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.

Turn over ▶

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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 table shows the real GDP growth rate and the unemployment rate for the USA for Quarter 1 and Quarter 2 in 2020.

	Real GDP growth rate (%)	Unemployment rate (%)
Q1 2020	–5.0	3.9
Q2 2020	–31.4	13.1

Which **one** of the following is most likely to have caused the **increase** in the unemployment rate between Q1 2020 and Q2 2020?

☒ **A** Real wage unemployment

☒ **B** Demand deficient unemployment

☒ **C** Structural unemployment

☒ **D** Seasonal unemployment

(Total for Question 1 = 1 mark)

2 In June 2020 the Bank of England increased the value of its asset purchases scheme (quantitative easing) by £100 billion.

Which **one** of the following correctly describes this economic policy?

☒ **A** Reflationary monetary policy

☒ **B** Deflationary monetary policy

☒ **C** Reflationary fiscal policy

☒ **D** Deflationary fiscal policy

(Total for Question 2 = 1 mark)

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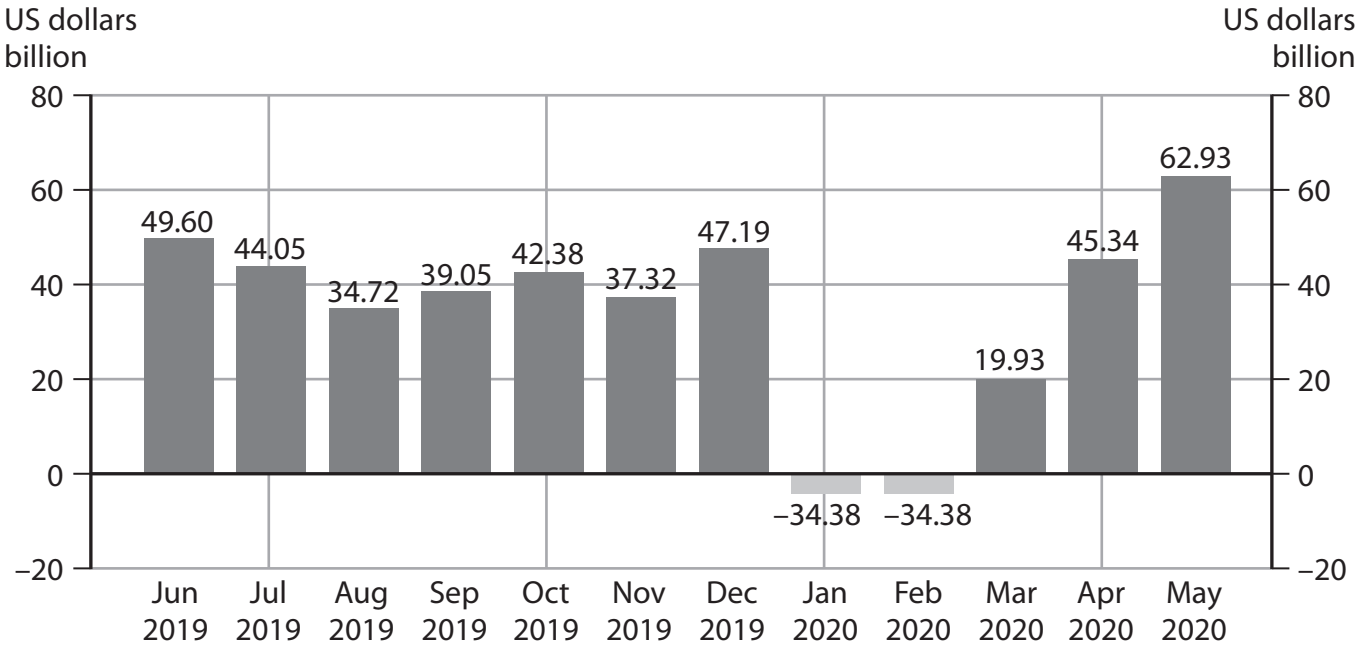
3 From Quarter 1 2020 to Quarter 2 2020, government expenditure in Russia increased by 25 billion roubles.

Ceteris paribus, what was the most likely effect of this increase?

- ☒ **A** Aggregate demand decreased
- ☒ **B** Withdrawals from the circular flow increased
- ☒ **C** Aggregate supply decreased
- ☒ **D** Injections into the circular flow increased

(Total for Question 3 = 1 mark)

4 The chart shows China's monthly balance of trade in US dollars from June 2019 to May 2020.



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

- ☒ **A** China had a current account deficit in August 2019
- ☒ **B** China's balance of trade surplus remained the same from January to February 2020
- ☒ **C** China's balance of trade surplus increased from April to May 2020
- ☒ **D** The value of China's exports decreased from February to March 2020

(Total for Question 4 = 1 mark)

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5 Which **one** of the following is most likely to result in an increase in investment?

- ☒ **A** An increase in the rate of corporation tax
- ☒ **B** An increase in the rate of tax relief for investment
- ☒ **C** An increase in the central bank's interest rate
- ☒ **D** An increase in commercial banks' reserve asset (liquidity) requirements

(Total for Question 5 = 1 mark)

6 The table shows the GDP and the population for India and Pakistan in 2019.

	GDP $ billion	Population (billions)
India	2 590.0	1.372
Pakistan	278.2	0.205

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

GDP per capita was

- ☒ **A** $202.77 in Pakistan
- ☒ **B** $1 357.07 in India
- ☒ **C** $1 887.76 in India
- ☒ **D** $12 634.15 in Pakistan

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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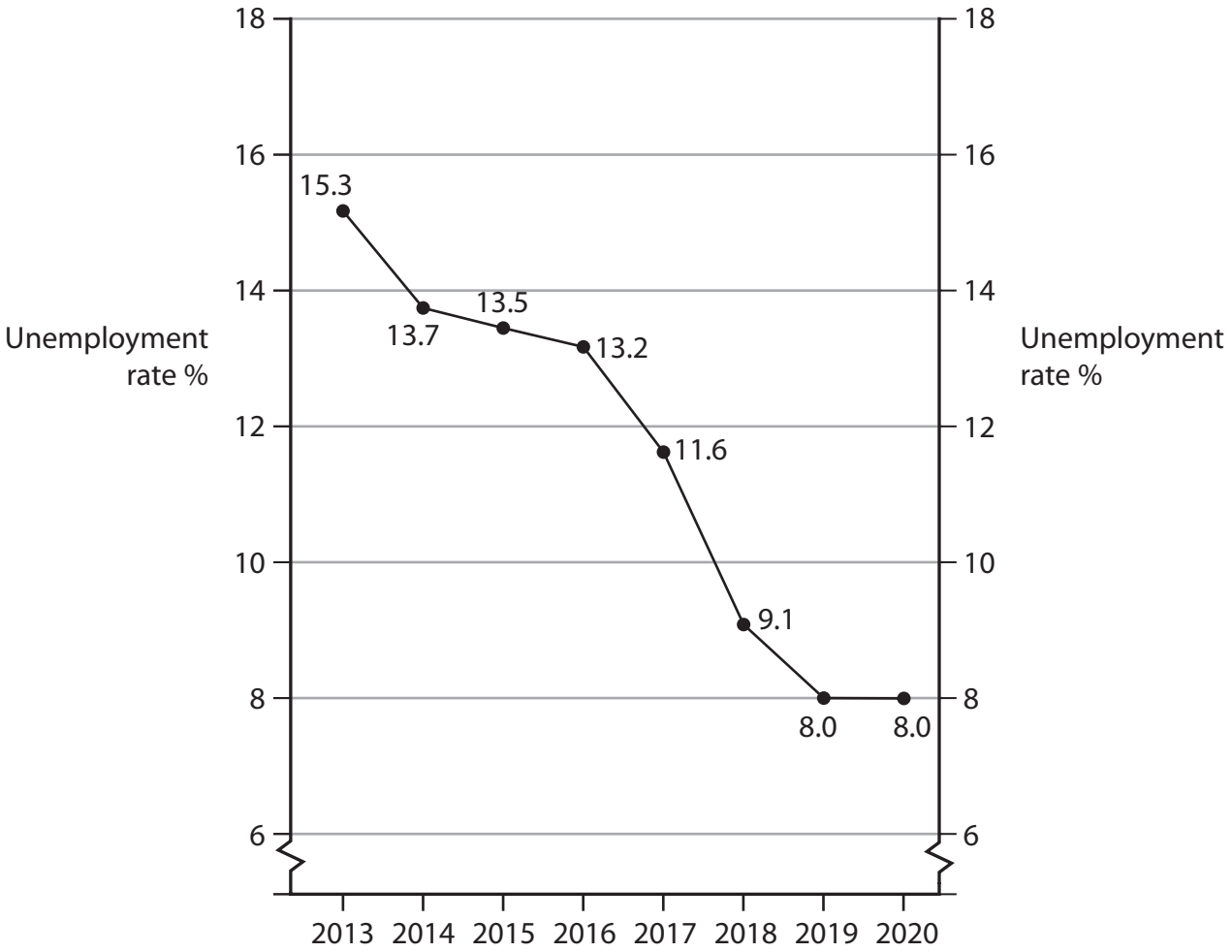
SECTION B BEGINS ON THE NEXT PAGE.

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SECTION B

Answer ALL questions in this section in the spaces provided.

7 The chart shows the unemployment rate in Jamaica between 2013 and 2020.



With reference to the chart, explain **one** likely impact of the trend in the unemployment rate on Jamaica's economy.

The unemployment rate is the number of people who are unemployed (willing and able to work and actively seeking work, but without a job) as a percentage of the labour force.

The chart shows that Jamaica's unemployment rate fell from 15.3% in 2013 to 8.0% in 2019 and 2020, a fall of 7.3 percentage points.

One likely impact is an improvement in the government's budget balance. As more people move into work, government spending on unemployment and other means-tested benefits falls. At the

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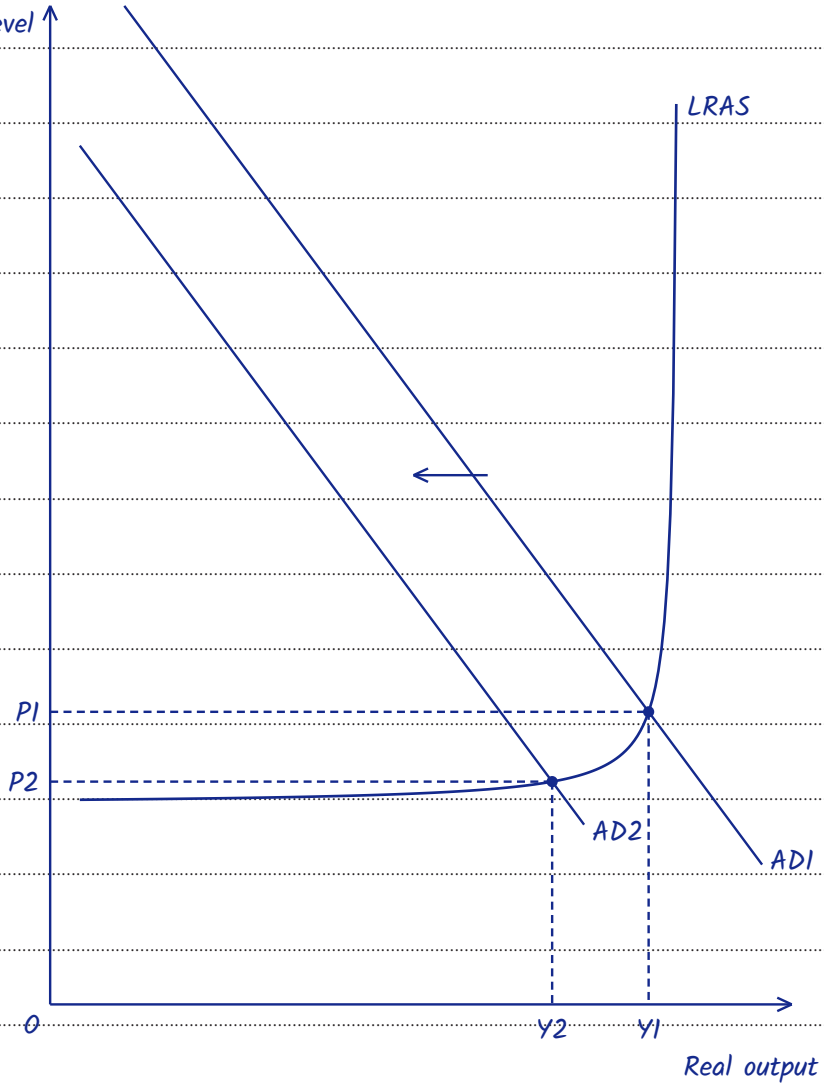
same time, the newly employed earn incomes and spend more, so tax revenue from income tax and taxes on spending such as VAT rises. With lower spending and higher revenue, Jamaica's budget deficit is likely to shrink, which could free up money for public services such as education and health.

(Total for Question 7 = 4 marks)

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8 In Australia the consumer confidence index fell from 91.9 in March 2020 to 75.6 in April 2020. A consumer confidence index score below 100 indicates that, on average, households think that economic conditions will worsen.

Draw a LRAS and AD diagram to show the possible impact of this change in consumer confidence on the average price level and real output level in Australia.



The fall in consumer confidence from 91.9 to 75.6 means households expect conditions to worsen, so they save more and cut consumption. AD shifts left from AD1 to AD2, so the average price level falls from P1 to P2 and real output falls from Y1 to Y2.

(Total for Question 8 = 4 marks)

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9 In April 2020 it was estimated that an increase in government spending of RM30 billion in Malaysia would eventually result in an increase in the country's national income of RM150 billion.

Based on this information, calculate the marginal propensity to consume (MPC) in Malaysia. Show your workings.

The multiplier = 1 ÷ (1 − MPC), where the MPC is the proportion of each extra unit of income that households spend on consumption (MPC = ΔC ÷ ΔY).

Multiplier = change in national income ÷ change in government spending

= RM150 billion ÷ RM30 billion = 5

1 ÷ (1 − MPC) = 5 ⇒ 1 − MPC = 1 ÷ 5 = 0.2 (this is the MPW)

MPC = 1 − 0.2 = 0.8

So the marginal propensity to consume in Malaysia is 0.8: households spend 80% of each additional ringgit of income.

(Total for Question 9 = 4 marks)

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10 In Q1 2019 Brazil's output gap was estimated to be equal to –5.6% of GDP.

Explain **one** likely impact of a negative output gap on Brazil's economy.

A negative output gap occurs when actual real GDP is below potential (full capacity) real GDP, so the economy has spare capacity. In Q1 2019 Brazil's actual output was 5.6% below its potential level.

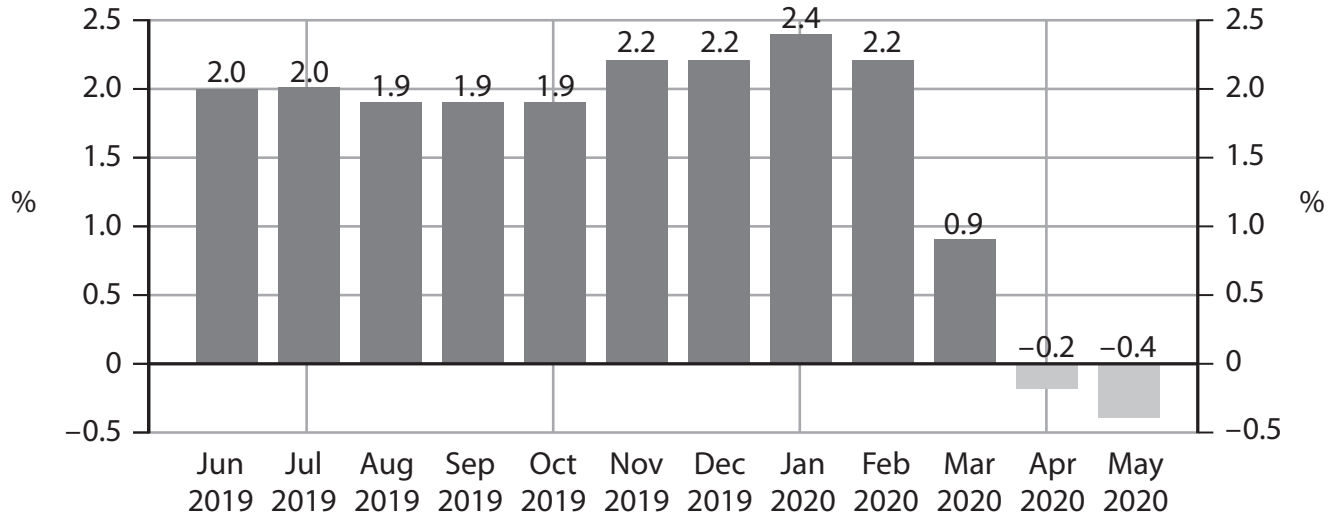
One likely impact is higher unemployment. Because aggregate demand is low, firms produce less than they are capable of, so they need fewer workers and the labour factor of production is under-used. Workers are laid off or not hired, creating demand deficient (cyclical) unemployment. This lowers household incomes, which further reduces consumption, so living standards fall, and it also increases government spending on unemployment benefits while reducing income tax revenue, worsening Brazil's budget balance.

(Total for Question 10 = 4 marks)

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11 The chart shows the CPI inflation rate in Canada between June 2019 and May 2020.



With reference to the data, explain the difference between disinflation and deflation.

Disinflation is a fall in the rate of inflation while it remains positive, so the average price level is still rising but more slowly than before.

Deflation is a fall in the average price level, so the rate of inflation is negative.

In Canada there was disinflation in March 2020, when the CPI inflation rate fell from 2.2% in February to 0.9%; prices were still rising, just more slowly. There was deflation in April 2020, when the inflation rate was −0.2%, and in May 2020 at −0.4%, because the price level was actually falling.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

Study Figures 1–3 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 'recession' (Extract A, line 7).

(2)

(b) With reference to Figure 2, explain how the CPI inflation rate is calculated.

(4)

(c) With reference to Figure 3 and Extract A, examine **two** likely effects on the French economy of the trend in the inflation rate in 2020.

(8)

(d) With reference to Extract A, analyse the likely effect of France's trade balance in April 2020 on its circular flow of income.

(6)

(e) With reference to Extract A and your own knowledge, discuss the likely effects of the ECB's monetary policy on the French economy.

(14)

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12 (a) Define the term 'recession' (Extract A, line 7).

(2)

A recession is a period of two or more consecutive quarters of negative economic growth, i.e. falling real GDP.

(b) With reference to Figure 2, explain how the CPI inflation rate is calculated.

(4)

Each month, prices of a representative basket of goods and services bought by typical households are surveyed. An annual household spending survey sets the weights, so each item is weighted in proportion to the share of household spending on it. The weighted average price change gives the CPI, with the base year index set at 100, and the inflation rate is the percentage change in the index over 12 months.

In Figure 2, services have the largest weight at 48.9%, so they make up 48.9% of average household spending in France and their 0.9% price rise has a big effect on the CPI. Tobacco has the smallest weight, 2.0%, so its 13.9% price rise only adds about 0.28 percentage points (0.02 × 13.9). Combining all groups gives an all-items inflation rate of 0.1%.

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(c) With reference to Figure 3 and Extract A, examine **two** likely effects on the French economy of the trend in the inflation rate in 2020.

(8)

The inflation rate is the annual percentage change in the average price level. Figure 3 shows that France experienced disinflation in 2020: the CPI inflation rate fell from 1.5% in January to 0.1% in June, its lowest level in over four years (Extract A).

Effect 1: an improvement in the trade balance. If French prices rise more slowly than prices in other countries, French exports become relatively more price competitive abroad, and domestically produced goods become relatively cheaper than imports. Demand for exports should rise and demand for imports fall, which would help to reduce France's trade deficit of €5 billion in April 2020 (€23.7 billion – €28.7 billion).

However, this depends on inflation rates in France's trading partners. Most French trade is with other euro area economies, which also faced falling energy prices, so France's relative price competitiveness may hardly change. In a global recession, falling foreign incomes are likely to matter more than small relative price changes.

Effect 2: higher real incomes and living standards. In 2019 prices rose faster than nominal wages, for example in Q4 2019 wages rose by 0.2% while inflation was 1.5%, so real wages fell. With inflation down to 0.1%, nominal incomes, especially fixed incomes such as pensions and benefits, buy more, so real incomes rise. This may raise consumption and help living standards recover.

However, the effect on real incomes also depends on what happens to nominal incomes. France was in recession, with real GDP falling by 5.3% in Q1 2020, so many workers faced lower hours, pay cuts or unemployment, so nominal incomes may have fallen faster than prices. Also, Figure

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3 only covers six months, so this may be a short-term effect caused by the fall in global energy prices rather than a lasting trend.

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(d) With reference to Extract A, analyse the likely effect of France's trade balance in April 2020 on its circular flow of income.

(6)

The circular flow of income is a model showing how money flows between households and firms in an economy, with injections (investment, government spending, exports) adding to the flow and withdrawals (savings, taxes, imports) leaking out of it. The trade balance is the value of exports of goods minus the value of imports of goods (X – M).

In April 2020 French exports were €23.7 billion and imports were €28.7 billion, so France had a trade deficit of €5 billion. Exports, an injection, fell by 32.4%, faster than imports, a withdrawal, which fell by 25%, so the deficit widened.

Because withdrawals through imports exceeded injections from exports, there was a net withdrawal of €5 billion from France's circular flow. Ceteris paribus, less money flows to French firms, so they cut output and employment, and the workers affected have lower incomes and spend less. This creates a negative multiplier effect, so national income falls by more than the initial €5 billion, deepening the recession. In addition, both injections and withdrawals fell, so the overall size of the flow linked to trade became smaller.

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(e) With reference to Extract A and your own knowledge, discuss the likely effects of the ECB's monetary policy on the French economy.

(14)

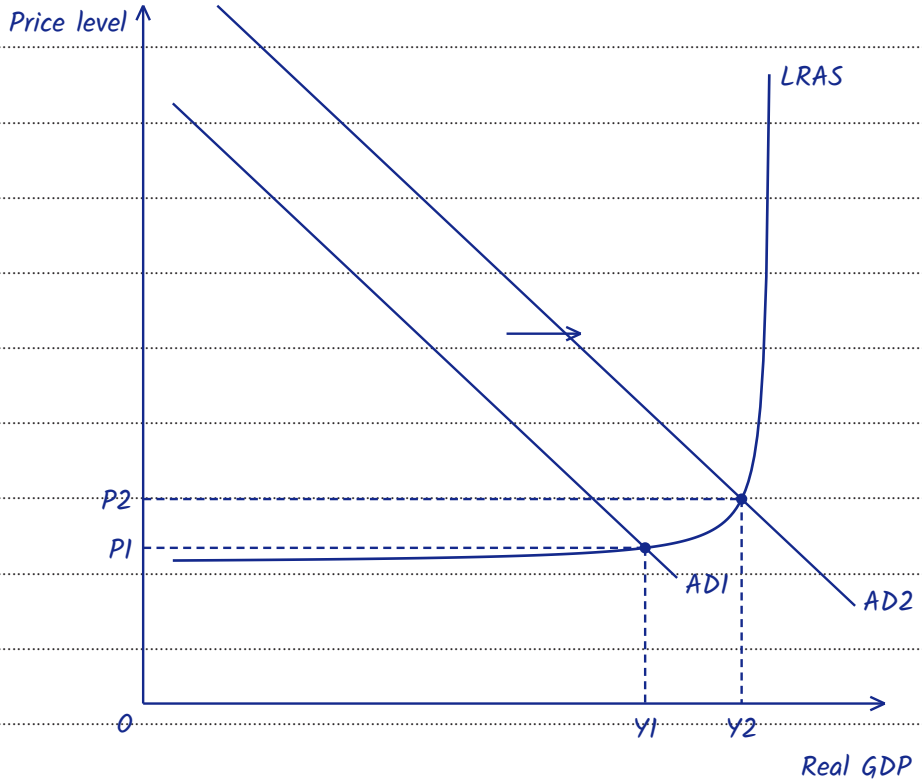
Monetary policy is the use of interest rates, the money supply and asset purchases by a central bank to influence aggregate demand. Extract A states that the ECB kept its base interest rate "very low" throughout 2020 and expanded quantitative easing (QE) by €600 billion to €1.35 trillion in June 2020, adding a further €500 billion in December 2020.

A very low interest rate reduces the cost of borrowing and the reward for saving. French households are encouraged to spend on credit rather than save, and those with variable rate mortgages pay less interest, so their discretionary income and consumption rise. Firms find it cheaper to borrow to finance investment, so investment should rise. Low rates may also reduce demand for the euro, so the euro depreciates, making French exports cheaper and imports dearer, improving net exports.

Under QE the ECB creates new money to buy government and corporate bonds. This increases the money supply and banks' reserves, so banks are more able to lend. Higher bond prices lower bond yields, so investors move into shares and property, raising their prices and creating a positive wealth effect on consumption, while lower corporate bond yields cut firms' borrowing costs.

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As C, I and (X – M) rise, AD shifts right from AD1 to AD2. Because France had large spare capacity after real GDP fell 5.3% in Q1 2020, real GDP rises from Y1 to Y2 with only a small rise in the price level from P1 to P2. This helps France recover from recession, reduces unemployment and adds demand-pull pressure, helping to avoid deflation when inflation was 0.1%.

However, the effects may be limited. Consumer and business confidence were very low in a recession, so even cheap credit may not encourage borrowing, as people choose to save and firms delay investment. Commercial banks may not pass the low rate on, and very low rates squeeze their profits, making them less willing to lend. The wealth effect mainly benefits high-income asset owners with a low MPC, so its impact on consumption may be small.

A weaker euro does little for France's trade with other euro area countries, which share the currency. There are also time lags of up to 18 months before monetary policy has its full effect, and we cannot assume ceteris paribus, as the French Government also spent €135 billion and

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guaranteed €342 billion of loans, so any recovery cannot be credited to the ECB alone. On the other hand, the scale of QE is very large: the €600 billion expansion was an 80% increase, reaching €1.85 trillion by December 2020.

Overall, the ECB's policy is likely to support AD and prevent deflation, but in a deep recession with low confidence its main effect is probably to stop the downturn worsening, and it works best alongside the expansionary fiscal policy.

(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 From 2009 to 2019 the value of Cambodia's currency significantly increased. Over the same period its balance of trade deficit increased from 1.6% of GDP to 8% of GDP.

Evaluate whether the exchange rate of a country's currency is the main factor influencing the country's balance of trade.

(Total for Question 13 = 20 marks)

OR

14 From 2004 to 2018 the Ethiopian economy grew at an average rate of over 10% per year. Over this period there has been significant deforestation in the country. Forests have been cleared to make space for farming and the wood has been used for fuel and construction.

Evaluate whether the costs of economic growth outweigh the benefits.

(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:

Economic growth is an increase in real GDP over time. Actual growth is a rise in the output produced, while potential growth is an increase in the productive capacity of the economy, shown by an outward shift of the PPF or a rightward shift of LRAS. Ethiopia grew at an average of over 10% a year from 2004 to 2018, which is very rapid.

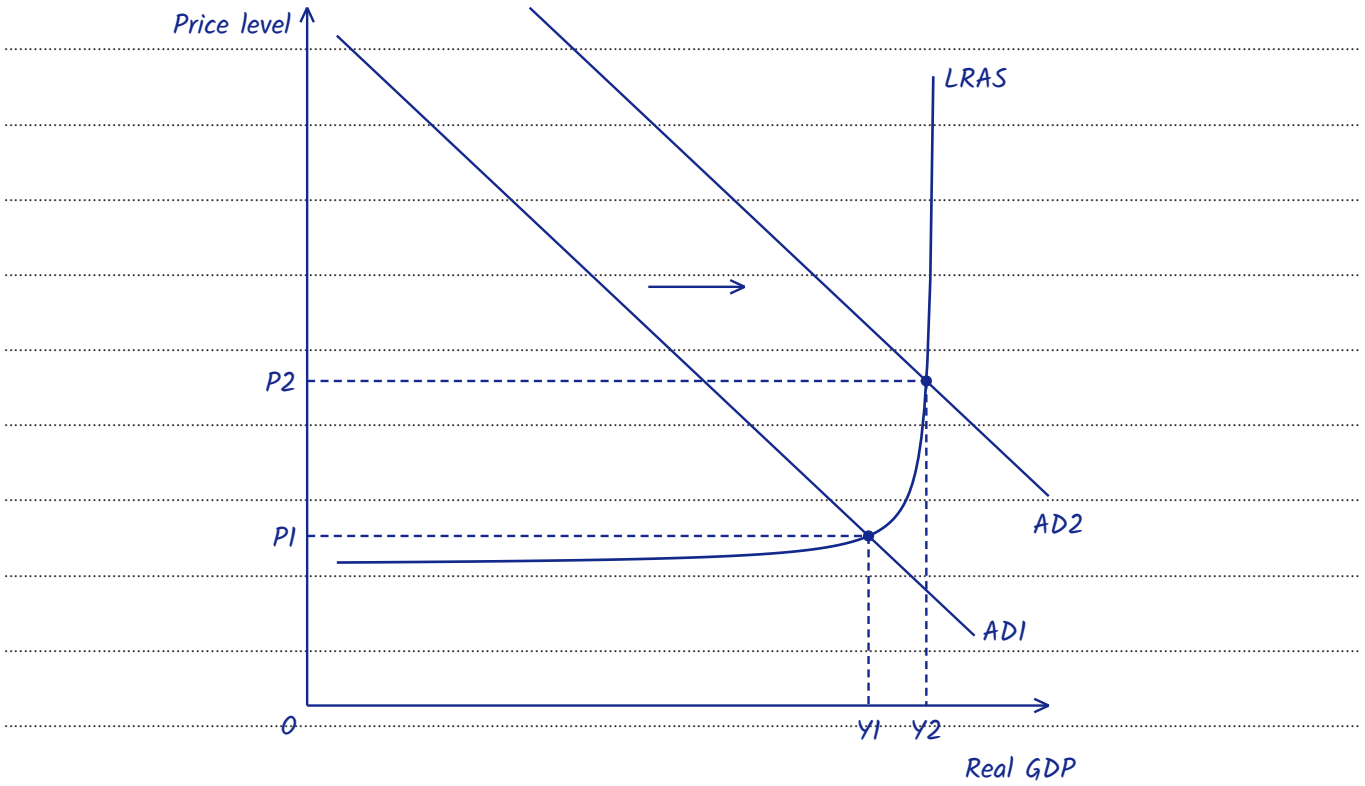
Cost 1: environmental damage. Faster growth requires more land, energy and raw materials. In Ethiopia forests were cleared for farming and the wood used for fuel and construction. Deforestation releases carbon dioxide, worsening climate change, and causes soil erosion and loss of biodiversity. These are negative externalities, so the costs fall on third parties and future generations, and lower soil quality may reduce farm productivity, so growth may not be sustainable. Burning wood and fossil fuels also causes air pollution, harming health.

Cost 2: inflation. Growth driven by rising consumption, investment and government spending shifts AD right. As the economy approaches full capacity, the LRAS curve becomes steeper, so further increases in AD mainly raise the price level, shown in the diagram as AD rises from AD1 to AD2 and the price level rises sharply from P1 to P2 while real GDP only rises from Y1 to Y2.

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Inflation reduces the real incomes of those on fixed incomes and makes exports less competitive. Growth may also worsen the trade balance, because higher incomes are spent partly on imports and firms import more raw materials and machinery. Finally, the gains are often unequally shared: owners of land and capital gain most, so income inequality may widen.

On the other hand, growth brings major benefits. Higher real incomes raise living standards, so households in a low-income country like Ethiopia can afford better food, housing and to send children to school. Firms need more workers, so unemployment falls and the economy moves closer to its PPF, using resources more efficiently. Higher incomes and profits raise tax revenue while spending on benefits falls, so the government can fund public services such as healthcare, education and access to clean water. Higher profits also encourage investment, which shifts LRAS right and allows non-inflationary growth in the future.

Evaluation: whether costs outweigh benefits depends on several factors. First, the type of growth: if it is potential growth from investment, education and technology, LRAS shifts right,

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so inflation is limited; if it is purely demand-led, inflation is a bigger risk. Second, sustainability: growth based on cutting down forests uses up natural resources, but if the government enforces replanting, regulation or taxes on pollution, much of the environmental cost can be reduced. Third, the trade balance may improve if growth is export-led.

Fourth, the effect on inequality depends on government policy: progressive taxes and spending on public services spread the benefits more widely, but if there is corruption, tax revenue may not reach the poor. Fifth, the time period matters: the costs of deforestation build up over the long run, whereas higher incomes are felt in the short run. Finally, a growth rate above 10% for 14 years is unusually fast, which makes overheating and environmental damage more likely than with moderate growth.

In conclusion, for a low-income country such as Ethiopia the benefits of growth, lower poverty, higher living standards and better public services, are likely to outweigh the costs in the short to medium term. However, if growth relies on deforestation without regulation, the long-run environmental costs could eventually outweigh these benefits, so the key is to make growth sustainable rather than to slow it down.

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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

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Total Marks

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Sources for use with Section C.

The French economy

Figure 1 Quarterly real GDP growth rate, Q2 2017 to Q1 2020

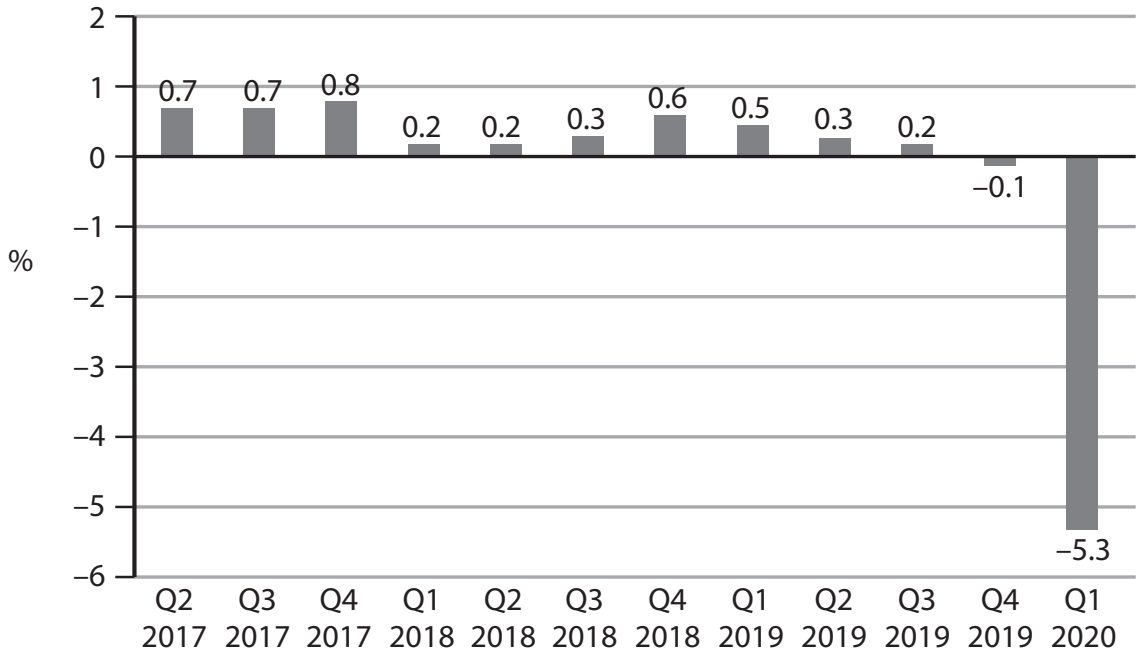
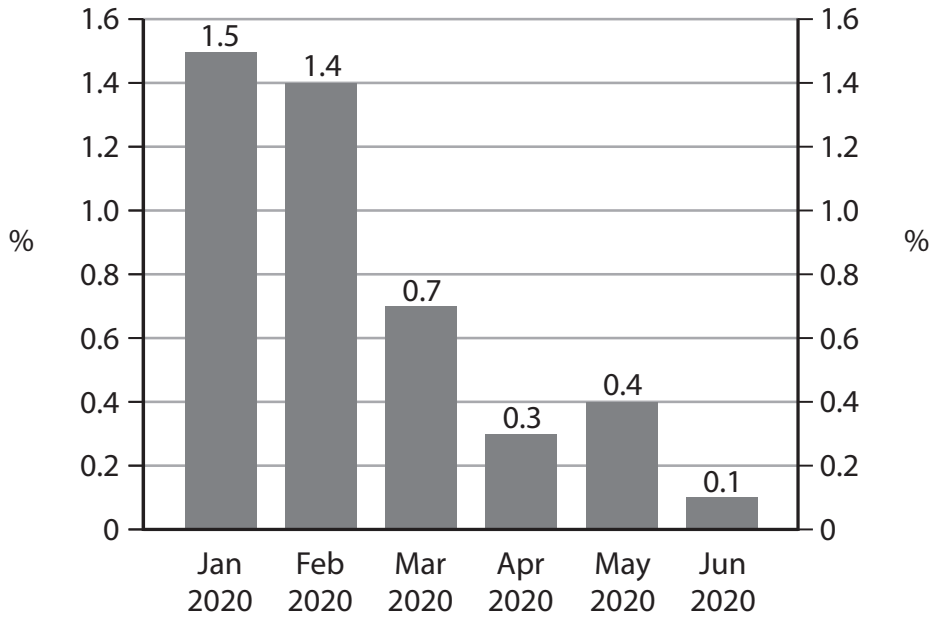


Figure 2 Consumer Price Index (CPI), weights and annual percentage price changes, June 2020

	Weight (%)	Price change (%)
Food	16.1	2.3
Tobacco	2.0	13.9
Energy	8.1	–9.3
Manufactured products	24.9	–1.1
Services	48.9	0.9
All items	100.0	0.1

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Figure 3 CPI inflation rate, January to June 2020



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Extract A Inflation, trade and demand-side policy

Throughout 2019 the average price level was rising at a faster rate than nominal wages in France. For example, in Q4 2019 nominal wages rose by 0.2% while the inflation rate was 1.5%. This caused a decrease in living standards for many people.

The inflation rate in France fell in the first six months of 2020. In June it was 0.1%, its lowest level in over four years. This was partly caused by the fall in global energy prices.

France was the first major global economy to announce that it was in recession in 2020. France's real GDP fell by 5.3% in Q1 of 2020.

In April 2020, the value of exports from France fell by 32.4% to €23.7 billion. In particular, France exported fewer cars and pharmaceutical products. In the same month, imports into France fell 25% to €28.7 billion.

In response to the fall in its real GDP, the French Government introduced a range of demand-side policies. It spent €135 billion (over 5% of French GDP) to help the economy to recover. The Government also delayed or cancelled many firms' tax payments and it guaranteed loans worth €342 billion to businesses.

As France is part of the euro area, monetary policy is conducted by the European Central Bank (ECB). The ECB kept its base interest rate very low throughout 2020. In June 2020 the weaker inflation outlook for the euro area caused the ECB to also expand the size of its asset purchase scheme (quantitative easing) by €600 billion to €1.35 trillion. In December 2020 a further increase in quantitative easing of €500 billion was announced by the ECB. The duration of the scheme was also extended to at least March 2022.

Acknowledgements

Figures 1–3 data from INSEE, France

Extract A adapted from: 'European Central Bank takes its pandemic bond buying to 1.35 trillion euros to try to prop up economy', CNBC, 4 June 2020, https://www.cnbc.com/2020/06/04/european-central-bank-ramps-up-its-pandemic-bond-buying-to-1point35-trillion-euros.html with additional data from tradingeconomics.com and INSEE, France