

Please write clearly in block capitals.

Centre number

Candidate number

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

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	



Section AAnswer **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**

Which one of the following is an example of contractionary monetary policy?

[1 mark]**A** A decrease in the rate of income tax☐**B** A decrease in the value of the currency☐**C** An increase in the money supply☐**D** An increase in the rate of interest☒**0 2**

Which one of the following statements is correct?

[1 mark]**A** Investment is an injection into the circular flow of income.☒**B** The marginal propensity to save is total savings as a proportion of total income.☐**C** The total value of savings must be greater than total investment.☐**D** When interest rates increase, investment will also increase.☐

0 3

Table 1 shows total injections into, and withdrawals from, an economy's circular flow of income in one year.

Table 1

Injections and withdrawals	\$m
Investment	200
Savings	150
Exports	400
Imports	450
Government spending	300
Taxation revenue	300

GDP at the start of the year was \$1200m.

All other things being equal, what is the value of GDP at the end of the year?

[1 mark]**A** \$200m☐**B** \$1200m☒**C** \$1800m☐**D** \$3000m☐

Turn over for the next question

Turn over ►



0 4

Table 2 shows data relating to the price index of an economy.

Table 2

Item	Weight	Price index in Year 2 (Year 1 = 100)
Food	30%	105
Housing	45%	102
Transport	25%	110

What is the weighted price index in Year 2?

[1 mark]

- A** 104.9 ☒
- B** 105.7 ☐
- C** 117.0 ☐
- D** 317.0 ☐

0 5

If a government has a balanced budget, this means that

[1 mark]

- A** fiscal policy is contractionary. ☐
- B** government spending equals tax revenue. ☒
- C** the value of exports equals the value of imports. ☐
- D** there is no government debt. ☐



0 6

National income rises by €500bn. In turn, consumer spending on domestically produced goods rises by €250bn, savings rise by €100bn and the tax paid rises by €50bn.

Which one of the following is true?

[1 mark]

A The increase in government spending equals €50bn.

☐

B The marginal propensity to import is 0.2

☒

C The marginal propensity to save is 0.1

☐

D Total withdrawals equal €100bn.

☐
0 7

An economy has a positive output gap.

Which one of the following must be true?

[1 mark]

A Employment levels are falling.

☐

B Inflationary pressure is falling.

☐

C Long-run economic growth is occurring.

☐

D Potential output is less than actual output.

☒

Turn over for the next question

Turn over ►



0 8

Table 3 shows selected macroeconomic data, in index form, from 2018 to 2020 (2017 = 100).

Table 3

Indicator	2018	2019	2020
Nominal GDP	102	104	106
Price level	101	105	108
Nominal investment	104	106	110

Which one of the following can be concluded from the data?

[1 mark]

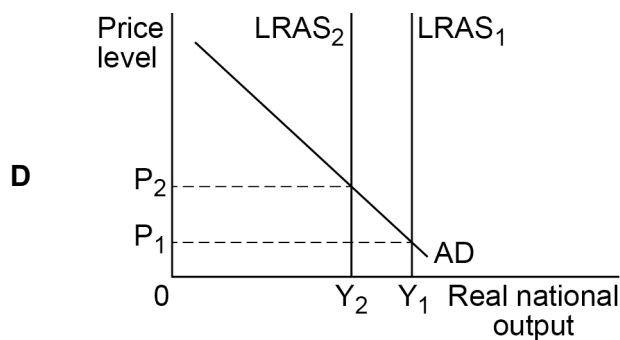
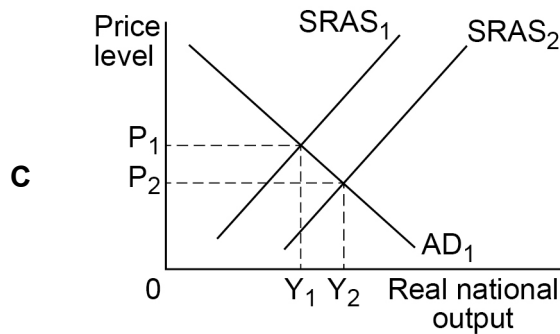
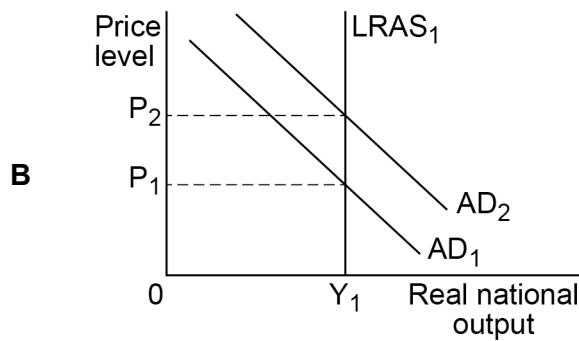
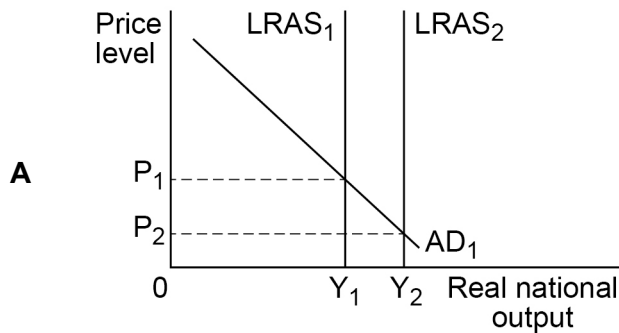
- A** Investment fell in real terms between 2018 and 2020.
- B** Nominal GDP growth was most rapid between 2019 and 2020.
- C** Prices were 8% higher in 2020 than in 2019.
- D** Real GDP rose by about 2% between 2018 and 2020.

☒
☐
☐
☐


0 9

The diagrams below show the initial aggregate demand (AD_1), short-run aggregate supply ($SRAS_1$) and long-run aggregate supply ($LRAS_1$) curves for an economy. The economy experiences a significant negative supply-side shock due to the collapse of airlines and shipping companies.

All other things being equal, which one of the following diagrams shows the most likely impact of this shock on the economy?

[1 mark]**Turn over ►**

1 0

Figure 1 shows data on Mexico's balance of payments on current account as a percentage of GDP, from 2000 to 2019.

Figure 1



Which one of the following can be concluded about Mexico's economy?

[1 mark]

- A** It experienced its largest current account deficit in both 2006 and 2019.
- B** Mexico's national income was fluctuating for the entire period.
- C** There was a deficit on the balance of trade in goods for the entire period.
- D** There were more outflows than inflows of money into its current account each year.

☐
☐
☐
☒


1 1

The cost of raw materials rises for all industries in an economy.

All other things being equal, what is the most likely impact on this economy's inflationary pressure and real national output?

[1 mark]

Impact	Inflationary pressure	Real national output	
A	Decreases	Decreases	☐
B	Decreases	Increases	☐
C	Increases	Decreases	☒
D	Increases	Increases	☐

1 2

Deflationary policy

[1 mark]

A aims to reduce aggregate demand.

☒

B causes short-run aggregate supply to increase.

☐

C is intended to result in deflation.

☐

D leads to a fall in the value of an economy's currency.

☐

Turn over for the next question

Turn over ►



1 3

Table 4 shows data on the value of exports, imports and aggregate demand for three economies in one year, in US dollars.

Table 4

Economy	Value of exports (\$m)	Value of imports (\$m)	Aggregate demand (\$m)
Economy X	500	100	4000
Economy Y	150	300	1200
Economy Z	800	600	4800

Which one of the following statements is true?

[1 mark]

- A** The aggregate demand of Economy Y is a quarter of Economy Z.
- B** The imports of Economy X add \$100m to its aggregate demand.
- C** The net exports of Economy Y are \$450m.
- D** The ratio of the value of exports to the value of imports in Economy Z is 3:2

☒☐☐☐**1 4**

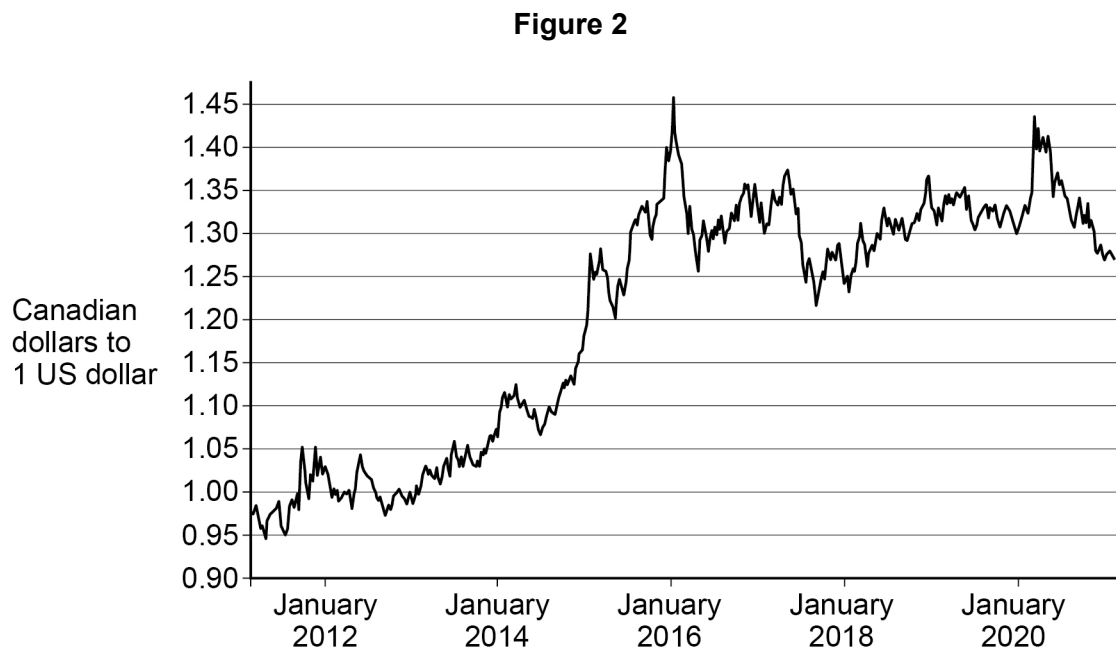
Which one of the following is a cyclical influence on a government's budget balance?

A change in

[1 mark]

- A** government spending on health care as the population ages.
- B** government spending on infrastructure to support export industries.
- C** tax revenue due to a fall in the level of GDP.
- D** tax revenue due to a fall in the rate of corporation tax.

☐☐☒☐

1 5**Figure 2** shows the value of the US dollar in Canadian dollars from 2011 to 2021.

All other things being equal, which one of the following can be concluded from the data?

[1 mark]

- A** Canada's aggregate demand has increased over the period shown. ☐
- B** The Canadian dollar was strongest against the US dollar at the start of 2016. ☐
- C** The US dollar appreciated against the Canadian dollar over the period shown. ☒
- D** The value of Canadian exports to the US has increased by around 30%. ☐

15**Turn over for Section B****Turn over ►**

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 'GDP per capita' (**Extract B**, line 2).

[3 marks]

GDP per capita is the total value of national output (national income) produced in an economy in a year divided by the size of its population. It shows the average output, or income, for each person in the economy and is often used as a measure of living standards.

1 6 . 2 Define 'underemployment' (**Extract C**, line 4).

[3 marks]

Underemployment is when people are in employment but are not working to their full capacity: they work fewer hours than they would like to (for example, part-time when they want full-time work), or they work in jobs requiring lower skills or education than they have.



1 7

Extract A shows data on the growth rates and unemployment rates of HICs and UMICs from 2010 to 2019.

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

1 7 . 1

Use **Extract A (i)** to calculate the change in the difference between the growth rates of HICs and UMICs in 2019 compared to 2010.

Give your answer to **one** decimal place.

[3 marks]

$$\text{Difference in 2010} = 7.6\% \text{ (UMICs)} - 2.9\% \text{ (HICs)} = 4.7 \text{ percentage points}$$

$$\text{Difference in 2019} = 3.6\% \text{ (UMICs)} - 1.6\% \text{ (HICs)} = 2.0 \text{ percentage points}$$

$$\text{Change in the difference} = 4.7 - 2.0 = 2.7$$

$$\text{Answer} = \text{the difference fell by 2.7 percentage points } (-2.7 \text{ percentage points})$$

1 7 . 2

In 2019, the labour force in HICs was 628 587 432 people.

Use **Extract A (ii)** to calculate the number of employed people in HICs in 2019.

Give your answer to the nearest **whole** number.

[3 marks]

$$\text{Employed} = \text{labour force} \times (100 - \text{unemployment rate}) \div 100$$

$$= 628\,587\,432 \times (100 - 4.8) \div 100 = 628\,587\,432 \times 0.952$$

$$= 598\,415\,235.26$$

$$\text{Answer} = 598\,415\,235 \text{ employed people}$$

Turn over ►

1 8

Extract C (lines 2–3) states: ‘economic growth can lead to falling unemployment.’

1 8 . 1

Explain why positive rates of economic growth can lead to falling unemployment.

[6 marks]*Economic growth is an increase in real GDP (real national output) over time.**Unemployment is the number of people in the labour force who are willing and able to work and actively seeking a job, but who do not have one.**Labour is a derived demand; firms demand workers in order to produce goods and services. When the rate of economic growth is positive, real output is rising, so firms need more labour to produce the extra output. Firms first make fuller use of existing staff, but then recruit more workers, so the demand for labour increases and unemployment, especially cyclical (demand-deficient) unemployment, falls.**Growth also means real incomes are rising. Households with higher incomes spend more on goods and services, so aggregate demand rises; through the multiplier this creates further rounds of spending, more demand for output and therefore even more demand for labour.**However, unemployment only falls if the demand for labour rises faster than the working population (labour force) grows.*

1 8 . 2

To what extent do the data suggest that positive rates of economic growth lead to falling unemployment?

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

[6 marks]

The data for UMICs give some support. Growth fell from 7.6% in 2010 to 3.6% in 2019 and unemployment rose from 5.4% to 6.2%, so as growth slowed, unemployment rose. Unemployment was highest (6.2%) in 2019, when growth was at its joint lowest of 3.6%. However, the rise in unemployment (0.8 percentage points, 14.8%) was much smaller than the fall in growth (4 percentage points, 52.6%), and the lowest unemployment (5.1%) was in 2013 and 2014, when growth was only 5% and 4.1%, not in 2010 when growth was highest.

The HIC data show positive growth with falling unemployment: unemployment fell fairly steadily from 8.3% to 4.8% while growth stayed positive at around 2%. But unemployment was highest in 2010, when growth was highest (2.9%), and it kept falling even though growth slowed to 1.6%.

The data are only averages for each group, there may be time lags, and labour forces grow faster in UMICs, so less growth is needed to cut unemployment in HICs. Overall, positive growth is linked to falling unemployment in HICs, but the data show only a weak, partial link.

12

Turn over for the next question

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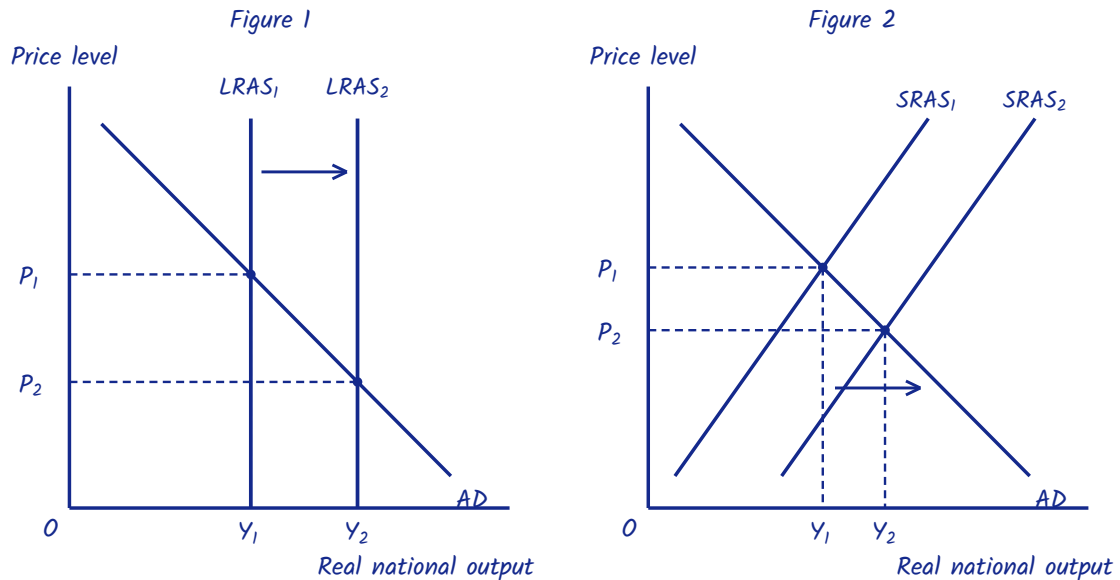


1 9

Extract B (lines 13–14) states: 'A rapid increase in productivity usually causes higher economic growth.'

With the help of a diagram, explain why an increase in productivity can lead to economic growth.

[9 marks]



Productivity is output per unit of input, for example output per worker per hour.

Long-run economic growth is an increase in the productive capacity (potential output) of the economy; short-run growth is an increase in real GDP using spare capacity.

If productivity rises, for example through better education or new technology (Extract B), the same quantity of factors of production can produce more output.

The economy's full-employment level of output increases, a supply-side improvement, so LRAS shifts right from $LRAS_1$ to $LRAS_2$ in Figure 1. Potential output rises from Y_1 to Y_2 , which is long-run growth, and the price level falls from P_1 to P_2 , so growth can be non-inflationary. A rise in the underlying rate of growth then allows a higher short-run rate of growth without inflation.

Higher productivity also lowers firms' costs of production; factors are used for less time to produce each unit, so unit labour costs fall if wages do not rise as fast.



SRAS shifts right from $SRAS_1$ to $SRAS_2$ in Figure 2, so real output rises from Y_1 to Y_2 and the price level falls from P_1 to P_2 . Lower prices make exports more competitive, raising $(X - M)$.

Finally, more productive workers can be paid higher real wages, so real incomes rise. This increases consumption and aggregate demand, shifting AD right and causing further short-run growth, as long as there is the capacity to meet the extra demand.

9

2 0

Extract B (lines 6–7) states: ‘The UMICs with the highest growth rates are usually those with increasing productivity’.

Analyse ways in which productivity can be increased in an economy.

[12 marks]

Productivity is the output produced per unit of a factor of production in a period of time, such as output per worker per hour (labour productivity). It rises when the same inputs produce more output or higher value output. Extract B links higher productivity to faster growth in UMICs.

One way is higher levels of education and training (Extract B). Education and training improve human capital, giving workers more skills and knowledge, so they can produce more goods and services, or higher value goods and services, in each hour, and can use more advanced machinery. Governments can fund schools, universities and apprenticeships, and firms can train staff.

A second way is greater use of the Internet. Better internet connectivity makes it easier to run a business, reach customers, share information and work flexibly, so entrepreneurs, labour and capital are used more efficiently. More investment in capital in general, such as new machinery and technology, gives each worker more and better capital to work with, raising output per worker. Spending on research and development (R&D) and copying innovations from other countries (Extract B)

Turn over ►



lead to new, more efficient methods of production.

Third, being more open to international trade can raise productivity. It allows economies to import more and better quality capital goods, which helps labour to be more productive, and it lets countries specialise in what they produce most efficiently. Trade also increases the competition facing domestic firms, which have an incentive to cut waste and become more efficient to survive, raising productivity.

Foreign direct investment brings in new capital, technology and management skills.

Fourth, greater diversification of the economy (Extract B) means workers and other factors of production are more likely to find work that suits their particular skills

Extra space and abilities, rather than being stuck in low-productivity farming, so resources are reallocated to more productive uses and output per worker rises.

Productivity can also be increased by government supply-side policies, such as better infrastructure (transport and energy) that cuts firms' costs and time, reducing excessive regulation, and tax incentives for investment, as well as by firms themselves through better management, motivation of workers and more efficient organisation to improve competitiveness.

The effect of these methods depends on how well they are carried out. Education and infrastructure take years to raise productivity, and new capital only helps if workers have the skills to use it, so the policies work best when combined.



2 1

Extract C (line 17) states: 'Governments need to use a range of policies to tackle the problem of unemployment'.

Use the extracts and your knowledge of economics to discuss policies that governments could use to reduce unemployment.

[20 marks]

Unemployment is when people in the labour force who are willing and able to work, and are actively looking for work, cannot find a job. It has different causes.

Cyclical (demand-deficient) unemployment is caused by a lack of aggregate demand, for example after global economic shocks or because uncertainty leads to low investment (Extract C). Structural unemployment is caused by a mismatch between workers' skills and the jobs available, made worse by poor education and skills, a lack of economic diversity and population changes, while frictional unemployment occurs as people move between jobs. Extract C also highlights youth unemployment and underemployment.

Governments could use demand-side policies to reduce cyclical unemployment.

Expansionary fiscal policy, such as higher government spending or lower taxes, raises aggregate demand directly and, through the multiplier, by more than the initial injection. Expansionary monetary policy, lower interest rates, reduces the cost of borrowing, encouraging consumption and investment. As AD shifts right, real output rises, and because labour is a derived demand firms take on more workers, so unemployment falls. This is likely to be effective when there is a negative output gap. However, if the economy is close to full capacity, more AD mainly raises the price level, causing demand-pull inflation, and higher spending may increase the budget deficit and debt. Demand-side policy also does nothing to fix a skills mismatch, and there are time lags.

Extract C describes job-based education and training. This raises human capital and gives unemployed and young people the skills that employers need, reducing structural and youth unemployment and also underemployment, while increasing

Turn over ►



productivity and LRAS. However, training is costly, takes time to have an effect and only works if it matches the skills firms actually demand; poorly designed schemes may be a waste of money, a government failure.

Subsidies to employers to cover part of workers' wages (Extract C) reduce the cost of employing labour, so firms demand more workers, especially young or inexperienced people, who also gain experience. The risk is that firms hire workers they would have employed anyway (deadweight), or replace other workers to get the subsidy, and that jobs disappear when the subsidy ends, while the opportunity cost is spending on health or education.

Providing job centres (Extract C) improves information about vacancies, so job seekers are matched with jobs more quickly, reducing frictional unemployment. This is relatively cheap, but it cannot help if there are simply too few jobs, as in a recession.

Encouraging new businesses, for example through grants, cheap loans, tax breaks and less regulation, creates jobs, increases enterprise and helps diversify the economy, reducing structural unemployment where an economy depends on a few industries. However, many new businesses fail, and the jobs created may be low

Extra space paid or in the informal sector.

Improving transport infrastructure (Extract C) increases the geographical mobility of labour, so workers can reach jobs in other areas, and it also creates construction jobs in the short run and lowers firms' costs, raising both AD and LRAS. But projects are very expensive, take years to complete and may suffer from cost overruns. Other policies include reducing unemployment benefits or income tax to increase the incentive to work, though cutting benefits may increase poverty and inequality.

The effectiveness of each policy depends on matching it to the cause of unemployment. Extract A suggests that in HICs unemployment fell steadily from



8.3% in 2010 to 4.8% in 2019 while growth stayed around 2%, so the high unemployment in 2010 was largely cyclical, after a global shock, and has been reduced as demand recovered; remaining unemployment is more likely to be structural or frictional, so supply-side measures such as training and job centres are now more suitable. In UMICs, unemployment rose from 5.4% to 6.2% even though growth remained positive at 3.6%, which suggests a rapidly growing labour force and structural problems such as poor education and a lack of diversity, so education, training and support for new businesses are likely to be more effective there than simply boosting demand.

Governments also face constraints and different priorities. Many UMICs have limited tax revenue and cannot afford large subsidies or infrastructure, and may need to borrow abroad, while HICs may already have high government debt. Some policies conflict with other objectives: expansionary demand-side policies may cause inflation and worsen the current account as imports rise, whereas supply-side policies improve several objectives together but only in the long run.

In conclusion, there is no single best policy. Extract C is right that governments need a range of policies, because unemployment usually has several causes at once.

Demand-side policy is most effective in the short run against cyclical unemployment in a recession, while supply-side policies, such as job-based training, job centres and better infrastructure, are needed to reduce structural and youth unemployment in the long run. The best mix depends on the type of unemployment, the size of the output gap, the state of government finances and how quickly results are needed, so a combination tailored to each country is likely to work best.

END OF QUESTIONS



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