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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
 - 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 US 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 *reserve assets* indicated in bold (**Text A**, paragraph **3**). [2]
- (a) (ii) Define the term *inflation* indicated in bold (**Text A**, paragraph **5**). [2]
- (b) (i) Using the data provided in **Table 3**, calculate the GDP price deflator for 2022. [2]
- (b) (ii) Using your answer to part (b)(i), determine the percentage change in prices from the base year. [1]
- (b) (iii) Sketch a Lorenz curve to show how the change in the “level of income on which no income tax is paid” may affect Argentina’s income distribution (**Text B**, paragraph **3**). [2]
- (c) Using an AD/AS diagram, explain how privatization might affect inflation (**Text B**, paragraph **1**). [4]
- (d) Using a demand and supply diagram, explain how eliminating the transport subsidies may impact transport producers’ revenue (which includes payments by the government) (**Text B**, paragraph **1**). [4]
- (e) Using an international trade diagram, explain how the quantity of laptops consumed will change due to the introduction of a tariff (**Text B**, paragraph **3**). [4]
- (f) Using a production possibilities curve (PPC) diagram, explain how following the experts’ recommendation about education may impact Argentina’s production possibilities (**Text C**). [4]
- (g) Using information from the text/data and your knowledge of economics, discuss the consequences on Argentina’s economy of a depreciation of the Argentine peso (ARS). [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 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. However, such revenues are unpredictable and probably unsustainable.
- 3** After the rapid depreciation of the 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. 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 to correct the welfare loss that occurs in the education market, but they are inadequate.

(This question continues on the following page)

(Question 2 continued)**Text E — Papua New Guinea’s balance of trade and trade strategies**

- 1** The surplus on PNG’s balance of trade in goods is due to the extraction sector, which earns 90 % of its export revenues. When global commodity prices were high, exports generated growth. Less than 10 % of export revenues come from agriculture, forestry and fishing, although these sectors employ more people. Over 85 % of PNG’s exports go to just five countries. 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 been attempting various trade strategies, including export promotion, import substitution and economic integration. 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. Unfortunately, the tariffs on machinery harmed some exporting industries by raising production costs. Additionally, there are restrictions on the exports of some primary goods. For example, exports of logs are restricted in order to encourage timber processing within PNG. However, the tax on log exports caused some logging companies to close down.
- 3** PNG has large trade surpluses (based on gas, minerals, and timber exports) with Australia and China, but it wants to diversify and promote agricultural exports. Therefore, it is now negotiating free trade agreements with both countries.
- 4** The overall trade surplus will possibly decrease. Exports of gold and copper are not growing strongly. The main agricultural and forestry exports are palm oil, coffee, cocoa and timber, but PNG’s shares in the global markets for these items have declined. PNG’s vulnerability to climate change is particularly concerning, due to its need to promote agriculture for future export growth and to raise rural incomes.

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** 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.

(This question continues on the following page)

(Question 2 continued)

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 |

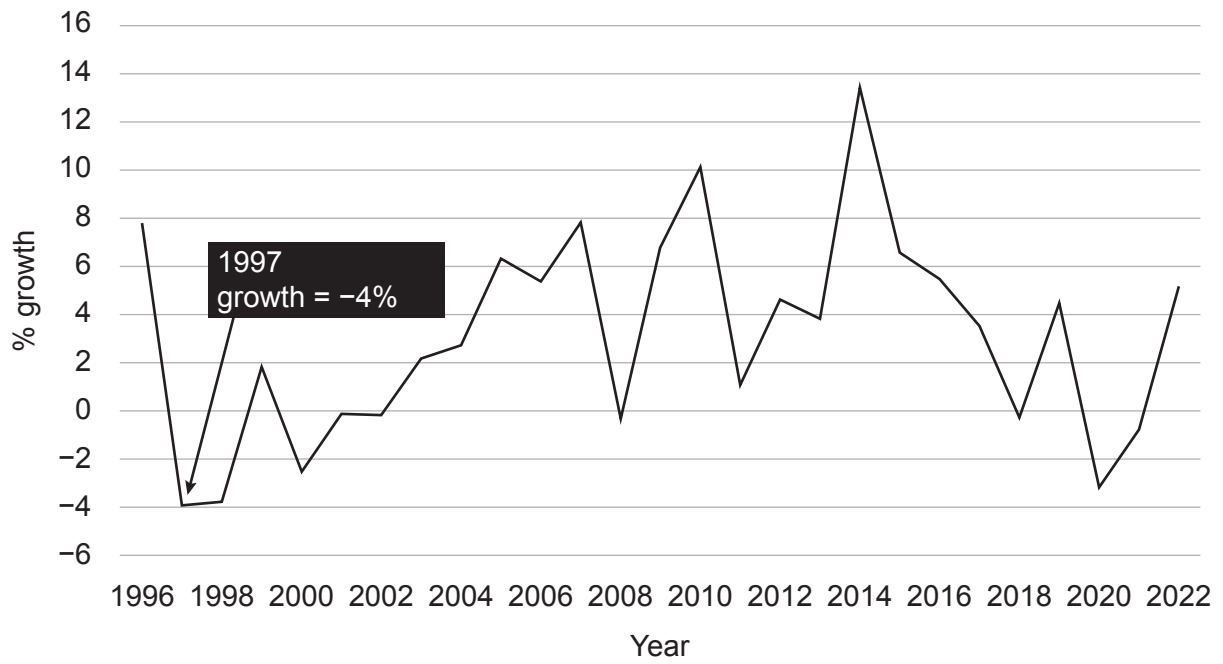
Table 5: Balance of payments data for Papua New Guinea

| | 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 |
| Portfolio investment (net) | –206 |

(This question continues on the following page)

(Question 2 continued)

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 *price inelastic* indicated in bold (**Text D**, paragraph **2**). [2]
 - (a) (ii) Define the term *portfolio investment* indicated in bold (**Table 5**). [2]
 - (b) (i) Calculate the expected percentage change in the quantity of copper demanded if the price of a pound (lb) of copper falls from USD 5.00 to USD 4.60 (**Text E**, paragraph **1**). [2]
 - (b) (ii) Determine whether revenue earned from copper exports will rise, fall or stay the same after the reduction in price. [1]
 - (b) (iii) Sketch a poverty cycle diagram and indicate where foreign aid that provides infrastructure would enter the cycle (**Text D**, paragraph **4**). [2]
 - (c) Using an exchange rate diagram, explain how the central bank in PNG prevented the depreciation of the kina (PGK) (**Text D**, paragraph **3**). [4]
 - (d) Using an AD/AS diagram, explain the impact of investment in human capital on potential (full employment) output in PNG (**Text D**, paragraph **4**). [4]
 - (e) Using an externalities diagram, explain why there is a welfare loss if the PNG government does not subsidize children’s education (**Text D**, paragraph **4**). [4]
 - (f) Using an AD/AS diagram, explain the likely fiscal policy used by the PNG government in response to the real GDP growth rate in 1997 (**Figure 1**). [4]
 - (g) Using information from the text/data and your knowledge of economics, evaluate whether the trade strategies that PNG is using will improve economic growth. [15]
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