Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Pearson Edexcel
International
Advanced Level

Centre Number	Candidate Number

Monday 14 October 2019

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 The short-run Phillips curve illustrates a possible trade-off between

- ☐ **A** economic growth and income inequality
- ☒ **B** inflation and unemployment
- ☐ **C** economic growth and protection of the environment
- ☐ **D** inflation and income inequality

(Total for Question 1 = 1 mark)

2 Ghana's rate of economic growth increased from 3.6% in 2016 to 8.5% in 2017.

Which **one** of the following is a likely result of this increase in the rate of economic growth?

- ☐ **A** An increase in unemployment
- ☐ **B** A decrease in investment
- ☒ **C** An increase in living standards
- ☐ **D** A decrease in tax revenues

(Total for Question 2 = 1 mark)

3 The UK Government is spending £56 billion on building HS2, a high-speed railway network.

Which **one** of the following is also an injection into the circular flow of income?

- ☐ **A** Increased spending on imports
- ☒ **B** Increased spending on exports
- ☐ **C** Increased levels of saving
- ☐ **D** Increased income tax receipts

(Total for Question 3 = 1 mark)

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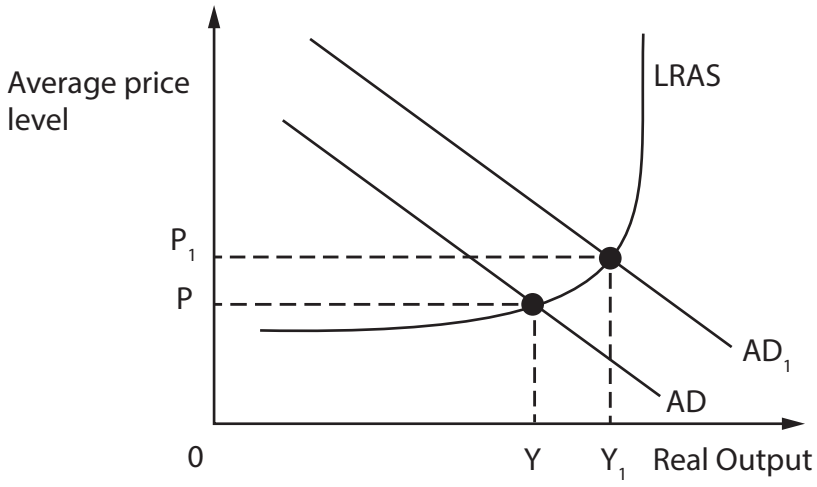
4 In 2017 a fall in mining and manufacturing production led to the Brazilian economy operating below its productive potential.

Which **one** of the following is most likely to be associated with a negative output gap?

- ☒ **A** High unemployment
- ☒ **B** High business confidence
- ☒ **C** An increase in house prices
- ☒ **D** An increase in wellbeing

(Total for Question 4 = 1 mark)

5 The diagram shows aggregate supply and aggregate demand for an economy.



Which **one** of the following was the most likely cause of the change from AD to AD_1?

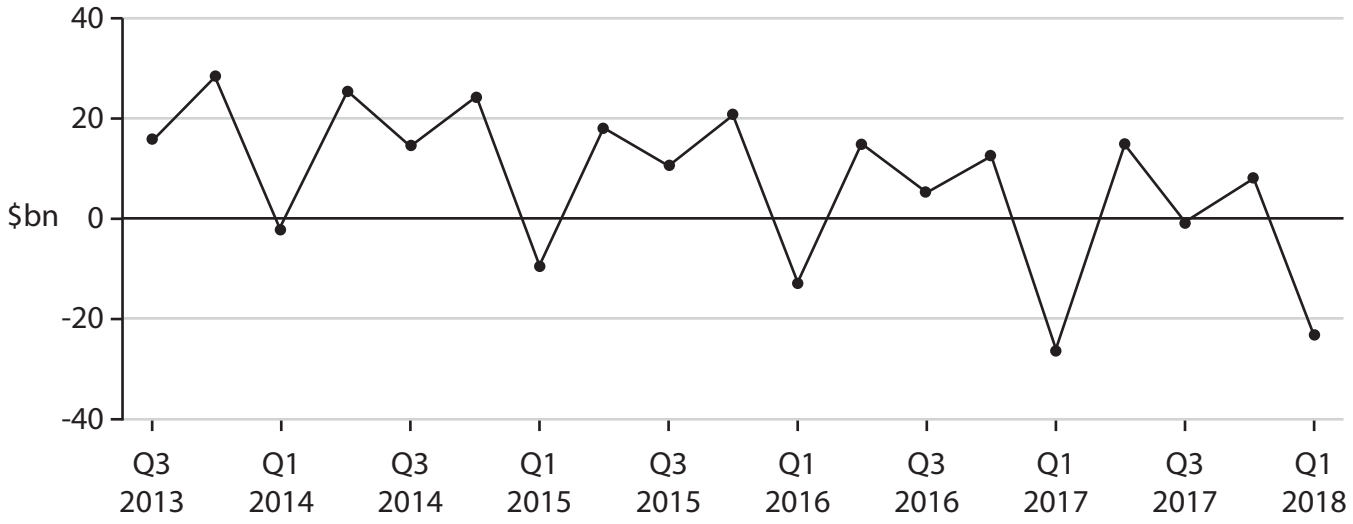
- ☒ **A** A decrease in government spending
- ☒ **B** An increase in interest rates
- ☒ **C** A decrease in net exports
- ☒ **D** An increase in consumption

(Total for Question 5 = 1 mark)

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6 The chart shows a government budget between quarter 3 2013 and quarter 1 2018 ($ billion).



What can be deduced from this chart?

- ☒ **A** There was a budget surplus in quarter 3 2015
- ☒ **B** There was a budget deficit in quarter 3 2013
- ☒ **C** Tax receipts exceeded government expenditure in quarter 1 2017
- ☒ **D** Government expenditure exceeded tax receipts in quarter 3 2015

(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 Bosnia and Herzegovina, a country in Europe, experienced high levels of unemployment. In 2013 the unemployment rate was 46% and in 2018 it was 37%.

Explain **one** possible effect of high rates of unemployment on the public finances of Bosnia and Herzegovina.

Unemployment is the number of people who are willing and able to work and are actively seeking work, but cannot find a job.

In Bosnia and Herzegovina unemployment is very high: although it fell by 9 percentage points, from 46% in 2013 to 37% in 2018, more than a third of the labour force is still out of work.

Unemployed people do not earn incomes, so the government receives less income tax, and as they spend less it also receives less indirect tax such as VAT. At the same time more people claim unemployment benefits, so government spending on welfare rises.

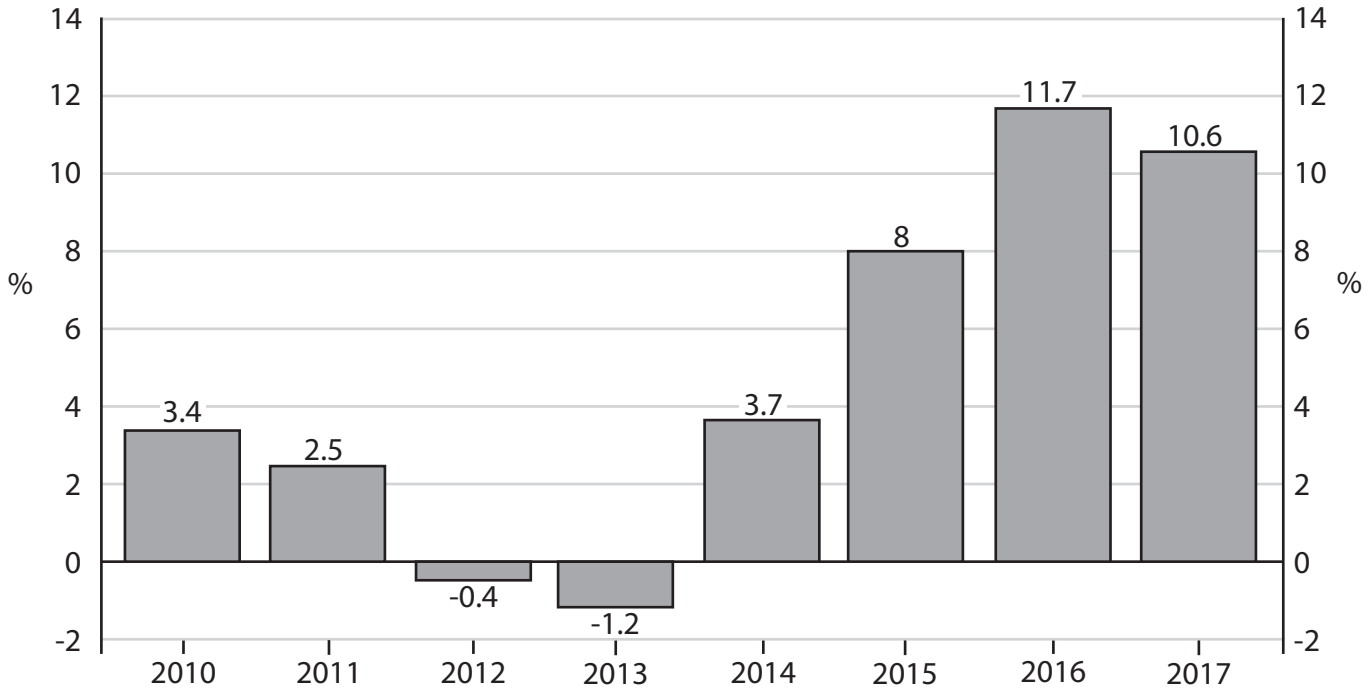
Lower tax revenue together with higher spending widens the budget deficit, so the government has to borrow more and the national debt rises, which worsens the public finances.

(Total for Question 7 = 4 marks)

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8 The chart shows the balance of payments on the current account for Thailand as a percentage of GDP for the period 2010-2017.



(Source: https://tradingeconomics.com/thailand/current-account-to-gdp)

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

A current account surplus is when the value of exports of goods and services, plus investment income and current transfers received, is greater than the value of imports of goods and services, plus investment income and transfers paid abroad. A current account deficit is when the value of these outflows (imports) is greater than the inflows (exports).

Thailand had a current account deficit in 2012 (−0.4% of GDP) and 2013 (−1.2% of GDP), so more money left the country than entered it. It had a surplus in 2010, 2011 and from 2014 to 2017, rising from 3.7% of GDP in 2014 to a peak of 11.7% in 2016, before falling to 10.6% in 2017.

(Total for Question 8 = 4 marks)

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9 Since 2012 the United Arab Emirates (UAE) has experienced a high rate of economic growth. This has resulted in rising business confidence.

Explain **one** possible impact of increased business confidence on the economy of the UAE.

Business confidence is how optimistic firms are about future economic conditions, sales and profits.

The UAE has had a high rate of economic growth since 2012, so firms expect demand for their products to keep rising. This increases the expected return on new capital, so firms increase investment in machinery, buildings and technology.

Investment is a component of aggregate demand (AD = C + I + G + X − M), so AD shifts to the right. The extra spending creates income for workers and suppliers, who spend part of it, so through the multiplier effect real GDP rises by more than the initial investment and unemployment falls.

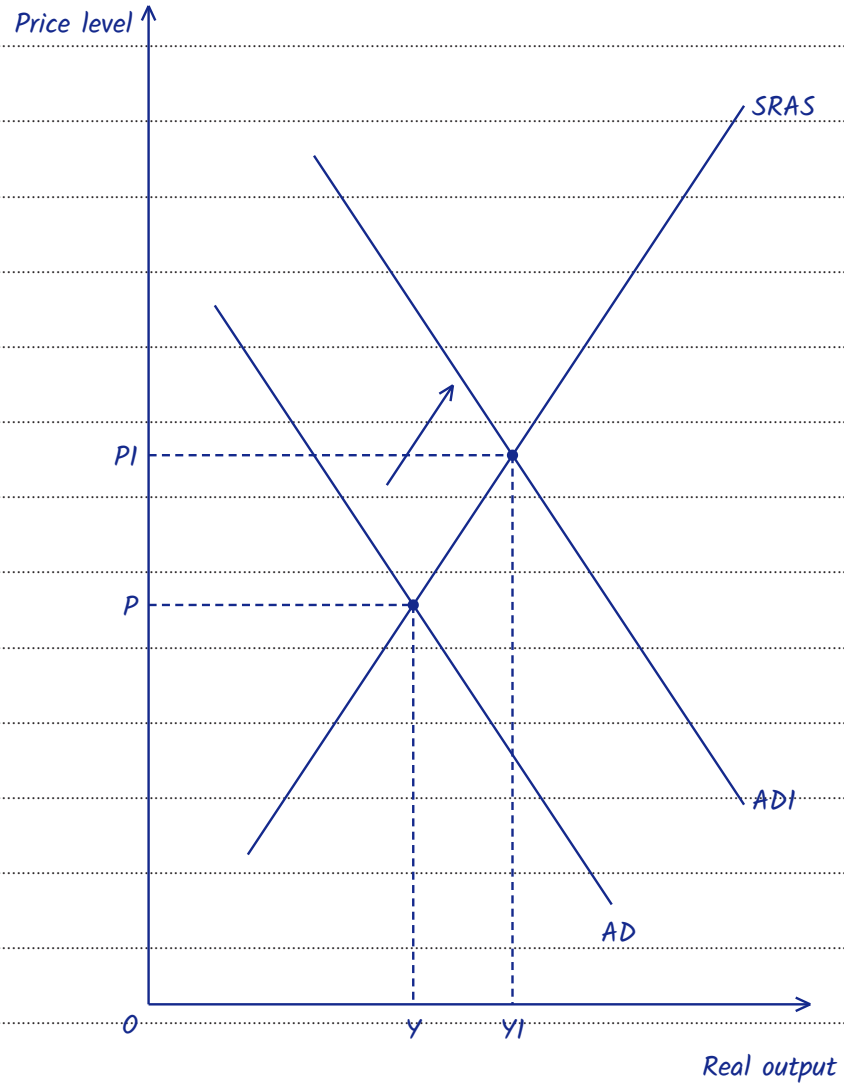
In the long run the extra capital also increases the productive capacity of the economy, so LRAS shifts to the right, allowing sustained growth without inflation.

(Total for Question 9 = 4 marks)

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10 In 2017 real wages rose by 19% in the Ukraine. This led to a 7.8% increase in consumption.

Draw a SRAS and AD diagram to show the possible impact of this increase in consumption on the price level **and** real output.



The 7.8% rise in consumption increases AD, so AD shifts right from AD to AD1. The price level rises from P to PI and real output rises from Y to YI.

(Total for Question 10 = 4 marks)

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11 The table shows the nominal GDP and the population for the USA in 2016 and 2017.

Year	GDP	Population	GDP per capita
2016	$18 624.5 billion	0.3234 billion	$57 589.70
2017	$19 390.6 billion	0.3257 billion	

Using the information above, calculate the change in GDP per capita between 2016 and 2017. Show your workings.

GDP per capita = GDP ÷ population

2017 GDP per capita = $19 390.6 billion ÷ 0.3257 billion

= $59 535.16

Change = $59 535.16 – $57 589.70

= $1 945.46 increase

Percentage change = ($1 945.46 ÷ $57 589.70) × 100 = 3.38% increase

(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 'base rate of interest' (Figure 1).

(2)

(b) With reference to Figure 2, explain the term 'recession'.

(4)

(c) With reference to Extract B, analyse **one** possible impact of the fall in the value of the peso on Argentina's current account on the balance of payments.

(6)

(d) With reference to the information provided, examine the likely impact of inflation on the economy of Argentina.

(8)

(e) Using the information in Extracts A and B, discuss policies that the Argentinian Government could use to increase consumption.

(14)

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12 (a) Define the term 'base rate of interest' (Figure 1).

(2)

The base rate of interest is the interest rate set by the central bank (here the Central Bank of Argentina) at which it lends to commercial banks. It determines the cost of borrowing and the return on saving in the economy.

(b) With reference to Figure 2, explain the term 'recession'.

(4)

A recession is when there are two or more consecutive quarters of negative economic growth, that is, a fall in real GDP.

Figure 2 shows that Argentina was in recession from Q4 2015 to Q2 2016. Real GDP fell for three quarters in a row: by 1.2% in Q4 2015, 0.2% in Q1 2016 and 2.1% in Q2 2016. The recession ended in Q3 2016 when growth became positive again at 0.3%.

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(c) With reference to Extract B, analyse **one** possible impact of the fall in the value of the peso on Argentina's current account on the balance of payments.

(6)

The current account of the balance of payments records the flows of money from trade in goods and services, investment income and current transfers between a country and the rest of the world. A fall in the value of the peso is a depreciation; a fall in the value of one currency against another.

In 2018 the peso lost around 12% of its value against the dollar. This makes Argentina's imports more expensive in pesos, so importing goods from the USA became very expensive. Argentinian consumers and firms therefore buy fewer imports and switch to domestically produced goods, so the value of imports falls.

At the same time, Argentina's exports become cheaper in dollars, so they are more price competitive abroad. Foreign demand for Argentinian goods, such as its commodity exports, rises, so the volume and value of exports increase.

Because export revenue rises and spending on imports falls, net exports increase, so the current account deficit becomes smaller and the current account improves.

However, this depends on the price elasticity of demand for exports and imports. If demand is price inelastic, as it often is for essential imports and commodities in the short run, the value of imports may rise and export revenue may fall, so the deficit could get worse at first (the J-curve effect). Extract B also shows that the value of commodity exports was falling, so the improvement may be limited.

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(d) With reference to the information provided, examine the likely impact of inflation on the economy of Argentina.

(8)

Inflation is a sustained rise in the general price level, measured by the consumer price index (CPI). Argentina has very high inflation: it was between 30% and 40% per year when the President was elected in 2015, rose to 40%, and was still 25% in 2017.

First, inflation reduces the purchasing power of incomes. Extract A shows that wages fell while inflation rose to 40%, so real incomes fell and living standards declined, especially for people on fixed incomes. This reduces consumption, so AD falls and economic growth slows.

Second, inflation creates uncertainty. Extract B states that firms are unsure about future costs, so domestic business investment has fallen. Lower investment reduces AD in the short run and limits the growth of productive capacity (LRAS) in the long run.

Third, if Argentina's inflation is higher than its trading partners', its exports become less price competitive, so exports fall and imports rise, worsening the current account deficit. To control inflation the central bank raised the base rate to 40%, which increases the cost of borrowing and further reduces consumption and investment.

However, the impact may be smaller than expected. Inflation fell from 40% to 25% in 2017, and Extract B shows real wages are now rising in many sectors, so real incomes are recovering and consumer spending is increasing. Business confidence also seems to be improving, as Mitsubishi, Marubeni and Apple are investing. Overall, the impact is likely to be significant but falling, and depends on whether the high interest rate succeeds in bringing inflation down.

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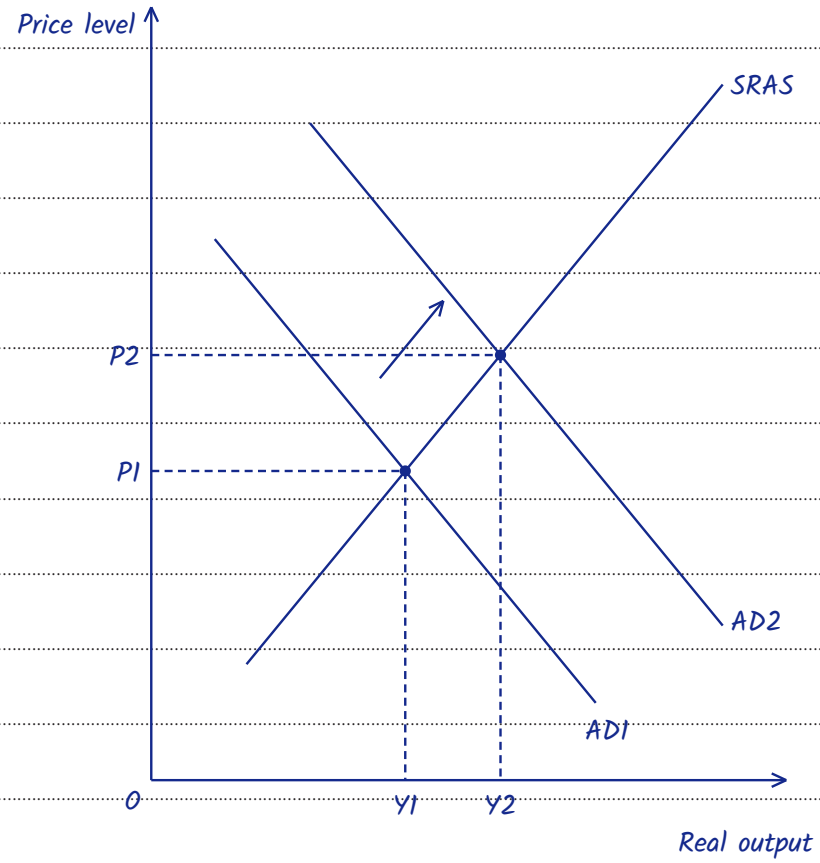
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(e) Using the information in Extracts A and B, discuss policies that the Argentinian Government could use to increase consumption.

(14)

Consumption is the total spending by households on goods and services. It is the largest component of aggregate demand. In Argentina, consumption fell because wages fell and inflation rose to 40%, reducing purchasing power (Extract A).

One policy is to reduce income tax. This increases households' disposable income, so they have more to spend and consumption rises. As consumption is part of AD, AD shifts right from AD1 to AD2, real output rises from Y1 to Y2 and, through the multiplier, incomes rise further.



A second policy is to increase government spending. The Government plans to spend US$14 billion on infrastructure. This creates jobs in construction, so employment and incomes rise and households spend more. It could also stop cutting spending and increase welfare payments, so people on low or fixed incomes can buy more goods and services, and those on

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low incomes have a high marginal propensity to consume.

A third policy is to bring inflation down, as the Government's key aim is to stabilise prices to encourage consumption. Lower inflation means real wages rise and consumer confidence improves. Subsidies to firms could also lower costs and prices, shifting SRAS right, so the price level falls and real incomes rise.

However, these policies have drawbacks. Argentina already has a large budget deficit of 7.1% of GDP, and the recession was caused partly by cutting spending to balance the budget. Tax cuts and higher spending would increase the deficit and the national debt, so the Government may not be able to afford them.

More importantly, higher consumption increases AD, so the price level rises from P1 to P2. With inflation already 25%, this demand-pull pressure would make inflation worse and could cancel out the rise in real incomes. More demand would also suck in imports, worsening the current account deficit, and the weak peso makes imports more expensive.

The effect also depends on confidence and interest rates. With the base rate at 40%, borrowing is very expensive and saving is attractive, so households may save a tax cut rather than spend it, reducing the multiplier. There are also time lags: infrastructure takes years to build, so its effect on employment and consumption may be small in the short run.

In conclusion, the best policy is probably to reduce inflation first, because stable prices raise real wages and confidence without increasing the budget deficit, and Extract B shows real wages and consumer spending are already rising. Targeted spending, such as the infrastructure programme, is more sustainable than broad tax cuts, but large fiscal stimulus is risky while

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inflation and the deficit remain so high.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

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SECTION D BEGINS ON THE NEXT PAGE.

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SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 Productivity in France and Germany was significantly higher than in the UK between 2007 and 2016.

Evaluate the importance of productivity for the rate of economic growth in a country.

(Total for Question 13 = 20 marks)

OR

14 In 2017 the rate of unemployment in South Africa was 27.7%. The Government is committed to reducing the unemployment rate by increasing spending on education and training.

Evaluate the use of supply-side policies as a means of reducing unemployment.

(Total for Question 14 = 20 marks)

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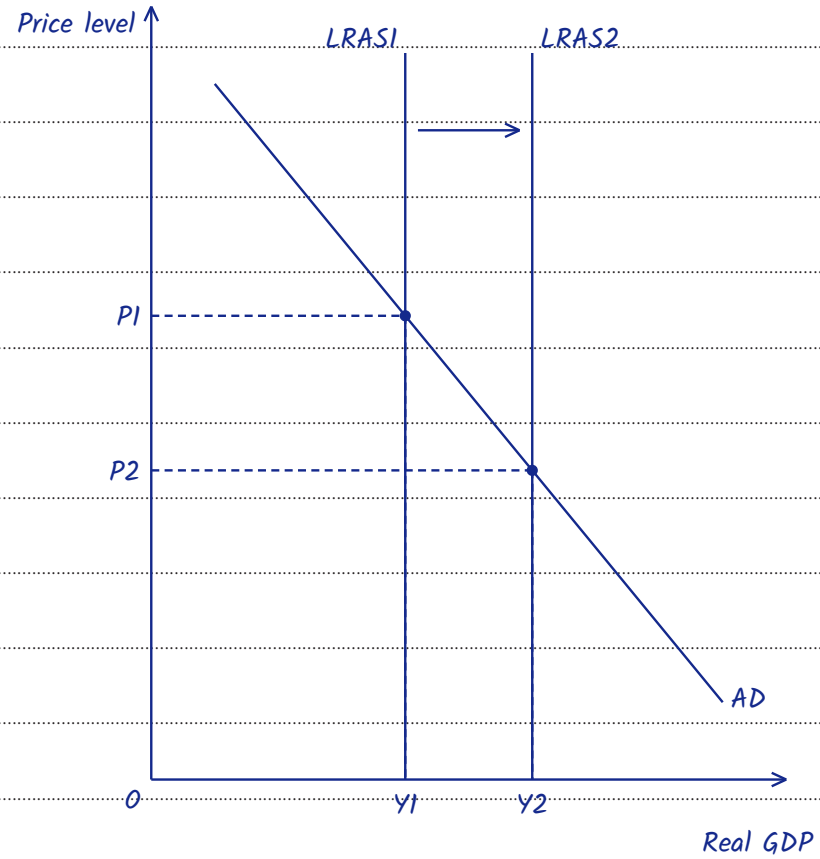
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

Productivity is output per unit of input, usually measured as output per worker or output per hour worked. Economic growth is an increase in real GDP. Actual growth is an increase in the output produced, while potential growth is an increase in the productive capacity of the economy.

Productivity is important because it increases productive potential. If workers produce more per hour, for example because of better education, training or more and better capital, the economy can produce more with the same resources. Firms' unit costs fall, so LRAS shifts right from LRAS1 to LRAS2. Real GDP rises from Y1 to Y2 and the price level falls from P1 to P2, so growth is achieved without inflation.



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Higher productivity also boosts AD. Lower costs make a country's goods more price competitive, so exports rise, which increases AD and improves the current account. More productive workers can be paid higher real wages, so consumption rises. Higher profits encourage firms to invest more, and higher incomes and profits raise tax revenue, which the government can spend on infrastructure, creating a multiplier effect on GDP.

This helps explain why France and Germany, whose productivity was significantly higher than the UK's between 2007 and 2016, have been able to produce more output per worker, support higher wages and remain internationally competitive, especially in manufacturing exports. Low productivity in the UK limits its potential growth rate.

In the long run, productivity is the main source of sustained growth. The size of the labour force cannot grow indefinitely, so rising living standards and real GDP per capita depend on producing more per worker.

However, productivity is not the only factor. Productivity raises potential growth, but actual growth depends on aggregate demand. If AD is weak, for example during a recession with low consumer and business confidence, the extra capacity will not be used, so there is a negative output gap. Investment depends more on confidence and interest rates than on productivity, so demand-side policies such as lower interest rates or higher government spending may be more important for growth in the short run.

Growth can also come from increasing the quantity of factors of production rather than their quality, for example through net migration increasing the labour force or discovering natural resources such as oil. So a country can grow quickly with low productivity, as many emerging

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economies do by moving labour from agriculture into industry.

The magnitude and time period also matter. Productivity improvements from education, training and infrastructure take many years to have an effect, and there is an opportunity cost of the government spending needed. Higher productivity may also mean firms use more capital and fewer workers, increasing structural unemployment in the short run. Faster growth may conflict with environmental sustainability if it uses more resources and creates more pollution.

In conclusion, productivity is the most important factor for long-run, sustainable economic growth, as it is the only way to keep increasing output per worker and living standards without inflation, which explains the stronger performance of France and Germany. However, in the short run growth depends heavily on aggregate demand and confidence, so productivity alone is not enough: it must be combined with sufficient demand for the extra capacity to be used.

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

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Pearson Edexcel International Advanced Level

Monday 14 October 2019

Afternoon | Paper Reference **WEC12/01**

Economics

International Advanced Subsidiary
Unit 2: Macroeconomic performance and policy

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Sources for use with Section C.

The economy of Argentina

Figure 1 The base rate of interest for Argentina, April 2013 – April 2018

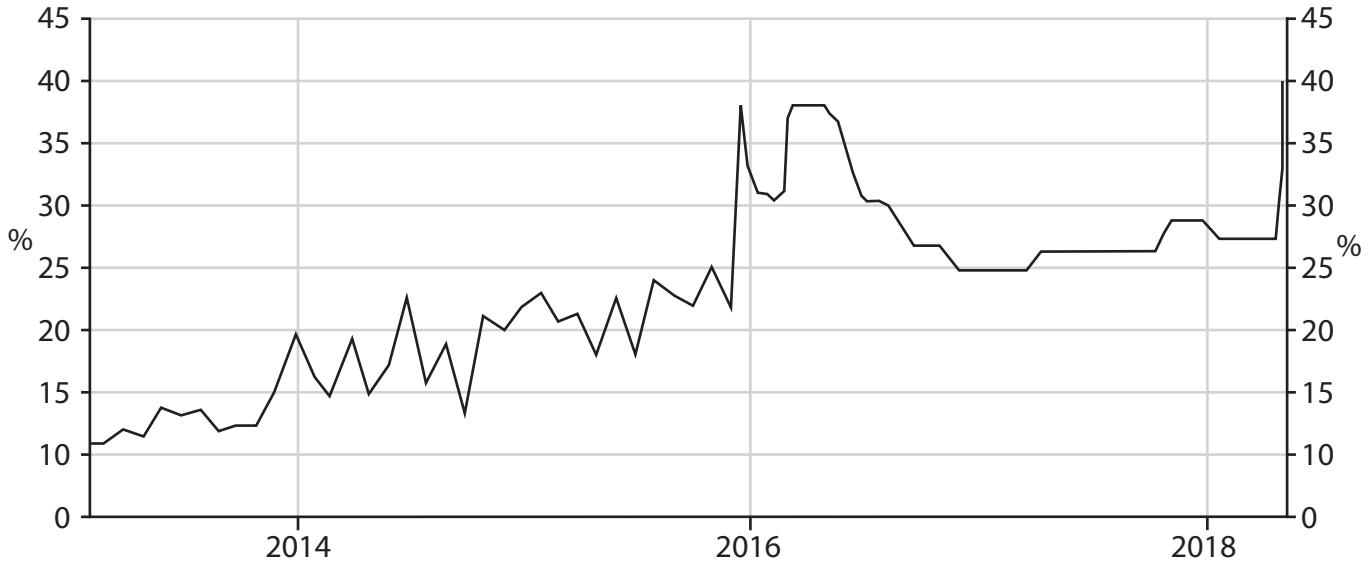
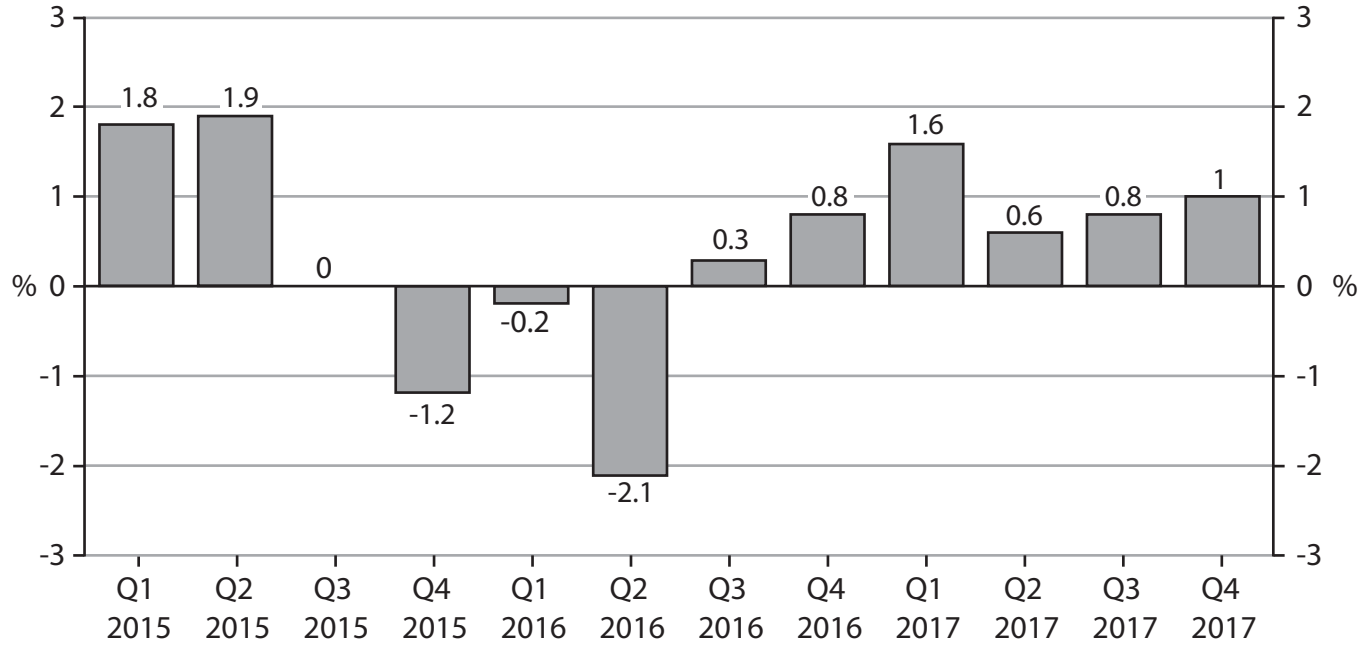


Figure 2 Quarterly GDP growth rate (%), 2015 – 2017



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Extract A The problems facing the economy

Argentina is South America's second largest economy. Mauricio Marci was elected as its President in 2015. He faced the difficult task of controlling inflation which was between 30%–40% per year. He also needed to reduce the large budget deficit which was 7.1% of GDP. Between the end of 2015 and the beginning of 2016 the economy went into recession. This was caused by a significant reduction in government spending in an attempt to balance the budget. The purchasing power of consumers declined as wages fell and the rate of inflation rose to 40%. A fall in demand for Argentina's exports also contributed to the decrease in economic growth.

Extract B Improving economic outlook

Since coming out of recession in 2016, economic growth in Argentina has stabilised at an annual rate of around 3% per year. However, high inflation is still a major problem. Inflation was 25% in 2017. The effect of this inflation is damaging to both households and businesses. Rising prices have reduced domestic business investment as firms are unsure about future costs. One of the Argentinian Government's key economic policies is to stabilise prices to encourage consumption and investment.

A fall in the value of the Argentinian currency, the peso, against the dollar also caused inflationary pressure. In 2018 the peso lost around 12% of its value against the dollar. This makes importing goods from the USA very expensive. At the same time there was a decrease in the value of commodity exports, causing a current account deficit. In an attempt to reduce the rate of inflation and to stabilise the currency, the Central Bank of Argentina increased the base rate of interest to 40%.

However, the situation is not all bad. Real wages are rising in many sectors and consumer spending is increasing. Also, the Government plans to spend US$14 billion on infrastructure. These positive changes have helped Argentina to attract investment from Japanese transport companies such as Mitsubishi and Marubeni Corp, and the American technology company, Apple.

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Acknowledgements

Figure 1 based on data taken from https://tradingeconomics.com/argentina/interest-rate

Figure 2 based on data taken from https://tradingeconomics.com/argentina/gdp-growth

Extract A adapted from https://www.washingtonpost.com/opinions/why-the-financial-crisis-in-argentina-matters/2018/05/13/ee84f270-553f-11e8-a551-5b648abe29ef_story.html?noredirect=on&utm_term=.3e3e5547ece8 and https://www.economist.com/briefing/2014/02/17/a-century-of-decline

Extract B adapted from https://news.sky.com/story/why-argentinas-economy-is-in-trouble-again-11358456 and https://www.cnbc.com/2018/05/09/argentina-looks-be-headed-for-another-economic-storm.html