large items in the CPI basket, so their higher prices directly raise the measured rate of inflation, and as the USA imports some energy and food this raises the cost of imports too.

Evaluation: the rise of 4.6 percentage points is large, so it was probably a combination of causes. Their significance changed over time: supply chain problems mattered most in 2021, energy and food in 2021–2022, and then high wage growth in 2022–2023 kept inflation high. Energy and food prices are volatile and had started to fall, which is why inflation fell to about 4% by the end of 2023, so these causes are likely to be short-run. However, because they are cost-push causes, the Fed has limited tools to control them without reducing output.

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

(4)

The rate of unemployment is the percentage of the labour force who are out of work but are willing and able to work and are actively seeking work.

rate of unemployment = (number unemployed ÷ labour force) × 100

The labour force is everyone in work plus the unemployed. Extract A says the rate of unemployment was 3.6% in 2023, a 50-year low, so only 3.6 in every 100 people in the US labour force had no job. The Fed forecast it would average 4% in 2024, an increase of 0.4 percentage points.

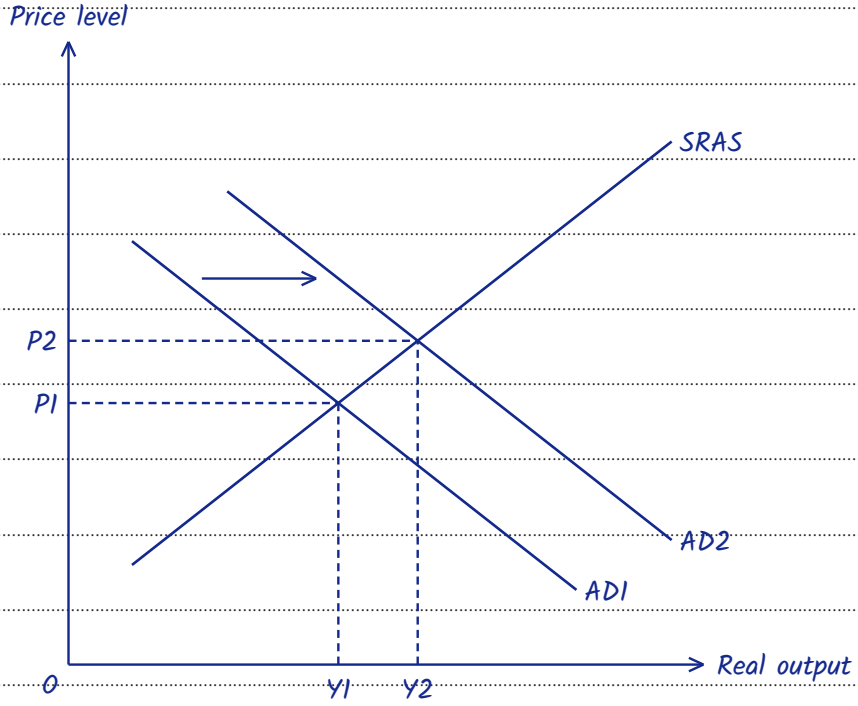
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(d) With reference to the first paragraph of Extract B, analyse **two** reasons why the USA's rate of economic growth increased in 2023.

(6)

Extract B says US economic growth increased from 1.9% in 2022 to 2.5% in 2023, a rise of 0.6 percentage points.

1. High consumer spending. There was high consumer spending on services such as hotels and travel. Consumption (C) is the largest component of aggregate demand (AD = C+I+G+(X−M)), so higher consumption shifts AD to the right from AD1 to AD2. Firms respond by producing more services, so real output rises from Y1 to Y2 and the rate of economic growth increases.



2. Government spending on infrastructure. The US Government spent $1 trillion on infrastructure projects such as roads, airports and bridges. This is an injection into the circular flow that increases government spending (G), shifting AD further to the right and raising real output. The projects created new jobs, so workers earned more income and spent more, causing a further rise in output through the multiplier effect. In the long run, better infrastructure also raises productivity and productive capacity, shifting LRAS to the right.

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(e) With reference to the information provided and your own knowledge, discuss the likely macroeconomic effects of the increase in the base rate of interest on the US economy.

(14)

The base rate is the interest rate set by the central bank, the Fed, at which it lends to commercial banks, and it influences all other interest rates in the economy. It is the main instrument of monetary policy. Extract B shows it rose from 0.25% in March 2022 to a record high of 5.5% in July 2023, an increase of 5.25 percentage points.

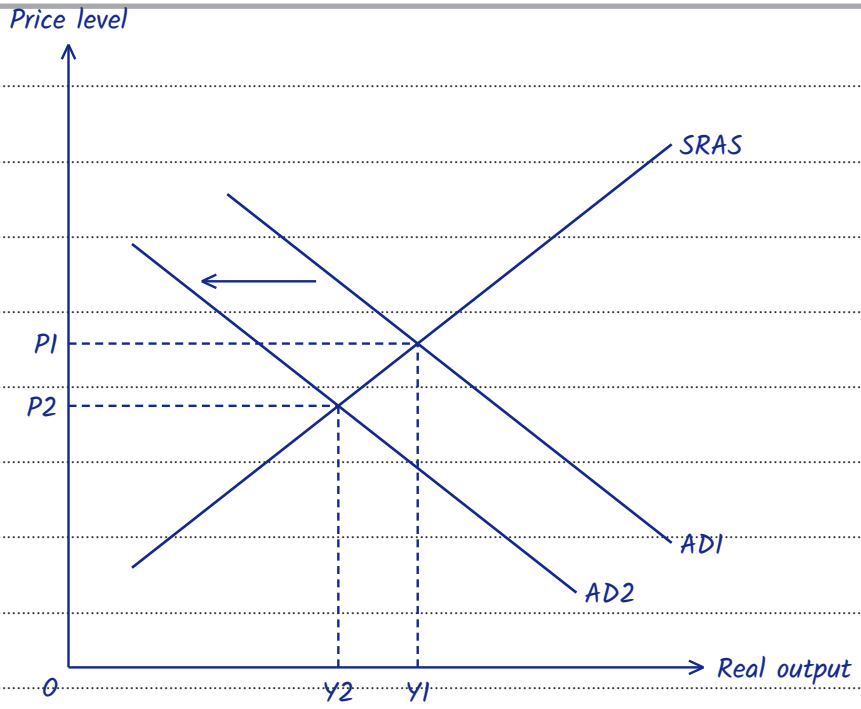
Consumption: higher interest rates raise the cost of borrowing, so consumers are less willing to use credit cards and loans to finance spending, especially on durable goods such as cars. Households with variable rate mortgages, car loans and credit card debt face higher interest payments, so their discretionary income falls; Extract B says more consumers would find it difficult to pay this interest. The reward for saving also rises, so households save more. Higher mortgage costs reduce demand for houses, so house prices fall, creating a negative wealth effect that reduces confidence and consumption further.

Investment and net exports: firms face a higher cost of borrowing, so fewer investment projects are profitable and investment (I) falls. Higher US interest rates also attract hot money inflows, increasing demand for the dollar so it appreciates. US exports become more expensive and imports cheaper, so (X–M) falls.

Since C, I and (X–M) all fall, AD shifts left from AD1 to AD2. As shown in the diagram, the price level falls from P1 to P2 and real output falls from Y1 to Y2.

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Lower demand-pull pressure means lower inflation: Figure 1 shows inflation fell from about 6.5% in 2022 to about 4% by the end of 2023, and the Fed forecast a return to its 2% target in 2024. However, lower real output means slower economic growth, which economists forecast for 2024, and since labour is a derived demand, firms need fewer workers, so unemployment rises from 3.6% to a forecast 4%. These effects are made bigger by the negative multiplier. Lower incomes also reduce spending on imports, which may improve the current account.

Evaluation: the size of the rise, 5.25 percentage points in just over a year, is large, so the effects are likely to be significant. However, changes in interest rates have a time lag of about 18 to 24 months, so the full impact of the July 2023 rise may not be felt until 2024 or 2025. The effect on consumption also depends on confidence: Extract B shows high consumer spending on services in 2023, and consumers relied more on credit cards rather than cutting spending, so C may fall less than expected. Firms that finance investment from retained profits are less affected by higher rates, and the impact on output depends on the size of the multiplier.

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The effect also depends on the cause of inflation and the level of spare capacity. Much of the inflation was cost-push, from supply chain problems and energy and food prices, which higher rates cannot directly reduce, so they may cut output more than prices. On the other hand, with unemployment at a 50-year low the economy was close to full capacity, so a fall in AD is more likely to reduce the price level than real output. The $1 trillion of government infrastructure spending also works in the opposite direction, partly offsetting the fall in AD.

Overall, the main effect is likely to be lower inflation with only a small rise in unemployment, as the Fed expected, so a recession may be avoided. However, the size of the effects depends heavily on time lags and consumer confidence.

(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 Between July 2023 and January 2024 the rate of employment in Colombia decreased from 58.6% to 55.3%.

Evaluate supply-side policies that could be used to increase the rate of employment. Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 In 2022 nominal GDP was $5 billion for Fiji, $477 billion for Egypt and $3 385 billion for India.

Evaluate the limitations of using GDP data to compare living standards between countries. Refer to countries 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:

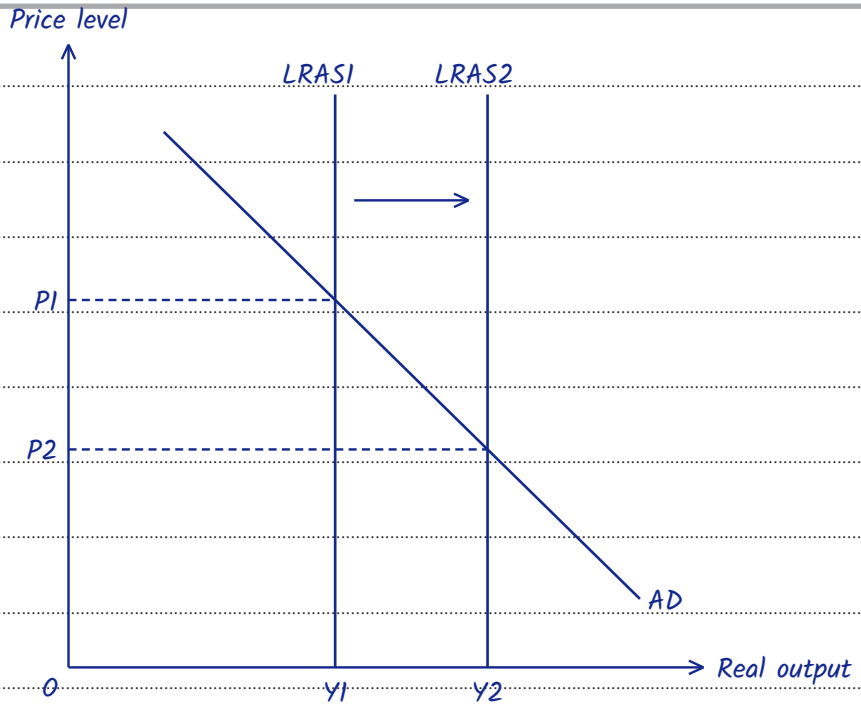
The rate of employment is the percentage of the working age population who are in work, either employed or self-employed. In Colombia it fell from 58.6% in July 2023 to 55.3% in January 2024, a fall of 3.3 percentage points. Supply-side policies are government policies that aim to increase the productive capacity of the economy by improving the quantity and quality of the factors of production and the incentives to work and hire. They can be interventionist or market-based. I will refer to Colombia.

Education and training: the government could spend more on vocational training, apprenticeships and education. This raises human capital, so workers have the skills firms need. This reduces structural unemployment caused by a mismatch between workers' skills and available jobs, and it increases occupational mobility, so unemployed workers can move into growing sectors. Workers become more productive, which lowers firms' unit labour costs and makes it profitable to hire more of them. Productive capacity increases, so LRAS shifts right from LRAS1 to LRAS2: real output rises from Y1 to Y2 and the price level falls from P1 to P2, so more jobs are created without causing inflation.

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However, education and training take a long time to have an effect, so they will not quickly reverse the fall in 2023–2024. They are also expensive, with an opportunity cost, and with a budget deficit the Colombian government may struggle to fund them. Their success also depends on the quality of the training and whether it matches the jobs firms actually want to fill.

Reducing the cost of hiring: Colombia has a large informal sector, where workers have no contracts. The government could cut payroll taxes and employer contributions, or give subsidies to firms that hire young people and the long-term unemployed. This lowers the cost of labour, so firms demand more workers and more jobs move into the formal sector. Making labour markets more flexible, so it is easier and cheaper to hire, can also encourage firms to create jobs, and lower corporation tax can encourage firms, including foreign firms, to expand or set up in Colombia, creating jobs.

However, these policies reduce tax revenue and may worsen the budget deficit, and there is a risk of deadweight loss if firms would have hired the workers anyway. Greater flexibility may also reduce job security and increase inequality.

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Incentives to work: lower income tax rates and lower or more conditional benefits increase the reward from working compared with not working, so more people actively seek work and the employment rate rises. Providing free or cheaper childcare would allow more parents, especially women, to join the labour force. However, the effect of a tax cut is uncertain: if the income effect outweighs the substitution effect some people may work fewer hours, and cutting benefits can increase poverty and inequality.

Overall evaluation: the effectiveness of supply-side policies depends on the cause of the fall in employment. If it was caused by a fall in aggregate demand, for example because of high interest rates or a global slowdown reducing demand for Colombia's exports, then the problem is cyclical, and supply-side policies would have little short-run effect; demand-side policies would be more effective. Supply-side policies are better at reducing structural unemployment in the long run. External factors such as world commodity prices are also beyond the government's control.

In my judgement, the most significant policy is investment in education and training because it tackles the main long-run causes of low employment and informality and raises productivity and living standards. However, because of its long time lag, it should be combined with hiring subsidies in the short run, and the government must make sure it can afford these policies without a large rise in its budget deficit.

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

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Pearson Edexcel International Advanced Level

Wednesday 14 May 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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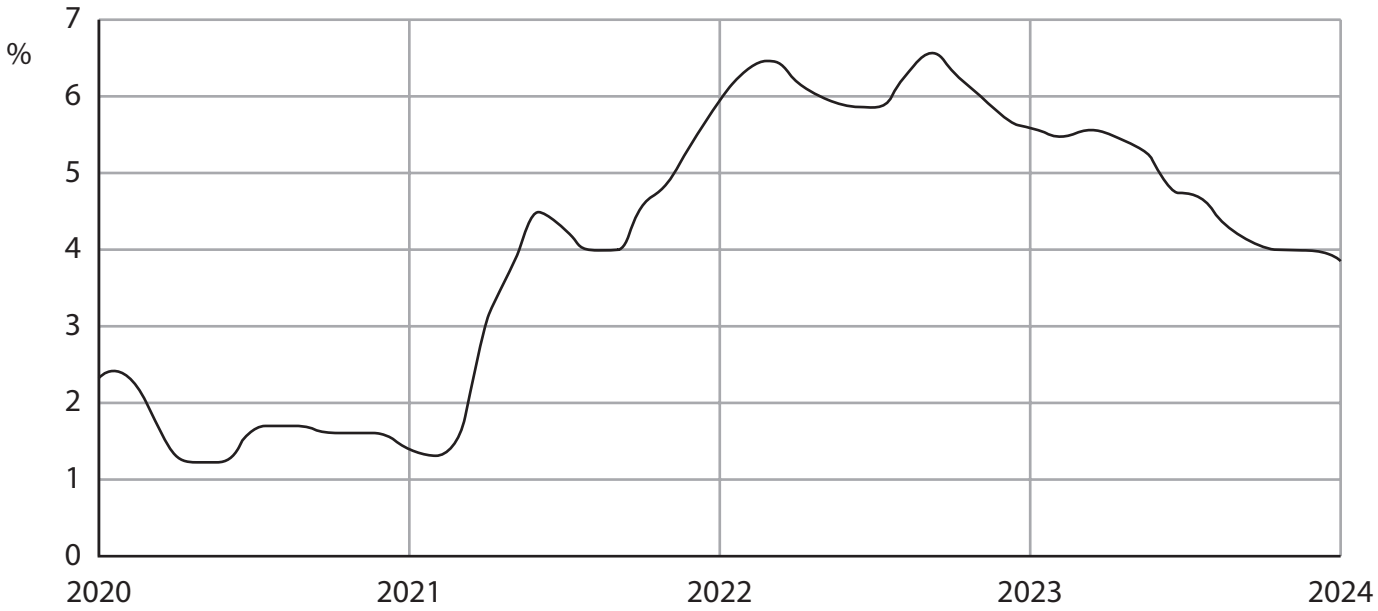
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Sources for use with Section C

The US economy

Figure 1 Annual rate of inflation*, as measured by the consumer price index (CPI), January 2020 to December 2023



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

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Extract A Rate of inflation

Between 2021 and 2023 the US economy experienced a relatively high rate of inflation. The main causes of this were:

- disruptions to the supply chain as a result of the global health crisis of 2020–2022
- rising global prices of energy and food in 2021–2022
- high wage growth in 2022–2023.

The country's central bank, the Federal Reserve (Fed), forecast that the rate of inflation would return to the inflation target of 2% in 2024. It indicated that energy prices and food prices had started to fall. It expected slower wage growth as the rate of inflation decreased.

The Fed believed that the rate of inflation would fall without causing a significant rise in the rate of unemployment. It forecast that the rate of unemployment would average 4% in 2024, a little higher than the 50-year low of 3.6% in 2023.

Extract B Economic growth

The USA's rate of economic growth increased from 1.9% in 2022 to 2.5% in 2023. High consumer spending on services, such as hotels and travel, was the major factor that contributed to economic growth. Government policy also played an important role in increasing the growth rate. The US Government spent $1 trillion on infrastructure projects including the building of roads, airports and bridges. These projects resulted in the creation of new jobs.

Economists forecast that the rate of increase in economic growth was likely to slow down in 2024. This is because there had been a series of interest rate increases by the Fed. This resulted in the country's base rate of interest increasing from 0.25% in March 2022 to a record high of 5.5% in July 2023. In addition, consumers in the USA were relying more on credit cards to finance their spending. It was predicted that more consumers would find it difficult to pay interest on their mortgages, car loans and credit cards. Consumers were also struggling to finance the rising costs of car insurance, medical care and childcare.

Although some economists expected a recession in 2024, many were optimistic that the US economy would stabilise without causing any major job losses.

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Acknowledgements

Figure 1 adapted from: https://tradingeconomics.com/united-states/core-inflation-rate

Extract A adapted from: FT, https://www.ft.com/content/d413fffb-77bd-4aa1-a02c-c07c7860fbc7

Extract B adapted from: WP, https://www.washingtonpost.com/business/2024/01/25/gdp-2023-economy-boom/