H2 Case Study Question 2 Answers

(a)	**(i)**	**Compare the trade balance between South Africa and United States from 2013 to 2017.**	**[2]**
		Skills: For the command word "Compare", should identify either ✓ 1 similarity and difference OR ✓ 2 differences Difference 1: South Africa's trade balance had improved while United States' trade balance had worsened from 2013 to 2017. Difference 2: South Africa's trade balance has improved from a deficit to a surplus trade balance while United States' trade balance was consistently in deficit throughout the years. *1 mark for each difference explained correctly*	
	(ii)	**Account for the change in the trade balance of United States observed in a(i).**	**[2]**
		Skills: ✓ Identify a reason from the extracts that accounts for the worsening of trade balance ✓ Explain how this reason leads to either fall in X or increase in M Trade balance refers to the difference between export revenue and import expenditure. US's trade balance has consistently been in a deficit and worsened over the years. Possible reason 1: Extract 5 mentions that China was accused of unfair trade practices, implying that they were possibly selling their exports at an unfairly low price. This could have been the reason for the United States importing more goods and services from China. Assuming export revenue of United States remain the same, this would cause the trade balance to worsen. OR Possible reason 2: Extract 5 mentions that the United States had structural issues in their economy, possibly causing its exports to be less competitive than before. Assuming that their demand for exports are price elastic, quantity demanded for their exports would have fallen more than proportionately when there is an increase in price of exports, leading to a fall in export revenue. Assuming that import expenditure remains the same, this would cause the trade balance to worsen. *1 mark for identifying one reason* *1 mark for explaining how the reason leads to a worsening of the trade balance in the US*	

(b)		**Using an aggregate demand and aggregate supply diagram, explain how trade wars among United States and China might affect domestic prices levels in Africa.**	**[5]**
		Skills: ✓ Explain how US tariffs on China would affect China's economy ✓ Explain how falling national income in China would cause demand for Africa's resources to fall ✓ Explain how fall in AD in African economics lead to decrease in domestic price level ✓ Illustrate leftward shift of AD curve with subsequent effect on GPL Trade wars among United States and China refer to increased protectionist measures against each other's imports. Evidence from Extract 5 show that there were 25% tariffs imposed by the US on steel imports from China. Such tariffs would cause prices of China's steel exports to be artificially higher, leading to a fall in export revenue (X) in China. As X is a component of AD, China's AD would decrease. This causes China's national income to fall and a fall in production of goods and services. According to Extract 5, China is a major importer of Africa's resources and commodities for its own industries. As China's production of goods and services has fallen, they would demand fewer resources from Africa causing Africa to experience falling export revenue. This would cause a leftward shift of Africa's AD curve from AD0 to AD1, causing domestic price levels in African economies to fall. *2 marks to explain effect of trade wars on China's national income* *2 marks to explain subsequent effect on Africa's domestic price levels* *1 mark for correct diagram on Africa's domestic price levels*	
(c)		**Explain why the Nigerian government might consider it a rational decision to delay its participation in the African Continental Free Trade Area.**	**[3]**
		Skills: ✓ Explain the benefits of participating in the AfCTA ✓ Explain the costs of participating in the AfCTA ✓ Explain how decision was rational by weighing costs and benefits The benefit of Nigeria participating in the African Continental Free Trade Area is an increased access to markets and a reduction of transaction costs in trade (Extract 6). This could benefit Nigeria's economy if export revenues increase, leading to positive macroeconomic outcomes. However, opening the economy to free trade would also leave Nigeria's firms to be susceptible to an increase in competition, causing many of its uncompetitive firms to shut-down, worsening its economic situation. From the Nigerian government's perspective, the economy might not have been ready to manage the increased competition and able to capitalize on the benefits. For example, table 1 suggests a worsening trade balance while in table 2, growth	

		has also fallen from 2013 to 2017. Therefore, it was a rational decision to delay its participation in the agreement as costs of participation was likely to outweigh the benefits. *1 mark for explaining the benefit of participation* *1 mark for explaining the costs of participation* *1 mark for explaining Nigeria government's rational decision*	
(d)		**Assess whether giving priority to private sector investments over public investments is a more appropriate approach in driving higher economic growth.**	**[8]**
		Approach to question: i. Unpack private sector investments and public investments ii. Explain how private sector investments drive higher economic growth iii. Explain the challenges of private sector investments driving higher economic growth iv. Explain how public investments drive higher economic growth v. Synthesize with economic criteria whether private sector investments is more appropriate than public investments Angles for evaluation: i. Judgement of the extent of priority given to private sector investments in developed vs developing countries ii. Discussion of conditions needed for private sector investments to drive higher economic growth (e.g. nature of industries) * *examples of evaluative comments in the suggested answers are highlighted* **Introduction:** Private sector investments refer to investments made by profit driven private companies which are not controlled by the government. Public investments refer to government spending on goods and services, usually on large scale infrastructure or services like healthcare and education. Both contribute to economic growth through investments (I) and government expenditure (G) respectively. Whether more priority should be given to private sector investments over public investments to increase economic growth depend on the types of industries invested in and the current state of the economy. **Thesis: Private sector investments can drive higher economic growth as it boosts competitiveness.** As private firms are profit maximisers, encouraging private sector investments would encourage competition between firms. With increased competition, firms are incentivized to innovate and find more productive methods to become more cost efficient and increase the quality of their products. Moreover, Extract 8 mentions that global companies bring along their technical and management techniques and upgrade the skills of local workers they employ. This transference of skills increase the quality of resources. With an increase in productivity and a fall in cost of production in the economy, the SRAS and LRAS will increase. In addition, increased competitiveness could lead to increase export revenue as the country's goods and services become more attractive. This leads to an increase in AD. Both effects drive higher actual and potential growth.	

Counter-argument: Private sector investments may only concentrate in certain sectors benefiting a small part of the economy.

While increase private sector investments improve productivity and create more jobs, they may be concentrated in only a few sectors. For example, Extract 8 explains that many of the FDI flowing into the South Africa are in financial services, real estate developments and other businesses, which constitute of jobs amongst the urban middle class. On the contrary, most of South Africa's population have lower skills and are unable to benefit from the job opportunities and higher wages. Employment levels may not have improved much and growth is only contained amongst a small proportion of the economy. Hence, this leads to an unequal distribution of economic growth and could limit the sustainability of the growth as South Africa's potential is not maximised.

Anti-Thesis: Public investments can also drive higher economic growth by laying foundations for skills training and in industries requiring large capital outlay.

The government can drive higher economic growth by ensuring and efficient network industries such as roads, rail, telecommunication and ports. The government plays as important role as such industries which require large fixed costs as many firms do not have the ability to fund such projects. For example, in extract 8, it is important that the South African government supports and make South Africa an attractive location for private sector investments boosting long term growth as it boosts both AD and LRAS.

In addition, as private firms are only interested in maximizing their own profits, they will only train workers to the point where MPB=MPC, not considering the positive externalities to the entire economy. This is especially seen in smaller firms with more constraints in funding. Moreover, the skills that are trained in their workers may be over-specialized to the needs of the company. As skills training is a merit good, governments may need to support and raise the level of skills training across workers in the entire economy (Extract 8). This ensures that workers are employable across industries leading to sustainable and inclusive growth.

Synthesis:

In conclusion, whether private sector investments or public investments should be given priority depends on the nature of the economy. Firms in developing countries may more likely lack the financial ability to fund large scale projects or continual skills training. In many of these countries which do not have the necessary foundations in place yet, public investments is more appropriate in supporting skills training and creating a conducive environment for businesses. Nevertheless, governments should eventually give private sector investments priority to take ownership and prevent over-reliance. This can create a dynamic economy which promotes higher growth in the long run.

Level Descriptors		Marks
L2	An answer which • Is developed and balanced, discusses how the importance of **both** private sector and public investments to drive higher economic growth	4-6

	• Has accurate use of economic analysis to show effects on both actual and potential growth • Has sufficient use of relevant examples from the extracts		
L1	An answer which • Is balanced but underdeveloped in discussing how both private sector and public investments drive higher economic growth OR • Is developed but one sided in discussing **either** private sector **or** public investments • Has explanation which is more intuitive and lacking conceptual support to show effects on both actual and potential growth • Has limited attempt to use relevant examples from the extracts	1-3
E2	Well-supported evaluation and reasoned judgement which is based on economic criteria such as effectiveness or appropriateness in given context. Able to give a considered statement after comparing the two strategies	2
E1	Some attempt to evaluate but with lack of substantiation No sound considered statement at the end of answer	1

(e) **Discuss whether the openness to trade in South Africa is likely, on balance, to have a beneficial effect on its economy and population.** **[10]**

Approach to question:

i. Unpack openness to trade in South Africa
ii. Explain how openness to trade in South Africa leads to beneficial effect on economy and population
iii. Explain how openness to trade in South Africa presents some challenges on economy and population
iv. Synthesize whether it is more beneficial or less beneficial to South Africa using economic criteria

Angles for evaluation:

i. Dependent on the readiness of firms and labour to compete
ii. Dependent on government's policies to help country to capitalize on gains and minimize undesirable effects of openness to trade

** example of evaluative comments in the suggested answers are highlighted*

Introduction: Openness to trade refers to the reduction or removal of restrictions on imports to facilitate trade between countries. For example, in Extract 6 participation in the African Continental Free Trade area aims to have agreements to facilitate trade, reduce transaction costs and increase flexibilities between countries. Whether openness to trade in South Africa is overall more beneficial to its economy and population depends on the extent of positive effects on both economy and population and the necessary government policies to capitalize on these gains.

Thesis: Openness to trade can help South Africa achieve its macro-economic objectives and increase the standard of living.

By opening up to trade, firms in South Africa will have increased access to larger markets beyond its geographical boundaries. This will increase opportunities to increase export revenue (X). Assuming that South Africa is currently producing below productive capacity, higher X will increase AD, resulting in **an increase in national income, ceteris paribus**.

Cheaper access to raw materials and resources from other countries will also lower cost of production in South Africa, leading to a rightward shift of the SRAS, also causing an **increase in national income and lowering the general price level of South Africa**.

As demand for goods and services produced in South Africa increases, firms will hire more resources to increase production, **leading to lower unemployment rates for the population.**

As income levels of the population increases, they now can afford more and better quality goods and services, **increasing the material SOL**. Enjoying free trade with other countries also increases the access to a greater variety and quality of goods and services, further increasing material SOL.

With lower unemployment rates, the government can reduce the amount of welfare benefits paid out to the population. Moreover, increased tax revenue collected from corporate firms and households increases the ability for the government to spend on merit goods like healthcare and education services. The improvement in quality and accessibility to these merit goods **increases the non-material SOL of the population.**

Counter Argument: However, Extract 7 mentions that many of the jobs created are in the service-oriented industries which demand higher skills. A large proportion of the population in South Africa is unskilled or semi-skilled (Extract 7 and 8) and may not be able to benefit from South Africa's openness to trade.

This could lead to a **worsening of income inequality** where skilled workers earn higher wages while the lower skilled workers earn lower or no wages.

Therefore, the government needs to ensure that it has the policies to upskill workers to remain employable to relevant sectors and capitalize on the gains of trade.

Anti-thesis: Openness to trade can make South Africa susceptible economic shifts like increased competition and other countries' trade policies

On the contrary, openness to trade can be harmful to South Africa if they are unable to withstand the increased competition from other countries. According to Extract 7, the manufacturing sector is shrinking as they are now unable to compete with manufacturing economies of Asia such as China, India and Vietnam etc. who can produce similar goods and services at lower costs. This will lead to a fall in (X-M) of South African and reduction in AD, contributing to a falling national income. Evidence from table 2 notes that South Africa's GDP growth rates were falling from 2013 to 2017 and remain relatively low. This would affect the material SOL of the population.

In addition, if South Africa becomes too reliant on exports for growth, they are also susceptible to the effects of changing trade policies of the countries. Extract 5 mentions that the impending trade wars amongst major economies could negatively impact African economies which export commodities to these countries.

Synthesis: In conclusion, while there are many benefits to be reaped from South Africa opening to trade, the extent of these benefits is dependent on the readiness of firms and labour to compete with the rest of the world. It is paramount that the government implements structural and labour reforms to manage the challenges from opening up to trade, ensuring that growth is sustainable and inclusive.

Level Descriptors		Marks
L2	An answer which • Developed and balanced, discusses how openness to trade in South Africa have both positive and negative effects on the economy and population • Has accurate use of economic analysis • Has sufficient use of relevant examples from the extracts	5-7
L1	An answer which • Is balanced but underdeveloped in discussing how openness to trade in South Africa have **either** positive **and** negative effects on **either** the economy **or** population OR • Is one-sided but developed • Has economic analysis but lacking in depth or has some inaccuracies • Has limited attempts to use relevant examples from the extracts and answer is more rehearsed rather than contextualizing to South Africa	1-4
E2	3 marks for answers with a sound conclusion that can give conditions for openness to trade to be overall beneficial o For South Africa to benefit from openness to trade, they have to ensure that the labour and firms are ready to compete with the rest of the world o The government has to ensure that it has mitigating policies such as structural and labour reforms to manage the challenges from opening up to trade Well-supported evaluation and reasoned judgement in weighing the benefits and costs of opening up to trade	2-3
E1	Some attempt to evaluate but with lack of substantiation	1