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

Tuesday 17 October 2023

Morning (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 Which **one** of the following will result in a movement along the AS curve?

- ☐ **A** An increase in the cost of raw materials
- ☐ **B** A decrease in the cost of energy
- ☒ **C** An increase in the price level
- ☐ **D** A decrease in the rate of indirect tax

(Total for Question 1 = 1 mark)

2 Japan's productivity is significantly lower than the productivity of France and Italy. The Government of Japan aims to increase the country's productivity.

Which **one** of the following is a free market supply-side policy?

- ☐ **A** Investment in education and training
- ☒ **B** Privatisation of state-owned industries
- ☐ **C** Investment in infrastructure projects
- ☐ **D** Providing finance for business start-ups

(Total for Question 2 = 1 mark)

3 The value of Burundi's multiplier is estimated to be approximately 0.1.

Ceteris paribus, which **one** of the following would cause an increase in the value of a country's multiplier?

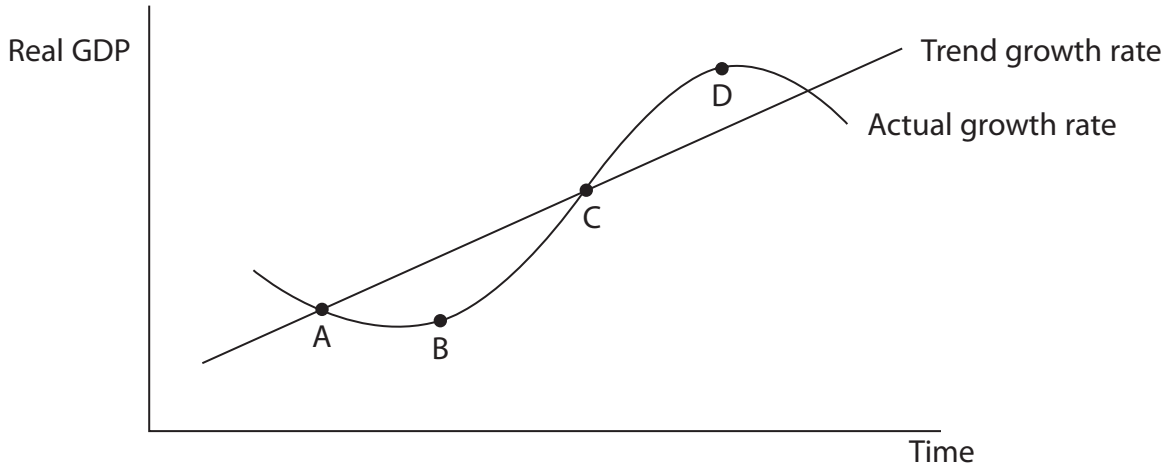
- ☐ **A** An increase in the marginal propensity to save
- ☐ **B** An increase in the marginal propensity to import
- ☒ **C** A decrease in the marginal propensity to tax
- ☐ **D** A decrease in the marginal propensity to consume

(Total for Question 3 = 1 mark)

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4 The diagram shows a country's trend growth rate and its actual growth rate.



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

- ☒ **A** The rate of economic growth is increasing between points A and B
- ☒ **B** There is a negative output gap at point B
- ☒ **C** There is a positive output gap at point C
- ☒ **D** The level of unemployment is increasing between points C and D

(Total for Question 4 = 1 mark)

5 The Bank of Israel is the country's central bank and it is the sole banker to Israel's Government.

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

- ☒ **A** To act as a lender of last resort
- ☒ **B** To achieve a balanced government budget
- ☒ **C** To change the level of welfare payments
- ☒ **D** To deregulate product and labour markets

(Total for Question 5 = 1 mark)

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6 The table shows Ireland's Gross National Income (GNI) between 2019 and 2021.

Year	GNI ($ billion)
2019	309.77
2020	324.08
2021	372.09

If 2019 is the base year, which **one** of the following represents the index number for 2021?

☒ **A** 100.0

☒ **B** 104.6

☒ **C** 114.8

☒ **D** 120.1

(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 2022 meat-free sausages and antibacterial surface wipes were added to the UK's consumer price index (CPI) basket of goods and services. At the same time, coal and men's suits 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 the CPI measures the rate of inflation accurately, reflecting what households actually buy.

Consumer tastes, preferences and spending patterns change over time, for example because of new technology, changing lifestyles and new products. If the basket were not updated, it would include goods that households rarely buy any more and leave out goods that now take a large share of spending, so the weights would not reflect current spending patterns and the CPI would over or understate the true change in the cost of living.

For example, in 2022 the UK added meat-free sausages and antibacterial surface wipes, because spending on them has grown, and removed coal and men's suits, which households now spend very little on.

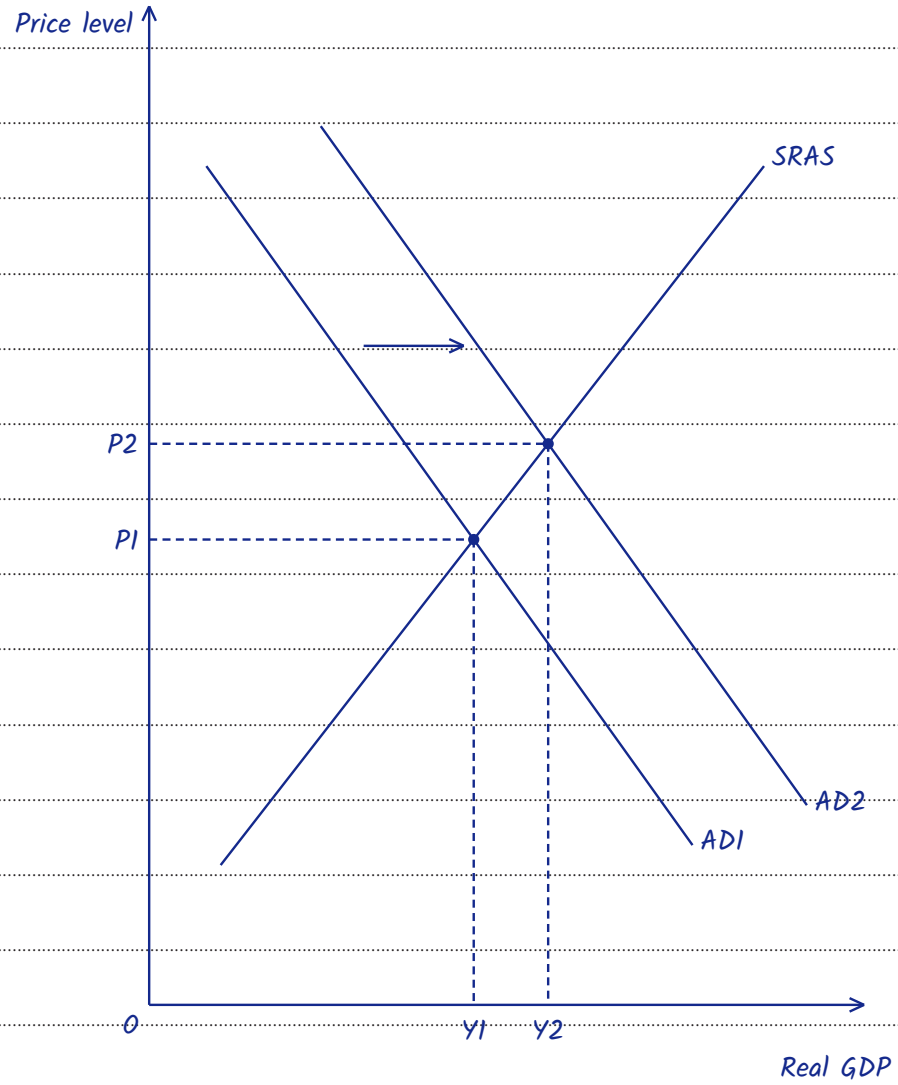
(Total for Question 7 = 4 marks)

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8 Between June 2021 and June 2022 the savings ratio in the USA fell from 9.5% to 5.1%.

Draw an AD and SRAS diagram to show the likely impact of this change in the savings ratio on the economy of the USA.



The fall in the savings ratio from 9.5% to 5.1% means US households are spending a larger share of their income, so consumption rises and AD shifts right from AD1 to AD2. The price level rises from P1 to P2 and real GDP (real output) rises from Y1 to Y2.

(Total for Question 8 = 4 marks)

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9 The table shows selected macroeconomic data for an economy in 2022.

Component	$ billion
Consumption	15.76
Savings by households	4.28
Investment	2.30
Government spending	6.14
Tax revenue	3.59
Imports	7.01
Exports	8.43

Ceteris paribus, calculate the value of aggregate demand for this economy in 2022.
Show your workings.

Aggregate demand is total planned spending on goods and services in an economy:

AD = C + I + G + (X − M)

AD = $15.76bn + $2.30bn + $6.14bn + ($8.43bn − $7.01bn)

= $24.20bn + $1.42bn

= $25.62 billion

(Savings and tax revenue are withdrawals, so they are not part of AD.)

(Total for Question 9 = 4 marks)

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10 Guinea's real GDP per capita increased from $4 127 to $5 434 between 2013 and 2021. Guinea's average world happiness score for 2012-2014 and 2020-2022 is shown in the table. This score gives a value between 0 and 10, where 10 is the highest level of subjective happiness.

	World Happiness Score
2012-14	3.667
2020-22	5.072

With reference to Guinea, explain **one** likely impact of higher real incomes on subjective happiness.

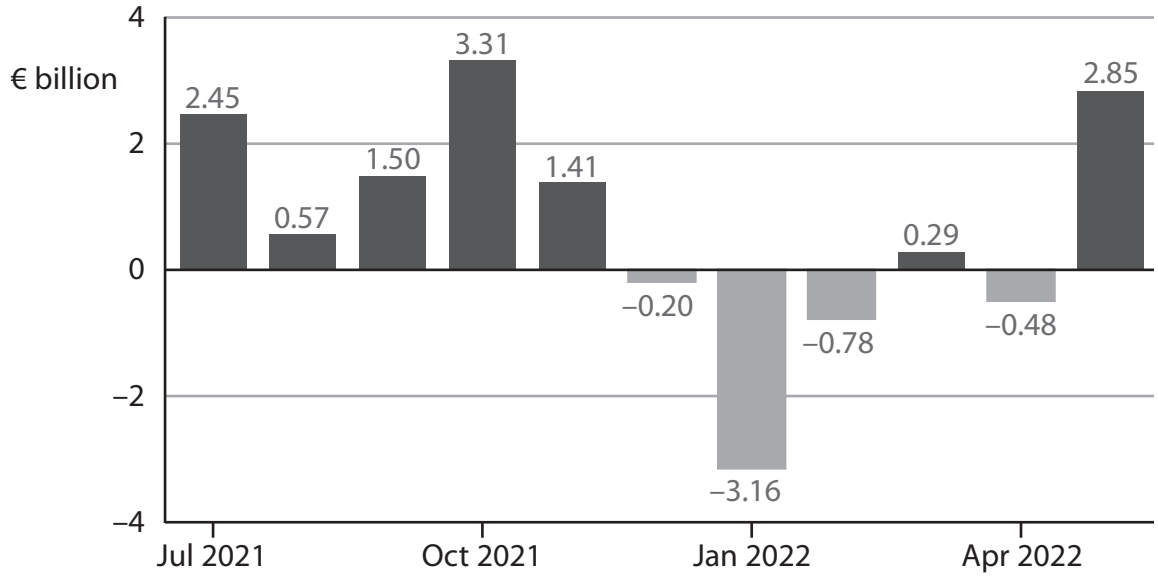
Higher real incomes are likely to raise subjective happiness. Guinea's real GDP per capita rose from $4 127 to $5 434 between 2013 and 2021, and over a similar period its World Happiness Score rose from 3.667 (2012-14) to 5.072 (2020-22).

Because real incomes have risen, households' purchasing power increases, so they can afford to buy more goods and services, such as better food, housing, healthcare and education. This means more of their needs and wants are satisfied, so their standard of living improves. In a low-income country like Guinea, where many basic needs were previously unmet, higher income also reduces worry about money and gives greater financial security, so people report higher life satisfaction and the happiness score rises.

(Total for Question 10 = 4 marks)

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11 The chart shows Spain's current account of the balance of payments between July 2021 and May 2022.



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 balance of trade in goods, trade in services, primary income and secondary income is negative, so more money flows out than in (mainly the value of imports is greater than the value of exports). For example, Spain had a deficit of €0.48 billion in April 2022, and was in deficit between December 2021 and February 2022 (eg −€3.16 billion).

A current account surplus is when this balance is positive, so the value of exports and income inflows is greater than imports and outflows. For example, Spain had a surplus of €2.85 billion in May 2022, and was in surplus from July 2021 to November 2021 (eg €3.31 billion).

(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 'real GDP' (Figure 1).

(2)

(b) With reference to Figure 2, explain how ILO unemployment is measured.

(4)

(c) With reference to Extract A, analyse **two** causes of China's high youth unemployment rate.

(6)

(d) With reference to Extract A, examine how a reflationary fiscal policy will impact China's circular flow of income.

(8)

(e) With reference to the information provided and your own knowledge, discuss the likely effects of a reflationary monetary policy on the economy of China.

(14)

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12 (a) Define the term 'real GDP' (Figure 1).

(2)

Real GDP is the total value of all goods and services produced in an economy in a given period (eg a year), adjusted for inflation, so it is measured at constant prices.

(b) With reference to Figure 2, explain how ILO unemployment is measured.

(4)

The ILO measure counts people as unemployed if they are without a job, have actively looked for work in the past four weeks and are available to start work within the next two weeks.

It is measured using a Labour Force Survey: a sample of households is asked questions through interviews or questionnaires, and the results are used to estimate the unemployment rate as a percentage of the labour force.

Figure 2 shows that China's ILO youth unemployment rate (16 to 24 year olds) rose from 15.3% in January 2022 to 19.3% in June 2022, an increase of 4 percentage points.

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(c) With reference to Extract A, analyse **two** causes of China's high youth unemployment rate.

(6)

One cause is the low rate of economic growth, causing demand-deficient (cyclical) unemployment. Extract A says domestic demand for goods and services and exports rose more slowly in Q2 2022, and the growth forecast for 2022 was cut from 5.5% to 4.3%. Because demand for labour is derived from the demand for goods and services, slower growth in AD means firms need fewer extra workers, so they cut back on hiring. Young people entering the labour market for the first time are hit hardest, because firms stop recruiting before they dismiss existing staff, so youth unemployment rises.

A second cause is structural unemployment from a mismatch of skills. Extract A states there was a mismatch between the jobs available and students' qualifications, and that China has too many college and university graduates for the economy to employ; at the start of Q3 2022 there were only 0.70 jobs for each graduate. This means there is an excess supply of graduates in the labour market, and many graduates lack the skills that the vacancies require (or are unwilling to take lower-skilled jobs), so even when vacancies exist they stay unfilled and young graduates remain unemployed for a long time.

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(d) With reference to Extract A, examine how a reflationary fiscal policy will impact China's circular flow of income.

(8)

The circular flow of income shows income flowing between households and firms, with injections (investment, government spending, exports) and withdrawals (savings, taxation, imports). A reflationary fiscal policy raises injections and/or cuts withdrawals.

Firstly, the Government increased spending on infrastructure by over $75 billion. Government spending is an injection, so injections rise above withdrawals and the circular flow of income expands. Firms receive more orders, pay more wages to households, who then spend more, so through the multiplier national income rises by more than the initial $75 billion.

Secondly, lower taxes for businesses and 100% tax breaks on research and development spending reduce taxation, a withdrawal. Firms keep more of their profits and the return on R&D rises, so investment, another injection, increases. Both effects raise net injections, so China's circular flow of income and real GDP grow.

However, the size of the impact depends on the other injections and withdrawals. If households save more of their extra income or spend it on imports, much of the injection leaks out, so the multiplier is small. Also, if exports keep rising slowly, as Extract A suggests, this offsets some of the fiscal injection. Finally, fiscal policy has time lags: infrastructure projects take time to plan and build, so the full effect on the circular flow may take 18 to 24 months, although $75 billion is a large injection, so the eventual effect is likely to be significant.

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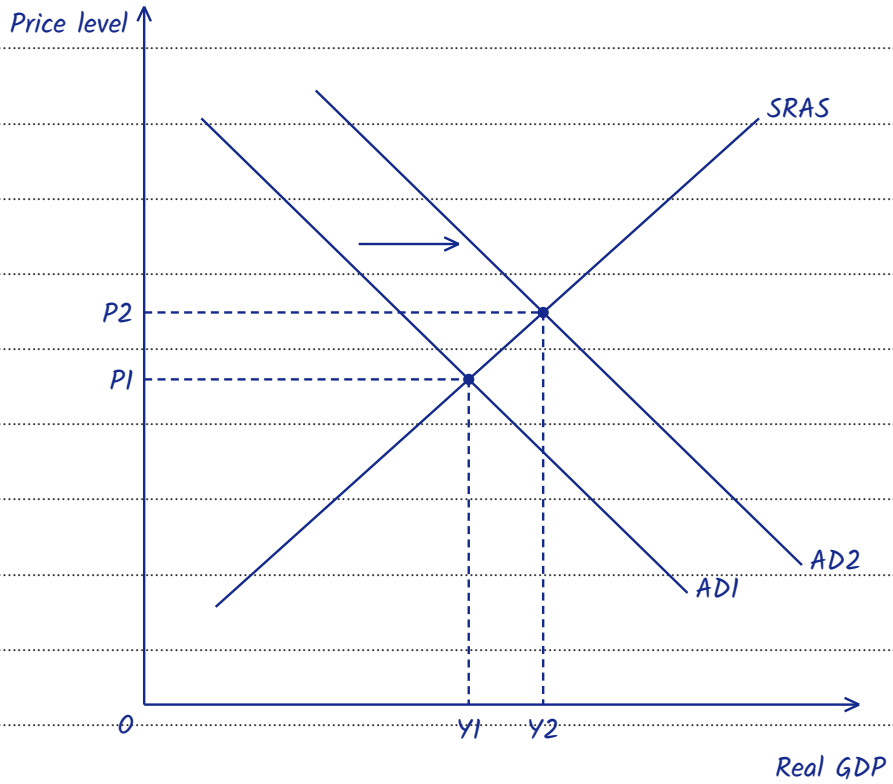
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(e) With reference to the information provided and your own knowledge, discuss the likely effects of a reflationary monetary policy on the economy of China.

(14)

A reflationary monetary policy uses interest rates and the money supply to increase aggregate demand. Extract A says the PBoC cut the base rate from 3.7% to 3.65% in August 2022 and reduced the reserve asset (liquidity) requirements in November 2022.

Lower interest rates reduce the cost of borrowing and the reward for saving, so households borrow more and save less, raising consumption. Households with variable-rate loans and mortgages pay less interest, increasing their discretionary income. Cheaper borrowing also lowers the cost of financing capital projects, so firms' investment rises. Lower mortgage rates raise demand for houses, pushing up house prices and creating a positive wealth effect, raising confidence and spending further. The lower reserve requirement means commercial banks can lend out more of their deposits, increasing the money supply and access to credit, which also boosts C and I.



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Lower interest rates also reduce the return on holding Renminbi, especially as US interest rates are rising, so hot money flows out and the currency depreciates. Chinese exports become cheaper and imports dearer, so net exports rise, helping China's slowly rising exports.

As shown in the diagram above, AD shifts right from AD1 to AD2, so real GDP rises from Y1 to Y2, raising the growth rate above the reduced 4.3% forecast. Higher output raises the derived demand for labour, so unemployment, including youth unemployment of 19.3% in June 2022, should fall. However, the price level rises from P1 to P2, causing some demand-pull inflation.

However, the cut of only 0.05 percentage points is very small, so its effect on borrowing costs is likely to be minimal. Commercial banks may not pass the cut on to borrowers, and if consumer and business confidence is low, as slowing demand suggests, households and firms may not borrow more even at lower rates. Monetary policy also works with a time lag of around 18 to 24 months.

The effect on output also depends on the size of the multiplier and the spare capacity in the economy. With growth slowing and youth unemployment high, there is likely to be a negative output gap, so AD growth mainly raises real GDP rather than prices. But the depreciation of the Renminbi is a risk: it raises import prices, which could cause cost-push inflation, and since the room for manoeuvre is limited by rising US interest rates, the PBoC may have to reverse the policy. Moreover, the main causes of youth unemployment are partly structural (skills mismatch), which monetary policy cannot solve, so supply-side policies such as training would also be needed.

Overall, reflationary monetary policy is likely to raise growth and employment in China, but

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because the rate cut is so small and lags are long, its impact will be limited unless supported by the fiscal policy already in place.

(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 the Government of India introduced new legislation with the aim of reducing pollution. It is predicted that this will cause India's real GDP to increase at a slower rate.

Evaluate the view that there will always be conflicts between macroeconomic objectives. Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 In July 2021 Rwanda's inflation rate was –1.1% and in November 2021 it was –3.4%.

Evaluate possible causes of deflation. Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

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

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

Write your answer here:

Deflation is a sustained fall in the general price level, so the rate of inflation is negative. Rwanda's inflation rate was −1.1% in July 2021 and −3.4% in November 2021, so prices were falling at an accelerating rate. Deflation can be caused by a fall in AD or an increase in AS.

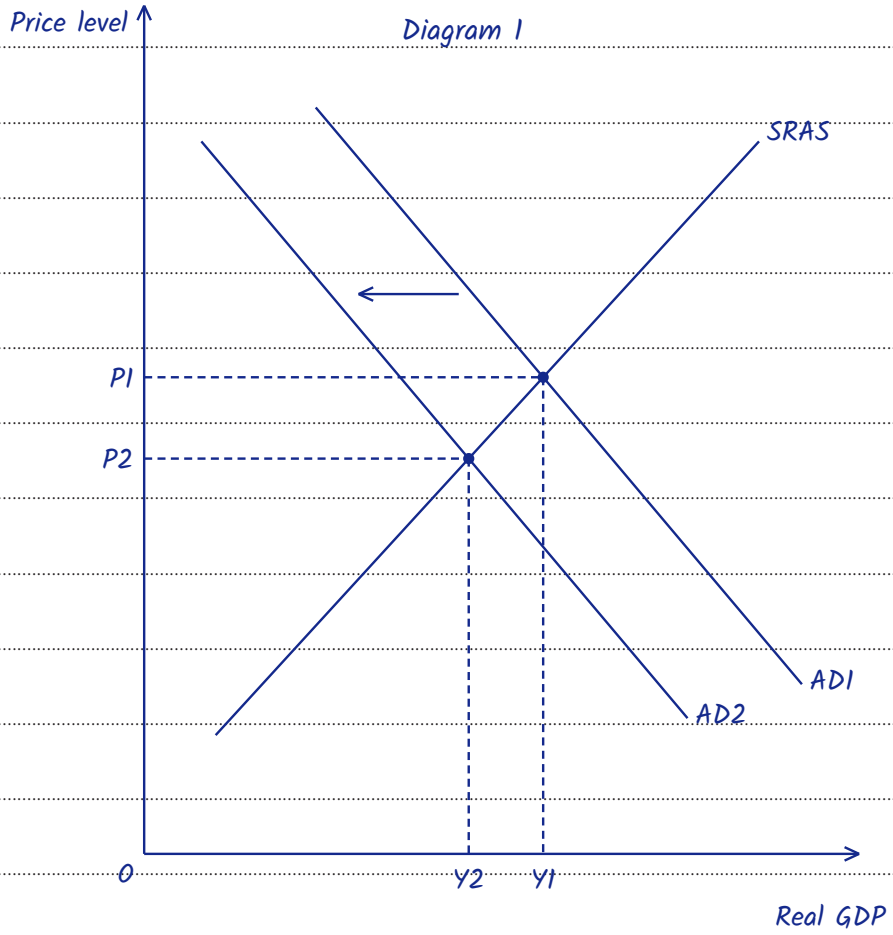
Firstly, deflation can be caused by a fall in aggregate demand (demand-side deflation). AD = C + I + G + (X − M). During and after the Covid-19 pandemic in 2020 and 2021, lockdowns and uncertainty reduced household incomes and confidence, so consumption fell and saving rose. Firms facing uncertain demand cut investment, and lower tourism receipts reduced Rwanda's exports. If the central bank raised interest rates, or the government cut spending or raised income tax, AD would fall further. As shown in Diagram 1, AD shifts left from AD1 to AD2, so the price level falls from P1 to P2 and real GDP falls from Y1 to Y2.

Once prices start falling, consumers may expect further falls, so they delay purchases of goods such as cars and furniture. This reduces consumption further, so AD falls again and a deflationary spiral can develop, with falling profits, rising unemployment and lower incomes.

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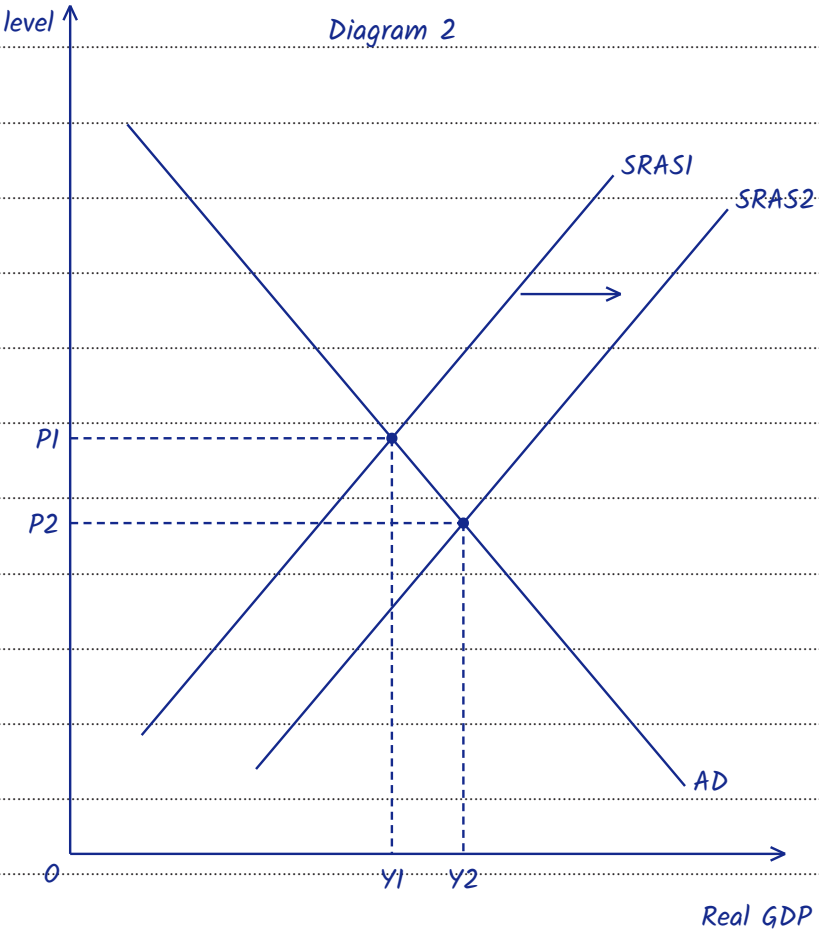


Secondly, deflation can be caused by an increase in short-run aggregate supply (supply-side deflation). A fall in costs of production, such as lower raw material, energy or food prices, lower indirect taxes, or an appreciation of the currency making imported inputs cheaper, allows firms to supply more at each price level. In Rwanda, where food has a large weight in the CPI, good harvests leading to a fall in food prices would have a big effect. As shown in Diagram 2, SRAS shifts right from SRAS1 to SRAS2, so the price level falls from P1 to P2 while real GDP rises from Y1 to Y2.

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Thirdly, long-run supply-side improvements, such as new technology, investment in education and skills, competition policy and higher productivity, shift LRAS to the right. Average costs fall and productive capacity rises, so there is downward pressure on prices as real GDP grows.

Evaluation: the cause matters for how harmful the deflation is. Demand-side deflation is "bad" deflation because it comes with falling real GDP and rising unemployment, and can lead to a spiral of delayed spending. Supply-side deflation is "benign" because output and real incomes rise. Rwanda's deflation in 2021 is likely to be largely supply-side, from falling food prices, while its economy was recovering, which suggests the deflation is less damaging.

The significance of each cause also depends on the time period. Changes in food and energy prices are volatile and likely to reverse as world demand recovers after the pandemic, so

deflation from this cause is likely to be short-lived. Supply-side improvements to LRAS only reduce prices after a long time lag, and usually slow inflation rather than cause deflation. Fiscal and monetary policy also take time to affect AD.

In reality, deflation is likely to be caused by a combination of factors, and the size of the fall in the price level depends on the magnitude of the shifts in AD and AS and on how much spare capacity the economy has. A currency depreciation would make imports dearer and offset falling costs.

In conclusion, the most likely causes of Rwanda's deflation are lower food and production costs (an increase in SRAS) combined with weak demand after the pandemic. The supply-side cause was probably the most significant in the short run, since prices fell quickly, which means the deflation is likely to be temporary rather than a sign of a deflationary spiral.

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

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Pearson Edexcel International Advanced Level

Tuesday 17 October 2023

Morning (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 China

Figure 1 Year on year real GDP growth rate by quarter, Q1 2020 to Q2 2022

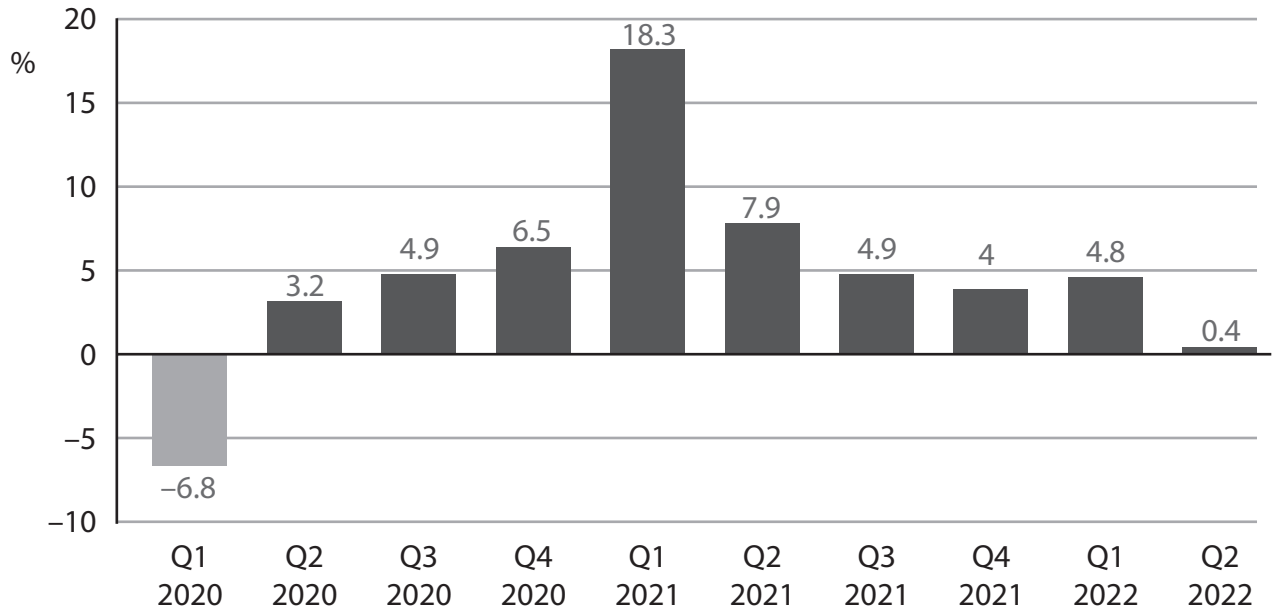


Figure 2 Youth unemployment rate (16 to 24 year olds), as measured by the International Labour Organization (ILO), January 2022 to June 2022

Date	Youth unemployment %
Jan 2022	15.3
Feb 2022	15.3
Mar 2022	16.0
Apr 2022	18.2
May 2022	18.4
June 2022	19.3

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Extract A Economic growth

In the second quarter of 2022 China experienced a low rate of economic growth. This was as a result of domestic demand for goods and services, and exports rising more slowly compared with the previous quarter. Economists estimated that China's economy would continue to experience a low rate of economic growth until the end of the year. Therefore, the country's economic growth forecast for 2022 was reduced from 5.5% to 4.3%.

This low economic growth rate resulted in a further increase in the already high rate of youth unemployment. China has too many college and university graduates for the economy to employ. In 2022 there was also a mismatch between the jobs that are available and students' qualifications. For example, at the start of the third quarter of 2022, only 0.70 jobs were available for each graduate.

To increase the rate of economic growth the Government implemented a reflationary fiscal policy. It increased spending on infrastructure by over $75 billion and reduced taxes for businesses. It planned to increase science and technology-related investments by providing 100% tax breaks on research and development spending.

The country's central bank, the People's Bank of China (PBoC), implemented a reflationary monetary policy to increase the country's economic growth rate. For example, the PBoC decreased the base rate of interest from 3.7% to 3.65% in August 2022. There was also a reduction in the reserve asset (liquidity) requirements in November 2022. This was in contrast to the policy of central banks in several advanced economies which implemented deflationary monetary policy.

One economist stated that "the room for manoeuvre" for a reflationary monetary policy by the PBoC was limited because of rising US interest rates. He also emphasised the risks associated with a fall in the external value of the Chinese currency, the *Renminbi*.

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Acknowledgements

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

Figure 2 adapted from
https://www.statista.com/statistics/1244339/surveyed-monthly-youth-unemployment-rate-in-china/

Extract A adapted from FT,
https://www.ft.com/content/bb302ef4-001a-478f-ac61-31cdc972cc8e;
https://www.fitchratings.com/research/sovereigns/china-loosens-fiscal-policy-to-support-slowing-economy-09-03-2022