

Please write clearly in block capitals.

Centre number

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Candidate number

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Surname *StemUp Model Solution*

Forename(s)

Candidate signature

I declare this is my own work.

INTERNATIONAL AS ECONOMICS

Unit 2 The National Economy in a Global Environment

Thursday 9 January 2025 07:00 GMT Time allowed: 1 hour 45 minutes

Materials

For this paper you must have:

- the Source Booklet, provided as an insert (enclosed)
- a calculator, which you are expected to use where appropriate.

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Fill in the boxes at the top of this page.
- Answer **all** questions.
- You must answer the questions in the spaces provided. Do **not** write outside the box around each page or on blank pages.
- Do **not** write in the Source Booklet.
- If you need extra space for your answer(s), use the lined pages at the end of this book. Write the question number against your answer(s).
- Do all rough work in this book. Cross through any work you do not want to be marked.

Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- You may use a bilingual dictionary for this exam.
- You may **not** use an English dictionary.

For Examiner's Use	
Question	Mark
1–15	
16	
17	
18	
19	
20	
21	
TOTAL	



J A N 2 5 E C O 2 0 1

Section A

Answer **all** questions in the spaces provided.

Only **one** answer per question is allowed.

For each question completely fill in the circle alongside the appropriate answer.

CORRECT METHOD



WRONG METHODS



If you want to change your answer you must cross out your original answer as shown.



If you wish to return to an answer previously crossed out, ring the answer you now wish to select as shown.



0 1

A country has a Gini coefficient close to 0. This means that the country has

[1 mark]

A a very equal income distribution.



B a very high budget deficit.



C a very low budget deficit.



D a very unequal income distribution.



0 2

All other things being equal, which one of the following is most likely to increase a country's imports?

[1 mark]

A A fall in the country's exchange rate



B A rise in inflation in other countries



C An increase in productivity in the country



D An increase in real incomes in the country



0 3

Table 1 shows a government's expected revenue and spending for the next year in billions of Indian rupees (₹).

Table 1

Budget item	Amount (₹ billion)
Capital spending	1450
Direct tax revenue	2500
Indirect tax revenue	1500
National debt interest payments	350
Other revenue	250
Spending on goods and services	3100

The government wants to balance the budget.

Which one of the following policies is most likely to achieve this objective?

[1 mark]

- A** Expansionary fiscal policy ☐
- B** Increase government borrowing ☐
- C** Increase spending on goods and services ☐
- D** Reduce capital spending ☒

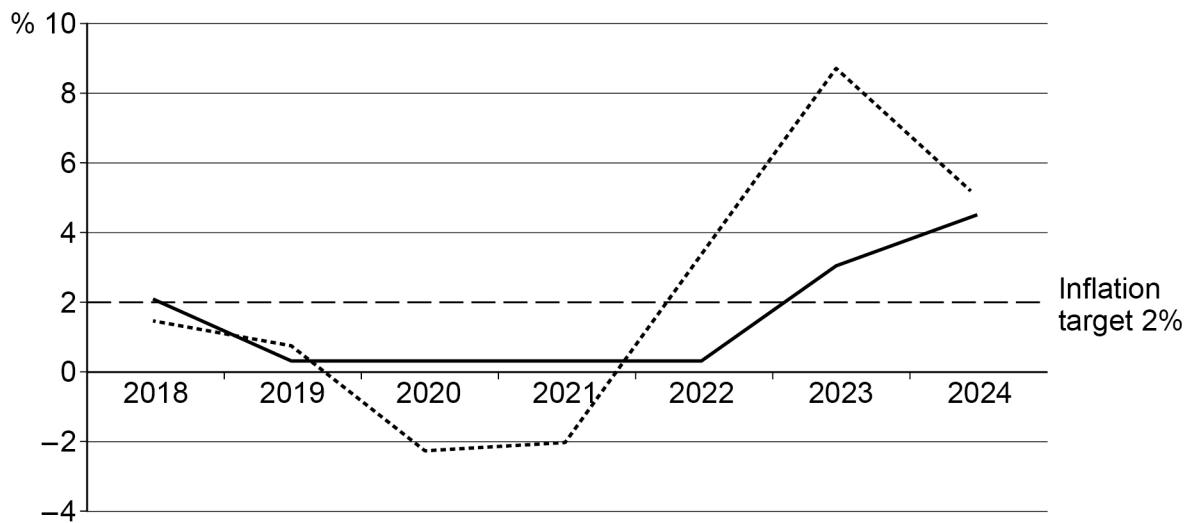
Turn over for the next question

Turn over ►



0 4

Figure 1 shows a country's rate of inflation and the interest rate set by the central bank between 2018 and 2024. It also shows the country's target for inflation, which is 2%.

Figure 1**Key**

- Rate of inflation
 — Interest rate

Which one of the following shows the most likely set of monetary policies used by the central bank to control inflation between 2018 and 2024?

[1 mark]

	2018 – 2019	2019 – 2022	2022 – 2024	
A	Contractionary interest rate policy	Expansionary interest rate policy	Quantitative easing	☐
B	Contractionary interest rate policy	Quantitative easing	Expansionary interest rate policy	☐
C	Expansionary interest rate policy	Quantitative easing	Contractionary interest rate policy	☒
D	Quantitative easing	Contractionary interest rate policy	Expansionary interest rate policy	☐



0 5

The economy of a country is close to its normal capacity level of real national output but has some underemployment.

Which one of the following policies could the government use to reduce the country's level of underemployment?

[1 mark]

- A** Give childcare subsidies to working parents so they can work longer hours ☒
- B** Increase government help for people who are looking for work but have no job ☐
- C** Pay extra money to retired workers to encourage them back into work ☐
- D** Reduce welfare payments to give people without a job more incentive to work ☐

0 6

Table 2 shows a weighted consumer price index for a country in euros (€) in 2022 and 2023 (2022 = 100).

Table 2

Item	Price in 2022 (€)	Index in 2022	Price in 2023 (€)	Index in 2023	Weight	Weighted value in 2023
Housing	2000	100	3000		5	
Food	500	100	600		3	
Clothes	300	100	270		2	
Totals:					10	
Overall price index:						

What is the value of the overall price index in 2023?

[1 mark]

- A** 60 ☐
- B** 129 ☒
- C** 138 ☐
- D** 360 ☐

Turn over ►

0 7

Which one of the following is most likely to cause short-run economic growth?

[1 mark]

A A fall in consumer confidence

☐

B A fall in energy costs for businesses

☒

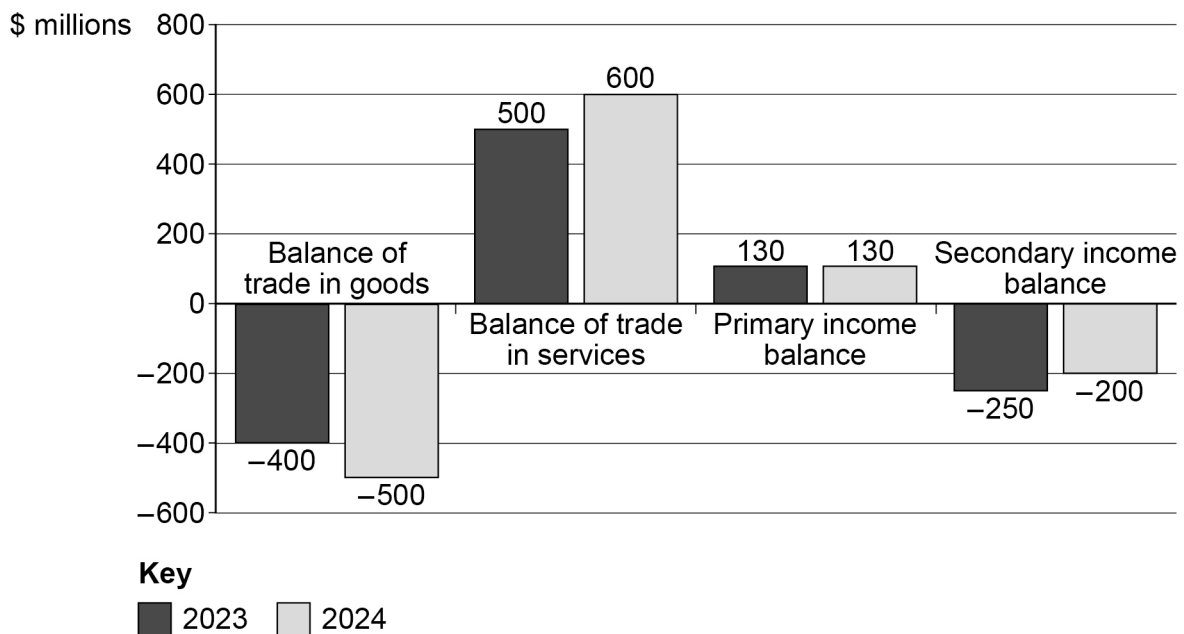
C An increase in demand for imports

☐

D An increase in the rate of interest

☐

0 8

Figure 2 shows different parts of a country's balance of payments on current account in 2023 and 2024 with figures in \$ millions.**Figure 2**

Between 2023 and 2024, the balance of payments on current account

[1 mark]

A improved by \$50 million.

☒

B increased its deficit by \$10 million.

☐

C stayed in a surplus of \$100 million.

☐

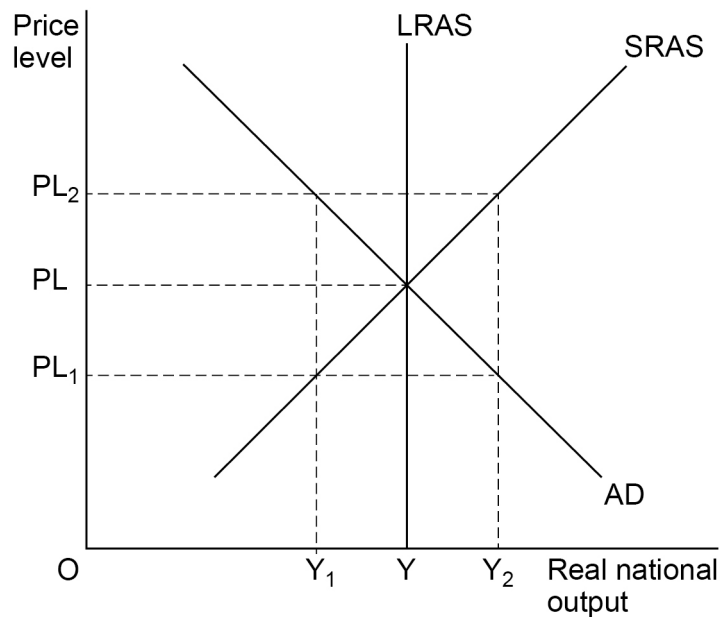
D went from a surplus to a deficit.

☐

0 9

Figure 3 shows a country's initial short-run aggregate supply (SRAS), long-run aggregate supply (LRAS) and aggregate demand (AD) curves.

Figure 3



The government raises income tax. Some skilled workers decide to leave the country.

All other things being equal, which is the most likely combination of price level and real national output after these changes?

[1 mark]

- A** PL and Y ☐
- B** PL_1 and Y_1 ☒
- C** PL_1 and Y_2 ☐
- D** PL_2 and Y_1 ☐

Turn over for the next question

Turn over ►



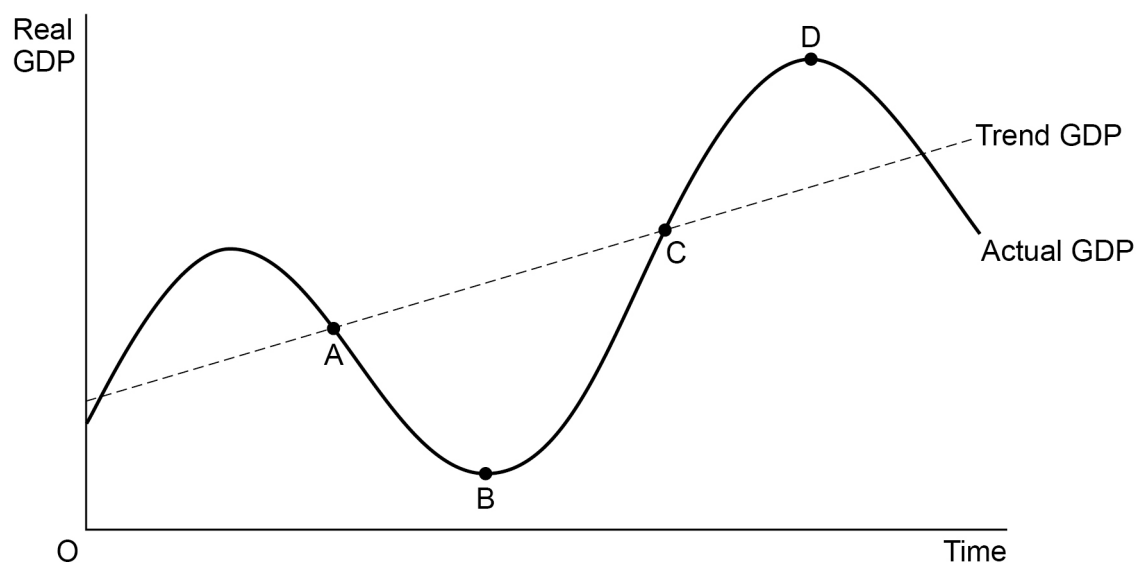
1 0

Workers in a country all have different incomes but they all pay the same amount of income tax, \$1000 per year.

What type of tax is this?

[1 mark]**A** Equitable☐**B** Progressive☐**C** Proportional☐**D** Regressive☒**1 1**

Figure 4 shows the economic cycle for a country.

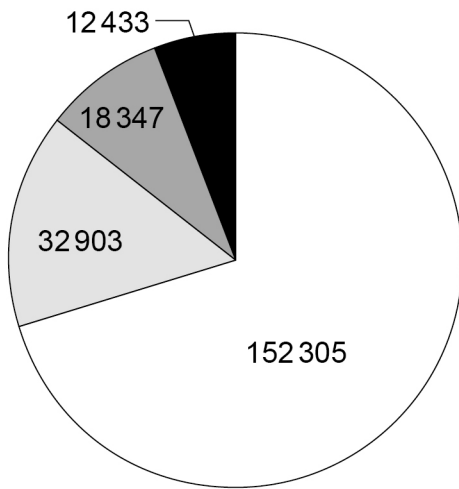
Figure 4

At which point in the cycle will the national debt be most likely to fall?

[1 mark]**A** Point A☐**B** Point B☐**C** Point C☐**D** Point D☒

1 2

Figure 5 shows the number of people unemployed in a country and the different causes of unemployment.

Figure 5**Key**

- ☐ Cannot find work because aggregate demand is too low
- ☐ Cannot find work because their skills are no longer needed by the economy
- ☐ Not currently in work because they are between jobs
- ☐ Not currently in work because their job only exists for part of the year

Total unemployment = 215 988

What is the total percentage of unemployed people who are in either cyclical or frictional unemployment?

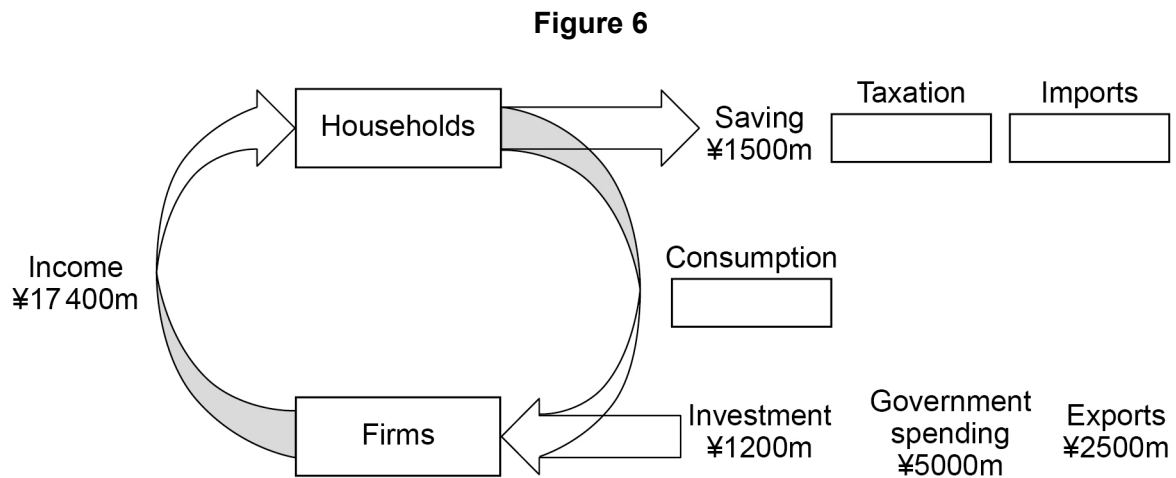
[1 mark]**A** 21.0%☐**B** 23.7%☐**C** 79.0%☒**D** 85.7%☐**1 3**

Which one of the following is an example of deregulation?

[1 mark]**A** Reducing aggregate demand using fiscal policy☐**B** Reducing the number of rules that businesses have to follow☒**C** Reducing the tax that companies pay on their profits☐**D** Reducing the value of a country's exchange rate☐**Turn over ►**

1 4

Figure 6 shows a country's circular flow of income with figures in millions of Japanese yen (¥).



The circular flow of income is in equilibrium. The country has a balanced budget and a surplus on its balance of payments on current account.

Which one of the following completes the circular flow of income correctly?

[1 mark]

	Taxation (¥)	Imports (¥)	Consumption (¥)
A	4700m	2500m	8700m
B	4700m	2200m	17 400m
C	5000m	2200m	8700m
D	5000m	2500m	17 400m

☐☐☒☐**1 5**

Which one of the following is a determinant of long-run aggregate supply?

[1 mark]

A Costs of production

☐

B Household income

☐

C Technology

☒

D The exchange rate

☐

Section B

Look at the Source Booklet and answer **all** questions in the spaces provided.

Do **not** write in the Source Booklet.

1 6 . 1 Define 'negative output gap' (**Extract B**, line 3).

[3 marks]

A negative output gap exists when the economy's equilibrium level of real national income, where aggregate demand equals short-run aggregate supply, is below (to the left of) the normal capacity level of real national output shown by the LRAS curve. It is the distance between actual real output and its higher potential level, so there is spare capacity and unemployment.

1 6 . 2 Define 'supply-side policies' (**Extract C**, line 10).

[3 marks]

Supply-side policies are government measures that aim to increase economic incentives, make markets work better (eg by correcting market failure) and improve the quality and/or quantity of the factors of production, so that the productive capacity of the economy increases and the long-run aggregate supply curve shifts to the right.

6

Turn over for the next question

Turn over ►



1 7

Extract A shows real government spending on goods and services and annual growth in real GDP in Malaysia and South Africa from 2018 to 2022.

You are advised to show your working for the calculations below.

1 7 . 1

South Africa's real GDP was US\$353.26 billion in 2021 and US\$360.47 billion in 2022.

Use **Extract A (i)** to calculate the difference between South Africa's government spending as a percentage of GDP in 2021 and its government spending as a percentage of GDP in 2022.

Give your answer to **two** decimal places.

[3 marks]

$$2021: \$70.1bn \div \$353.26bn \times 100 = 19.84374\% \text{ of GDP}$$

$$2022: \$70.7bn \div \$360.47bn \times 100 = 19.61328\% \text{ of GDP}$$

$$\text{Difference} = 19.84374\% - 19.61328\% = 0.23046\%$$

$$\text{Answer} = 0.23\% \text{ (a fall of 0.23 percentage points, to 2 decimal places)}$$

1 7 . 2

Use **Extract A (ii)** to calculate Malaysia's mean annual percentage growth in real GDP from 2018 to 2022.

[3 marks]

$$\text{Mean} = (4.8\% + 4.4\% + (-5.5\%) + 3.1\% + 8.7\%) \div 5$$

$$= 15.5\% \div 5$$

$$\text{Answer} = 3.1\% \text{ per year}$$



1 8

Extract C (lines 4–5) states: ‘A change in government spending can lead to a larger change in real national income’.

1 8 . 1

Explain how a change in government spending can lead to a larger change in real national income.

[6 marks]

Government spending is spending by the government on goods and services such as health care, education, defence and infrastructure, and real national income is the total income of the economy adjusted for inflation. Government spending is an injection into the circular flow of income and a component of aggregate demand ($AD = C + I + G + X - M$).

If the government increases its spending, for example by building new roads, the firms that receive the contracts earn more revenue and pay this out as wages and profits, so household incomes rise. Households then spend part of this extra income, so consumption increases. This raises the revenue of firms such as shops, which take on more workers and may invest in extra capacity, so their employees and suppliers also receive more income, which is spent again. Each round of spending increases AD further. This is the multiplier process: an initial change in an injection causes a larger, multiplied change in real national income.

The size of the final change depends on withdrawals. In each round some income leaks out of the circular flow as saving, taxation and spending on imports, so each round is smaller than the last. The multiplier = $1 \div (1 -$

Extra space $MPC)$, or $1 \div MPW$, so the lower the withdrawals, the bigger the change in real national income. For example, if the MPW is 0.5, a \$10bn rise in government spending raises national income by \$20bn, provided there is spare capacity. The process also works in reverse: a cut in government spending reduces incomes and consumption, causing a larger fall in national income.

Turn over ►



1 8 . 2

To what extent do the data suggest that a change in government spending leads to a larger change in real national income?

Use the data in **Extract A** to support your answer.

[6 marks]

Some data support the idea. In Malaysia, government spending grew by 1.6% between 2018 and 2019 and real GDP grew by a larger 4.4% in 2019; government spending grew by 3.9% between 2021 and 2022 and real GDP grew by a much larger 8.7% in 2022. In South Africa, government spending grew by only 0.6% between 2020 and 2021 and 0.9% between 2021 and 2022, yet real GDP grew by 4.9% and 2.0%.

However, other data contradict it. In Malaysia government spending grew by 5.0% between 2019 and 2020 and by 5.4% between 2020 and 2021, but real GDP fell by 5.5% in 2020 and grew by only 3.1% in 2021. In South Africa government spending grew by 2.1% between 2018 and 2019 and by 0.7% between 2019 and 2020, but real GDP grew by only 0.3% in 2019 and fell by 6.3% in 2020.

The data must be treated with caution. Government spending takes time to work through the circular flow, so comparing it with GDP growth in the same year may be misleading. The global pandemic dominated GDP in 2020 and the 2021 recovery. Many other factors affect real national income, such as consumer Extra space and business confidence, exchange rates, inflation and world demand for exports.

Overall, the data suggest that government spending has some effect on real national income, but as other things are not equal, Extract A only weakly supports the view that it causes a larger change.



1 9

Extract B (lines 12–13) states: ‘South Africa suffered from demand-pull inflation after the economy came out of lockdown.’

With the help of a diagram, explain the causes of demand-pull inflation.

[9 marks]

Inflation is a sustained rise in the general price level. Demand-pull inflation occurs when aggregate demand (total planned spending on domestic output, $C + I + G + X - M$) increases faster than aggregate supply (the total output firms are willing to produce at each price level).

AD can rise for several reasons: higher consumption due to rising incomes, lower interest rates or greater consumer confidence; higher investment due to higher profits or business confidence; a rise in government spending; or a rise in net exports, eg after a depreciation or faster world growth. Extract B shows that South Africa, like many countries, experienced a sudden rise in AD as it came out of lockdown, as households spent savings built up when shops were closed.

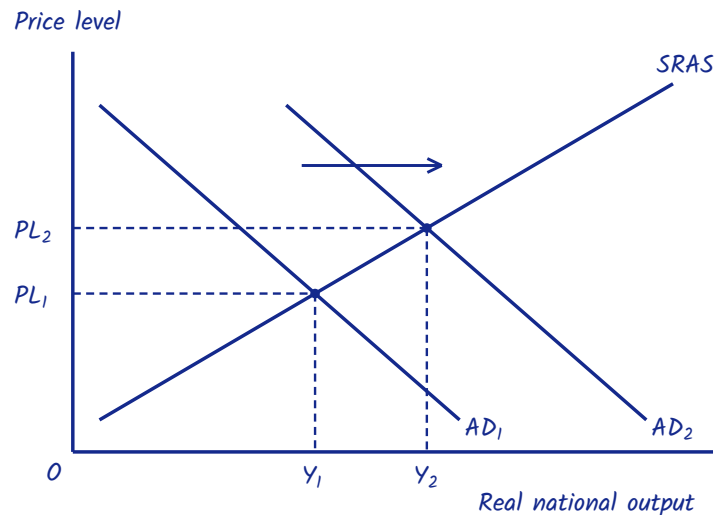
In the diagram AD shifts right from AD_1 to AD_2 . At the initial price level PL_1 there is now excess demand, a shortage of supply, so firms can raise their prices and the price level rises to PL_2 . Higher prices make production more profitable, so there is an extension along SRAS and real national output rises from Y_1 to Y_2 . As firms compete for scarce labour and materials, costs rise too, so the increase in AD is partly reflected in higher prices rather than more output.

Demand-pull inflation is worse when supply cannot respond. Extract B suggests that short-run restrictions on supply after lockdown, such as shortages of components and

Extra space workers, made SRAS steeper, so the rise in AD mainly raised prices. If AD rises so far that the economy moves past its normal capacity level of output, creating a positive output gap, the inflation is even greater.

Turn over ►





9

2 0

Extract B (lines 14–15) states: ‘South Africa’s real GDP is now back at its 2019 level but the number of jobs is around half a million lower than in 2019.’

Analyse the factors that determine the level of employment in an economy.

[12 marks]

Employment is the number of people in paid work. It is determined by both the demand for labour, which is a derived demand from the demand for goods and services, and the supply of labour. Jobs may be part-time, so an economy can have both unemployment and underemployment.

On the demand side, the key factor is aggregate demand. If consumption, investment, government spending or net exports rise, firms must produce more output, so they hire more workers and cyclical unemployment falls. Employment therefore depends on the stage in the economic cycle: in a recession with a negative output gap, employment falls. Exports matter, as in Extract C: they depend on competitiveness, the level of world economic activity and trade restrictions, so a fall in world demand or new tariffs reduces jobs in export industries. Employers' confidence matters too: if firms expect weak demand, they hesitate to take on staff even when output recovers.

Technology and the relative cost of labour and capital also determine employment. If wages, minimum wages or employment taxes rise relative to the cost of machines,



firms substitute capital for labour. Higher labour productivity can reduce the number of workers needed for a given output, which helps explain why South Africa's real GDP is back at its 2019 level while jobs are around half a million lower (Extract B). However, higher productivity lowers unit costs and may make firms more competitive, raising demand and employment in the long run.

On the supply side, employment depends on the size of the labour force: the size and age structure of the population, the legal working age and retirement age, and participation rates. Generous out-of-work benefits relative to wages (a high replacement ratio) reduce the incentive to work. The health of the population,

Extra space mentioned in Extract B, matters: illness after the pandemic may keep some people out of the labour force. Education and skills are vital: if workers lack the skills firms need, there will be structural unemployment even when vacancies exist.

The occupational and geographical mobility of labour determines how quickly workers can move into new jobs, so low mobility raises structural and frictional unemployment. Trade unions that push wages above the market-clearing level may reduce employment, and strict employment legislation can make firms reluctant to hire, while flexible labour markets encourage hiring. Overall, employment depends on the interaction of AD, which creates the demand for workers, and supply-side factors, which determine whether people are able and willing to fill the jobs.



2 1

Extract C (lines 20–21) states: ‘The Malaysian government now aims to encourage growth in exports. It believes this is the best way to increase economic growth.’

Use the extracts and your knowledge of economics to assess whether the best way to increase economic growth is to increase exports.

[20 marks]

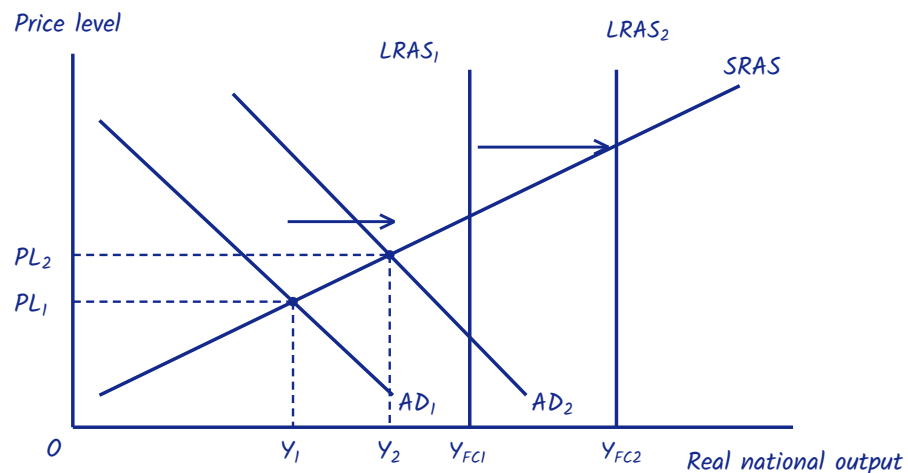
Economic growth is an increase in real GDP. Short-run growth comes from a rise in aggregate demand that uses spare capacity, while long-run growth is an increase in the productive capacity of the economy, shown by a rightward shift of LRAS.

Exports are a component of aggregate demand ($AD = C + I + G + X - M$) and an injection into the circular flow of income.

There are strong arguments that increasing exports is the best way to achieve growth. When foreign demand for exports rises, AD shifts from AD_1 to AD_2 in the diagram and real output rises from Y_1 to Y_2 . Export firms earn more revenue, hire more workers and pay more wages, which are then spent, so through the multiplier process real national income rises by more than the initial rise in exports. Higher sales and profits also encourage firms to invest through the accelerator, and this investment adds to the capital stock and shifts LRAS from $LRAS_1$ to $LRAS_2$, so export-led growth can become long-run growth. Extract C shows that strong demand for its exports enabled Malaysia to become one of the most successful economies in Asia.

Export-led growth is attractive because, unlike consumption-led growth, it supports the balance of payments objective: higher exports improve the current account rather than sucking in imports. A large world market is much bigger than the domestic market, so firms can gain economies of scale, lowering unit costs and making them even more competitive. The government can help by targeting grants and subsidies at export industries to reduce their costs of production and the costs of exporting, allowing them to cut export prices; by reducing regulations so more firms export; and by keeping monetary policy tight so that interest rates and inflation are low and





stable. Low inflation keeps exporters' costs and prices down and encourages investment, while economic stability helps to keep the exchange rate stable, increasing the confidence of exporters and their foreign customers.

However, there are strong reasons why a policy to increase exports may not succeed. Demand for exports depends on economic activity and consumer preferences in other countries, which the government cannot control. If Malaysia's trading partners enter a recession, export demand and growth fall. Countries that rely on exports are very vulnerable to demand-side shocks such as the global pandemic, when world trade collapsed and Malaysia's real GDP fell by 5.5% in 2020 (Extract A). Export demand also depends on the productivity and efficiency of firms in competitor countries and on the exchange rate, which the government cannot fully control: an appreciation of the ringgit would make exports more expensive and reduce demand. Trade restrictions imposed by other countries, such as tariffs and quotas, can also limit export growth. Encouraging exports may also conflict with other objectives. Subsidies and grants for exporters must be funded through higher taxation or government borrowing, which may reduce consumption or increase the national debt and has an opportunity cost, eg less spending on health or education. If export demand rises when the economy is close to its normal capacity, it creates demand-pull inflation, with the price level rising from PL_1 to PL_2 , which as Extract B shows can be damaging. A rise in export

Turn over ►



Extra space *demand on its own increases short-run growth but may not increase*

long-run growth unless firms use the extra revenue to invest in capacity.

There are alternative policies that may be more effective. Supply-side policies, such as improving education, training and health, as the Malaysian government aims to do (Extract C), raise labour productivity and efficiency and shift LRAS to the right.

This increases the normal capacity level of real national output, allowing growth without demand-pull inflation (Extract B), which is especially important if a country's productive capacity has been damaged by the pandemic (Extract C).

Supply-side improvements also lower costs and make firms more competitive, so they will increase exports and make imports less attractive anyway. Alternatively, expansionary fiscal policy and/or monetary policy, such as higher government spending or lower interest rates, can boost domestic consumption and investment and generate growth, especially in the private sector, as in the United States (Extract C). These policies are within the government's control, unlike foreign demand, although supply-side policies take a long time and are costly, and demand-side policies may cause inflation or a larger budget deficit.

Whether increasing exports is the best way to increase growth depends on several factors. First, it depends on the size and openness of the economy: for a relatively small, open economy such as Malaysia, the domestic market is limited, so exports are a far larger potential source of demand than for a large economy such as the United States. Second, it depends on the state of the world economy: export-led growth works well when world demand is strong but poorly in a global downturn.

Third, it depends on the economy's spare capacity: with a negative output gap, more exports raise output and jobs with little inflation, but near full capacity they mainly raise prices. Fourth, it depends on why exports rise: if they rise because of genuine improvements in productivity and quality, growth is sustainable, but if they rely on subsidies or a weak currency it may not last.



In conclusion, increasing exports is a powerful way to increase economic growth, especially for an open economy like Malaysia, since it raises AD through the multiplier, encourages investment and supports the current account. However, it is not the best way on its own, because export demand depends on factors outside the government's control and mainly creates short-run growth. The most effective approach is to combine supply-side policies that raise productivity and competitiveness with export promotion: firms that are more productive will export more, so long-run growth and export growth support each other.

END OF QUESTIONS



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