Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Centre Number | Candidate Number

Pearson Edexcel International Advanced Level

Wednesday 16 October 2024

Afternoon (Time: 1 hour 45 minutes)

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary
UNIT 2: Macroeconomic performance and policy

You must have:
Source Booklet (enclosed)

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **ALL** questions in Sections A, B and C.
- Answer **ONE** question in Section D.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

Turn over ▶

P78381A

©2024 Pearson Education Ltd.
V:1/1/1/1/

P 7 8 3 8 1 A 0 1 2 8

Pearson

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 represents net investment?

- ☐ **A** Gross investment minus corporation tax
- ☒ **B** Gross investment minus capital depreciation
- ☐ **C** Gross investment minus the rate of inflation
- ☐ **D** Gross investment minus money supply

(Total for Question 1 = 1 mark)

2 In Chad unemployment is higher in the winter months than in the summer months. This is because the demand for agricultural labour is lower in the winter months.

Which **one** of the following best describes the cause of this unemployment in Chad?

- ☐ **A** Frictional unemployment
- ☐ **B** Real wage inflexibility
- ☒ **C** Seasonal unemployment
- ☐ **D** Structural unemployment

(Total for Question 2 = 1 mark)

3 Between 2020 and 2022 Qatar's GNI increased from $141.37 billion to $229.01 billion.

Which **one** of the following is the ratio of Qatar's GNI in 2022 to its GNI in 2020?

- ☒ **A** 1 : 0.62
- ☐ **B** 1 : 1.62
- ☐ **C** 1 : 61.99
- ☐ **D** 1 : 87.64

(Total for Question 3 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

4 Which **one** of the following would cause a leftward shift in a country's short-run aggregate supply (SRAS) curve?

- ☒ **A** A decrease in bank lending to consumers
- ☒ **B** A decrease in the rate of indirect tax
- ☒ **C** An increase in the price of natural gas
- ☒ **D** An increase in investment in healthcare

(Total for Question 4 = 1 mark)

5 In 2022 the Czech Republic's economy was operating below its productive potential as a result of a fall in its manufacturing production.

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

- ☒ **A** An increase in house prices
- ☒ **B** An increase in the rate of inflation
- ☒ **C** An increase in business confidence
- ☒ **D** An increase in unemployment

(Total for Question 5 = 1 mark)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

6 The table shows Mexico's consumer confidence index (CCI), April 2021 to April 2023.

Year	CCI
April 2021	101.5
April 2022	102.8
April 2023	103.4

The CCI is a measure of consumers' willingness to spend.

With reference to the above table, which **one** of the following is most likely to result from this change in consumer confidence between April 2021 and April 2023?

		Price level	Real output
☒	**A**	Fall	Fall
☒	**B**	Fall	Rise
☒	**C**	Rise	Fall
☒	**D**	Rise	Rise

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

BLANK PAGE

SECTION B

Answer ALL questions in this section in the space provided.

7 Between quarter 2 2022 and quarter 2 2023 average house prices in Canada decreased by 8.5%.

With reference to the information above, explain **one** likely macroeconomic impact of this decrease in house prices on existing homeowners.

A fall in house prices is likely to reduce consumption, and so aggregate demand (AD). Average house prices in Canada decreased by 8.5% between quarter 2 2022 and quarter 2 2023.

For existing homeowners, a house is their main asset, so an 8.5% fall in its value makes them feel less wealthy. This is a negative wealth effect. Homeowners are also less able to borrow against the value of their homes (equity withdrawal), and their consumer confidence falls, so they save more and spend less on goods and services, for example cars, furniture and holidays.

As consumption is the largest component of AD (AD = C + I + G + (X − M)), AD shifts to the left. Firms sell less, so they cut output, and through the negative multiplier effect real output in Canada falls and the price level falls (or rises more slowly), which may also increase unemployment.

(Total for Question 7 = 4 marks)

DO NOT WRITE IN THIS AREA

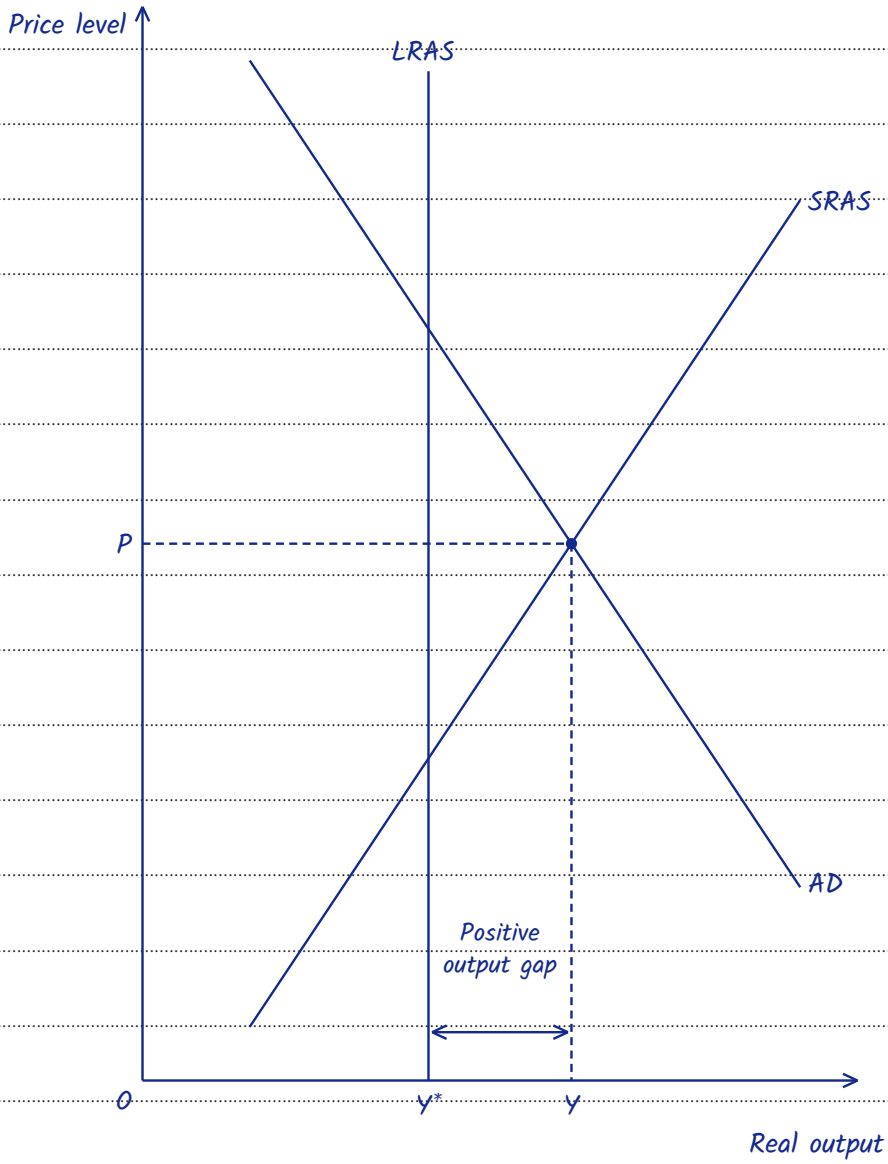
DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

8 Croatia experienced a positive output gap in 2022.

Draw an AD/AS diagram to illustrate a positive output gap.



Short-run equilibrium is where AD = SRAS, at real output Y, which is greater than the full employment level of output Y^* on the LRAS curve. Croatia's actual output was above its productive potential, so the gap Y^* to Y is a positive output gap.

(Total for Question 8 = 4 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

9 The table shows selected macroeconomic data for an economy in 2023.

Macroeconomic data	$ billion
Aggregate demand	32.91
Investment	4.57
Government spending	9.22
Imports	5.89
Exports	7.64

Calculate the value of consumption for this economy in 2023.
Show your workings.

Aggregate demand: AD = C + I + G + (X − M), so C = AD − (I + G + (X − M))

Net exports: X − M = $7.64bn − $5.89bn = $1.75bn

C = $32.91bn − ($4.57bn + $9.22bn + $1.75bn)

= $32.91bn − $15.54bn

= $17.37 billion

The value of consumption for this economy in 2023 was $17.37 billion.

(Total for Question 9 = 4 marks)

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

P 7 8 3 8 1 A 0 8 2 8 stemup.co.uk

10 In the USA 11.2% of graduates were working in low-skilled jobs in June 2023. At the same time, 25.7 million people were working part-time. Many of these part-time employees wanted to work more hours.

With reference to the information above, explain the term 'underemployment'.

Underemployment occurs when people are in employment (they have a job) but they want to work more hours than they are currently able to, or they are working in a job that does not use their skills and qualifications, so they are working below their full potential.

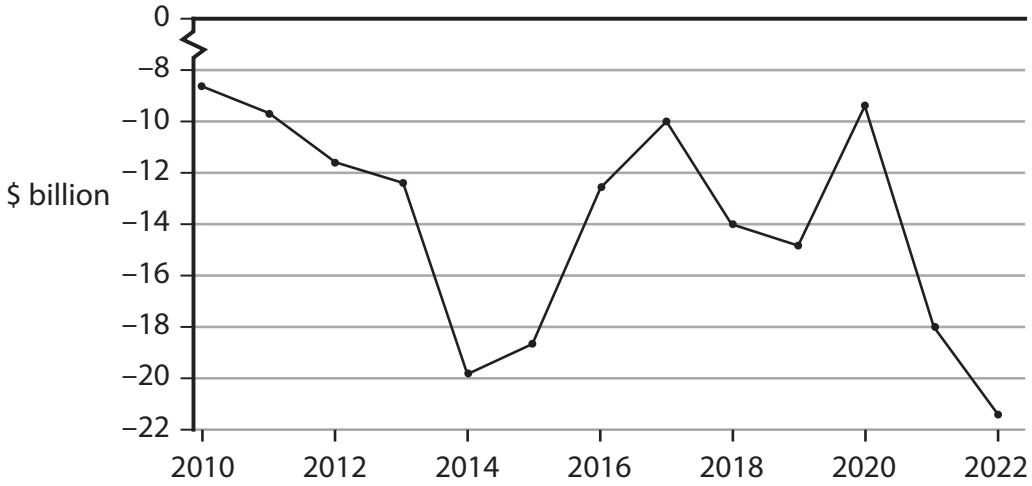
In the USA in June 2023, 11.2% of graduates were working in low-skilled jobs. These graduates are employed, but their skills are not fully used, so they are underemployed.

At the same time 25.7 million people were working part-time and many of them wanted to work more hours. They count as employed in the official figures, but they are underemployed because they would like to work full-time. This means that the US unemployment rate understates the amount of spare capacity in the labour market, as labour resources are being under-used.

(Total for Question 10 = 4 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

11 The chart shows Colombia's net balance of trade in goods and services, 2010–2022.



With reference to the chart, explain **one** likely cause of the deficit in Colombia's balance of trade in goods and services.

The chart shows Colombia had a trade deficit in goods and services every year from 2010 to 2022; it was smallest in 2010 (about $8.5bn) and largest in 2022 (about $21.5bn), more than doubling after 2020.

One likely cause is rising real incomes as Colombia's economy grew, especially as it recovered after 2020. As incomes rise, consumers and firms spend more, and part of this extra spending goes on imports, such as cars, electronics and machinery, because of the marginal propensity to import.

So the value of imports increases faster than the value of exports, and the deficit widens, from about $9.5bn in 2020 to about $21.5bn in 2022.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

BLANK PAGE

SECTION C

Study Figure 1, Figure 2, Figure 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 'living standards'.

(2)

(b) With reference to Figure 2, explain the difference between disinflation and inflation.

(4)

(c) With reference to Figure 2 and Extract A, examine **two** ways by which the increase in the base interest rate could reduce the rate of inflation.

(8)

(d) With reference to Extract A, examine the impact of a deflationary fiscal policy on Brazil's circular flow of income.

(6)

(e) With reference to the information provided, discuss the likely effects on living standards of the supply-side policies proposed by President Lula.

(14)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

12 (a) Define the term 'living standards'.

(2)

Living standards are the level of material wellbeing and welfare of people in a country: the quantity and quality of goods and services available to the population, together with quality of life, such as health, education and the environment.

(b) With reference to Figure 2, explain the difference between disinflation and inflation.

(4)

Inflation is a sustained increase in the average price level in an economy over a period of time, shown by a positive rate of inflation. Brazil had inflation over the whole period January 2021 to January 2023, as the CPI inflation rate was always positive; for example it rose from about 4.5% in January 2021 to about 12% in mid-2022.

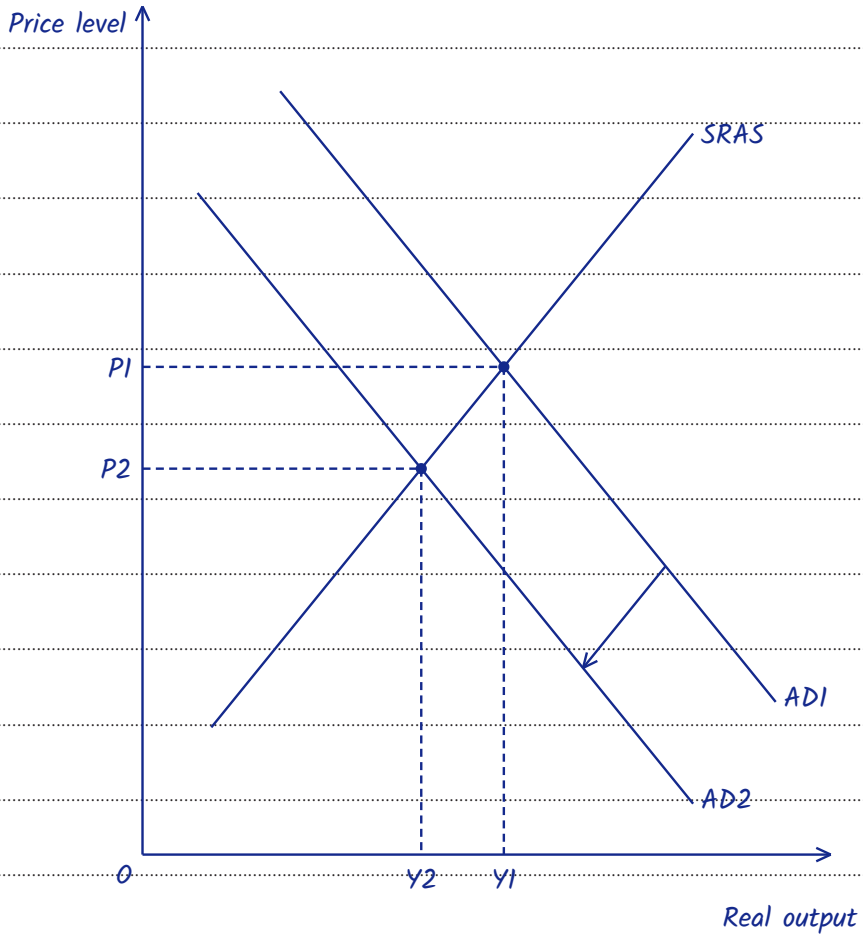
Disinflation is a fall in the rate of inflation while it remains positive, so the average price level is still rising, but at a slower rate. Brazil experienced disinflation between July 2022 and January 2023, when the rate of inflation fell from about 12% to about 5.8%, a fall of about 6 percentage points. Prices were still rising, just more slowly.

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

(c) With reference to Figure 2 and Extract A, examine **two** ways by which the increase in the base interest rate could reduce the rate of inflation.

(8)

Extract A shows that between January 2021 and June 2022 the Central Bank of Brazil raised the base interest rate from an all-time low of 2% to 13.25%, an increase of 11.25 percentage points. Figure 2 shows that inflation rose from about 4.5% in January 2021 to about 12% by June 2022, and then fell to about 5.8% by January 2023.



First, higher interest rates reduce consumption. The reward for saving rises, so households save more and spend less. Borrowing for cars and other durable goods becomes more expensive, and households with variable-rate mortgages have higher repayments, so their disposable income falls. Extract A says the rise significantly affected consumer spending.

Second, higher interest rates reduce investment. The cost of borrowing from banks rises, so

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

fewer investment projects are profitable, and firms may cut spending on new machinery and buildings. The extract states that business investment was significantly affected.

As consumption and investment are components of AD, AD shifts left from AD1 to AD2 in the diagram, with a negative multiplier effect. The price level falls from P1 to P2, compared with what it would have been, so demand-pull inflationary pressure and the rate of inflation fall.

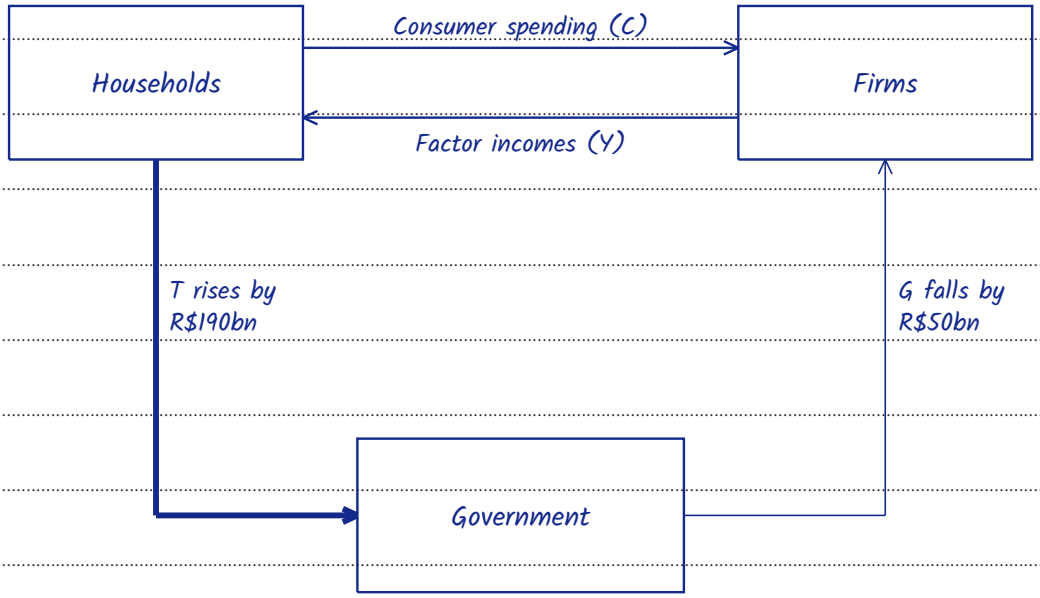
However, the effect depends on time lags: monetary policy can take 18 to 24 months to have its full effect, and people on fixed-rate mortgages are not affected at first. Also, commercial banks may not pass on the full rise to borrowers. Nevertheless, the magnitude of the rise is very large, so it is likely to have a significant impact, which is consistent with inflation falling by over 6 percentage points after June 2022. If inflation was partly cost-push, for example due to world energy prices, the effect of interest rates would be smaller.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

(d) With reference to Extract A, examine the impact of a deflationary fiscal policy on Brazil's circular flow of income.

(6)

The circular flow of income shows how money flows between households and firms: households receive factor incomes and spend them on goods and services. Injections (I, G, X) add to the flow and withdrawals (S, T, M) take money out of it.



Brazil's deflationary fiscal policy aims to reduce government expenditure by R$50 billion. Government spending is an injection, so less money flows into firms, for example from fewer public sector contracts. The policy also aims to raise tax revenues by R$190 billion. Taxes are a withdrawal, so households have less disposable income and firms have lower post-tax profits.

So withdrawals rise and injections fall, and the circular flow of income shrinks. Firms receive less revenue, so they cut output and employment and pay lower factor incomes to households, who then spend less, so through the negative multiplier the fall in national income is larger than the initial R$240 billion change in injections and withdrawals. This could slow economic

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk

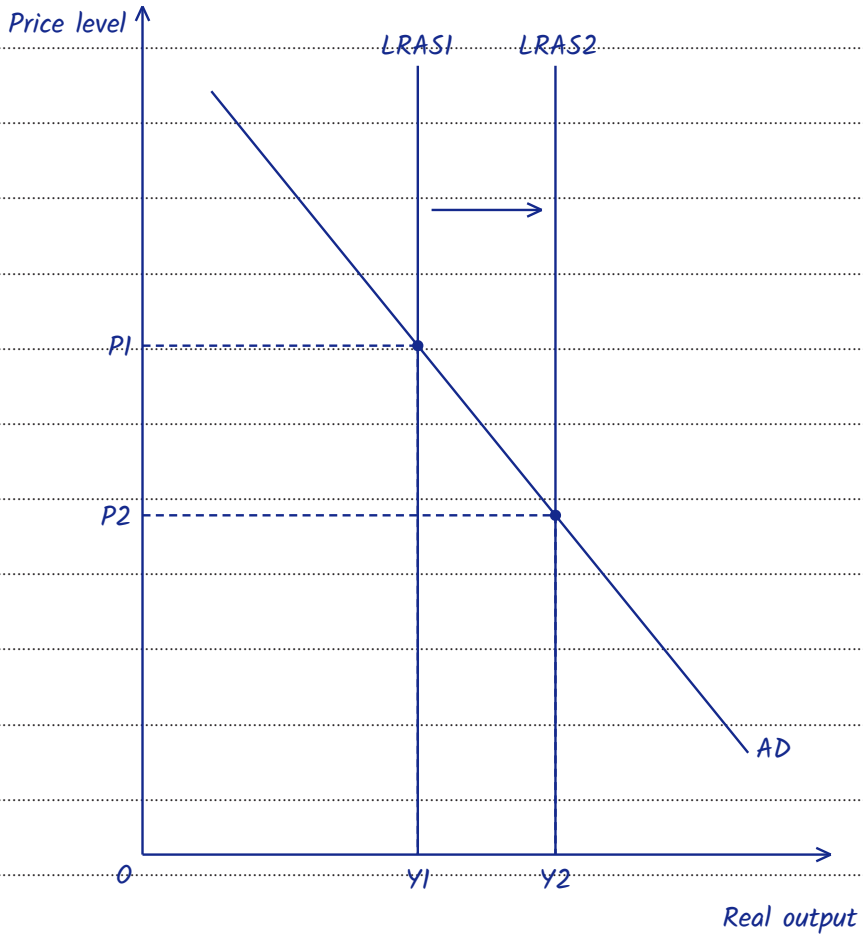
growth further, as real GDP growth was already forecast to be below 1% in 2023.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

(e) With reference to the information provided, discuss the likely effects on living standards of the supply-side policies proposed by President Lula.

(14)

Supply-side policies aim to increase the productive capacity of the economy (shift LRAS to the right). In mid-2022 President Lula promised to raise real incomes and create new jobs by increasing welfare payments and investment in healthcare, infrastructure and education, training and skills, costing R$371 billion over four years.



Investment in education, training and skills increases human capital. Workers become more productive and more employable, so they can earn higher wages and move into more skilled jobs. Higher real incomes allow them to buy more goods and services, raising material living standards.

Investment in healthcare improves the health of the population. Workers take fewer days off

DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA DO NOT WRITE IN THIS AREA

stemup.co.uk

sick and can work for longer, so productivity and incomes rise. Better healthcare also directly improves quality of life and life expectancy, which are part of living standards.

Investment in infrastructure, such as roads, railways and broadband, reduces firms' transport costs and improves access to markets, and allows workers to travel to where jobs are. Building infrastructure also creates jobs in construction straight away, through an increase in AD and the multiplier effect.

As shown in the diagram, these policies shift LRAS right from LRAS1 to LRAS2, so real output rises from Y1 to Y2 and the price level falls from P1 to P2. This allows sustainable, non-inflationary growth in real GDP per capita, which raises living standards. Higher welfare payments also raise the incomes of the poorest households, reducing poverty and inequality and helping them meet basic needs.

However, the magnitude may be small. R$371 billion over four years is about R$92.75 billion per year, spread across four policies, which may not be enough to have a significant effect on a large economy.

Financing is also a problem. Figure 3 shows that the Government has had a budget deficit in almost every month since February 2022, for example about R$84 billion in June 2022, and the extract says it has insufficient tax revenue. If it raises taxes by R$190 billion and cuts spending by R$50 billion, disposable incomes and AD fall, which may offset the gains in living standards in the short run.

There are also long time lags. Better education and healthcare may take many years to raise productivity, so living standards may not rise within Lula's four-year term. Higher welfare

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

payments may reduce the incentive to work, which reduces the effect on output and employment.

Effectiveness depends on the quality of the projects. Previously, many large-scale investments in similar projects were not successful and represented a waste of resources, so there is a large opportunity cost: the money could have been spent in other areas.

In conclusion, the supply-side policies are likely to improve living standards in the long run, especially education and healthcare, which raise both incomes and quality of life. However, the effect depends on how they are financed and on the quality of spending; with the deflationary fiscal policy and slow growth, the improvement in the short run is likely to be limited.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

BLANK PAGE

SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 India's unemployment rate increased from 7.1% in January 2023 to 8.5% in June 2023.

Evaluate the likely effects of an increase in the unemployment rate on workers **and** public finances. Refer to a country of your choice in your answer.

(Total for Question 13 = 20 marks)

OR

14 Germany experienced a recession in the first six months of 2023. The country's rate of economic growth was –0.4% in quarter 1 2023 and was –0.1% in quarter 2 2023.

Evaluate the likely effects of a recession. Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

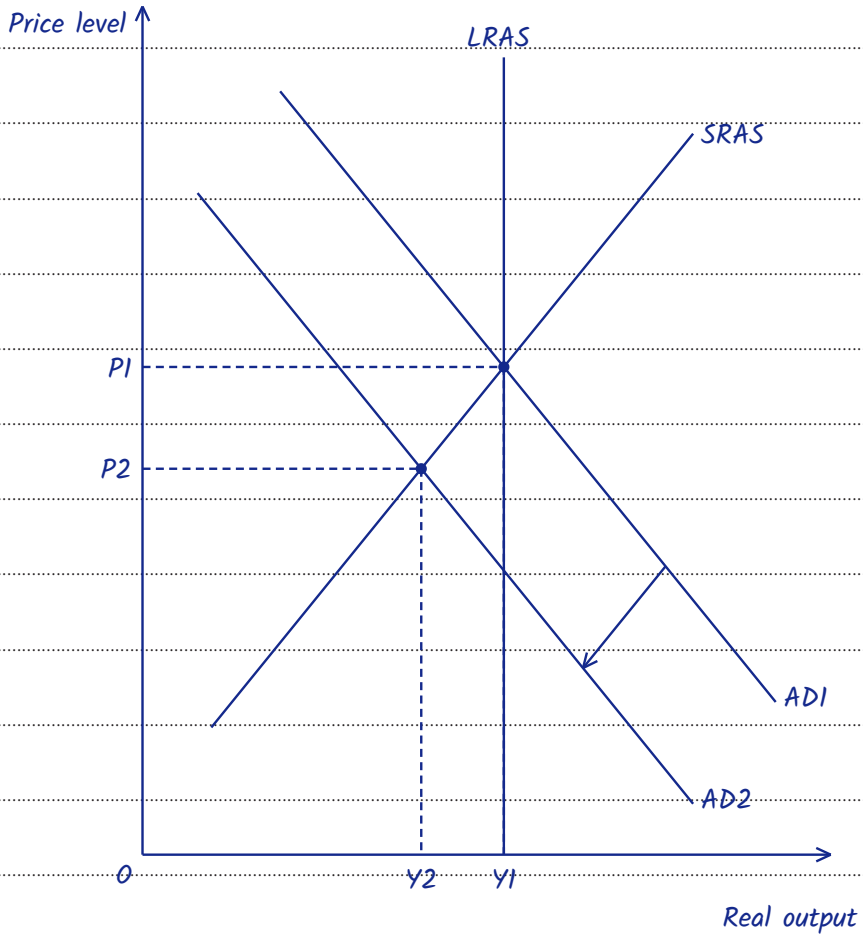
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

A recession is a period of negative economic growth (a fall in real GDP) for two or more consecutive quarters. Germany's economic growth rate was −0.4% in quarter 1 2023 and −0.1% in quarter 2 2023, so it was in a recession. Contributing factors included high energy prices after Russia's invasion of Ukraine, high inflation reducing real incomes, and higher interest rates set by the ECB.

Recessions are caused by a fall in AD. As shown in the diagram, AD shifts left from AD1 to AD2, so real output falls from Y1 to Y2, creating a negative output gap below the LRAS (full capacity) level.



DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

The first effect is higher unemployment. Labour is a derived demand, so as firms sell less, they cut output and need fewer workers. This is cyclical (demand-deficient) unemployment. Unemployed workers lose income, so they cut their spending, which reduces AD further through the negative multiplier effect. Long-term unemployment can cause a loss of skills and social problems such as stress, poorer health and crime.

Second, living standards fall. With lower real incomes, households in Germany can afford fewer goods and services, and many struggle to pay for basic needs such as energy, which reduces subjective happiness.

Third, firms make lower profits as consumer spending falls. Some firms close, and others delay investment in new capital, research and development. This is especially important for Germany's manufacturing sector, such as car makers, which depend on long-term investment. Lower investment reduces the growth of productive capacity, so the recession can reduce Germany's long-run growth (hysteresis).

Fourth, public finances worsen. Tax revenues from income tax, VAT and corporation tax fall, while government spending on unemployment benefits rises automatically. The budget deficit increases and national debt grows, which may mean higher taxes or spending cuts in the future, so the opportunity cost is less spending on healthcare and education.

However, a recession can also have some positive effects. Lower AD reduces demand-pull inflation, and falling demand for raw materials can reduce cost-push pressures. This would be helpful for Germany, where inflation had been high. Spending on imports falls as incomes fall, which can improve the current account of the balance of payments. Lower output also means lower pollution and less use of non-renewable resources, reducing negative externalities.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

The size of the effects depends on the magnitude and length of the recession. Germany's contraction was very small: only −0.4% and −0.1%, so real GDP fell by about 0.5% in total. This is much less severe than the recession in 2020 during the global health crisis, so the effects on unemployment and living standards are likely to be limited. Unemployment is also a lagging indicator, so its effects may only appear later, and if the recession is short, firms may keep skilled workers (labour hoarding), for example through short-time working schemes.

The effects also depend on policy. The Government can use automatic stabilisers and expansionary fiscal policy, such as higher government spending, to raise AD. However, if the central bank keeps interest rates high to control inflation, the recession could last longer. Germany also depends heavily on exports, so recovery depends on the level of world income, especially in China and the rest of the EU.

In conclusion, a recession is likely to have mainly negative effects: higher unemployment, lower living standards, lower investment and worse public finances. The most important effect is on unemployment, because it reduces incomes and can cause long-term damage. However, because Germany's recession was mild and short, these effects are likely to be small, and the fall in inflation may even be a benefit, so the overall impact depends mostly on how long the recession lasts.

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

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

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

stemup.co.uk

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

DO NOT WRITE IN THIS AREA

BLANK PAGE

stemup.co.uk

BLANK PAGE

DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA
DO NOT WRITE IN THIS AREA

stemup.co.uk

Pearson Edexcel International Advanced Level

Wednesday 16 October 2024

Afternoon (Time: 1 hour 45 minutes)

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary

UNIT 2: Macroeconomic performance and policy

Source Booklet

Do not return this Booklet with the question paper.

Turn over ▶

P78381A

©2024 Pearson Education Ltd.

V:1/1/1/1/

P 7 8 3 8 1 A

Pearson

stemup.co.uk

Sources for use with Section C

The economy of Brazil

Figure 1 Real GDP growth rate, 2018 to 2023

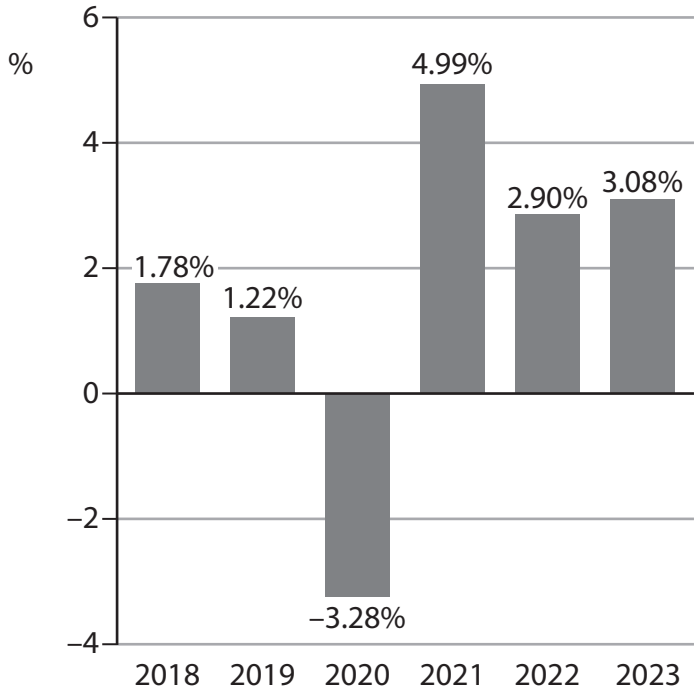
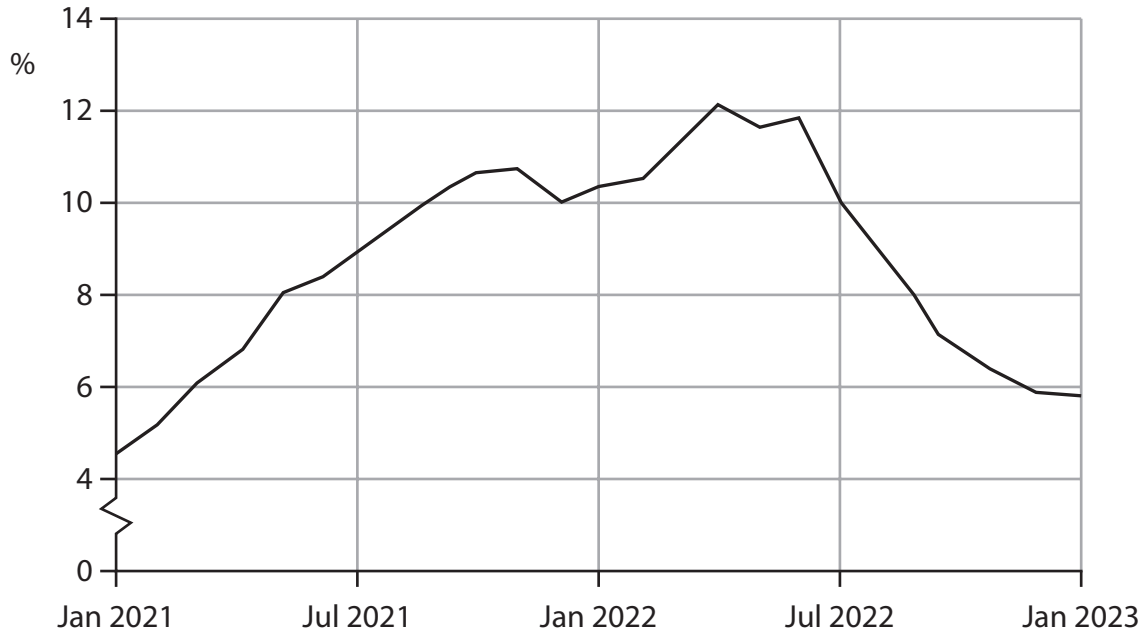


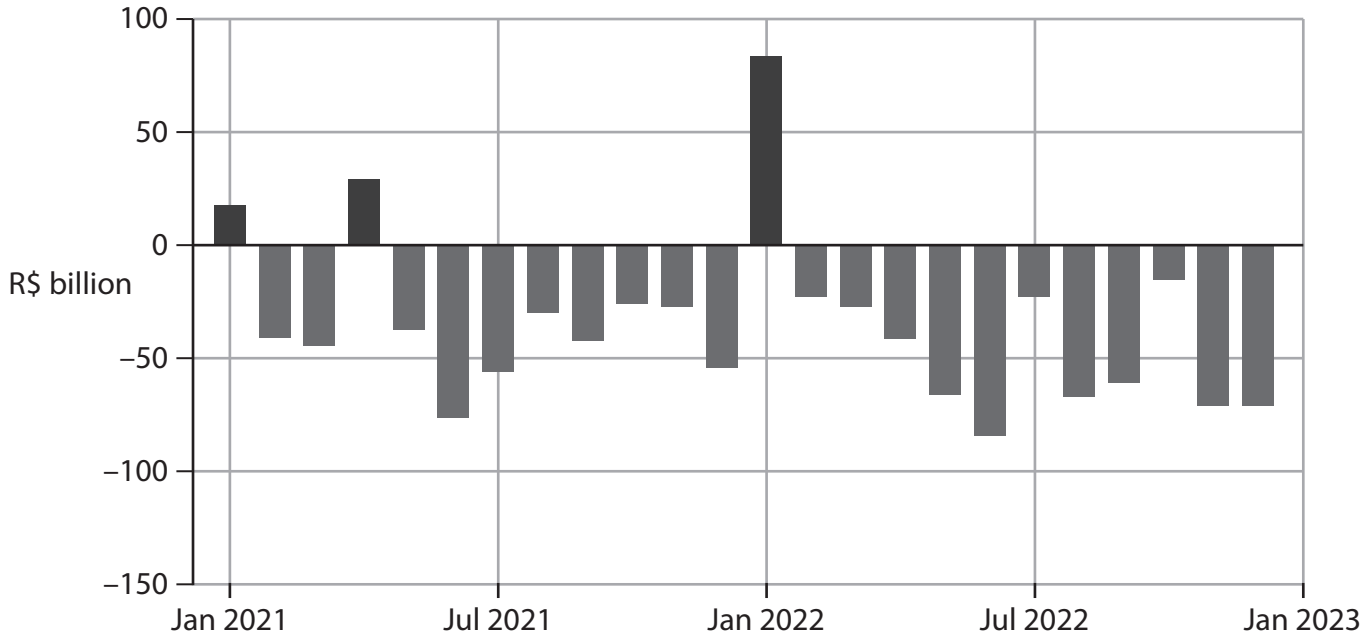
Figure 2 Annual rate of inflation*, as measured by the consumer price index (CPI), January 2021 to January 2023



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

stemup.co.uk

Figure 3 Government monthly budget balance, *real billion, January 2021 to December 2022**



**real* is the currency of Brazil and is denoted as R$.

stemup.co.uk

Extract A Economic growth

Brazil's rate of economic growth fell between 2021 and 2022. This weaker economic performance was as a direct result of a significant decrease in industrial output and a slowdown in the services sector in 2022.

Many economists indicated that this slower rate of economic growth resulted from the Central Bank of Brazil's deflationary monetary policy to control the rising rate of inflation. Between January 2021 and June 2022 the Central Bank raised the country's base interest rate from an all-time low of 2% to 13.25%. This significantly affected consumer spending and business investment, both of which are major contributors to economic growth. As a result, economists predicted that Brazil's annual increase in real GDP would be below 1% in 2023.

The slowdown in economic growth will limit the Government's ability to improve living standards. In mid-2022 President Lula had promised to raise the real incomes of the country's population and create new jobs. He suggested that he was going to achieve his objective by increasing:

- the level of welfare payments
- investment in healthcare provision
- investment in infrastructure development
- investment in education, training and skills.

President Lula aimed to introduce these supply-side policies in 2023. These policies would cost R$371 billion over four years. However, the Government has insufficient tax revenues to finance its spending and investment. Previously, many large-scale investments in similar projects were not successful and represented a waste of resources.

Consequently, the Government proposed tax increases and cuts in government expenditure to achieve a balanced budget. This deflationary fiscal policy aims to increase tax revenues by R$190 billion and reduce government expenditure by R$50 billion.

Acknowledgements

Figure 1 adapted from https://www.statista.com/statistics/263615/gross-domestic-product-gdp-growth-rate-in-brazil/

Figure 2 adapted from https://tradingeconomics.com/brazil/inflation-cpi

Figure 3 adapted from https://tradingeconomics.com/brazil/government-budget-value

Extract A adapted from FT, https://www.ft.com/content/2b1cbe31-a2da-4841-a418-8c10c8cc267d and https://www.ft.com/content/1b297b16-5b19-4cb5-b0fd-de77f6f1f1a5