

Suggested Answer

- (a) (i) Describe the trend of Spain's balance of trade between 2007 and 2011. [2]

General: Spain's BOT deficit is generally decreasing (1 mark) and/or Spain is constantly in a deficit (1 mark)

Specific: In 2009, Spain's trade deficit fall sharply. (1 mark)

- (ii) Compare this trend with changes in Germany's balance of trade during the same period. [2]

Spain is experiencing a decreasing trade deficit (1 mark) whereas Germany is experiencing a decreasing trade surplus (1 mark).

- (b) From Table 2,

- (i) Identify the base year for Spain. [1]

Year 2008

- (ii) Explain the difference between GDP at constant price and GDP at current prices. [3]

GDP is the monetary value of all final goods and services produced within the country regardless of nationality in a given year. (1 mark)

Spain's GDP at constant price is generally lower than its GDP at current price from the period of 2009 to 2011. (1 mark) This is due to the increasing general price level/ inflation. (1 mark)

- (c) Explain why governments should be concerned with rising youth unemployment in recent years. [4]

The rising youth unemployment is a concern to the governments as it will lead to loss of resources and rising welfare expenditure.

Rising youth unemployment will lead to a fall in income tax revenue collected. This will lead to lesser revenue for government to spend on infrastructure development and provision of merit and public goods. This in turn will result in fall in the countries' standard of living. In addition, welfare countries like UK and Spain will also have to experience an increase in unemployment benefit expenditure (extract 3), thus leading to an increase in budget deficit. (2 marks)

(or any other SR consequences that results from rising youth unemployment – 1 mark)

In the long run, the rising youth unemployment will lead to a fall in productive capacity of the country as the unemployed youth will miss out their opportunity to accumulate working experience or gain on the job training (extract 3), hence their current skills or knowledge will gradually

become obsolete. This will in turn reduce the efficiency and productive level of the labour force, thus leading to the fall in productive capacity and a leftward shift of the LRAS from LRAS₀ to LRAS₁. This will lead to a fall in the country's potential economic growth. (2marks)

- (d) (i) To what extent was the "2008 financial crisis" a cause of the increase [8] in youth unemployment in Spain and the UK?

Thesis:

The rising youth unemployment could be due to 2008 financial crisis.

- From Table 2 & 3, GDP at constant price for both UK and Spain has decreased in 2009.
- Analysis: The 2008 financial crisis → worldwide recession → income level of household around the world has fallen → demand for imports from all countries fallen => the demand for export from Spain and UK fallen → fall in AD → multiplied fall in NY => lower production level → lesser need for factor of production → increase in cyclical unemployment (as in table 4, the unemployment rate for UK and Spain has been rising in 2009). Hence the 2008 financial crisis → fall in no. of job vacancies available, coupled with the rising trend among older workers who wish to hold on to their job as long as possible (extract 4) → no. of job opportunities for the youth is significantly reduced → rising youth unemployment
- However, in 2010 and 2011, the GDP at constant price for both Spain and UK has increased, which indicate increase in production level in both countries and thus increasing need for factor of production such as labour, but the unemployment rate for both countries are still rising the same period → this indicate that it is possible that the rising youth unemployment may not be due to the 2008 financial crisis.

Anti-thesis:

The rising youth unemployment can be due to mismatch of skill sets and increase factor mobility within the Eurozone region.

- The reduction of university tuition fee subsidy in UK (extract 4) → university education to be less affordable as university tuition fee increases → more youth are not able to receive higher education → youths that start working at earlier age lacks the required skill sets or knowledge for the jobs in the various industries (extract 2) → inability to get a job → rising youth employment
- In addition, the lack of barrier to labour mobility within the Eurozone → increased ease for UK and Spain employers to hire older EU-foreign workers, which the employers preferred over the youth workers as the older workers have more experienced or skills as well as better working attitude than the youth workers → less job opportunities for youth → rising youth unemployment.

Conclusion:

The 2008 financial crisis could be the main cause of rising youth cyclical unemployment in UK and Spain in 2009, but the lack of appropriate skill sets

among the youth is the main cause for the persistent increase in youth structural unemployment.

| Level | Descriptor | Marks |
|-------|--|-------|
| L3 | For an answer that presents a 2-sided discussion with reference to case evidence and sufficient reasoned judgment on view | 7-8 |
| L2 | For an answer that presents a underdeveloped 2-sided discussion with reference to case evidence but no judgment on view For a one-sided answer with reference to case evidence –max 4 marks | 4-6 |
| L1 | For an answer with no attempt to answer directly to question OR For an answer with gross misconceptions OR For a one-sided answer without reference to case evidence | 1-3 |

- (ii) Internal devaluation will allow “Spain’s economy to grow over time with [10] increase competitiveness”.

To what extent is internal devaluation the best policy for the Spanish government to resolve its rising youth unemployment.

Internal Evaluation:

Spain’s rising youth unemployment is caused by both cyclical unemployment resulting from the 2008 financial crisis as well as structural unemployment due to lack of relevant skill and knowledge among the youth. Hence the Spanish government can reduce its rising youth unemployment from by adopting internal devaluation, expansionary monetary or fiscal policy or supply-side policy.

Internal devaluation:

- Objective of policy: To boost competitiveness to simulate E.G
- By adopting an internal devaluation policy → reduce the wages of public sector’s wages → fall in COP → fall in SRAS → decrease in GPL (with diagram)
- As GPL falls => price of export and domestic goods to fall → increase price competitiveness → qty demanded for export and consumption to increase → AD increase in the future → increase NY → increase the cyclical employment

Limitation:

- Wage stickiness: The reduction in the public sector may not necessarily lead to a significant reduction in wage reduction in private sector → the fall in COP will be significant to increase the price competitiveness of Spain's export and domestic goods.
- The fall in wage rate can be a further disincentive for worker to seek employment since unemployment benefit is provided → insignificant increase in youth employment.
- Only more effective in the LR when AD is boost due to increase competitiveness.
- Only effective to resolve cyclical causes of youth unemployment.

Expansionary Monetary or Fiscal Policy:

Objective: To simulate AD with increase in components of AD

Fiscal policy:

- Spain government can increase government expenditure → increase G as well as reduce corporate and income tax → increase I & C, thus leading to increase AD → increase in NY (with diagram)

Limitation:

- Reduce of tax → insignificant increase in I & C. Corporate tax is not the only consideration for investment, the other factors such as poor economic outlook in Spain & social instability → lead to uncertainty in investor → I may not increase. In addition, the Spain's domestic goods are not as price competitive than the imports from the other Eurozone countries, so C may not increase despite the increase in disposable income due to lower income tax. Hence rendering the fiscal policy to be ineffective.
- Spain is in a severe fiscal budget deficit, so the increase G or reduction in tax → worsening of their fiscal position. In addition, Spain is pressured by the other countries to reduce her fiscal budget deficit in return for assistance from the IMF (extract 1, para 3) → rendering them unable to adopt expansionary fiscal policy.

Monetary policy:

- Spain government can increase money supply and lower interest rate → lower COB for investors → increase I → increase AD → increase NY (with diagram) → increase in youth unemployment as more job opportunities are provided.

Limitation:

- Interest rate is not the only consideration for investment, the other factors such as poor economic outlook in Spain & social instability → lead to uncertainty in investor → I may not increase.
- The monetary policy is controlled by the ECB, which is adopting a contractionary monetary policy (extract 1, para 3), and Spain government has

little influence over the decision as compared to the larger Eurozone countries like Germany and France etc. Hence this is not a viable option for Spain unless she leaves the Eurozone.

Although adoption of expansionary policies is able to increase the demand-deficiency in SR and improve the youth unemployment, but these policies are still unable to resolve the structural cause of youth unemployment.

Supply-side policies:

Objective: To reduce the mismatch of skill between the youth and industry's requirement as well as increase the youth's productivity.

Example: On the job training to be incorporated into their school curriculum and provide more apprenticeship training programme. (Extract 4, para 3)

- The provision of these programme → increase the opportunity for youth to gain more working experience and increase their awareness/knowledge about the job requirement → reduces job mismatch and allowing the youths to better transit from school to the job → increase the employability of youth → reducing youth unemployment
- In addition, the on-the-job training and apprenticeship → increase in productivity level among youth workers → increase in LRAS → increase potential E.G and increase Spain's future competitiveness against other Eurozone countries → increase in AD in the future → further fall in youth unemployment due to demand-deficiency reasons.

Limitation:

- Long term policy → no immediate reduction in youth unemployment
- A concerted effort needed from the government, trade unions and Employers for the policy to be effective (extract 4, para 4).
 - Corporate employers might not be willing to accept apprentice due to the lower productivity level in early part of training and some of these apprentice may switch to other firms after learning the skills.
 - Corporate employers may exploit the apprentice or student on training by offering a relative low wage or providing sub-standard working environment or conditions, which may disincentivise youth from participating in the programmes.

| Level | Descriptor | Marks |
|-------|---|-------|
| L3 | For a well-developed answer with 2 policies. The answer should contained the detailed analysis and limitations, with evidence from the C.S. | 7-8 |

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| L2 | For a underdeveloped answer with 2 policies. The answer contained under-developed analysis and limitations, with little/no evidence from C.S. | 4-6 |
| L1 | For an answer with no attempt to answer directly to question <u>OR</u> For an answer with gross misconceptions. | 1-3 |
| E2 | Well explained and reasoned judgement. | 2 |
| E1 | Judgement that is not well explained or reasoned. | 1 |