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Economics

Higher level and standard level

Paper 2

7 November 2025

Zone A afternoon | Zone B afternoon | Zone C afternoon

1 hour 45 minutes

Instructions to candidates

- Do not open this paper until instructed to do so.
- You are permitted access to a calculator for this paper.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- Answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is **[40 marks]**.

Answer **one** question.

1. Read the extracts and answer the questions that follow.

Text A — The economy of Argentina

- 1** Argentina, the third-largest economy in Latin America, has experienced several cycles of high economic growth and deep recessions over the last 70 years. It has vast natural resources in energy and agriculture and potential for renewable energy. Its leading exports include soybeans and beef products, which contribute significantly to gross domestic product (GDP) and employment and are major sources of foreign currency. However, Argentina faces unfavourable climate conditions that create problems for the agriculture sector. A drought in 2023 caused over 20 billion United States dollars (USD) in losses for soybean farmers.
- 2** Argentina faces high **relative poverty** rates despite redistribution policies such as transfer payments. Argentina is known for extensive government intervention, including price ceilings on rent and strong protection for labour unions and workers.
- 3** For many years, Argentina managed its exchange rate by limiting the amount of foreign currency that citizens could purchase as well as by restricting imports. The aim was to protect reserve assets and prevent currency depreciation. This led to the establishment of an informal (unofficial) foreign exchange market and discouraged foreign direct investment (FDI). However, the foreign currency limitations resulted in an overvalued currency and failed to stop the level of reserve assets from decreasing.
- 4** In 2018, Argentina requested a loan from the International Monetary Fund (IMF) to help fund its budget deficit and large external debt repayments. However, Argentina defaulted on its debt repayments to the IMF, which led to low consumer and business confidence, causing large FDI and portfolio investment outflows. To receive future loans, the IMF requires Argentina to promote good governance, reduce government spending, increase reserve assets and control inflation.
- 5** In 2022, Argentina’s economic challenges continued with high inflation and a persistent budget deficit, leading to unsustainable debt. High inflation has led to declining real wages. Moreover, uncertainty about future prices has contributed to lower business investment.

(This question continues on the following page)

(Question 1 continued)

Text B — Argentina’s new economic reforms

- 1** In December 2023, Argentina’s new government initiated reforms to help solve its economic challenges. The new economic reforms included:
 - deregulating markets, such as removing price controls and restrictions on buying foreign currency
 - privatization of 41 state-owned enterprises to improve efficiency, including the national airline, rail networks, state media, and major oil, water and sewage companies, many of which were recording losses and burdening the government budget
 - increasing labour market flexibility by reducing labour union power and lowering labour costs
 - reducing government spending by cancelling infrastructure projects, reducing the size of the public sector and eliminating transport and energy subsidies.

- 2** The immediate result of removing restrictions on foreign currency purchases was a large **depreciation** of the Argentine peso (ARS), Argentina’s currency, as predicted by speculators. Moreover, inflation increased to over 250%. The new government maintained that while the reforms may cause a short-term recession, the policies would ultimately lead to long-term price stability and economic growth, despite predictions that relative poverty rates could increase to 60%. However, the government has stated it will continue spending on programmes to decrease poverty.

- 3** To address the budget deficit and maintain a trade surplus, the government increased taxes on cigarettes and imposed tariffs on imports such as laptops. Income taxes were increased, but the level of income on which no income tax is paid was raised from ARS 1.35 million to ARS 1.55 million per month.

- 4** The IMF supported the reforms and agreed to grant future loans to Argentina. The loans are important to establish international credibility and finance government spending.

Table 1: Argentina’s exchange rates

	Argentine peso (ARS) per USA dollar (USD)
2023 (before removing foreign exchange market restrictions)	350
2024 (after removing foreign exchange market restrictions)	820

(This question continues on the following page)

(Question 1 continued)

Text C — Education and productivity in Argentina

Despite significant investments in education, achievement levels are not improving. Experts recommend that Argentina focus on improving the quality of education to decrease poverty rates and increase the economy’s productive capacity. Additionally, Argentina’s low female labour force participation rate indicates an underutilized resource. An improved education system could increase female participation in the economy and raise household incomes.

Table 2: Development data for Argentina

	2013	2022
Gini coefficient	0.409	0.420
Relative poverty rate (%)	30	40
Human Development Index (HDI)	0.845	0.842
Gender Inequality Index (GII)	0.356	0.287

Table 3: Economic data for Argentina

	2013	2022
Real GDP (USD billion)	593.86	598.31
Nominal GDP (USD billion)	526.32	631.31
Gross national income (USD billion)	540.19	619.14
Net trade in goods and services (USD million)	–694	5440
Inflation rate (%)	10.9	94.8
Unemployment rate (%)	7.1	6.8
Exports (% of GDP)	10.7	16.3
Female labour force participation rate (%)	48	50
Government (national) debt (% of GDP)	40.1	89.5
Government budget (% of GDP)	–1.9	–4.2
Government employment (public sector) (% of total employment)	18.0	23.4

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term *relative poverty* indicated in bold (**Text A**, paragraph **2**). [2]
- (a) (ii) Define the term *depreciation* indicated in bold (**Text B**, paragraph **2**). [2]
- (b) (i) Using information from **Table 1**, calculate the cost of importing raw materials valued at USD 1200 in Argentine pesos (ARS) in 2023 **and** in 2024. [2]
- (b) (ii) Sketch a business cycle diagram and indicate a period of economic growth **and** a period of recession on the diagram (**Text A**, paragraph **1**). [3]
- (c) Using a demand and supply diagram to indicate the total cost of the subsidy to the government, explain how eliminating energy subsidies may affect government spending (**Text B**, paragraph **1**). [4]
- (d) Using an exchange rate diagram, explain how speculation in the foreign exchange market might influence the value of the Argentine peso (ARS) (**Text B**, paragraph **2**). [4]
- (e) Using a poverty cycle diagram, explain how improving the quality of education in Argentina may help to break the poverty cycle (**Text C**). [4]
- (f) Using a Lorenz curve diagram, explain how the income distribution changed in Argentina between 2013 and 2022 (**Table 2**). [4]
- (g) Using information from the text/data and your knowledge of economics, evaluate the likely consequences of Argentina’s new economic reforms on its economy. [15]

2. Read the extracts and answer the questions that follow.

Text D — Overview of Papua New Guinea

- 1** Papua New Guinea (PNG) consists of hundreds of small islands near Australia. Over 50 % of the labour force is employed in agriculture, forestry and fishing. The extraction sector, which mines non-renewable minerals (gold and copper) and extracts energy products (oil and gas), provides 30 % of the gross domestic product (GDP). The mining operations, usually carried out by foreign-owned firms, sometimes cause environmental damage and disputes over land rights.
- 2** The lack of substitutes and the difficulty of extracting gold, copper and gas cause both global demand and supply to be price inelastic. Consequently, changes in global demand result in volatile prices, which lead to macroeconomic instability because the extraction sector in PNG is so large. Fiscal policies have been unable to reduce the business cycle fluctuations. Tax revenue has declined as a percentage of GDP partly due to lower commodity prices and thus business tax revenue. The government could get more revenue from the extraction sector through ownership or part-ownership of the firms. Alternatively, taxes on the use of natural resources or higher business taxes could be imposed. However, such revenues are unpredictable and probably unsustainable.
- 3** After the rapid depreciation of the Papua New Guinea kina (PGK), PNG's currency, between 2012 and 2015, the central bank moved away from a floating exchange rate system to a managed exchange rate system. It used reserve assets in the foreign exchange market to prevent excessive currency depreciation, thereby lowering cost-push inflationary pressures. However, this intervention caused the PGK to become an **overvalued currency**. Therefore, the International Monetary Fund (IMF) recommended less intervention in the foreign exchange market so the PGK would gradually depreciate.
- 4** Official development assistance (ODA) is providing funds and technical assistance to improve **infrastructure** and therefore assist economic growth, which is one of the objectives of aid. The other two objectives are promoting effective governance and improving health and education. The World Bank's aid programme provides advice and funds for investment in human capital, especially for women and children's education. The government provides subsidies for schools, but they are inadequate, and government spending per student has declined due to the growing population. Many women work in the informal sector where they earn lower wages, contributing to rising gender inequality in PNG.
- 5** The IMF's aid is in the form of loans at low interest rates. Its programme aims to support growth that also benefits women and minorities, while improving the management of government (national) debt. It sets performance criteria, including reductions in the government's budget deficit.
- 6** There is criticism that too much aid is for improving governance and more should be allocated to infrastructure, including transportation networks, water, sanitation and electricity, which is accessible to only 21 % of the population.

(This question continues on the following page)

(Question 2 continued)

Text E — Papua New Guinea’s balance of trade

- 1** The surplus on PNG’s balance of trade in goods is due to the extraction sector, which earns 90 % of its export revenues. Less than 10 % of export revenues come from agriculture, forestry and fishing, although these sectors employ more people. Studies show that PNG exports have a high income elasticity of demand ($YED = +3.0$), but price elasticities of demand are low, particularly for mineral exports such as copper ($PED = -0.18$).
- 2** PNG has relatively low tariffs on most imports. However, tariffs on manufactured items, including machinery for palm oil production, were increased in 2019 to protect local manufacturing companies.

Text F — Foreign direct investment and Papua New Guinea

- 1** The capital and financial accounts on the balance of payments have large deficits. The outflows are mainly due to the repayment of loans that were used to develop the extraction sector. Most inward foreign direct investment (FDI) has been for mining and energy extraction projects. The FDI inflows fall once the project is completed.
- 2** FDI into other sectors is low due to regulations and inadequate infrastructure. The regulations limit certain economic activities and restrict land purchases to PNG citizens and state-owned enterprises. However, increased competition from foreign firms could raise efficiency in some industries.
- 3** PNG is setting up special economic zones in certain regions, which provide tax exemptions and eased regulations. The aim is to encourage FDI into tourism and industries that process agricultural and fishing products. Aid agencies recommend using FDI for renewable energy and environmental projects.

Table 4: Economic and development data for Papua New Guinea

	2012	2022
Real GDP per capita (United States dollars (USD))	2154.10	2462.50
Government expenditure (% of GDP)	27.50	22.00
Government taxation revenue (% of GDP)	20.10	14.80
Government revenue from resources (mining, oil, gas) (% of GDP)	5.50	3.90
Population (million)	8.03	10.14
Human Development Index (HDI)	0.561	0.558
Gender Inequality Index (GII)	0.59	0.72
Official development assistance (ODA) received (USD million)	670	1180

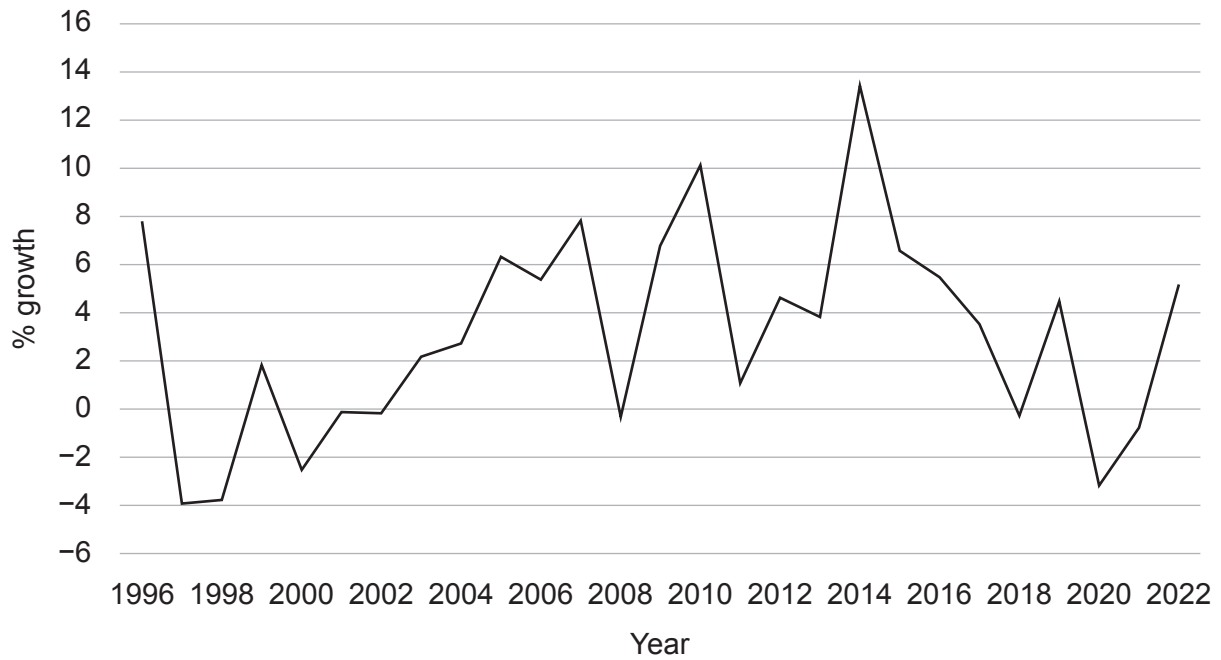
(This question continues on the following page)

(Question 2 continued)

Table 5: Balance of payments data for Papua New Guinea

	2022 (USD million)
Balance of trade in goods	10 153
Balance of trade in services	-1829
Income (net)	-1388
Current transfers (net)	239
FDI (inflows)	327

Figure 1: Real GDP annual growth rates in Papua New Guinea between 1996 and 2022



(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *overvalued currency* indicated in bold (**Text D**, paragraph **3**). [2]
 - (a) (ii) Define the term *infrastructure* indicated in bold (**Text D**, paragraph **4**). [2]
 - (b) (i) Calculate the expected percentage change in the quantity of PNG’s exports if world incomes rise by 3.5% (**Text E**, paragraph **1**). [2]
 - (b) (ii) Using information from **Table 4**, calculate PNG’s real GDP in millions of USD in 2022. [1]
 - (b) (iii) Sketch an externalities diagram and indicate the socially optimum output of copper when mining in PNG causes environmental damage (**Text D**, paragraph **1**). [2]
 - (c) Using a demand and supply diagram, explain why an increase in demand for copper causes a greater change in the price of copper when PNG’s supply is price inelastic than when its supply is price elastic (**Text D**, paragraph **2**). [4]
 - (d) Using an AD/AS diagram, explain why there were inflationary pressures when PNG’s currency depreciated between 2012 and 2015 (**Text D**, paragraph **3**). [4]
 - (e) Using a production possibilities curve (PPC) diagram, explain the impact of investment in human capital on production possibilities in PNG (**Text D**, paragraph **4**). [4]
 - (f) Using an international trade diagram, explain how producer surplus for PNG producers changed when the tariff on imports of machinery into PNG was raised (**Text E**, paragraph **2**). [4]
 - (g) Using information from the text/data and your knowledge of economics, discuss the view that foreign aid is more beneficial than foreign direct investment (FDI) for economic growth **and** economic development in PNG. [15]
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