

PJC 2017 H1 Prelim Exam Paper 1

Question 2: Economic Performance, Prospects and Lessons

- (a) Describe the change in China's real GDP between 2011 and 2015 [2]

Suggested answer:

China's real GDP increases at a decreasing rate between 2011 and 2015.

- (b) Extract 7 suggests an increase in China investment overseas.
Comment on the likely effects of this on China's balance of payments [4]

Suggested answer:

An increase in China investment overseas will lead to a deterioration of her capital account in the short run as this is recorded as a debit entry in the long run capital account. Ceteris paribus, her BOP will deteriorate. However, in the long run her balance of payment may improve as investment overseas reap returns in the form of investment income such as profits and dividends. These are remitted back to China and are recorded as credit entry in China's Current account in her Balance of Payment.

- (c) Explain the case **for** the use of protectionist measures by the EU government [4]

Suggested answer:

The argument advanced for protectionism is to save jobs as dumping of cheap stainless steel product has "put thousands of jobs at stake" in the EU stainless steel industry. With China dumping cheap stainless steel in the EU market below cost, many EU firms are forced to sell at 'below cost price' as they cannot compete with cheap China made stainless steel. As a result, many were forced to cut back production and hence employment.

To prevent such massive job losses, governments have resorted to protectionism such as imposition of tariff so that imported stainless steel products are more expensive and EU stainless steel producers can still sell their products and hence prevent job losses. This will allow an increase in demand for domestic produce stainless steel and reduce demand for imported stainless steel. When demand rises, there will be an increase in production and hence a rise in derived demand for labor, hence preventing further job losses. In this way jobs may be saved.

- (d) With reference to Extract 7, using AD/AS analysis, explain how the 'Belt-and-Road Initiative' impact the Chinese economy. [4]

Suggested answer:

The 'Belt-and-Road Initiative' is an infrastructure development plan proposed to improve the connectivity of the country. As this project is undertaken by the Chinese government, it represents an increase in G and hence an increase in AD of which G is a component. Through the multiplier process, this will bring about an increase in actual growth in the short run as seen in the increase in real GDP. As real GDP increase, firms hire more labour to produce more output. This improves the employment of the economy as well. In the long run, an improvement in infrastructure increases connectivity and efficiency. Better infrastructure leads to time saved on the road and allows time for productive activity. This increases workers productivity and a fall in per unit cost represented by an outward shift of the LRAS. This will result in a fall in GPL and an increase in long run economic growth. The fall in GPL may also help improve her BOP as this enhances her exports competitiveness.

- (e) Discuss whether the data provided are sufficient to assess changes in standard of living of China over the period of 2011 and 2015. [8]

Suggested answer:

Define SOL

Standard of living of a country refers to the social and economic well-being of a country which includes both the material and non-material aspects of life. The material well-being is determined by the quantity and quality of goods and services for consumption while the non-material well-being is the quality of life and environment which ones lives determined by the intangible factors such amount of leisure and life expectancy.

Real GDP is the total money value of final output produced within the geographical boundary of the country, regardless of ownership of factors of production, over one year and before adjustment for depreciation excluding the effect of inflation. The real positive GDP growth data shows that the level of real GDP rose during the period. This means that there are more goods and services produced in the economy. Assuming that the population size rises marginally, real GDP per capita implies that on average citizens have more goods and services available for consumption. A higher level of good and services led to an increase in demand for labour, resulting in an increase in wages. A higher wage means Chinese households was earning higher income and disposable income and they had higher purchasing power to buy more and better quality goods and services.

If the increase in real GDP is due to longer working hours of workers, this meant that the Chinese had less leisure time and rest. This could lead to a declining health condition and an increase in stress level. As a result, the workers could have experienced a fall in a quality of life. Hence, we need to know whether there is an increase in working hours to determine whether the workers could have experienced a fall in a quality of life.

Unemployment rate measures the % of the labour force who is willing and able to work but cannot find a job despite an active search. An increase in unemployment rate from 4.3 to 4.6. A rise in unemployment rate could be due to China's transition from export led model of growth to a consumption and innovation driven one which could cause structural unemployment as workers do not have the necessary skills required in the labour market. With a rise in unemployment, it would lead to lower wages and hence lower ability to consume and lower material SOL. However, given that unemployment rose marginally by 0.3, it had minimal effect on the standard of living in China as the improvement in the standard of living due to the high real GDP growth in the same period outweighed the effects of unemployment on the standard of living.

PM2.5 air pollution represents the atmospheric particulate matter that have diameter less than 2.5micrometers which is the air quality report from environmental authorities. PM2.5 air pollution has increased. This could imply that the quality of air had dropped due to a greater amount of pollutants in the environment. Thus, we could expect an increase in health problems such as respiratory problems which reduced the quality of life of individuals staying in China.

Given data is necessary but not sufficient to assess how China's average SOL has changed over time. There is a lack of information to indicate the change in the both material and non-material well-being. E.g. the higher growth may bring about greater pollution and less leisure. Thus, a higher real GDP may not necessarily lead to higher SOL if people's health is affected by pollution and greater stress. To have better assessment of SOL, more indicators such as PSI, literacy rate and working hours are required. Composite index such as measure of economic welfare (MEW) could be given to indicate change in material and non-material SOL. MEW adds to GDP intangibles such as leisure and services of public amenities which will increase the non-material

well-being and deducts negative externalities such as pollution which will reduce the non-material well-being. Thus, it is a better indicator for assessing changing of SOL.

- (f) In view of the anti-globalisation sentiments, discuss whether globalisation should be the driver of growth for emerging economies such as China. [8]

Suggested answer:

Claim: Globalisation should be the driver of growth for emerging economies such as China.

Globalisation is the greater integration of the global economies due to greater trade and capital flows. With globalisation, China can gain access to more markets and can export more of its goods that it has comparative advantage (CA) in to the rest of the world resulting in higher export earnings (X). This causes her AD to rise in resulting in her NY rising by a larger extent via k effect. This can be seen in the positive economic growth rates of more than 6% as shown in Table 2. In addition, greater flow of investment resulted in transfer of knowledge and technology from foreign MNCs to China's firms, and subsequently expands China's AS. As stated in Extract 7, China firms like Haier are now able to produce better quality products as they obtained improved manufacturing facilities and talents through increased outbound FDI. Capital flows also allow China to gain presence in new markets, which will benefit the economy as an additional source of export earnings. Lastly, as China struggles with rising wage rates and cost of production, globalisation and ease of capital flows will allow firms to tap on pools of resources in other developing countries with more competitive cost of production such as India.

As a whole, globalisation should be the driver of growth for China as it brings about increases in AD and AS leading to a sustained economic growth in China.

However, while increased trade and capital flows due to globalisation helps an economy achieve sustained economic growth, it has also led to greater interdependence among countries. If China focuses on globalisation as a driver of growth, China will be vulnerable to changes in the level of economic activities in the global economy. As mentioned in Extract 7, in the face of shrinking external demand, rising trade disputes and protectionism as well as other factors that result in China losing its competitiveness in low cost of production, the Chinese government wants to move the economy towards a consumption and innovation driven one. This is evidently important, as seen in the economy's success in bringing up the percentage contribution of consumption expenditure (C) towards its GDP. On top of that, as mentioned in Extract 5, globalisation threatens the employment of jobs in developed countries that are in direct competition with developing countries, particularly low-skilled jobs. Even though China is also a developing country, it is a fact that the economy is suffering from rising wage rates and overall cost of production. This puts its low-skilled workers in a vulnerable position as they may lose their jobs if firms decide to outsource the production to economies with lower cost of production. In light of rising cost of production, China's government needs to focus on improving the economy's productivity so as to improve its competitiveness in the global economy. Lastly, globalisation led to rapid urbanization of China, exposing the country to various environmental and income distribution challenges. The Chinese government has implemented many relevant initiatives and plans such as the Belt and Road and the New Type Urbanization Plan to tackle these issues.

Despite the challenges, globalisation should still be the driver of growth for emerging economies such as China. The economy will benefit from increased trade and capital flows, as long as the government put in place appropriate policies to minimize the negative impacts of globalisation and must not be complacent and should regularly review their policies. In the long run, China needs to balance its economic growth

dependence on external and internal demand. The government can also retrain their workers and reallocate their resources to industries where they have CA, this would enable them to promote greater growth and welfare than if they had resisted globalisation through putting up more protectionistic barriers.