H

ST. ANDREW'S JUNIOR COLLEGE
PRELIMINARY EXAMINATIONS – 2018 (JC2)
General Certificate of Education Advanced Level
Higher 2

ECONOMICS **9757/01**

Paper 1 **27 August 2018**

2 hours 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your name and class on all the work you hand in.
Write in dark blue or black pen on both sides of the paper.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.

Start Question 1 and 2 on a fresh sheet of paper.
At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **7** printed pages and **1** blank page.

Answer all questions

Question 1: Steel Industry in India

Table 1: World Steel Output and Consumption (million tonnes)

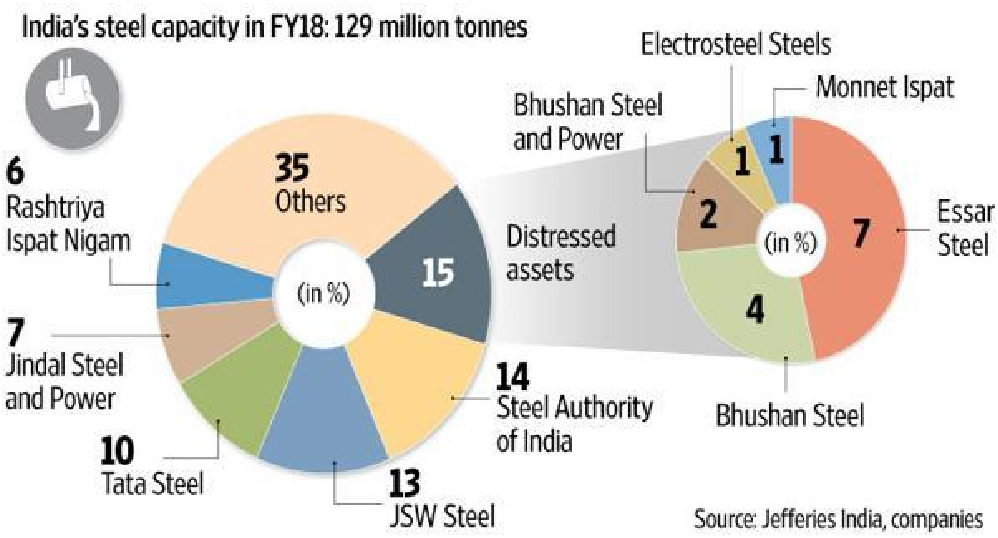
	2014	2015	2016	2017
Output	1,669	1,620	1,627	1,689
Consumption	1,546	1,500	1,516	1,587

Source: World Steel Association

Figure 1: World Steel Prices (USD/tonne)

Source: Tradingeconomics.com

Figure 2: Key Steel Producers in India



Extract 1 Steel industry gets protection

India's Steel Minister Narendra Singh Tomar said that additional steps will be taken to protect domestic steel industry, which is facing a bad patch, in wake of cheap Chinese imported steel. "China was trying to dump its cheap steel in India and as a result of it, the domestic steel industry was in distress. To protest domestic industry, we enhanced import duty and imposed safeguard duty. But these steps were not enough and we will be taking additional steps in this regard", said Tomar.

Steel ministry along with the Finance and Commerce ministries are engaged in a dialogue to work out the steps that need to be taken for protecting domestic steel industry in the near future, according to media reports. "China is offering steel at half price compared to domestic industry in India. The way China is working, it appears (that) an economic war was on," he said.

Giving relief to domestic steel producers against cheap in-bound shipments, the government on Friday imposed a minimum import price (MIP) on 173 steel products ranging between $341 and $752 per tonne. The minimum price will remain in place for six months only.

The Minister further said state-run steel production centres are being expanded and modernised and four new steel plants were being set up in Jharkhand, Odisha, Chhattisgarh and Karnataka.

Source: realtyplusmag.com, 01 Feb 2016, www.thehindubusinessline.com, 05 Feb 2016

Extract 2: 'Iron and steel industries are economy's backbone'

NAGPUR: Iron ore and steel industry is one of the basic industries of the country and plays an important role in strengthening the economy.

Delivering a talk on the 'Indian iron ore industry-an overview', CS Gundewar, controller general, Indian Bureau of Mines said that India was the fourth largest producer of steel in the world. Iron and steel was one of the largest industries supporting the country's economy.

At present India produces 65 million tonnes steel, but as per the 'National Steel Policy', the country is expected to raise this production to 180 million tonnes by the year 2020. But this, he said, would be possible only by exploring new mines. Though India has large resources of iron ores with estimated capacity of 28.52 billion tonnes, magnetite reserves could not be exploited due to the presence of these ores in the 'eco-fragile' zones mainly in Western Ghats. Gundewar also stressed on the need for more scientific and environment conscious mining by using eco-friendly technologies.

Source: Timesofindia.indiatimes.com, 15 May 2013

Extract 3: What is making Indian steel expensive?

A World Steel Dynamics (WSD) report has ranked India ahead of most countries, except those from the Commonwealth of Independent States, in terms of the cost curve. Yet, the sector is reeling from cheap imports and high inventory levels.

According to WSD data for January this year, production cost for hot-rolled coils in India was $349 a tonne, compared with $428 in China, $429 in South Korea, $448 in Japan and the global average of $418. Add to it the taxes, freight and the cost of capital, and the picture isn't really rosy for domestic steel makers, companies claim.

"Our internal freight rate is two-three times higher compared to China," says Sushim Banerjee, director-general of the Institute for Steel Development and Growth.

Logistics costs from Bellary to Delhi would be $60, while for the same distance in China, a producer would pay only $18, says Jayant Acharya, director (commercial and marketing), JSW Steel.

Former Tata Steel former managing director, J J Irani, says, "Most modern steel plants are shore-based, as the cost of transporting ores in large carriers is much cheaper than hauling it in trains. Korean and Japanese plants are all shore-based. They also import ores rather than mine ores."

Adapted from www.business-standard.com, 24 Sep 2015

Questions

(a) **(i)** Describe the trend of world steel prices from Jan 2016 to Dec 2017. [1]

(ii) With reference to Table 1, explain a possible reason for the apparent contradiction between the data and the trend of world price of steel in **(a)(i)**. [3]

(b) **(i)** Using an example, explain what is meant by a price floor. [2]

(ii) With the use of a diagram, explain how a minimum import price could achieve the Indian government's intended objective. [4]

(c) In view of the current market structure in the Indian steel industry, discuss the possible impact of the Indian government's removal of the minimum import price after six months on consumers and producers of steel in India. [8]

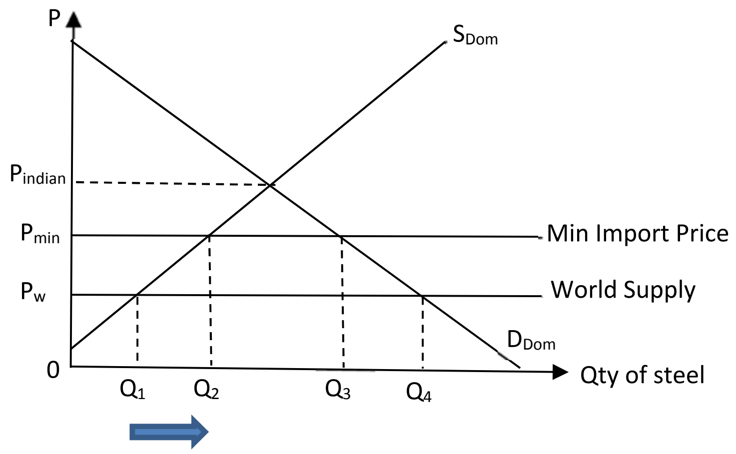
(d) **(i)** With the use of an example, explain what is meant by comparative advantage. [2]

(ii) Assess the options that are available to the Indian government to secure India's comparative advantage in steel production. [10]

[Total: 30]

Suggested Answers

(a)	**(i)**	**Describe the trend of world steel prices from Jan 2016 to Dec 2017.**	**[1]**
		The trend is generally a rising one. [1]	
	(ii)	**With reference to Table 1, explain a possible reason for the apparent contradiction between the data and the trend of world price of steel in (a) (i).**	**[3]**
		Table 1 seems to suggest that *there had been a **surplus*** in the market from 2016 to 2017 as every year, the production is greater than consumption.[1] Hence, the **world market price of steel *ought to be falling***. [1] Possible reason for 'anomaly' [1] However, as **output may not equate to supply** (portion of steel may be produced but not offered for sale), Table 1 may not therefore show the supply, and hence, the surplus of steel from 2016 to 2017. It is possible to postulate that some steel producers may have tried to withhold some amount of produced steel from the market in order to induce an upward pressure on steel prices.	
(b)	**(i)**	**Using an example, explain what is meant by price floor.**	**[2]**
		A price floor is the legally minimum market price of a good or service and is set above the market equilibrium price. [1] E.g. A minimum import price on imported steel imposed by Indian government means that imported steel must not be sold less than the legally permissible price set by the Indian government. [1] Or A minimum wage is a form of price floor. It is the lowest wage a worker may be paid. Workers must not be paid lower than this legally permissible wage, usually set by governments or trade-unions. [1]	
	(ii)	**With the use of a diagram, explain how a minimum import price could achieve the Indian government's intended objective.**	**[4]**

		• The objective of the minimum import price is to protect domestic steel producers or **<u>to protect steel workers</u>** **<u>by raising the price of imported steel</u>**. • Given that local steel producers are facing a bad patch in wake of cheap Chinese imported steel ($0P_w$), Indian government adopted minimum import price, which brought the equilibrium price to $0P_{min}$. • As price of imported steel increases, quantity demand for imported steel by Indian consumers falls. • At the same time, domestic consumers switched from imported steel to domestic steel. Domestic firms increase output from $0Q_1$ to $0Q_2$, a success of imposing minimum import price. <u>Fig 1: MIP impact on Indian (Domestic) Steel Market</u>  	
(c)		**In view of the current market structure in the Indian steel industry, discuss the possible impact of the Indian government's removal of the minimum import price after six months on consumers and producers of steel in India.**	**[8]**
		<u>Removal of minimum import price</u> means that imported steel will be bought and sold at the original price previously. <u>Current Steel Market Structure is an oligopolistic one.</u> Current steel market dominated by 5 largest producers with a combined market share of 51% (Fig. 2). <u>Steel **producers** in India – **Positive** impact</u> • The expectation of a return of foreign competition with the removal of minimum import price will force local producers to further explore ways to be even more efficient. Dominant oligopolistic steel producers may have used their supernormal profits to invest heavily on R&D to seek more efficient production methods and produce more quality steel to better compete with foreign suppliers (e.g. China). • Some dominant firms may even collude in order to consolidate their resources for R&D and gain greater market share. With greater market share comes higher IEOS. This can help indian made steel be more price competitive as producers	

		pass cost savings to consumers. Continued effort to be more competitive may allow such dominant local steel firms to grow even stronger in due course, further entrenching their oligopoly position.
		
		Steel **producers** in India – **Negative** impact
		• The smaller steel producers are likely to be the distressed ones. With the impending removal of minimum import price only after six months of implementation, such small steel producers would unlikely have had the time nor the financial resources to ready themselves for the return of foreign stronger competitors.
		• Assuming that there is no collusion with bigger dominant firms, their low output and less ability to reap iEOS, they are likely to lose customers to the foreign suppliers.
		• They could suffer from falling TR, profits and thus, exit the industry altogether.
		• Their exit may allow foreign firms to take over their market share.
		
		Steel **consumers** in India – **Positive** impact
		• However, the removal of minimum import price will no doubt reduce cost of production (COP) of steel consumers, who use steel as a factor of production. Lowered COP for steel consumers could mean higher profits, assuming unchanged TR.
		• This is especially true for heavy steel users such as car and equipment manufacturers.
		• With heightened foreign competition, existing oligopolists will even be more unlikely to employ collusion tactics for fear of losing significant amount of customers e.g. via predatory pricing
		    o This could bring about greater cost savings to consumers, steel consumers may enjoy even lower prices than those charged by Chinese steel producers.
		
		Steel **consumers** in India – **Negative** impact
		• Removal of minimum import prices is likely to lead to entry of foreign steel producers in Indian steel market.
		• Should these foreign producers, being more efficient than local ones, and dominate the Indian steel market in the foreseeable future, steel consumers in India may become increasingly reliant on foreign steel.
		• Heavy reliance on such a critical input may put the domestic steel consumers at risk of future unexpected trade dispute or transport delay.
		
		EVALUATION
		• Dominant oligopolistic Indian steel producers are unlikely to exit the industry than the smaller local steel producers. This is due to their stronger past super-normal profits/ financial reserves either to withstand foreign competition or to plough into the R&D and/or marketing efforts to gain further market share.
		• However, R&D may not always be successful. In the event that R&D outcome is not realised in time, the dominant oligopolistic Indian firms may not be able to compete with foreign firms and lose their market share when MIP is lifted.
		    o As more foreign firms enter the once oligopolistic indian steel market, **it may eventually become monopolistic competitive**.

- Alternatively, on the other hand, if a single foreign firm manage to dominate the Indian steel market, **it may even become monopolistic.**

- Given steel industry is one key pillar of Indian economy (Ext 2), it is unlikely that Indian government will allow foreign firms to dominate the domestic steel industry. Hence, steel consumers will continue to be able to import steel at a lower price than before removal of minimum import prices and not run the risk of having to buy steel exclusively from only foreign steel producers even in the longer term.

Level (Marks)	Knowledge, Application, Understanding, Analysis
L2 (4 – 6)	- Clear explanation of impact on both consumers and producers. Balanced answer given based on sound economic arguments. - Explanation needs to include both positive and negative impact on the consumers and producers.
L1 (1 – 3)	- Weak explanation (incomplete or contains errors) of impact presented. - Lack of supporting evidence from case materials.
E (1 – 2)	- Suitable judgement provided for producers and consumers – 2m. - Merely stand given without substantiation – 1m.

(d) (i) With the use of an example, explain what is meant by comparative advantage. **[2]**

- Define comparative advantage (CA) – A country is said to have CA if it is able to produce a good with less opportunity cost than another country producing the same good.

- Example: Production of vegetables in Singapore vs Malaysia

- Singapore faces land scarcity and lack of expertise in farming. On the other hand, Malaysia has land and farming know-how.

- Hence, per kilogramme of vegetables produced in Singapore, Singapore may need to sacrifice more resources and hence output from the next best sector (e.g. tourism services). Hence, opportunity costs in terms of tourism services produced will be much higher in Singapore than in Malaysia. [1]

	(ii)	**Assess the options that are available to the Indian government to secure India's comparative advantage in steel production.**	**[10]**

INTRODUCTION

- A country's CA depends on 1) quality and quantity of factors of production and 2) availability of suitable production techniques/technology.
- Options that are available to the Indian government to secure CA must at least ensure no erosion/loss of (1) and (2).

- Based on extract, options available include
  - #1: modernising state-run production centres
  - #2: improve transport network/infrastructure to cut freight costs
  - #3: build more shore-based plants

BODY

- **Option #1:** State-run steel production centres are being expanded and modernised (Ext 1). Doing so could help steel firms
  - Expansion helps to reap EOS by expanding scale of production and lower unit COP
  - Modernisation helps to increase efficiency and productivity by using modern technology; as such reduce unit COP

- Lower COP could help to secure CA.
  - Lower COP implies less funding/resources has been sacrificed from elsewhere to pay for the steel production → lower opportunity cost
  - Also, with more efficient and productive technology to produce steel, this could also mean fewer units of resources are needed to produce the same quantity of steel, thus freeing up such scarce resources to produce more units of other goods → lower opportunity cost

Advantages/Limitations

- Concern remains whether such state-run centres will strive to be as cost efficient as possible. As steel is one large industry in India (Ext 2), such state-run centres may have an even more important objective – create jobs. Hence, the state-run firms may compromise cost efficiency and instead choose to employ excessive workers. In so doing, these state-run firms may not be able to help India secure its CA.

- **Option #2:** Improve transport network/infrastructure to reduce internal freight rate (Ext 3)
  - Improve the transport infrastructure network (construct dedicated rail tracks, etc) to cut down on freight cost to transport raw materials to steel production plants as well as finished products to the ports to be exported.

- **Option #3:** Build more shore-based plants
    - Could explore building shore-based plants like those in Korea and Japan.
    - Cuts down freight/transport costs (Ext 3 – much cheaper to carry ore in ships than hauling ore in trains).

- Both options lower transportation cost. This could help secure CA.
    - Lower COP implies less funding/resources has been sacrificed from elsewhere to pay for the steel production → lower opportunity cost

<u>Advantages/Limitations</u>

- <u>Option 2</u> would be highly necessary if ore deposits are located far away from steel plants. Huge investment would be needed to lay rail tracks – hence may strain govt budget. Should the govt need to borrow to finance this project, financial crowding out effect may retard actual economic growth.

- <u>Option 3</u> would allow India to reap long term benefits, as shore-based plants will forever terminate the need to haul ores via trains, a more expensive option of obtaining raw materials for steel producers.

- Although there may be pollution, pollution would unlikely affect large population due to location near sea – generates minimal negative externality.

<u>EVALUATION</u>

- Though improving the transport network could help to secure CA for India, this method will require continual upgrading of the network once the current ore mines get exhausted. The network will need to reach newer ore mines, which means a drain on future government budget as well as making the existing network under-utilised.

- The Indian government should consider building only shore-based steel plants so as to cut down on the need to continuously improve the transport network. Given India's long shoreline, the government is unlikely to have to vacate or evict any existing occupants of the land, thereby reducing any opportunity cost of steel production. In addition, due to its proximity to the sea and away from population, the minimal negative externalities generated should help align Indian government's aim to be eco-friendly in its quest to achieve economic growth.

Level (Marks)	Knowledge, Application, Understanding, Analysis
L2 (5 – 7)	- Clear explanation of **<u>any two</u>** options available, detailing how India's CA in steel production could be secured. - Explanation needs to draw suitable evidence from the case materials.
L1 (1 – 4)	- Superficial explanation (incomplete or contains errors) of options was given. - Lack of supporting evidence from case materials.
E (1 – 3)	- Appropriate assessment provided with justification based on sound economic argument. - Merely stand given without substantiation – 1m.

[Total: 30]

Question 2: The Debate on Globalisation

Table 2: Current account balance of various economies (US$, billions)

	2011	2012	2013	2014	2015	2016
India	-62.5	-91.5	-49.1	-27.3	-22.5	-12.1
U.S.	-465.9	-426.2	-349.5	-373.8	-434.6	-451.7
China	136.1	215.4	148.2	236	304.2	196.4

Source: *World Bank*

Table 3: China's inflation rate (annual %)

Year	2011	2012	2013	2014	2015	2016
Inflation rate (%)	5.41	2.64	2.63	2.0	1.44	2.0

Source: *World Bank*

Extract 4: China eyes improved India ties in case of Sino-U.S. trade war

China is currently facing down a list of import tariffs levied by the Trump administration, agitated by the country's $375 billion trade surplus with the United States. In response, it has hinted at relaxing rules on some American imports and suggested dialogue rather than escalating a potential trade war.

That is not all, however. China is now taking steps to protect itself if a trade war does come to pass, and is looking to India as a potential ally, although India's government is not all too happy with its own China trade deficit. China wants to treat other countries, especially major partners, well in case U.S. tariffs force Chinese exporters to depend more on markets outside the United States, analysts say. India is a prime target. Beijing knows India finds the trade relationship uneven, experts say, increasing the urgency to please it.

"Indian officials see China pursuing a 'beggar-thy-neighbour' policy and undermining India's manufacturing sector by dumping cheap, subsidised goods in the Indian market while importing raw materials from India," says Mohan Malik, a professor at the Asia-Pacific Centre for Security Studies in Honolulu, Hawaii. India has filed the largest number of anti-dumping cases in the World Trade Organisation (WTO) against China, he notes.

A closer trade relationship with India means more opportunities in the future, as India is expected to be the fastest-growing economy for the next decade. India's GDP, the world's fourth-largest, is growing at around 6.5% -- close to China's own rate of acceleration.

However, China has cause to fear India's economic expansion as Indian wages are generally lower than Chinese equivalents, keeping manufacturing costs down, says Stuart Orr, professor of strategic management at Deakin University in Australia. India would also not be burdened by U.S. tariffs aimed at China. "If India increases its imports from the U.S., the doors will be open for India to export more to the U.S. as well," Orr says. "As China's wage rates continue to rise, China has every basis for fearing an India with a developed manufacturing capability, fueled by the demand of more exports to the U.S.," he says.

Source: *Forbes*, 3 April 2018

Extract 5: China's vanished current-account surplus will change the world economy

The State Administration of Foreign Exchange (SAFE) said on Friday that China had recorded a deficit of US$28.2 billion in its current account for the first three months of 2018, in what is the first quarterly deficit since the second quarter of 2001. Economists said it could signal a fundamental shift in China's international payment position.

Ding Shuang, the chief China economist with Standard Chartered in Hong Kong, wrote in a note that China has run a current account surplus on an annual basis in the past 25 years and "people tend to take China's surplus for granted". However, "a moderate shock, against the backdrop of intensifying trade frictions, can push China's current account into deficit," he wrote.

The merchandise trade surplus dropped 35 per cent year-on-year to US$53.4 billion in the first three months of this year, SAFE said. Meanwhile, the service trade deficit, including tourism, was US$76.2 billion, resulting in an overall current account deficit, according to China's official balance of payment figures.

Ding forecasts that China's current account will likely return to a surplus in the coming months, but the surplus will be just 1% of GDP this year and 0.5% next year. The trade ruckus with the U.S. could reinforce the downward trend.

Adapted from *South China Morning Post*, 4 May 2018 and *The Economist*, 17 May 2018

Extract 6: Globalisation or de-globalisation?

A cursory glance at economic preferences of people around the world point at two prominent trends. Firstly, those in advanced countries are increasingly interested in de-globalisation.

The term de-globalisation is used to highlight the trend of several countries wanting to go back to economic and trade policies that put their national interests first. These policies often take the form of tariffs or quantitative barriers that impede free movement of people, products and services among countries. The idea behind all this protectionism is to shield local manufacturing by making imports costlier. The present talk around 'trade war' and 'de-globalisation' cropped up after the U.S., in March, imposed 25 per cent and 10 per cent duty on steel and aluminium imports, respectively, from certain countries, citing national security and job creation as the triggering factors.

The second trend, on the other hand, is that less developed countries have become vanguards of interconnected economy, as it provides them, through the expansion of markets and infusion of foreign capital and technology, with the chance to develop economically. The proponents say globalisation represents free trade, which promotes global economic growth, creates jobs, allows labour to move from country to country to market their skills and makes companies more competitive.

An IMF Working Paper looked at how globalisation affects the distribution of incomes across and within countries. "In rich economies, globalisation still represents a source of economic growth, but the expected gains are lower than in poor and emerging market economies, where globalisation increases economic well-being and reduces poverty. While in the average developing economy the poor as well as the wealthy benefit from globalisation, in many advanced economies globalisation often has little effect on the incomes of the poor," they claimed. This is a point that explains why a majority of people in economically advanced countries are rallying against globalisation, leading to protectionist trade practices.

The economists have an advice for the governments. "Government policies matter in making the benefits of globalisation more inclusive. Investments in education that raise skill levels, as well as taxes and transfers that spread the benefits more broadly, can help globalisation fulfil its promise of generating gains for all," they argued.

Adapted from *Forbes*, 6 May 2015 and *The Asian Age*, 25 June 2018

Questions

(a) Using Table 2, compare the current account balance of India and the U.S. from 2011 to 2016. **[2]**

(b) How far do Tables 2 and 3 show an improvement in China's economic performance from 2011 to 2016? **[5]**

(c) With reference to Extract 4, explain the potential macroeconomic impact of U.S. tariffs on both China and India. **[5]**

(d) Extracts 4 and 5 mention some of the challenges faced by the Chinese economy in recent times. **[8]**

Using the data and your own relevant knowledge, evaluate **two** policy options the Chinese government may consider in overcoming **any two** of these challenges.

(e) With reference to data where appropriate, assess the extent to which world economies should pursue deglobalisation. **[10]**

Total: 30 marks

Suggested answers

(a)	**Using Table 2, compare the current account balance of India and the U.S. from 2011 to 2016.**	**[2]**
	Similarity: Both India and US are facing a current account deficit from 2011 to 2016. OR Both countries' current account deficits are improving/becoming smaller. Difference: India's current account deficit is always smaller than that of US.	 **[1]** **[1]**
(b)	**How far do Tables 2 and 3 show an improvement in China's economic performance from 2011 to 2016?**	**[5]**
	Introduction: • China's economic performance can be measured through the 4 macroeconomic indicators i.e. economic growth, inflation rate, unemployment rate and BOP position. Thesis: • Table 1 shows a rising CA surplus, which may imply rising AD in China and hence, actual growth and an increase in employment. • Furthermore, a rising CA surplus may also reflect an improving BOP position of short term BOP surpluses, assuming BOP equilibrium. • Table 2 shows a slowing inflation rate in China which could reflect moving towards the goal of low and stable inflation. Anti-thesis: • However, a rising CA surplus may not necessarily mean an improvement in economic performance as it is not reflect the entire BOP, which also takes into account flows in the KFA. • Additionally, a rising CA surplus in the long term may result in long term BOP surpluses, which worsens China's economic performance in achieving long term BOP equilibrium. • A slowing inflation rate may also mean the economy's growth is slowing down, therefore worsening China's economic performance. Evaluation: • Given that Tables 1 and 2 only provide China's CA balance and inflation rate respectively, there is insufficient data to accurately conclude if there has been an overall improvement in China's economic performance as the data provided does not give a complete picture of the four key areas of economic performance. Hence, the tables show an improvement in China's economic performance to a small extent.	

(c)	**With reference to Extract 4, explain the potential macroeconomic impact of U.S. tariffs on both China and India.**	**[5]**
	Define tariff: Tariffs are duties paid for certain types of imports. OR Explanation of the impact of the tariff on Chinese goods. Macroeconomic impact of U.S. tariffs on China: • A U.S. tariff on Chinese products would make Chinese goods more expensive in the U.S., resulting in a fall in quantity demanded for China's exports. • Ceteris paribus, this may cause a decline in AD, resulting in real national income decreasing via the multiplier effect (negative economic growth), increasing the level of unemployment in China. OR • Ceteris paribus, this may worsen China's CA and hence, BOP position. Macroeconomic impact of U.S. tariffs on the India: • As India would not be burdened by the U.S. tariffs aimed at China (Extract 1 para 5), India may potentially be able to trade more with the U.S. • If export revenue of India exceeds its import expenditure, this may increase AD, ceteris paribus, causing an increase in real national income via the multiplier effect, resulting in actual economic growth as well as an increase in employment. OR • Ceteris paribus, this may improve India's CA and hence, BOP position. • If export revenue of India is smaller than its import expenditure, this may decrease AD, ceteris paribus, causing a fall in real national income via the multiplier effect, resulting in negative economic growth as well as an increase in unemployment. OR • Ceteris paribus, this may worsen India's CA and hence, BOP position.	**[1]** **[2]** **[2]**
(d)	**Extracts 4 and 5 mention some of the challenges faced by the Chinese economy in recent times.** **Using the data and your own relevant knowledge, evaluate <u>two</u> policy options the Chinese government may consider in overcoming <u>any two</u> of these challenges.**	**[8]**
	Introduction Challenges faced by the Chinese economy: 1. Looming trade war between China and the U.S. 2. Potential loss in competitiveness to countries such as India 3. China's declining CA balance These challenges faced by China have varied negative impacts on economic growth, employment and BOP position in China. **Body** <u>Challenge #1</u> The looming trade war may result in the loss of one of China's largest markets abroad, which may negatively affect China's export revenue and hence, economic growth, unemployment as well as BOP position.	

Policy considerations:

1. Trade policies to appease the U.S.

   Evidence: It has hinted at relaxing rules on some American imports and suggested dialogue rather than escalating a potential trade war (Extract 4 para 1)

   By relaxing rules on some American imports, this may help ease some tension between China and the U.S. as the U.S. would have greater access to China's market, potentially reducing the CA surplus China has with the U.S. to some degree by reducing China's export revenue from the U.S., and increasing its import expenditure to the U.S.

   In the longer term, this would be beneficial to not only the U.S., but to China as well as the improved trade relations would still mean that they would be able to continue to trade with the U.S., rather than shutting out all opportunities to trade.

   These trade policies may reduce the extent of the decrease in export revenue as compared to a trade war with the U.S., hence, alleviating the impact on China's economic growth, unemployment and BOP position.

2. Trade policies to improve trade relations between China and other countries such as India

   Evidence: Undermining India's manufacturing sector by dumping cheap, subsidised goods in the Indian market (Extract 4)

   China should address the dumping allegations by India and use fairer trade practices to improve trade relations with India. Furthermore, given that India is expected to be the fastest-growing economy for the next decade (Extract 1), fairer trade practices should encourage greater trade between China and India, allowing China to ride on India's growth as a source of external growth. Hence, this may help to increase China's export revenue in the longer term, positively impacting its economic growth, unemployment and BOP position.

Evaluation: However, there is no guarantee of success with trade policies as China has also threatened to impose tariffs on U.S. goods to China, which may further worsen the already volatile trade relations between the two countries. Similarly, China may refute India's allegations on dumping, potentially worsening trade relations between the two countries.

<u>Challenge #2</u>

Evidence: China has cause to fear India's economic expansion as Indian wages are generally lower than Chinese equivalents, keeping manufacturing costs down (Extract 4 para 3).

A loss in price competitiveness may signal a decline in China's future export revenue and as a result, have negative implications on it economic growth, unemployment and BOP position.

Policy considerations:

1. Supply-side policies

   For example, China may need to move further up the value-added chain in order to remain competitive in the global economy. This may involve education and training to restructure the economy, in harnessing a new area of comparative advantage to increase export price competitiveness internationally. This should help to increase export revenue in China, boosting actual economic growth, employment and improving the BOP position, ceteris paribus.

   Evaluation: In moving up the value-added chain, it may also be important for China to look into increase its non-price competitiveness of exports, rather than just price competitiveness, as higher value-added products usually require greater polish and are of higher quality.

<u>Challenge #3</u>

Evidence: China had recorded a deficit of US$28.2 billion in its current account for the first three months of 2018, in what is the first quarterly deficit since the second quarter of 2001 (Extract 5 para 1).

A deficit in the CA could signal a worsening balance of trade and as a result, negative growth and a fall in employment.

Policy considerations:

1. One of the wider-known macroeconomic policies in China is the rebalancing of growth, from externally-driven sources, to more internally-driven sources. In recent years, China has been striving to rebalance from export-driven growth to that of consumption-led growth. The refocusing of their drivers of growth reduce reliance on the global economy to drive more stable growth and employment.

   Evaluation: Rebalancing of growth may take some time to change as it involves large macroeconomic changes and a fundamental change in mindsets of consumers from saving, to consumption.

Note: Students may choose to discuss <u>**any appropriate policy**</u> option to tackle the various challenges China may face.
Accepted policies include:

- Expenditure reducing (contractionary MP and FP)
- Expenditure switching (depreciation)
- Retaliatory protectionism

Synthesis

In view of the various challenges China is experiencing, China may need to prioritise the issues at hand in order of importance, in order to effectively reduce its negative impacts on the macroeconomy. In so doing, China will better be able to achieve its aims of high and sustained economic growth, low unemployment and a favourable BOP position. Furthermore, given that some policy options require some time before its effects can be seen in the macroeconomy, it would be wise of the Chinese government to consider a combination of short term and long term policy options in order to see the best outcome in mitigating these challenges.

Level	Knowledge, Application, Understanding, Analysis	Marks
L2	For a well-developed answer that demonstrates a good understanding of the issues faced by the Chinese economy. Responses show sound understanding of causes of the problems and how the policies may alleviate the challenges faced by China, as well as the shortcomings of the policies.	**4-6**
L1	For an under-developed answer that demonstrates some understanding of the challenges faced by the Chinese economy. Policy options offered may largely be rehashed without consideration of the context of the situation. Answers may contain misconceptions and tend to be one-sided.	**1-3**
E	For an explained judgement.	**2**
	For an unexplained judgement.	**1**

(e) **With reference to data where appropriate, assess the extent to which world economies should pursue deglobalisation.** **[10]**

Introduction

Globalisation has its advantages and disadvantages. However, not all economies are equal and hence, the extent to which these economies see the benefits and costs of globalisation may differ largely. More often than not, deglobalisation is pursued because of national interest, which may relate to any of the 4 macroeconomic or 2 microeconomic aims of a government.

Thesis

Economies **may** choose to pursue deglobalisation if the costs of globalisation exceeds its benefits.

Evidence: In rich economies, globalisation still represents a source of economic growth, but the expected gains are lower than in poor and emerging market economies, where globalisation increases economic well-being and reduces poverty (Extract 6 para 4).

Data appears to suggest that the benefits of globalisation for developed countries are small relative to the costs of globalisation. Hence, these economies may choose to pursue deglobalisation in order to reduce the costs of globalisation.

1. Some economies may choose to pursue deglobalisation in order to achieve a healthier BOP position:

   Evidence: China is currently facing down a list of import tariffs levied by the Trump administration, agitated by the country's $375 billion trade surplus with the United States (Extract 4 para 1).

   Economies that are currently experiencing a CA and/or BOP deficits, such as the U.S., may want to pursue deglobalisation in order to reduce these deficits. By implementing protectionistic measures such as tariffs, imports become relatively more expensive, resulting in a decrease in quantity demanded of imports and therefore, import expenditure. Ceteris paribus, this should reduce the CA and BOP deficits, allowing economies such as the U.S. to achieve a healthier BOP position.

2. Some economies may also choose to pursue deglobalisation in order to achieve greater levels of economic growth and employment:

   Evidence: The idea behind all this protectionism is to shield local manufacturing by making imports costlier. The present talk around 'trade war' and 'deglobalisation' cropped up after the U.S., in March, imposed 25 per cent and 10 per cent duty on steel and aluminium imports, respectively, from certain countries, citing national security and job creation as the triggering factors. (Extract 6).

   Shielding local manufacturing by making imports costlier would cause a substitution effect with foreign-produced goods to that of domestically produced goods as they are now relatively cheaper. This would result in a decrease in import expenditure and an increase in consumption. Ceteris paribus, this should increase AD and hence, real national income via the multiplier effect. As more output is produced, there is an increase in derived demand for labour, resulting in greater levels of employment.

3. Some economies may also choose to pursue deglobalisation in order to reduce income inequality.

   Evidence: In many advanced economies globalisation often has little effect on the incomes of the poor (Extract 6 para 4).

   Developed economies may lose their comparative advantage in the production of labour-intensive manufactured goods to developing countries with cheaper labour. As these jobs tend to be filled by the less-educated and poor, they may find themselves structurally unemployed, worsening the income gap between the rich and the poor. The imposition of protectionist measures that shield such domestic industries (as explained previously) allows the poor retain the work that they do, and may hence alleviate the widening income disparity that was a result of globalisation.

Anti-thesis

However, not all economies may choose to pursue deglobalisation. Economies may **not** choose to pursue deglobalisation if the benefits of globalisation exceeds its costs.

1. Some economies may not choose to pursue deglobalisation in order to achieve greater levels of growth and employment.

   Evidence: It provides them, through the expansion of markets and infusion of foreign capital and technology, with the chance to develop economically (Extract 6 para 3).

   Developing economies may enjoy larger consumer based because of globalisation as it allows for greater movement of goods and services abroad. This allows them to sell relatively cheaper goods abroad, raising their export revenue. Ceteris paribus, this increases AD and hence real national income via the multiplier effect.

   Developing economies stand to benefit from the gains in transfer of capital and technology brought forth by globalisation. As globalisation allows for greater movement of capital and technology, this may increase FDI from developed economies to developing economies. Ceteris paribus, an increase in FDI would cause an increase in the investment component of AD, causing an increase in real national income via the multiplier effect, allowing developing countries to experience actual economic growth. Furthermore, this would increase derived demand for labour, increasing the level of employment.

   Transfer of capital and technology could also result in an increase in the LRAS of the developing country as it adds to the quality of factors of production. This would result in an increase in productive capacity of the economy, resulting in potential economic growth.

Evaluation/conclusion

How far world economies should pursue deglobalisation may depend on:

1. The stage of development of the economy

   As developed economies are increasingly seeing rising costs and declining benefits of globalisation, many developed economies are more inclined towards deglobalisation as they are further away from achieving their various microeconomic and/or macroeconomic goals. Developing countries, on the other hand, continue to enjoy the benefits of globalisation and may therefore see little benefit of pursuing deglobalisation.

2. The policies implemented by the various governments to deal with the costs of globalisation, while maximising on its benefits

   Evidence: Government policies matter in making the benefits of globalisation more inclusive. Investments in education that raise skill levels, as well as taxes and transfers that spread the benefits more broadly, can help globalisation fulfil its promise of generating gains for all (Extract 6).

   While developed economies may appear to face the brunt of the costs of globalisation, suitably chosen government policies may help to alleviate these costs, making globalisation more desirable as a whole. For example, the investment in education may be important to reduce the degree of structural unemployment in an economy due to loss in areas of comparative advantage. This would increase occupational mobility, allowing displaced workers to find other sources of employment elsewhere.

Evidence: In rich economies, globalisation still represents a source of economic growth, but the expected gains are lower than in poor and emerging market economies (Extract 6 para 4).

Given that in developed countries, globalisation is still a source of growth, such economies may need to rethink the pursuit of deglobalisation and make use of appropriate policies that may allow them to continue to ride the wave of globalisation.

Level	Knowledge, Application, Understanding, Analysis	Marks
L2	For a well-developed response that demonstrates good use of information from the data to support their arguments for **and** against globalisation. Answers make use of sound economic theory and show good links to the macroeconomic aims of an economy.	**5-7**
L1	For an under-developed response that shows some arguments for **or** against globalisation. Answers tend to be largely theoretical in nature and may not relate to the macroeconomic aims of an economy.	**1-4**
E2	For an explained judgement.	**2-3**
E1	For an unexplained judgement.	**1**