

ECONOMICS

9732/01

PAPER 1 Case Study

8 September 2008

2 hour 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your name and CT 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.
Answer question 2 on a fresh sheet of paper.

At the end of the test, submit your answers to question 1 and question 2 separately.
The number of marks is given in brackets [] at the end of each question or part question.

This document consists **7** printed pages.



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[Turn over

Answer **All** questions.

Question 1 Globalisation and Inflation

Extract 1 Globalisation and Inflation

The entry of China, India and Eastern Europe into the global market economy effectively doubled the economy's labour supply driving down the wages of unskilled labour. The result of this progressive integration of more countries into the international trading system - production of goods and services that is intensive in the use of unskilled labour and labour-intensive elements within production cycles have shifted to these emerging economies. This has increased the scope for businesses in the industrialised world to organise production in the most cost-efficient manner possible.

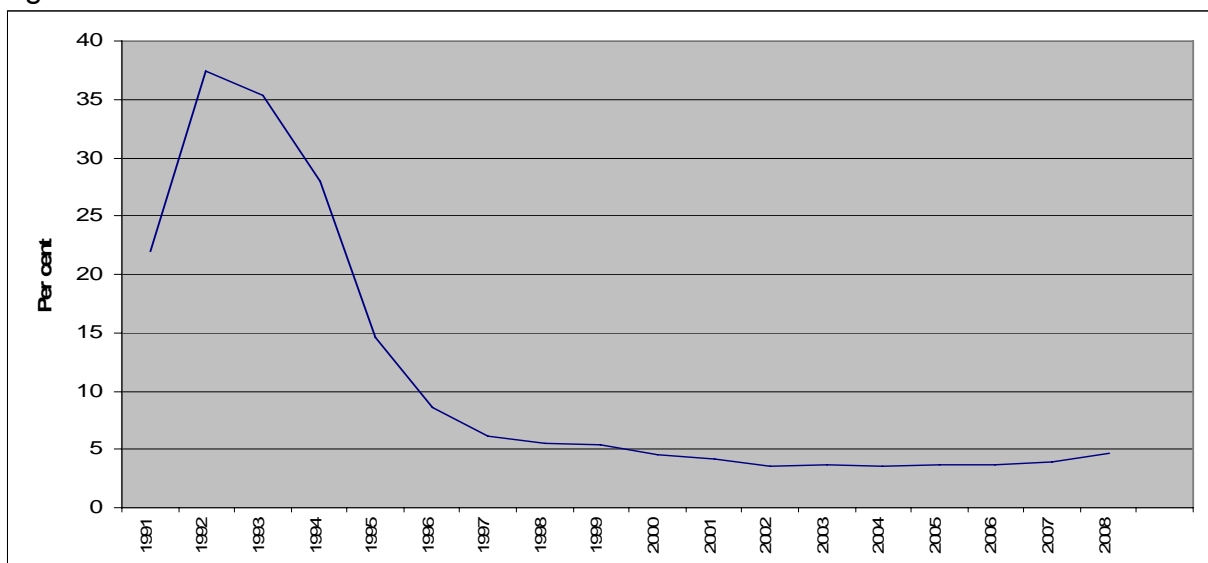
However, the rapid Asian growth has also been a major driver of the tripling of oil prices since 2004, as well as pushing up the prices of non-oil commodities substantially. Countries importing these commodities have therefore suffered an increase in the price of these imports.

Globalisation has changed the inflationary process. Increased competition from these labour-abundant economies, freer movement of labour and increased trade and specialisation associated with globalisation reduces the response of inflation to the domestic output gap¹, and at the same time potentially more sensitive to the balance between world demand and supply. Variations in aggregate demand become less effective as a means of controlling inflation.

The integration of China and the other emerging economies represents both an opportunity and a challenge for the industrialised economies. It is an opportunity because it allows a more efficient international division of labour and has the potential to raise living standards in both East and West. And it is a challenge because the global relocation of activities potentially involves losers as well as gainers. The danger is then that the realisation of those potential gains is prevented by the imposition of protectionist measures.

Adapted from Speech by Charles Bean Executive Director and Chief Economist of the Bank of England, 24 October 2006

Figure 1: World inflation rate 1991 to 2008*

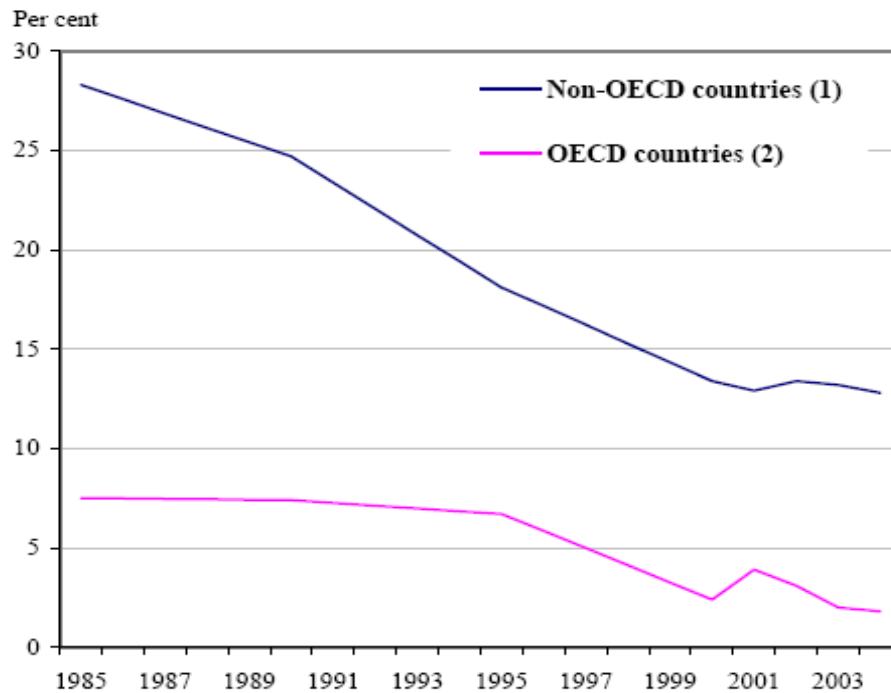


* Estimated for 2008

Source: International Monetary Fund database

¹ Output gap refers to the difference between actual output and the potential output.

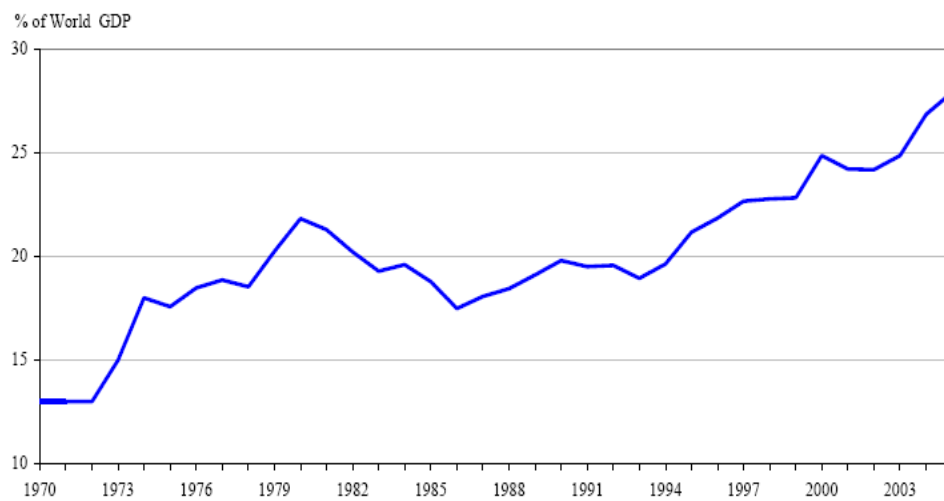
Figure 2: Tariff rates of OECD* and non-OECD countries 1985 - 2003



*OECD consists of 30 full members. Of these, 27 are high-income countries as classified by the World Bank in 2007.

Source: Organisation for Economic Co-operation and Development (OECD) database

Figure 3: Imports of goods & services as % of world GDP



Source: Organisation for Economic Co-operation and Development (OECD) database

Questions

- (a) (i) With reference to Figure 2 and Figure 3, state the relationship between tariffs and imports. [1]
- (ii) Explain the law of comparative advantage. [2]
- (iii) Explain how the law of comparative advantage can explain the relationship identified in (ai). [3]
- (b) (i) Define inflation. [1]
- (ii) Describe the trend of inflation for the period 1990 to 2008. [1]
- (iii) Explain the costs and benefits brought about by globalisation. [6]
- (c) (i) Examine how globalisation has changed the inflationary process. [6]
- (ii) "Globalisation brings about a change in the kind of policies a government needs to implement in order to achieve the macroeconomic goals." Discuss. [10]

Question 2 Pharmaceutical Industry

Extract 2 Global Pharmaceutical Industry

The global pharmaceutical industry consists of thousands of companies, including biotech firms, generic drugmakers, contract research organisations, wholesalers and retailers. On top of them all sits “Big Pharma”—a dozen or so multinational firms with headquarters in Europe or America. Their sales account for roughly half of the world's \$500 billion retail drug market.

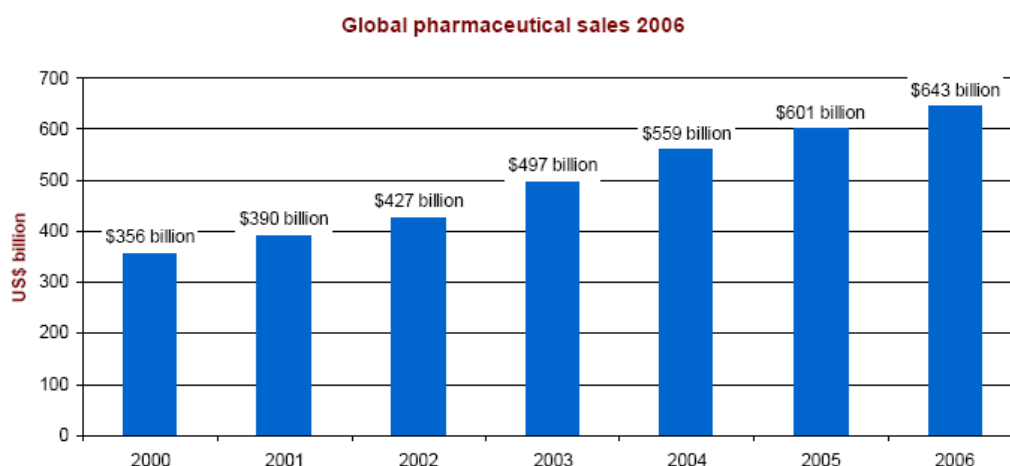
On the face of it, Big Pharma firms are in a business to die for. Populations in rich countries—and increasingly developing ones too—are getting older, and many people suffer from chronic conditions. But behind the healthy glow, a more worrying picture emerges. In the past few years large drug companies have had trouble getting new drugs out of their pipelines and into the market. At the same time, several high-profile medicines have been withdrawn because of safety concerns.

The internal struggles of the world's leading drugmakers have been compounded by a broader social debate about the purpose and practices of the industry, again mostly in America. The US pharmaceutical industry is dominated by a few large firms that make up a significant share of the market. It has been argued that the drug industry derived a higher rate of return on its investment than other American industries. It has been argued that the pharmaceutical companies have at times exaggerated in their claims for the therapeutic value of certain drugs. It has been argued that the drug companies have spent an unreasonable portion of their budgets in order to indoctrinate doctors so that they would prescribe high-priced trade-marked products.

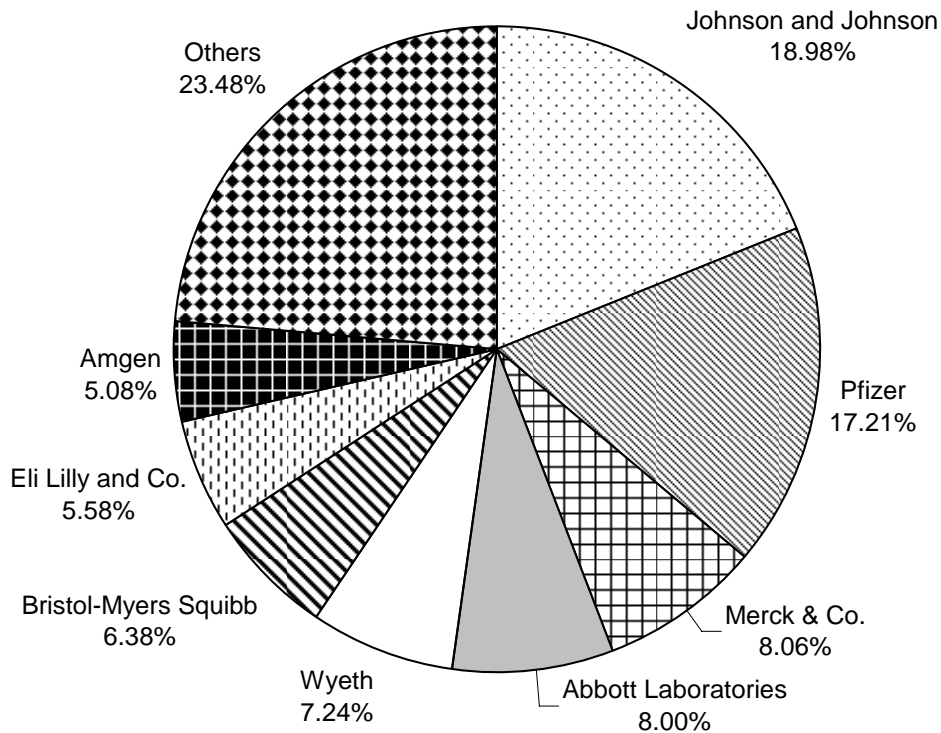
Some critics of the drug industry argue that drugmaking should be taken out of private hands and put in the public domain; after all, many of the basic discoveries that drug companies develop and profit from came from universities and government institutes in the first place. But there is little evidence that governments or universities are any better than the private sector at bringing new drugs to market. The top US pharmaceutical companies have collectively invested around 18% of sales on R&D over the past 7 years. The government may not like the way drug firms choose to spend their R&D dollars, or how they go about promoting their wares, but at least they have a record of bringing them to market in the first place.

Adapted from: Prescription for Change, 16 Jun 2005, The Economist

Figure 4: Global Pharmaceutical Sales



Source: IMS Health, February 2007

Figure 5: Market share of US Pharmaceutical firms in 2006

Source: http://en.wikipedia.org/wiki/List_of_pharmaceutical_companies

Extract 3 Chinese Pharmaceutical Industry

In China, the biopharmaceutical industry has been recognized by the government as the most important and promising sector for the 21st century. With a healthy 20–25% annual growth rate and a diversified pipeline, the Chinese biopharmaceutical industry is moving toward globalization.

The first Chinese biotech companies were mostly vaccine providers. These organizations have a relatively long history in China, and because of the domestic healthcare and vaccine needs of the world's largest population they tend to be quite large.

In China vaccines are classified into two categories: government "planned immunization" vaccines and "non-planned immunization" or "charged" vaccines. The first category of vaccines is ordered by the government, and supplied to Chinese citizens (mostly children) at no charge, in light of the benefits these vaccines possess. In the current Chinese market, domestic products completely control the planned immunization vaccine market.

The second category is for-profit with high margins of 30–40% for imported vaccines and more than 50% for domestic vaccines. These are "charged for," or "non-planned" vaccines, produced by manufacturers based on the market demand. The charged vaccines may be purchased by consumers voluntarily.

Chinese domestic vaccine manufacturers are now facing challenges as a growing number of imported products are entering the market. Domestic vaccines have dominated the Chinese market for decades, thanks to government protection (through restriction on foreign companies to set up vaccine manufacturing facilities) and lower prices. Furthermore, the majority of these Chinese biotech firms do not invest enough in R&D and as a result do not possess innovative research personnel. Thus, the question posed in China today is how competitive are its domestic vaccine manufacturers compared with the multinational giants.

"Which other country (than China) in the world would be able to satisfy the needs of vaccines for 1.3 billion people?" asked Dr. Weidong Yin, CEO of Sinovac Biotech. "Only we Chinese people can help ourselves. We will master core technologies and protect national security and public health...to prevent public crisis such as pandemic influenza, the key is to develop Chinese-owned vaccine products." Given the demographics, healthcare policy, and national needs, we believe there is a promising future for the Chinese vaccine industry.

Adapted from: China Today: Vaccine Development in China, Eliza Yibing Zhou, BioPharm International Vol 20 Issue 4, April 1, 2007

Questions

- (a) (i) State the trend of global pharmaceutical sales from 2000 to 2006. [1]
- (ii) With reference to Extract 2, use demand and supply analysis to account for the trend. [4]
- (b) (i) Identify the type of market structure the US pharmaceutical industry operates in. [1]
- (ii) Justify your answer. [2]
- (c) (i) Explain two sources of market failure that could account for the Chinese government's provision of vaccination. [4]
- (ii) Evaluate the above policy that the Chinese government uses for planned immunization from the efficiency viewpoint. [8]
- (d) Given the different situations in US & China, assess if protectionism is the best policy for China's pharmaceutical industry. [10]