Diploma Programme
Programme du diplôme
Programa del Diploma

Economics
Higher level and standard level
Paper 2

8 November 2024

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]**.

8824–9421

Answer **one** question.

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

Text A — India-United Kingdom trade agreement negotiations

1 India is a country located in South Asia. India's government predicts 7 % annual economic growth and it is expected to become the third-largest global economy by 2030. To support growth, India is establishing trade agreements to diversify trade partners, and reduce the impact of global political and economic shocks. However, the annual inflation rate increased from 4 % in 2021 to 7.8 % in 2022 due to supply chain issues and oil price increases. In response, India's government has reduced taxes on fuel while the central bank has tightened **monetary policy**.

2 The United Kingdom (UK), a country in Europe, needs trade agreements with countries in Asia as this area contains some of the world's fastest-growing economies and represents over 40 % of global gross domestic product (GDP). It is currently negotiating a free trade agreement (FTA) with India, which aims to double trade between the two countries by 2030. The agreement is also expected to increase labour movement and job opportunities and protect intellectual property. The Indian government is negotiating easier access to UK work permits and student visas but is concerned that some of its citizens may not return home with their skills.

3 The India-UK FTA would reduce trade protection, including tariffs and quotas, and administrative barriers. India expects to increase its exports of textiles, leather goods, footwear, and pharmaceutical products, whereas the UK aims to boost its exports of British cars, wine, spirits and vinegar. Additionally, foreign direct investment (FDI) between the two countries is expected to increase. The FDI inflows could help to finance India's large **current account deficit**, which has increased as worker remittances from abroad have fallen. However, the current account deficit may decrease anyway because of recent increases in portfolio investment outflows, which could also impact the value of the rupee (India's currency).

4 Increased competition from UK imports may threaten the growth of infant industries in India. An example is the local wine industry in India, which has grown by 30-40 % in recent years. However, to protect infant industries, the reduction in tariffs will be gradual and business taxes will be lowered.

5 Another discussion area in India-UK trade negotiations is the possible privatization of essential services in India, such as healthcare, education, and water. There has been encouragement from the UK for India to open these markets to foreign investment and competition.

6 Increased trade and competition could lower prices, forcing firms to cut labour costs. Indian labour protection groups want the UK to stop trade talks until India changes a law restricting labour unions. They believe the trade agreement should include regulations to protect against poor working conditions and low pay, which impact gender inequality and child welfare.

(This question continues on the following page)

(Question 1 continued)

Text B — India-UK trade negotiations and Sustainable Development Goals

1 India and the UK recognize the relationship between trade and sustainable development and are committed to supporting the sustainable development goals (SDG).

2 The India-UK FTA negotiations are encouraging collaborative research and development projects in the following areas:
- Clean energy and green technologies; decreasing the market failure associated with fossil fuel energy, developing electric vehicles, and waste management practices.
- Gender inequalities; improving access to credit and markets for women, improving education opportunities, and increasing labour participation rate of females in India.
- Human and labour rights; supporting programmes that create work opportunities and better working conditions.
- The agricultural sector and food security; addressing India's low productivity rates, which are blamed on ineffective fertilizer subsidies, lack of infrastructure, and flooding and drought problems from climate change.
- The healthcare sector; developing pharmaceutical products.

Table 1: Development data for India

	2021
Gender inequality index	0.490
Female labour force participation rate (% of female population ages 15+) World average = 46.2 %	23

3 India-UK's previous health sector collaboration resulted in global vaccine development and helped decrease the market failure in the industry. However, possible FTA intellectual property rules may limit India's ability to produce low-price medication, resulting in reduced export opportunities and possibly creating monopolies. On the other hand, targeted research and development could lead to cheaper medication, and the UK's insurance expertise may improve India's health insurance programme.

4 Growth in India-UK trade may increase carbon emissions, deforestation, and air and water pollution. Experts estimate the FTA could increase trade-related transport emissions by up to 36 %. Environmental experts believe this is significant as the UK continues cutting solar panel subsidies, slowing the conversion to clean energy.

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(Question 1 continued)

Table 2: India and UK SDG data in 2021

	India	UK
Overall progress in all SDGs (100 = all achieved)	59.98	80.53
SDG progress – World ranking (out of 163 countries)	121	11

Table 3: India's SDG progress in 2021

Selected SDGs	India
Goal 1: No poverty	Moderately improving
Goal 2: Zero hunger	Stagnating
Goal 3: Good health and well-being	Decreasing
Goal 4: Quality education	Stagnating
Goal 5: Gender equality	Stagnating
Goal 7: Affordable and clean energy	Moderately improving
Goal 8: Decent work and economic growth	Moderately improving
Goal 9: Industry, innovation and infrastructure	Moderately improving
Goal 13: Climate action	On track
Goal 17: Partnerships for the goals	Stagnating

Table 4: Economic data for India

	2017	2021
Real GDP (US$ trillion)	2.43	2.73
Population (billion)	1.35	1.41
Annual unemployment rate (%)	7.7	7.9
Labour force (million)	476	508
Current account balance (US$ billion)	−30.14	−33.42

(This question continues on the following page)

(Question 1 continued)

(a) (i) Define the term *monetary policy* indicated in bold (**Text A**, paragraph 1). [2]

(ii) Define the term *current account deficit* indicated in bold (**Text A**, paragraph 3). [2]

(b) (i) Using information from **Table 4**, calculate the percentage change in real GDP per capita between 2017 and 2021. [3]

(ii) Sketch an AD/AS diagram to show the possible impact on India's inflation rate of a tighter monetary policy (**Text A**, paragraph 1). [2]

(c) Using information from **Text A**, paragraph 3 and **Table 4**, explain the interdependence between the accounts in India's balance of payments. [4]

(d) Using an international trade diagram for India, explain how lowering tariffs on British wine might impact UK wine producer revenue (**Text A**, paragraph 3). [4]

(e) Using an externalities diagram, explain the market failure that could occur in the market for fossil fuel energy (**Text B**, paragraph 2). [4]

(f) Using an AD/AS diagram, explain how increased female participation rates may impact India's potential output (**Text B**, paragraph 2 and **Table 1**). [4]

(g) Using information from the text/data and your knowledge of economics, discuss the impact an India-UK trade agreement may have on India's ability to achieve **two** sustainable development goals. [15]

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

Text C — Overview of the economy and government policies in Malaysia

1 Malaysia, located in Southeast Asia, is an upper-middle-income country. While aiming to increase incomes further, mainly through trade and foreign direct investment (FDI), the government also has the objectives of reducing carbon emissions and inequality. Annual rates of economic growth have been averaging between 4% and 5% in the early 2020s.

2 Inflation in the early 2020s has been low, despite rising global prices. However, unemployment is high, particularly among young people. Real wages in many jobs are lower than four years ago. Therefore, a deflationary (recessionary) gap exists and real gross domestic product (GDP) is below its potential. **Fiscal policy** could be more expansionary, because government debt is not very large.

3 Absolute poverty has been eliminated, but income inequality remains high because there are many low-income and unskilled workers in the informal sector. In addition to spending on education and health, the government provides subsidies for necessities, such as gasoline, flour and electricity. However, high-income households often benefit more from subsidies than low-income households. For example, high-income households represent 10% of electricity users, but they receive over 50% of the energy subsidies. There are also concerns that subsidies for gasoline add to government spending and have caused external costs to rise due to cars being used more.

4 The government is considering targeted measures, such as providing electricity subsidies only to low-income households. In addition, from May 2022, the minimum wage was increased by 30%. Although there were concerns that this might increase unemployment, research studies into the effects of a previous rise in the minimum wage in Malaysia show that it increased labour productivity by motivating workers, reduced unemployment by increasing consumption, and increased the labour force participation rate, particularly for females.

5 Government spending is promoting growth by spending on infrastructure, accelerating innovation, and providing subsidies or loans with low interest rates for agriculture and fishing. In addition, the government is increasing growth in potential output by raising labour productivity through investment in human capital, with measures to improve schooling and nutrition.

6 Malaysia has consistently had a current account surplus through the early 2000s. Import tariffs have been reduced, because Malaysia is a member of two large free trade areas. However, administrative barriers to trade are high and the International Monetary Fund recommends their removal.

7 The central bank of Malaysia manages the exchange rate of the ringgit (Malaysia's currency) by using reserve assets. Some trading partners suggest that the ringgit is an undervalued currency. There are financial market regulations affecting the inflows and outflows of FDI and portfolio investment, because the flows are large and volatile. However, transactions on the capital and financial accounts of the balance of payments are gradually being liberalized.

(This question continues on the following page)

(Question 2 continued)

Text D — Environmental policies in Malaysia

1 The Malaysian government is committed to a 55% reduction in carbon emissions, which are mostly due to electricity generation and private transportation. Therefore, many government investments are in green projects.

2 The government is implementing measures to encourage the use of renewable energy, rather than fossil fuels, to generate energy so that the output of energy becomes closer to the socially optimum output. A **tradable permits** scheme for emissions is being considered and the subsidies on gasoline may be restricted. Carbon taxes, which could generate up to 3% of GDP in revenue, may also be implemented. Low-income households would be provided with transfer payments as compensation for the resulting higher energy prices.

3 Although environmental regulations on firms exist, there is concern that such regulations may be weakened when the government encourages investment by firms. However, the government could make support for investment conditional on firms meeting environmental standards.

Text E — The taxation system in Malaysia

The 2023 budget in Malaysia contained measures to raise more government revenue through additional taxes on luxury goods and e-cigarettes. A study has shown that a 10% increase in price leads to a 24% reduction in demand for e-cigarettes by teenagers. Therefore, the tax on e-cigarettes is impacting the markets for other goods, such as tobacco cigarettes. The budget also raised income tax rates for high-earners and reduced the rates for low-earners. Corporate income tax rates were lowered for small and medium-sized firms.

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(Question 2 continued)

Table 5: Selected data for Malaysia

	2012	**2021**
Nominal GDP (US dollars (US$) billion)	314	375
GDP price deflator (base year 2015)	96	111
Population (million)	29.7	33.5
Government (national) debt (% of GDP)	54.6	65.2
Balance of trade in goods and services (US$ billion)	33.9	26.5
FDI, net inflows (US$ billion)	8.00	–6.84
Portfolio investment, net inflows (US$ billion)	–20.7	–4.55
Female labour force participation rate (% of female population ages 15+)	47	52
Absolute poverty (% of population living on less than US$2.15 (2017 PPP) per day)	0.1	0
Human Development Index (HDI)	0.780	0.803
HDI rank	64	62

Table 6: Gini coefficient data

	2012	**2021**
Malaysia	0.44	0.41
Thailand	0.39	0.35

(This question continues on the following page)

(Question 2 continued)

(a) (i) Define the term *fiscal policy* indicated in bold (**Text C**, paragraph 2). [2]

(ii) Define the term *tradable permits* indicated in bold (**Text D**, paragraph 2). [2]

(b) (i) Using information from **Table 5**, calculate real GDP in 2021 for Malaysia in US$. [2]

(ii) Using information from **Table 5** and your answer to (b)(i), calculate real GDP per capita in 2021 for Malaysia in US$. [1]

(iii) Sketch a business cycle diagram to show how real GDP can be different from potential output (**Text C**, paragraph 2). [2]

(c) Using an AD/AS diagram, explain how an expansionary fiscal policy can remove a deflationary (recessionary) gap (**Text C**, paragraph 2). [4]

(d) Using a demand and supply diagram, explain how a subsidy on gasoline increases Malaysian government spending (**Text C**, paragraph 3). [4]

(e) Using an exchange rate diagram, explain the possible effect on the exchange rate for the ringgit (Malaysia's currency) of removing administrative barriers to imports (**Text C**, paragraph 6). [4]

(f) Using a Lorenz curve diagram, explain the difference in Gini coefficient data between Malaysia and Thailand in 2021 (**Table 6**). [4]

(g) Using information from the text/data and your knowledge of economics, evaluate whether intervention in markets in Malaysia is meeting the government's economic objectives. [15]

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Tables 2 and 3

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