2011 H2 Prelim 2 Q2

(a) (i) Compare the GDP growth of China and India from 2007 to 2009. [2]

Both are GDP growth of China and India are declining. However, the growth rate of China remains higher than India's.

(ii) What evidence is contained in the data to suggest that Asia did not "decouple" from the West? [2]

The growth rates of China and India moves in tandem with that of the US Germany. As US and Germany experiences a slowdown in their growth and moves into a recession in 2009, China and India's growth rates declined as well.

(b) With reference to the data, explain why the changes in unemployment rates differ from country to country. [4]

Possible reasons:
Extent of the slowdown in the economy is one possible reason accounting for the variation in the changes in the unemployment rates between countries.
E.g. US economy contracted, thereby leading to a more significant decline in demand for labour and rise in unemployment while those of other economies like China and India, are still growing, though at a slower rate

Degree of flexibility of the labour market is another factor accounting for the variation in the changes in the unemployment rates.
For instance, Germany did not experience a rise in unemployment though it had similarly experienced negative growth like the US in 2009 as its labour markets was more rigid, hence its demand for labour did not fall as significantly as the fall in output.

(c) Explain why governments should cut their "spending on keeping people in old jobs". [4]

Spending on keeping people in old jobs is appropriate if the objective is to minimize cyclical unemployment.
As highlighted in Extract 2 the old jobs might no longer be in existence even as the economy recovers and this form of spending will inevitably place a burden on the government's budget in the long term.

Governments should cut their spending on keeping workers in jobs that are no longer required and focus their spending on restructuring their economies and providing training to equip the workers with a new set of skills to adapt to the changing demands of their economies.
More beneficial in enhancing productive capacity of the economy and thus economic growth in the long run

(d) Discuss the extent to which global current account imbalances are the result of "the surplus countries' inflexible exchange rate regimes." **[8]**

The global current account imbalances occurs when some countries run high current account surpluses while other countries run high current account deficits.

<u>Global current account imbalances are the result of inflexible exchange rate regimes of surplus countries like China</u>
Under its inflexible exchange rate regime it is possible that Chinese authorities have been intervening in the foreign exchange market, thereby holding the value of the Yuan lower to gain an advantage for its exports.

A lower value of the Yuan would lower the price of Chinese exports in terms of foreign currency and raises the price of imports in terms of Yuan. Assuming that the Marshall-Lerner condition holds in China it would lead to an improvement in the current account balance, ceteris paribus.
Other countries would experience a fall in their export revenue as less of their goods are exported due to their inability to compete with Chinese goods and rise in import spending as their own consumers may find the Chinese imports cheaper relative to their domestically produced goods. Thus, the other countries would experience a current account deficit as a result.

(Extract 3 and Table 2, China's inflexible exchange rate regime might have explained the large current account surplus it enjoyed and the large current account deficit incurred by the US)

<u>Global current account imbalances are not the result of inflexible exchange rate regimes of surplus countries</u>
Appreciation of the Yuan, as seen in Figure 1, and the growing current account surplus of China from 2005 to 2008 suggest otherwise.

Floating exchange rate regimes like Germany consistently had a fairly large current account surplus (Extract 3)

Deficits could also arise due to other reasons like rising import spending from growing demand for more imported raw materials and machinery from developing economies like India (Table 2)

Another factor accounting for the different current account positions is likely to be relative competitiveness of the countries. The growing current deficits experienced by US could be a result of loss of comparative advantage and hence export competitiveness, while countries that are having current account surpluses like China and Germany are basically more competitive.

Level	**Level Descriptors**	**Marks**
L3	Able to thoroughly discuss whether the global current account imbalances are the result of the surplus countries' inflexible exchange rate regimes, supported by clear, detailed economic analysis and wide range of the data provided from case materials.	7-8
L2	Able to provide an explanation on whether the global current account imbalances are the result of the surplus countries' inflexible exchange rate regimes, but lacks detailed economic analysis and limited reference to case materials.	4-6
L1	Able to provide few valid points on whether the global current account imbalances are the result of the surplus countries' inflexible exchange rate regimes. However, economic analysis and clear reference to the case materials is lacking.	1-3

(e) **Extract 1 suggests that globalisation has increased a country's vulnerability to external shocks. Discuss the policy options available to governments to rebalance their countries' growth strategies.** **[10]**

As mentioned in Extract 1, Asia's development strategy in recent decades has prioritized export-oriented growth, which depends on demand from developed economies.

Possible strategies that the governments can consider to rebalance growth strategies:

- Increase domestic household consumption to reduce the emphasis on export of commodities as the engine of growth. E.g. China should expand its social safety net to reduce savings and encourage growth in the services industries
- Increase levels of domestic investment, through more concert efforts to developing local enterprises and attention to improving infrastructure to support these enterprises

  Evaluation:
  Cost involved in restructuring the economy to focus on services, e.g. resources devoted to export sector might not be highly mobile or suitable for use in another sector and sizeable proportion of workforce in the export sector might become structurally unemployed unless they are retrained for jobs in the new areas of growth

- Supply-side policies to boost economic growth and thus increasing the income that households can earn

  Evaluation:
  Measures to increase wealth of households should take into account of need to distribute wealth so that population in general has ability to spend

- Diversification of export markets to reduce reliance on demand from the developed economies.

  Evaluation:
  Spending power of other emerging economies might be limited in the short run as their income levels are not as high as the developed economies

  Conclusion:
  Measures to ensure more stable and sustainable economic growth is desirable but costs involved in restructuring an economy
  Government needs to balance this against the other macroeconomic objectives of low unemployment and low inflation

Level	Level Descriptors	Marks
L2	Able to use detailed economic analysis to underpin discussion on the possible policy options to rebalance growth strategies.	4-6
L1	Able to provide some valid points on the possible policy options to rebalance growth strategies. But there is insufficient depth in analysis.	1-3
E2	Evaluation well-supported with justification	3-4
E1	Unexplained evaluation	1-2