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Write your name here

Surname	Other names

Pearson Edexcel
International Advanced Level

Centre Number | | | | | |

Candidate Number | | | | |

Economics

International Advanced Subsidiary
Unit 2: Macroeconomic Performance and Policy

Thursday 22 January 2015 – Afternoon
Time: 1 hour 30 minutes

Paper Reference
WEC02/01

You do not need any other materials.

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 Section A and **one** question from Section B.
- 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.*
- In your responses, you should take particular care with punctuation and grammar, as well as the clarity of your expression.
- 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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1/2/2/2/2

P 4 5 0 5 0 A 0 1 4 0

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Section A: Answer all questions in this section.

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1 The table below shows the annual percentage change in GDP for Italy and France between 2009 and 2011.

Country	2009	2010	2011
Italy	–5.49	1.72	0.37
France	–3.15	1.72	2.03

(Source: http://data.worldbank.org/)

From the data it can be deduced that

(1)

A GDP growth was higher in Italy than in France in 2009

B Total GDP was the same in Italy and France in 2010

C Total GDP of France was lower in 2011 than it was in 2009

D Total GDP of Italy was lower in 2011 than it was in 2009

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 1 = 4 marks)

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2 Which **one** of the following is most likely to reduce inflationary pressures in an economy?

(1)

A An increase in labour productivity

B A fall in the exchange rate of the country's currency

C A positive output gap

D A decrease in interest rates

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 2 = 4 marks)

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3 In 2007, farmers in Peru protested against the decision by the government to approve the opening of a large copper mine by a transnational company. The farmers claimed that the mine would damage the local environment and destroy their way of life.

This can be interpreted as evidence that

(1)

A there is a choice between different macroeconomic policy instruments

B the long-run aggregate supply curve in Peru is vertical

C there is a conflict between macroeconomic policy objectives

D the government is sacrificing future investment in favour of current consumption

(a) Answer ☐

(b) Explanation

(3)

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(Total for Question 3 = 4 marks)

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4 In Greece, total investment as a percentage of GDP fell between 2008 and 2012.

Investment is best defined as

(1)

A the flow of money into the stock of savings from firms

B spending on capital goods by firms and government

C the profit retained by firms to finance future expansion

D an increase in wages paid by firms to employees

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 4 = 4 marks)

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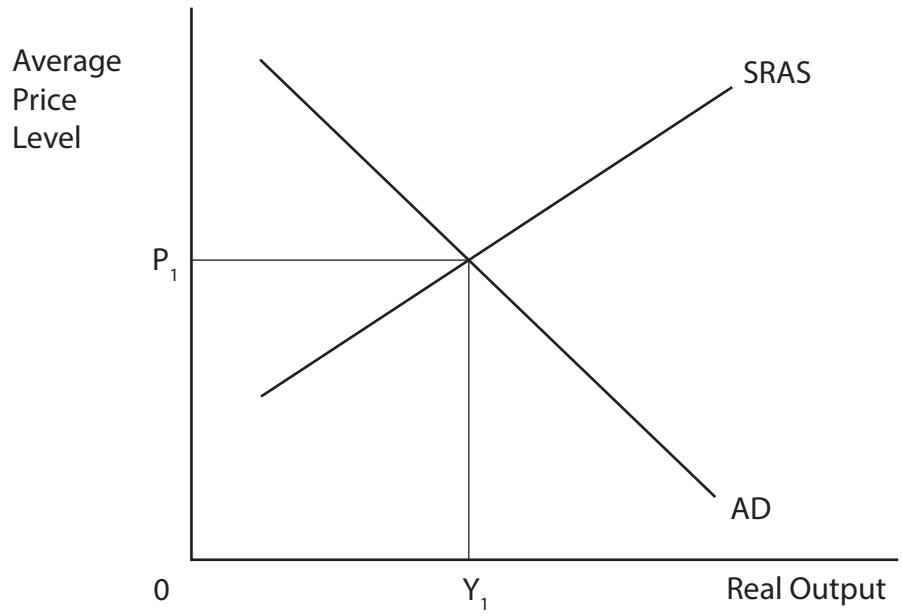
5 The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for a developed economy.



(1)

What would be the most likely effect of a fall in commodity prices on the country's average price level and real output? **Annotate** the diagram in your answer.

	Average Price Level	**Real Output**
A	Fall	Rise
B	Rise	No change
C	Rise	Fall
D	Fall	No change

(a) Answer ☐

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(b) Explanation

(3)

(Total for Question 5 = 4 marks)

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6 The Japanese Government plans to spend 200 million yen on building new power stations. The final increase in GDP as a result of this investment is estimated to be 300 million yen.

In this case the value of the multiplier would be

(1)

A 1.2

B 1.0

C 1.5

D 2.0

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 6 = 4 marks)

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7 Ceteris paribus (all other things being equal), which one of the following is most likely to cause a shift to the right in an economy's long-run aggregate supply curve?

An increase in

(1)

A the rate of income tax

B childcare costs

C immigration

D regulation

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 7 = 4 marks)

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8 Household consumption in the Netherlands fell by 4.4% between 2008 and 2012.

The impact of reduced household consumption, ceteris paribus, will be a

(1)

A rise in imports and a fall in the average price level

B fall in imports and a rise in the average price level

C fall in the average price level and a rise in real output

D fall in the average price level and a fall in real output

(a) Answer ☐

(b) Explanation

(3)

(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A = 32 MARKS

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Section B: Answer either Question 9 or Question 10.

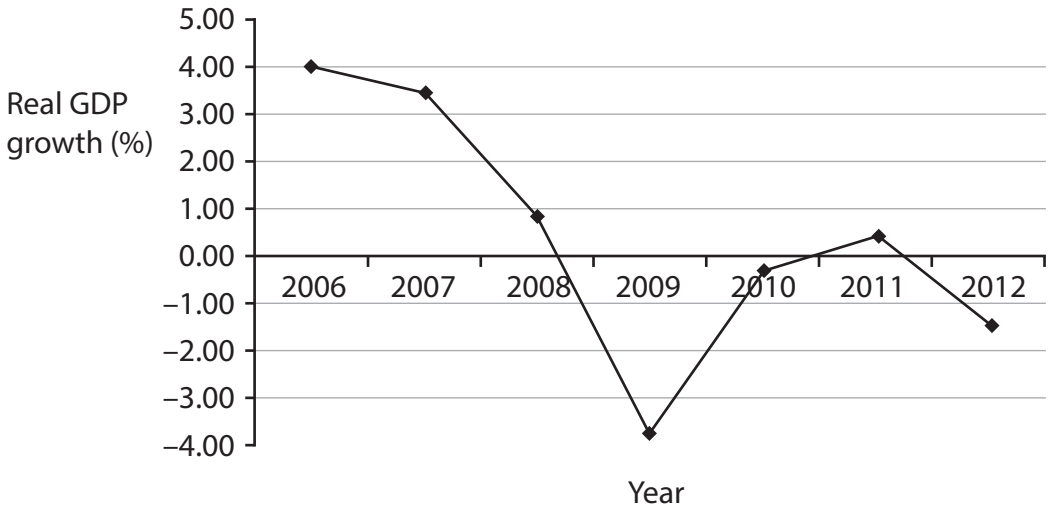
If you answer Question 9 put a cross in this box ☒ .

Question 10 starts on page 26.

You should spend 55 minutes on this section.

9 The Spanish Economy

Figure 1 Spanish real GDP growth, 2006–2012



(Source: http://data.worldbank.org/)

Extract 1 From boom to bust

After 2000 there was a large expansion of the construction industry in Spain. There were several reasons, including the lack of profitability in the manufacturing and service sectors which led to the shift of investment to construction. In addition, during the second half of the 1990s, there had been deregulation of construction and urban planning. This occurred at the same time as the increase in availability of low interest loans for the construction industry and cheap mortgages for house purchases.

From 2004 more than 500 000 apartments and houses were built per year, and in 2005 more houses were built in Spain than in France, Germany and the United Kingdom combined. This created a housing stock of 23 million units in a country of 45 million inhabitants. The construction boom led to a period of apparent prosperity between 2003 and 2007. Construction is labour intensive and uses much low skilled labour, resulting in high employment. By early 2007, 1.8 million new jobs had been created, unemployment had fallen to a record low of 8.3% of the active workforce, and 60% of all new jobs in the EU were created in Spain.

The good times could not last. In the second half of 2007, there was an economic collapse resulting from the global financial crisis.

(Adapted from: http://corporateeurope.org/2012/03/spain-crisis-role-eu)

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Extract 2 Spanish Government spending cuts and tax rises

The Spanish Government presented a draft budget for 2013 with a package of tax increases and spending cuts. The Government said these would guarantee that the cuts in the budget deficit would meet the targets agreed with the rest of the eurozone. The new budget was introduced at a time of street demonstrations, high unemployment and a recession.

The 2013 budget plan is meant to help to reduce the central government's budget deficit by €65 billion, or US$84 billion, over two and a half years. The plan involves an average cut of almost 9% in the spending of each government ministry next year. The salaries of civil servants will be frozen for a third consecutive year.

New measures would include the removal of a tax allowance for home purchases and an increase in VAT from 18% to 21%. In total, the government said the tax measures would increase revenue by €4.4 billion in 2014.

(Source: http://www.nytimes.com/2012/09/28/business/global/spain-unveils-sweeping-budget-cuts.html?pagewanted=2&_r=0)

Figure 2 Spain's unemployment rate and budget balance, 2006–2012

Year	ILO unemployment rate (%)	Budget balance as % of GDP
2006	8.5	2.3
2007	8.3	2.5
2008	11.3	–2.3
2009	18.0	–8.6
2010	20.1	–5.2
2011	21.6	–3.5
2012	26.2	–7.1

(Source: http://data.worldbank.org/)

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(a) With reference to Figure 2, explain the term ILO unemployment rate.

(4)

(b) With reference to the information provided, evaluate the impact of the construction industry on the Spanish economy.

(14)

(c) Assess the economic costs of rising unemployment in Spain.

(10)

(d) With reference to Figure 2, explain the likely relationship between Spain's ILO unemployment rate and the government's budget balance.

(6)

(e) With reference to Extract 2 and your own knowledge, evaluate the likely economic impact of the Spanish Government's measures to reduce the budget deficit. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

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(a) With reference to Figure 2, explain the term ILO unemployment rate.

(4)

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(b) With reference to the information provided, evaluate the impact of the construction industry on the Spanish economy.

(14)

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(10)

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(6)

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(e) With reference to Extract 2 and your own knowledge, evaluate the likely economic impact of the Spanish Government's measures to reduce the budget deficit. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

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(Total for Question 9 = 48 marks)

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If you answer Question 10 put a cross in this box ☒ .

10 The UK Economy

Figure 1 Annual inflation rate (Consumer Price Index) in UK and Ireland, 2009–2012

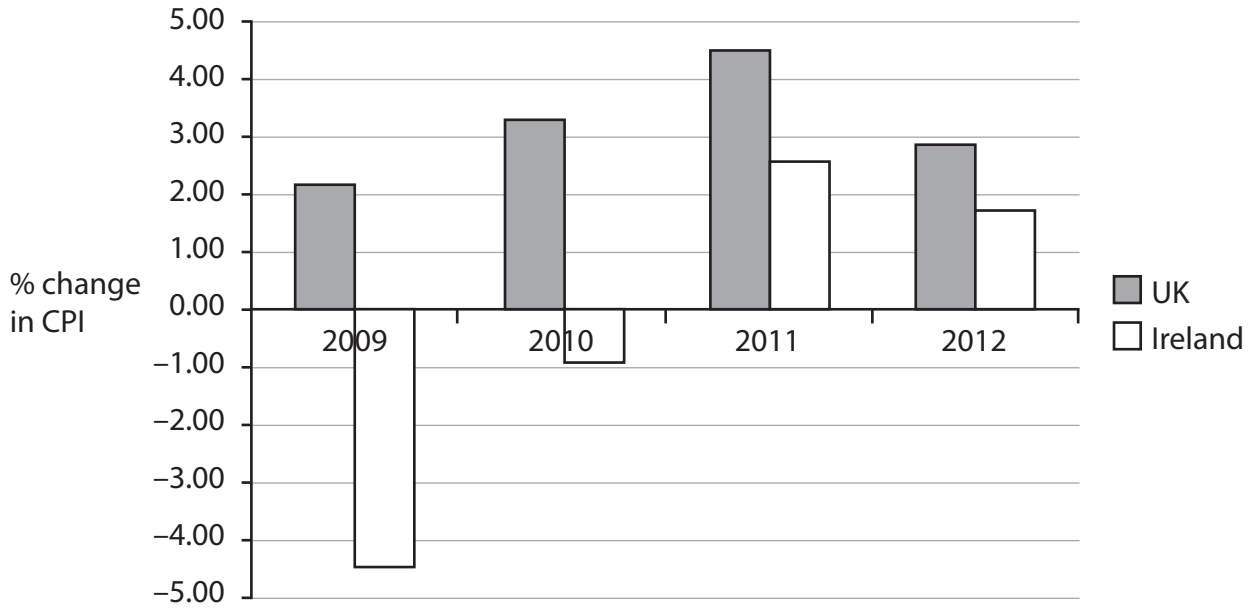
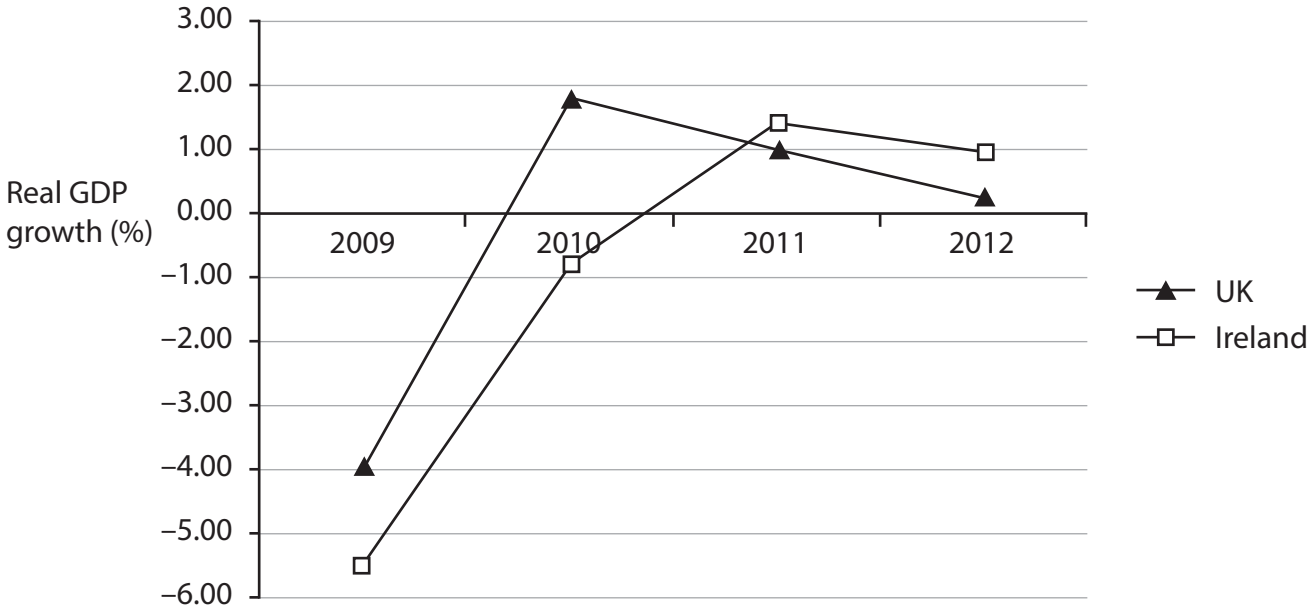


Figure 2 Real GDP growth in the UK and Ireland, 2009–2012



(Source: http://data.worldbank.org/)

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Extract 1 Inflation in the United Kingdom relative to other countries

Comparing inflation between the United Kingdom and Ireland shows that prices rose very much faster in the United Kingdom during the period 2007–2012. Ireland's food prices rose by 1% over six years, the United Kingdom's by 35.6%; energy prices increased 28% in Ireland but 61% in the United Kingdom.

Overall prices in Ireland increased by 3% over six years, the United Kingdom's by 21%. This compares with 9.8% in France, 10% in Canada, 10.2% in Germany, 12.4% in the USA and 13.5% in Italy. In contrast, prices fell by 0.5% in Japan over the same period.

Had the United Kingdom experienced any of those inflation rates it would have escaped the reduction in real wages. One of the likely reasons for the UK's higher rate of inflation was the fall in the average exchange rate of sterling.

(Source: adapted from *Sunday Times*, 20th October 2013
http://www.thesundaytimes.co.uk/sto/business/article1329423.ece)

Extract 2 UK Investment

A post-recession slump in business investment and weaker profits have damaged the UK's growth prospects, according to the Government's official budget forecaster.

The Office for Budget Responsibility (OBR) said that spending cuts and tax rises had harmed growth more than originally assumed. However, it was the "almost complete absence" of the expected contribution from private investment that explained the £100 billion shortfall in the OBR's forecast for UK GDP since June 2010. Low levels of investment damage the UK's relative productivity and competitiveness.

The inadequate supply and high cost of credit have been important factors in reducing enterprise and investment. Encouraging enterprise and investment are two key objectives of supply-side policies and could result in stronger macroeconomic performance.

(Source: http://www.telegraph.co.uk/finance/economics/10367229/
OBR-UK-hurt-more-by-lack-of-investment-than-austerity.html)

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(a) Explain the process of calculating the rate of inflation by using the Consumer Price Index.

(6)

(b) With reference to the information provided and your own knowledge, assess the impact of a fall in the average exchange rate of sterling on the UK's rate of inflation.

(10)

(c) With reference to Extract 1 and your own knowledge, evaluate the impact of relatively high inflation on the UK economy.

(14)

(d) With reference to Extract 2, explain the term supply-side policies.

(4)

(e) With reference to Extract 2, assess the importance of investment to the UK economy. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

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(a) Explain the process of calculating the rate of inflation by using the Consumer Price Index.

(6)

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(b) With reference to the information provided and your own knowledge, assess the impact of a fall in the average exchange rate of sterling on the UK's rate of inflation.

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(14)

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(4)

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(e) With reference to Extract 2, assess the importance of investment to the UK economy. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

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(Total for Question 10 = 48 marks)

TOTAL FOR SECTION B = 48 MARKS
TOTAL FOR PAPER = 80 MARKS

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