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Centre number

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Candidate number

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Surname *StemUp Model Solution*

Forename(s)

Candidate signature

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INTERNATIONAL AS ECONOMICS

Unit 2 The National Economy in a Global Environment

Friday 16 May 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 U N 2 5 E C O 2 0 1

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** A central bank using quantitative easing would be most likely to**[1 mark]****A** buy more government and corporate bonds.**B** increase the interest rate it charges banks.**C** reduce the interest rate it charges banks.**D** sell more government and corporate bonds.**0 2** Which one of the following means a country is experiencing deflation?**[1 mark]****A** Average prices are rising more slowly.**B** Interest rates are rising.**C** The exchange rate is falling.**D** The general price level is falling.

0 3

Table 1 shows a country's GDP and selected figures from its balance of payments on current account in millions of euros (€).

Table 1

GDP	€54 000m
Trade in goods	€4 200m
Trade in services	–€3 800m
Primary income	€1 100m

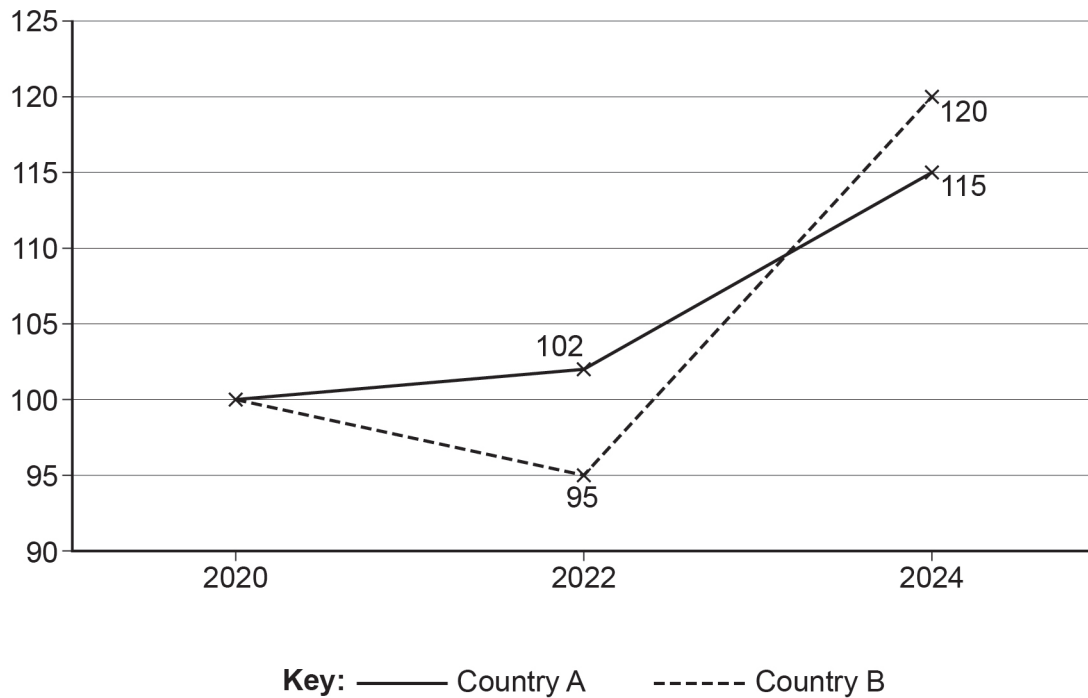
The country has a current account deficit equal to 2% of GDP. What is the value of secondary income?

[1 mark]**A** –€420 million☐**B** –€1080 million☐**C** –€2580 million☒**D** –€10 180 million☐**Turn over for the next question****Turn over ►**

0 4

Figure 1 shows an index of GDP per capita for two countries with a base year of 2020.

Figure 1



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

[1 mark]

- A** Country A's GDP grew more slowly than Country B's GDP between 2022 and 2024. ☐
- B** Country A's GDP per capita was 15% higher in 2024 than in 2020. ☒
- C** Country B's GDP fell between 2020 and 2022 and rose between 2022 and 2024. ☐
- D** The two countries had the same GDP per capita in 2020. ☐



0 5

All other things being equal, which one of the following would be most likely to increase a country's normal capacity level of output?

[1 mark]

A A fall in cyclical unemployment

☐

B A fall in the marginal propensity to save

☐

C An increase in consumer confidence

☐

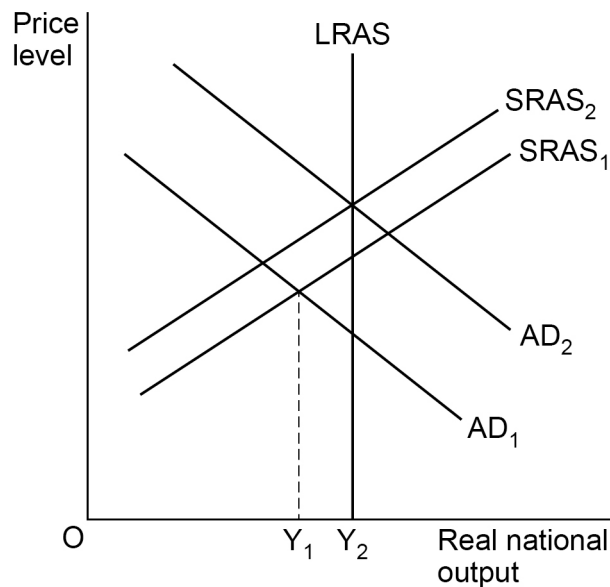
D An increase in the capital stock

☒

0 6

Figure 2 shows the initial aggregate demand (AD_1), short-run aggregate supply ($SRAS_1$) and long-run aggregate supply ($LRAS$) curves for an economy.

Figure 2



All other things being equal, which one of the following could have caused the shift from Y_1 to Y_2 ?

[1 mark]

A A rise in consumer income and a rise in indirect taxes

☒

B A rise in exports and a rise in business subsidies

☐

C A rise in imports and a rise in interest rates

☐

D A rise in investment and a rise in productivity

☐

Turn over ►



0 7

A government provides more information about jobs to help reduce unemployment.

Which one of the following types of unemployment is this most likely to affect?

[1 mark]

A Cyclical

☐

B Frictional

☒

C Seasonal

☐

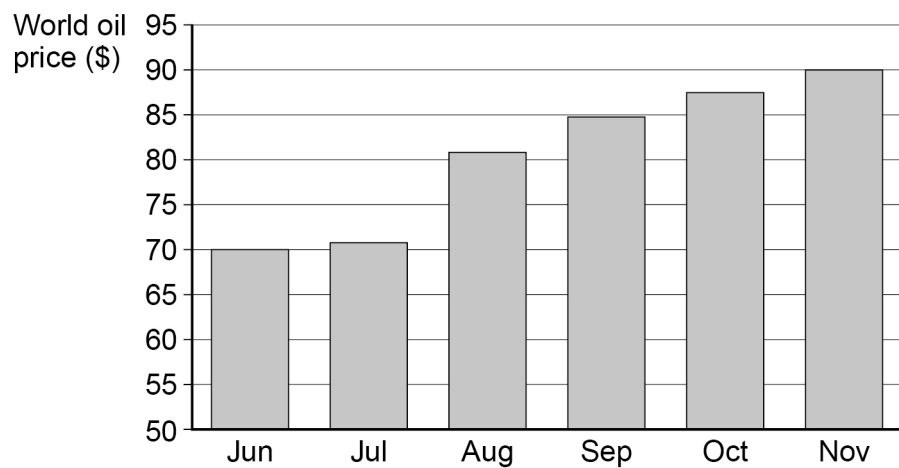
D Structural

☐

0 8

Figure 3 shows changes in the world oil price in US dollars (\$) over several months.

Figure 3



A country imports most of the oil used in its economy.

All other things being equal, which one of the following is most likely to increase as a result of the price changes?

[1 mark]

A Cost-push inflation

☒

B Current account surplus

☐

C Demand-pull inflation

☐

D Economic growth

☐


0 9

Each extra £1 of income in a country leads to £0.65 more consumption, £0.15 more savings, £0.18 more tax payments and £0.02 more spending on imports.

What is the value of the multiplier to two decimal places?

[1 mark]**A** 1.00☐**B** 1.54☐**C** 2.86☒**D** 3.03☐**1 0**

A government reduces the rate of tax on company profits as an incentive for firms to increase investment.

This is an example of

[1 mark]**A** contractionary fiscal policy.☐**B** deregulation policy.☐**C** expansionary monetary policy.☐**D** supply-side policy.☒

Turn over for the next question

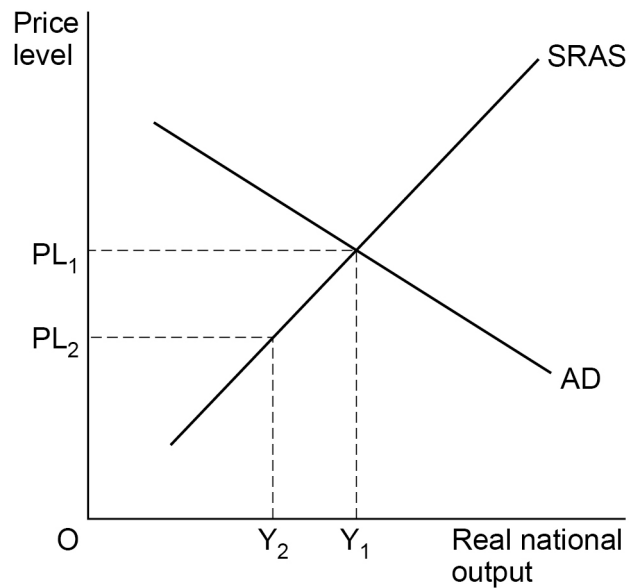
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1 1

Figure 4 shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for an economy.

Figure 4



The economy was originally in equilibrium at PL_1 Y_1 but has now moved to a new equilibrium at PL_2 Y_2 .

Which one of the following is most likely to have caused this change?

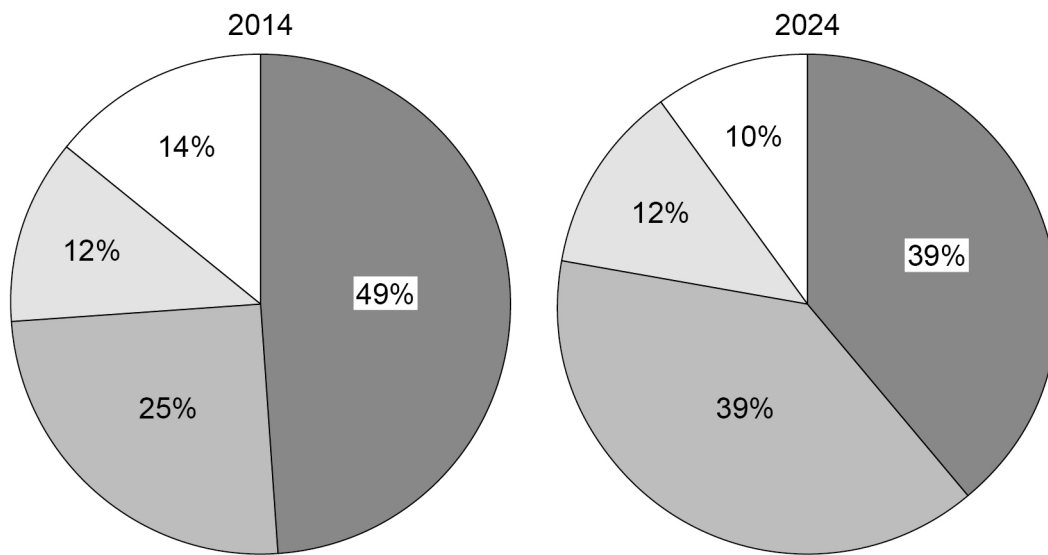
[1 mark]

- A** A reduction in the marginal propensity to pay tax in the economy
- B** A rise in energy and transport costs for the economy's firms
- C** Falling unemployment and a rise in average wages in the economy
- D** Negative economic growth in a country that buys the economy's exports

☐
☐
☐
☒


1 2

Figure 5 shows the percentage of government income from different sources in 2014 and 2024. Total government income has not changed in real terms.

Figure 5**Key**

Direct tax
 Indirect tax
 Other revenue
 Borrowing

Direct tax in the country is progressive.

All other things being equal, which one of the following is the most likely result of the change?

[1 mark]

- A** A fall in the rate of inflation ☐
- B** A higher rate of interest ☐
- C** A less equal distribution of income ☒
- D** A rise in the budget deficit ☐

Turn over for the next question

Turn over ►



1 3

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

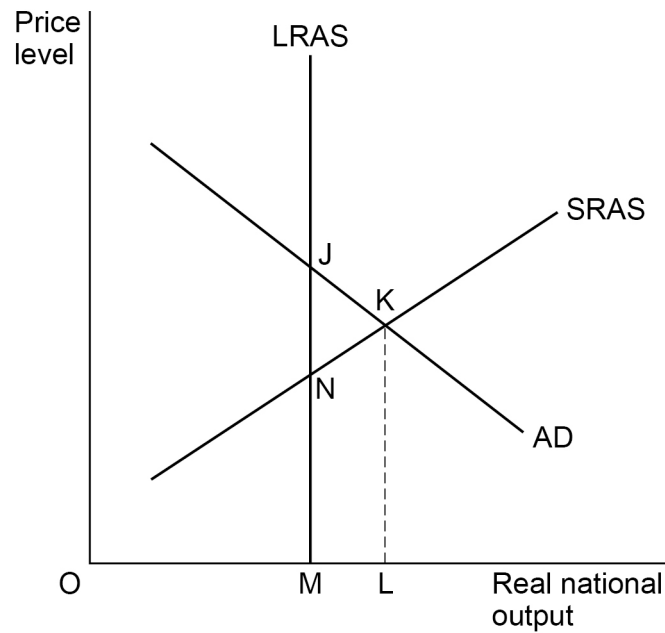
[1 mark]**A** Consumer income☐**B** Education and skills☐**C** Production costs☒**D** Quantity of factors of production☐**1 4**

All other things being equal, which one of the following is most likely to increase savings in an economy?

[1 mark]**A** A contractionary fiscal policy☐**B** A rise in disposable income☒**C** An expansionary monetary policy☐**D** An increase in consumer confidence☐

1 5

Figure 6 shows the aggregate demand (AD), short-run aggregate supply (SRAS) and long-run aggregate supply (LRAS) curves for an economy.

Figure 6

The economy has

[1 mark]

- A** a negative output gap from K to J.
- B** a negative output gap from L to M.
- C** a positive output gap from M to L.
- D** a positive output gap of JKN.

☐
☐
☒
☐

15

Turn over for the next section

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 'national debt' (**Extract B**, line 16).

[3 marks]

National debt is the total accumulated stock of outstanding government debt: the total amount the government owes as a result of borrowing in previous years to finance budget deficits, minus any amounts repaid.

1 6 . 2 Define 'national income' (**Extract C**, line 16).

[3 marks]

National income is the total monetary value of all the goods and services produced by an economy in a given time period, eg a year. It also equals the total income received by the owners of the factors of production, or total expenditure on domestic output, in that period.



1 7

Extract A (i) shows investment as a percentage of nominal GDP for selected countries and the world as an average for 2019 to 2021. **Extract C** gives further information about population and economic growth in Ethiopia.

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

1 7 . 1

Ethiopia's nominal GDP was \$111.3bn in 2021.

Use **Extract A (i)** to calculate how much more investment would be needed to bring Ethiopia's investment as a percentage of nominal GDP up to the same percentage as China's.

Give your answer in \$bn to **two** decimal places.

[3 marks]

$$\text{Investment needed at China's 43.3\%: } \$111.3\text{bn} \times 0.433 = \$48.1929\text{bn}$$

$$\text{Ethiopia's actual investment at 31.3\%: } \$111.3\text{bn} \times 0.313 = \$34.8369\text{bn}$$

$$\text{Extra investment} = \$48.1929\text{bn} - \$34.8369\text{bn} = \$13.356\text{bn}$$

$$\text{Answer} = \$13.36\text{bn (to 2 decimal places)}$$

1 7 . 2

Use **Extract C** (lines 8–10) to calculate the percentage change in real GDP per capita in Ethiopia between 2021 and 2022.

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

[3 marks]

$$\text{Real GDP per capita 2021} = \$100.435\text{bn} \div 120.3\text{m} = \$834.87$$

$$\text{Real GDP per capita 2022} = \$105.776\text{bn} \div 123.4\text{m} = \$857.18$$

$$\% \text{ change} = (857.18 - 834.87) \div 834.87 \times 100 = 2.672\%$$

$$\text{Answer} = 2.7\% \text{ increase (to 1 decimal place)}$$

Turn over ►



1 8

Extract B (line 6) states: 'China's strong growth has been based on high investment (as a percentage of GDP)'.

1 8 . 1

Explain how high investment, as a percentage of GDP, can lead to high future economic growth.

[6 marks]

Investment is spending by firms and the government on capital goods such as machinery, factories and infrastructure, and economic growth is an increase in real GDP. High investment as a percentage of GDP means a large share of the economy's output is used to add to the capital stock rather than for consumption, as in China.

In the short run, investment is a component of aggregate demand ($AD = C + I + G + X - M$) and an injection into the circular flow of income. Higher investment shifts AD to the right, and through the multiplier process the incomes of construction workers and suppliers are spent again, so real GDP rises by more than the initial investment. Faster growth then raises expected sales, which through the accelerator encourages further investment. This short-run growth uses spare capacity.

More importantly, investment increases the quantity and quality of the capital stock. Workers with more and better machinery and technology produce more output per hour, so labour productivity rises and firms' unit costs fall.

Investment in infrastructure, such as roads, ports, power and

Extra space telecommunications, raises the productivity of all firms. This increases the productive capacity of the economy, shifting LRAS to the right and raising the normal capacity level of output. Because capacity rises, AD can keep growing without causing inflation, so high investment allows high and sustained long-run economic growth in the future.



1 8 . 2

To what extent do the data suggest that high investment, as a percentage of GDP, leads to high future economic growth?

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

[6 marks]

The data largely support the link. Ethiopia had the second highest investment as a percentage of GDP in 2019 to 2021 at 31.3% and has the highest predicted growth, between 6.1% and 6.8% a year. The United States had the lowest investment at 21.2%, 5.5 percentage points below the world average, and has the lowest predicted growth, only 1.5% to 2.1%, below the world average for the whole period from 2023 to 2027. China had the highest investment at 43.3% and the second highest predicted growth of 3.7% to 5.0%.

However, the link is not exact. China invested over one and a half times the world average yet its growth is predicted to be lower than Ethiopia's and to fall close to the world average by 2027, suggesting diminishing returns to capital. The investment data cover only one three-year period, 2019 to 2021, which may not be typical as countries were affected by the pandemic in different ways. The growth figures are only predictions and may be inaccurate, and the gap between the two periods may be too short for investment to raise capacity. Growth also depends on other factors, such as the starting level

Extra space of income, population growth and government policy.

Overall, the data suggest that high investment as a percentage of GDP is associated with higher future growth, but it is not the only factor, so the evidence supports the link only to a large extent rather than proving it.

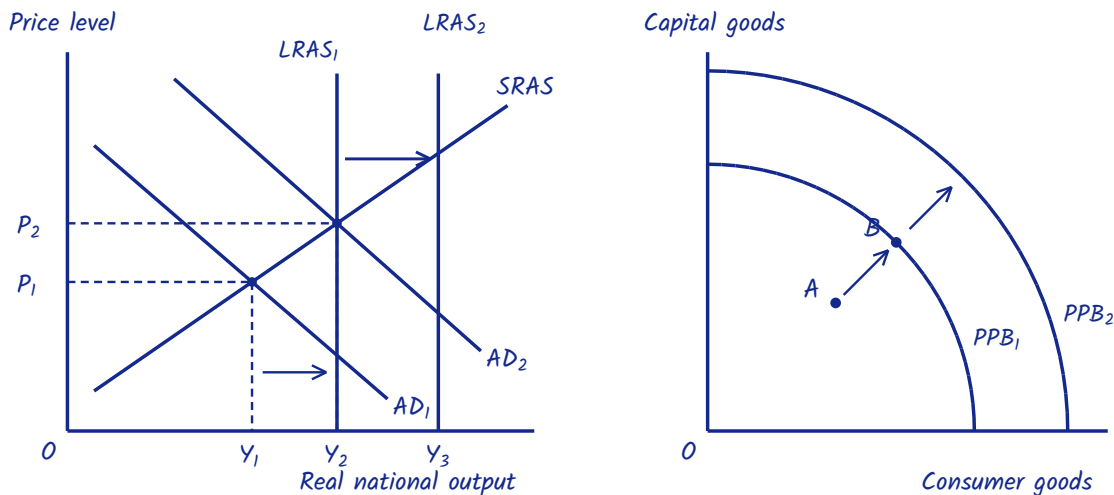


1 9

Extract B (line 9) states: 'The Chinese government believes that investment creates long-run economic growth'.

With the help of a diagram(s), explain the difference between short-run and long-run economic growth.

[9 marks]



Short-run economic growth is an increase in real GDP that comes from making fuller use of existing factors of production, ie using spare capacity. It is caused by a rise in aggregate demand, for example higher consumption (Extract B) or higher investment spending. In the left diagram AD shifts from AD_1 to AD_2 and real output rises from Y_1 to Y_2 ; on the PPF the economy moves from A, inside the boundary, to B on PPB_1 . The productive potential of the economy has not changed, so once spare capacity is used up, at the normal capacity level Y_2 , further rises in AD mostly cause inflation rather than more output.

Long-run economic growth is an increase in the productive capacity of the economy, ie the normal capacity level of output. It comes from the supply side:

Extra space more or better factors of production, such as investment in capital goods and infrastructure (Extract C), new technology, a larger or better educated labour force and higher productivity. LRAS shifts right from $LRAS_1$ to $LRAS_2$, so capacity rises from Y_2 to Y_3 , and the PPF shifts outwards from PPB_1 to PPB_2 .

So the key difference is that short-run growth closes a negative output gap



through higher AD, whereas long-run growth raises potential output. This is why the Chinese government believes investment creates long-run growth: investment both raises AD now and adds to the capital stock. Sustained, non-inflationary growth needs both, with AD growing in line with rising capacity.

9

2 0

Extract C (lines 16–17) states: ‘Ethiopia has had a current account deficit of around 4% of GDP.’

Analyse the factors that influence a country's balance of payments on current account.

[12 marks]

The current account of the balance of payments records a country's trade in goods and services with the rest of the world, plus primary income (eg profits, interest and dividends earned on overseas investments and wages of workers abroad) and secondary income (current transfers such as remittances and foreign aid). A deficit, as in Ethiopia at around 4% of GDP, means that outflows exceed inflows; a surplus means inflows exceed outflows.

Relative inflation and productivity are key price factors. If a country's inflation rate is higher than its trading partners', or its productivity grows more slowly so unit labour costs rise faster, its exports become relatively more expensive and imports relatively cheaper. Export volumes fall and import volumes rise, and if demand is price elastic, export revenue falls and import spending rises, so the current account worsens.

The exchange rate matters too. A depreciation, such as that of the Ethiopian birr (Extract C), makes exports cheaper in foreign currency and imports dearer in domestic currency. Provided the Marshall–Lerner condition holds, so that the

Turn over ►



combined price elasticities of demand for exports and imports exceed one, the current account improves, although at first it may worsen because demand is inelastic in the short run (the J-curve). An appreciation has the opposite effect. The level of economic activity at home and abroad also influences trade. When domestic incomes rise during rapid growth, consumers buy more imports, and firms import more capital goods and raw materials, so a fast-growing country with a high marginal propensity to import, like Ethiopia, tends to run a deficit. Growth in the countries that buy a country's exports raises export demand, eg world demand for Ethiopia's gold and coffee (Extract C). Changes in world prices matter: higher prices for a country's commodity exports raise export revenue, while a rise in the world price of imports such as oil increases the import bill.

Non-price factors are also important: product quality, design, reliability, technology, brand reputation, after-sales service and political relations or trade agreements between countries. Protectionism by trading partners, such as tariffs and quotas, reduces exports.

Primary income depends on the ownership of assets across borders. If domestic residents and firms own many assets abroad, inflows of profits, interest and dividends are large; if foreign firms own many assets in the domestic economy, eg through foreign direct investment, profits flow out. Secondary income depends on transfers that involve no goods or services in return, such as migrant workers' remittances, foreign aid and contributions to international bodies.

In conclusion, the current account balance reflects a country's international competitiveness, its exchange rate and the relative strength of domestic and world demand, as well as its net income from overseas assets and transfers.



2 1

Extract C (lines 22–23) refers to: ‘potential conflicts between economic growth and other macroeconomic policy objectives.’

Use the extracts and your knowledge of economics to discuss how economic growth may affect other macroeconomic policy objectives.

[20 marks]

Economic growth is an increase in real GDP, in the short run from a rise in aggregate demand and in the long run from an increase in productive capacity. The other main macroeconomic objectives are price stability (low and stable inflation), low unemployment, and a stable balance of payments on current account; additional objectives include a balanced budget, a more equal distribution of income and wealth, and protecting the environment. Extract C refers to potential conflicts, but growth can also support these objectives.

Growth can help reduce unemployment. As output rises, the derived demand for labour increases, so firms create jobs and cyclical unemployment falls. Extract C suggests that growth in Ethiopia has provided additional jobs and opportunities for workers to develop new skills, which also reduces structural unemployment over time and raises future productivity. Rising incomes (Extract B) and reduced poverty (Extract C) mean higher living standards.

Growth also benefits public finances. Higher incomes, profits and spending raise tax revenue, and spending on unemployment benefits falls, so the budget deficit narrows and the national debt becomes more affordable relative to GDP. The extra revenue allows the government to invest in infrastructure, education, healthcare and public goods, and to fund research and development into cleaner technology that protects the environment.

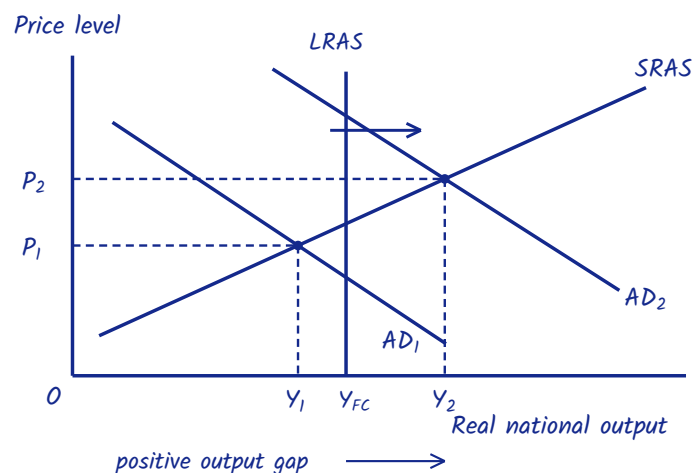
If growth is long-run, coming from higher investment and productivity, it supports price stability and the current account. Rising LRAS allows AD to increase without upward pressure on the price level, and lower unit costs make firms more internationally competitive, so they can export more and the country becomes less

Turn over ►



dependent on imports. A balance between short-run and long-run growth, as China has tried to achieve (Extract B), helps economic stability.

However, growth may conflict with other objectives. Short-run growth driven by AD, for example by expansionary fiscal policy (Extract B), can push output beyond the normal capacity level. In the diagram AD shifts from AD_1 to AD_2 , output rises from Y_1 to Y_2 , above Y_{FC} , creating a positive output gap, and the price level rises from P_1 to P_2 . Labour shortages push up wages and firms raise prices, causing demand-pull and cost-push inflation, which erodes competitiveness.



Rapid growth can also worsen the current account. Rising incomes increase demand for imports, especially if the marginal propensity to import is high, and domestic firms may divert output from exports to the home market. Ethiopia's fast growth has come with a current account deficit of around 4% of GDP (Extract C), partly because it imports capital goods and fuel to support that growth. Growth based on government investment (Extract B) may lead to a large budget deficit, increased borrowing and higher interest rates, which can crowd out private investment.

Growth may also increase some unemployment and inequality. If growth is based on capital investment and new technology, workers whose skills become obsolete may face structural unemployment. Where ownership of capital and land is unequal, the gains from growth go mainly to owners of capital and skilled workers, so the distribution of income and wealth becomes less equitable even if absolute poverty



Extra space *falls. Finally, rapid industrial growth, as in China (Extract B), increases pollution, carbon emissions and the depletion of natural resources, harming the environment and the welfare of future generations.*

The extent of these effects depends on several factors. First, it depends on the type of growth: long-run, supply-side growth based on investment is far less likely to cause inflation or a current account deficit than short-run, demand-led growth based on consumption or government spending. Second, it depends on the rate of growth relative to capacity: steady growth close to the trend rate supports most objectives, while growth well above trend leads to overheating. Third, it depends on the economy's starting point: in a country with a large negative output gap and high unemployment, growth reduces unemployment with little inflation, whereas near full capacity the conflict is much greater.

It also depends on the time period and on government policy. A current account deficit caused by importing capital goods may be temporary, since the investment raises future export capacity, as Ethiopia hopes for its gold and coffee exports.

Governments can use supply-side policies to retrain workers, progressive taxes and benefits to redistribute the gains, and environmental regulation or carbon taxes to make growth more sustainable, so the conflicts can be reduced, although such policies are costly and take time.

In conclusion, economic growth is generally beneficial for unemployment, living standards and public finances, and it is essential for reducing poverty in a developing country such as Ethiopia. However, when growth is too rapid or driven mainly by aggregate demand, it is likely to conflict with price stability, the current account, income equality and the environment, as China's experience shows. The most important factor is whether growth is sustainable and supply-led: if productive capacity grows in line with demand, the conflicts are small and manageable, so growth should be managed rather than restricted.

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2 8



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