



**Jurong Junior College
2017 JC2 Preliminary Examination**

ECONOMICS

Higher 1

8819/01

Paper 1

24 August 2017

3 hours

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.

Section A

Answer **all** questions.

Section B

Answer **one** question.

Start with Section B essay question first. Spend 45 minutes on the essay question.
Begin essay answer for Section B and each case study answer for Section A on a fresh sheet of writing paper.

Attempt case study questions in ascending order of question sequence and indicate questions attempted clearly on answer sheet.

Fill in the necessary information on the cover sheet.

At the end of the examination, fasten all your work securely with the **cover sheet at the top**.
The number of marks is given in brackets [] at the end of each question or part question.

Section A

Answer **all** questions in this section.

Question 1

The Development of the Garment Industry in Bangladesh

Extract 1: What happens when fashion comes fast and disposable

Fashion cycles are moving faster than ever as compared to the past. A Quartz article in December revealed how both non-designer clothing brands like Primark, Gap, H&M and designer clothing brands like Armani Collection and Versace are churning out new styles more frequently, a trend dubbed "fast fashion" by many in the industry in the recent years. "It used to be 4 seasons in a year; now it may be up to 11 or 15 or more," says Tasha Lewis, a professor at Cornell University's Department of Fiber Science and Apparel Design.

More styles mean more purchases and that leads to more demand for cotton, linen and even polyester. Coupled with the decrease in world average yield for cotton through excess rainfall, drought and disease, this had set off an alarm in the fashion industry with an increase in price of cotton which will further push up their cost. Despite this, the US-based International Cotton Advisory Committee says it is no time to panic as it expects the global cotton production to bounce back in 2017.

Source: *National Public Radio*, 10 April 2016

Extract 2: Cotton produce on the rise

Traditional soybean growers of the state, who contribute to about 70% of the country's total output, are expected to shift to cotton lured by attractive prices and better demand. Soybean prices fell over 20% this year as against the same period a year ago on higher outputs and below expected exports of soybean. At the same time, cotton prices rose about 27% from a year ago in the same time period.

Kailash Agrawal, an agricultural expert said, "Areas under soybean cultivation will drop this year as farmers did not get good money for their produce. Farmers will thus be more likely to sow cotton this season."

Source: *The Times of India*, 24 April 2017

Extract 3: Pollution in Bangladesh, told in colours and smell

On the worst days, the toxic stench wafting through Genda Government Primary School is almost suffocating. Teachers struggle to concentrate, students often become lightheaded and dizzy. The odour arises from the polluted canal behind the school house where nearby garment factories dump their wastewater. Most of these factories export clothing to Europe, United States and even Asia. Bangladesh's garments and textile industries have contributed heavily to what experts describe - a water pollution disaster, especially in the large industrial areas of Dhaka, the capital. Many rice paddies are inundated with toxic wastewater and fish stocks are dying, threatening not only public health but agriculture.

Here in Savar, an industrial suburb of Dhaka, some factories treat their wastewater but many do not have treatment plants or chose not to operate them to save on utility costs. Few steps have been taken by the government to improve the environment issues and there is poor government regulation on proper waste disposal. "The garment industry is thriving on the under-pricing

environmental externalities. There is a need to impose regulations on these factories to establish true price in the market.” said Rizwana Hasan, a prominent environmental lawyer.

Source: *The New York Times*, 14 July 2013

Table 1: Bangladesh Economic Indicators

	2011	2012	2013	2014	2015	2016
Real GDP growth (%)	6.5	6.5	6.0	6.0	6.6	-
Unemployment Rate (%)	4.5	4.4	4.2	4.2	4.1	4.0
Consumer Price Index (2010=100)	110.7	117.6	126.4	135.3	143.7	151.6

Source: *World Bank*

Extract 4: Bangladesh garment-making success prompts fears for wider implications

Bangladesh garment industry has generated \$28bn of exports in 2015 with a 10% growth from the previous year, according to Export Promotion Bureau data. The growth has been attributed by large clothing retailers increasing shift towards Bangladesh. Large clothing retailers have relocated their production to Bangladesh and have gradually reduced their use of Chinese factories. Bangladesh is currently one of China's biggest rival in terms of garment production.

Mark Anner, associate professor at Pennsylvania State University, found that the garment sector is continuing to grow based largely on its cost competitiveness. Despite the growth in sales and the overall Bangladeshi economy, the minimum monthly wage has remained at about US\$67 since 2013 and income inequality continues to widen. But he added that the industry represented the best hope of employment for millions of poor, uneducated Bangladeshis, especially women, who make up 70% of the workforce.

Nazma Akter, founder of the Awaj union for women garment makers, said, “Economic growth has increased but standard of living is not improving. Pointing to the crowded shanty town beneath her Dhaka office, she added, “That’s where the workers live — children are separated from their parents and people do not eat properly and are subjected to water pollution. The factories have improved but not the living conditions.” More importantly, clothing retailers rely on a business model that thrived on the premise of low labour cost. In the long term, when Bangladesh loses its cost competitiveness like China, garment production may relocate to countries with even lower wages like Myanmar prompting fear of wider implications on the economy.

Source: Adapted from *Dhaka Tribune*, 14 July 2016 and *Financial Times*, 6 January 2017

Questions

- (a) Using a demand and supply diagram, explain the reasons for the change in world price of cotton in 2016. [4]
- (b) With reference to your own knowledge, analyse the impact on the market for designer and non-designer clothing due to the change in world price of cotton. [5]
- (c) (i) Using a diagram, explain the opportunity cost for farmers in India when they choose to produce cotton as seen in Extract 2. [2]
- (ii) Comment on the usefulness of opportunity cost in explaining the basis of trade. [3]
- (d) With reference to Extract 3, explain how imposing regulations like forcing factories to treat wastewater can ensure that a true price is charged in the garment market. [6]
- (e) Extract 4 mentions that “Large clothing retailers have relocated their production to Bangladesh and have gradually reduced their use of Chinese factories.”
- (i) Explain why large clothing retailers have relocated their production to Bangladesh. [2]
- (ii) Discuss the extent to which large clothing retailers’ relocation to Bangladesh is likely to lead to a long-term improvement in the workers’ standard of living. [8]

[Total: 30]

Question 2**Economies of China and United States****Extract 5: Weakening of renminbi**

China's central bank shocked markets on 11 August when it weakens its currency, the renminbi, by lowering its daily mid-point trading price to 1.87% weaker against the US dollar. A day later, the central bank sent shockwaves again with a second weakening of 1.62% against the US dollar. Fears have mounted of a regional currency war of competitive devaluation as China's moves come on the back of the softening of Japan's yen and the Korean won over the past year and after previous efforts to boost exports and growth failed. China's currency weakening is seen largely as a bid to boost their export competitiveness as export volume continue to weaken. However, this may risk creating other problems for the economy.

Cracks have also begun to appear in other areas in China: capital outflows have surged, bankruptcies are occurring more frequently and bad loans in the banking sector are rising. The central bank had reassured the financial markets that it was not embarking on a steady depreciation and it was just a "one-off weakening." Nonetheless, weakening of the renminbi by about 4% had dealt a blow to investors. They fear that a prolonged currency war that could damage world trade should the US and Japan retaliate and drive down the value of the dollar and yen as well.

Source: *The Guardian*, 12 Aug 2015

Table 2: Macroeconomic Indicators of United States

	2013	2014	2015	2016
Real GDP growth (%)	2.7	2.5	1.9	2.0
Rate of inflation (%)	1.5	0.8	0.7	2.1
Unemployment (%)	7.4	6.2	5.3	4.9
Current account balance (US\$ billion)	-2.4	-2.2	-2.6	-2.6
Fiscal balance (% of real GDP)	-4.1	-2.8	-2.4	-3.2

Source: Various

Extract 6: America finally got a rate hike this year.

The US Federal Reserve has raised its target for short-term interest rates by 0.25 percentage points to a range of 0.50% and 0.75%. This move could be the first of many more. Some economists believe that the Fed will need to raise rates more often and perhaps at higher levels if President Donald Trump spends big on infrastructure which could cause prices to accelerate from its low levels.

"With the economy much closer to full employment now and a strong likelihood of a fiscal stimulus next year, we expect the Fed to accelerate the pace of interest rate hikes next year," says Paul Ashworth, chief US economist at Capital Economics.

Source: *CNN*, 15th December 2016

Extract 7: A more effective US trade policy is needed to level the playing field

Foreign government subsidies and other market-distorting policies have resulted in massive global steel overcapacity and significant levels of steel imports. This have caused the US numerous plant closures and thousands of job losses. Of particular note, China's steel industry remains state-owned and heavily subsidized. Other major offshore steel producers also continue to use subsidies, tariffs and investment restrictions to protect their markets and expand their steel production and exports. The United States must aggressively enforce US trade laws against injurious dumping and subsidies and respond to foreign government currency manipulation in order to combat unfair trade practices so as to preserve and strengthen her manufacturing base.

Source: *www.steel.org* assessed on 7 July 2017

Extract 8: Japan and European Union's huge new trade agreement

Japan and the European Union agreed on an outline for a massive trade deal on the eve of G20 meeting in Hamburg.

EU-Japan negotiations have already began in 2012 but then stalled. It was Donald Trump's election, and the inward turn America is taking, that spurred the EU and Japan to overcome their differences. Both want to show domestic audiences they can deliver signature deals that promise new economic opportunities. They also want to send a clear message internationally that the EU and Japan remain committed to a liberal, free-trading, rules-based world, and they will seek to shape it even if the US would not.

The agreement between Japan and the EU is currently very broad, and there are still plenty of details that need to be hammered out over the next several months before final ratification. But overall, it is designed to do what most free trade deals do: lower and eliminate trade barriers such as tariffs between countries. The core of the agreement aims to increase the flow of Japanese cars to Europe and of European food to Japan. For instance, the Europeans are expected to scrap a 10 percent tariff on passenger cars made in Japan, over a period of seven years. The Japanese, in return, are expected to lower duties on European agriculture products such as cheeses from the Netherlands. Tokyo is also likely to make it easier for European companies to bid for major government contracts, a move that could benefit train makers like Siemens of Germany and Alstom of France.

Source: *www.vox.com*, 7 July 2017

Extract 9: Trump's protectionism would not solve unemployment problem

One of US President Donald Trump's key strategies to help get more Americans into work is to introduce protectionist trade measures. The idea is that by raising taxes on goods imported from overseas, it will encourage businesses to bring jobs back to America as it is no longer economical to manufacture elsewhere and then ship to the US.

But Dr Nariman Behraves, the chief global economist at IHS Markit, told Business Insider (BI) that this effort to try and solve the employment problem is, in fact, the biggest economic risk of 2017 globally.

He said, "If you look at the risks in the coming year, it is political uncertainty — vis-a-vis what Trump may do and what happens with Brexit. If we do go down the path of more protectionist measure, then it could massively impact the US economy, as well as the rest of the world.

According to an HSBC report released in December, if Trump goes ahead with his protectionist trade measures and with the combination of a "hard Brexit", it could kill US\$1.2 trillion worth of global trade. That is because higher tariffs and other trade barriers will reduce the total amount of trade, which means less production and fewer jobs for all, including the Americans. It would also mean more expensive goods, as import taxes are factored into prices".

"For example, if Trump did raise tariffs and costs for Chinese goods, it would hit inflation and hurt poor people because they are typically the demographic that benefits from cheap imports. It hurts the people he says he wants to help. The single biggest challenge is to think about how Brexit and the election of Trump came about," Dr Behraveh said. "A lot of people are angry at being left behind because of technology and globalisation. This is because they feel that they are losing jobs to immigrants but do not have the kind of higher level skills to fulfil new roles being created."

Dr. Behravesch said that companies and governments should instead, "Invest in people's skillsets so that when society evolves through globalisation, workers will be able to cope and change roles without getting left behind."

Source: *Business Insider*, 16 January 2017

Questions

- (a) (i) With reference to Extract 5 and with the aid of a diagram, explain the factors which could lead to the weakening of the renminbi in China. [4]
- (ii) Discuss whether the weakening of the renminbi is beneficial to the Chinese economy. [8]
- (b) Using data from Table 2, explain the change in standard of living for the United States from 2013 to 2016. [2]
- (c) Extract 6 states that if President Donald Trump 'spends big on infrastructure', it would 'cause prices to accelerate from its low levels'.
Comment on the validity of this statement. [4]
- (d) Explain the consequences to the US economy if prices accelerate from its low levels. [4]
- (e) Discuss the appropriateness of President Trump's proposed protectionist policy in protecting and creating jobs for the people in US. [8]

[Total: 30]

Section B

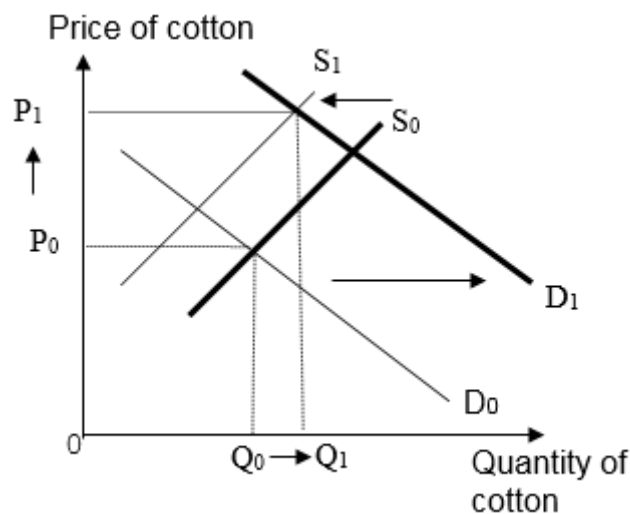
Answer **one** question from this section.

- 3** A resurgent US shale oil industry will see global crude oil supply growing faster than demand in 2018, dealing a blow to OPEC and other rival producers that have cut output to boost prices. The slowdown of the global economy has brought further shocks to the crude oil market.
- (a) Using the concept of elasticity, explain how each of the above events impact the crude oil market. [10]
- (b) In the oil-rich nations such as Venezuela and Iran, the production of crude oil is heavily subsidized. In contrast, in countries such as Germany and Australia, crude oil production is heavily taxed.
- Assess the economic case for these two different approaches. [15]
- 4** (a) Explain why current account deficits might be harmful for some economies but not others. [10]
- (b) Discuss the view that an appropriate exchange rate policy is more useful than supply-side policies in correcting a current account deficit. [15]

Answers

a) Using a demand and supply diagram, explain the reasons for the change in world price of cotton in 2016. [4]

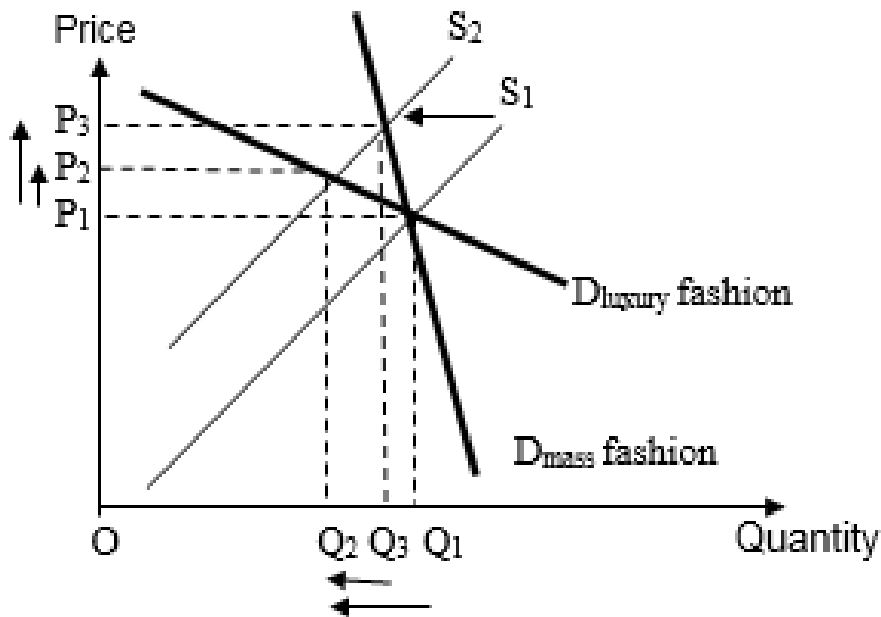
- Due to unfavourable weather conditions like drought and also diseases to the crops and with cotton being an agriculture good, supply has decreased in 2016. [1]
- On the other hand, demand for cotton has increased with the increase in fast fashion as seen in Extract 1. This means that people are starting to demand for more clothes. Since cotton is required to manufacture clothes, demand for cotton will also increase (derived demand) [1]
- With an increase in supply from S_0 to S_1 and increase in demand from D_0 to D_1 , both will have an mutually reinforcing effect on price which leads to an increase in price from P_0 to P_1 . [1]



(a) With reference to your own knowledge, analyse the impact on the market for designer and non-designer clothing due to the change in world price of cotton. [5]

- PED measures the responsiveness of quantity demanded of a good to a change in the price of the good itself, *ceteris paribus*.
- Demand for non-designer clothing tend to be price inelastic as it is a necessity and takes up a smaller proportion of income. In contrast the demand for designer clothing is more price elastic as it tends to be a luxury brand as it usually constitutes a larger proportion of income of the middle income group. [1]
- Due to an increase in world price of cotton, it is likely that supply for clothing will fall. Since cotton is required to make clothes, cost of production for both designer and non-designer clothing will increase. This means that supply curve shifts to the left from S_1 to S_2 . [1]
- Due to its elasticity demand, when there is a fall in supply, designer clothing will experience a more significant fall in their quantity of fashion from Q_1 to Q_2 compared to Q_1 to Q_2 for non-designer clothing. On the other hand, designer clothing will experience a less significant increase in their prices from P_1 to P_2 as compared to P_1 to P_3 for non-designer clothing. [2 marks with diagram]
- However, there are also other factors that affect the extent of the change in price and quantity for both market. For example, there could be other demand factors such as increasing affluence

which leads to more preference for designer clothing. Hence the price of designer clothing might have increased more significantly due to increase in demand. [1]



(b) (i) Using a diagram, explain the opportunity cost for farmers in India when they choose to produce cotton as seen in Extract 2. [2]

- Opportunity cost is the next best alternative forgone when making a choice. [1]
- With reference to Extract 2, farmers in India have a choice of either producing soybeans or cotton. If farmers choose to produce more cotton eg move from Point B on the Production Possibility Curve to Point C on the Production Possibility Curve, farmers must forego producing more soybeans.

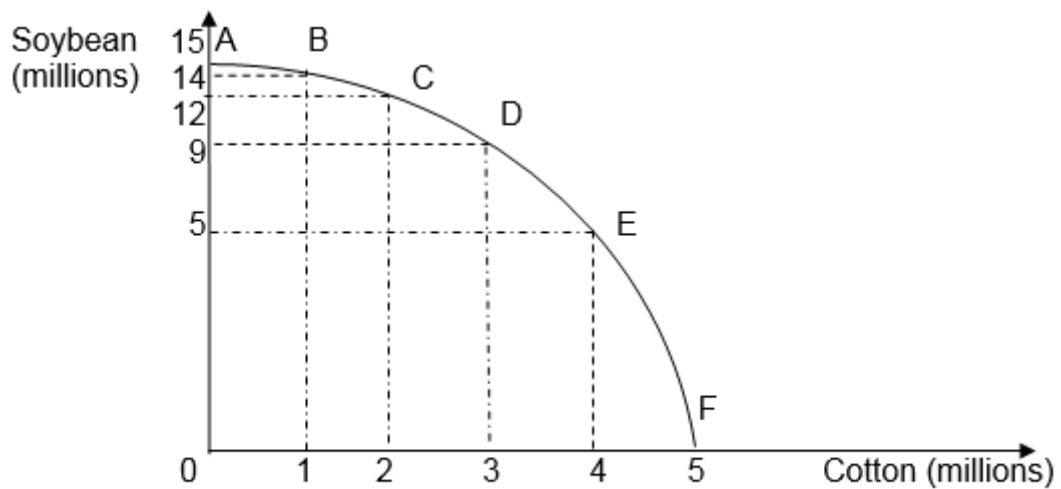


Figure 3: The Production Possibility Curve

(c)(ii) Comment on the usefulness of opportunity cost in explaining the basis of trade.

- The opportunity cost of producing good X in a country is the amount of the other good Y which has to be sacrificed in order to produce an additional unit of X. Hence each

country will have a different relative opportunity due to the differences in factor endowments of the different countries.

- The opportunity cost is thus useful in explaining the basis of international trade – the Theory of Comparative Advantage which states that trade between nations is beneficial to both, in terms of an increase in output and consumption, if there is a difference in relative opportunity cost and with each country specializing according to its comparative advantage
- However, the opportunity cost might not be useful in explaining the basis of trade as it assumes that there is no trade restrictions. If there is trade restriction such as tariffs and quotas, it may limit trade. For example, the rise in prices of imports may offset the price differential between countries from specialisation, thus making it not profitable to trade even if the country has a lower opportunity cost. [accept any other limitations for CA]

(c) With reference to Extract 3, explain how imposing regulations like forcing factories to treat wastewater can ensure that a true price is charged in the garment market. [6]

Identify the market failure: As seen in Extract 3, the **external cost** is the loss of livelihood of fishermen affected due to the decrease in the fish population, the destruction of marine life and the eco system and the health problems cause to the nearby citizens as factories dump their wastewater into the nearby rivers.

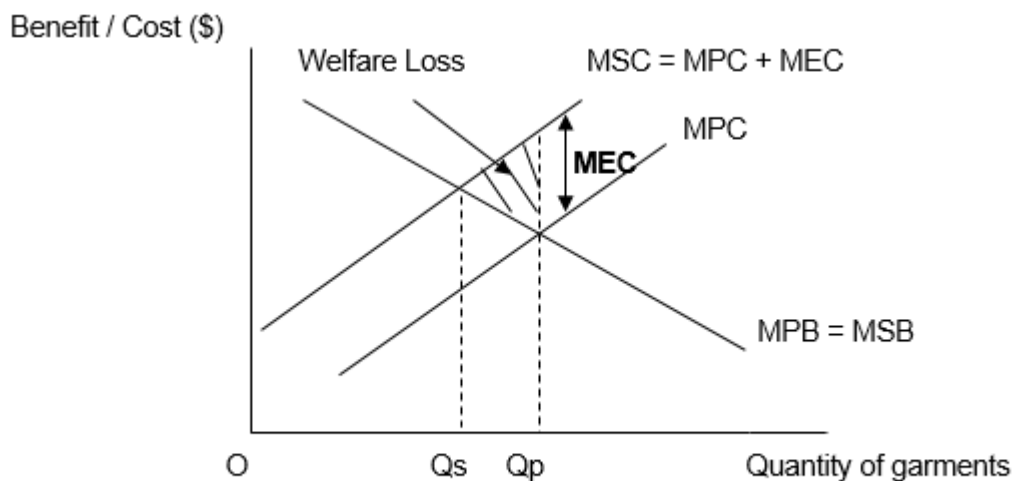


Figure 2: Market Failure due to production of garments

Due to the presence of negative externalities in the production of garments shown by the MEC at a particular level of output, MSC will be greater than marginal private cost (MPC), i.e. $MSC > MPC$. Since producers will only consider their private costs and benefits while ignoring the external costs to the third parties, they will price at OP_1 , where $MPB = MPC$, charging a price OP_1 . However, the socially optimal level of price occurs at OP_s where $MSC = MSB$. Since OP_1 is lower than OP_s , it means that there is under-pricing in the production of the garment market.

Hence the Bangladesh government can to impose government legalisation to regulate the garment factories to treat the wastewater the river. The government can pass legislation to prohibit or regulate behaviour that generates external costs. For example, it can establish laws to force garments factories to bear the costs of proper disposal of wastewater or treat the wastewater before emitting into the river. Such actions force the firms, under the threat of legal action, to bear all the

costs associated with their production. Again, such regulations incur cost and cause MPC to shift to the left to MSC, increasing the price to the socially efficient level at OPs. This will help to achieve a more efficient relocation of resources.

(d) Extract 4 mentions that “Large clothing retailers have relocated their production to Bangladesh and have gradually reduced their use of Chinese factories.”

(i) Explain why large clothing retailers have relocated their production to Bangladesh. [2]

Large clothing retailers are moving production towards Bangladesh due to the low wages of the workers. Since garment production is a labour intensive industry, wages will form a large portion of their cost of production. With lower wages in Bangladesh, firms will be able to enjoy a lower cost of production.

(ii) Discuss the extent to which large clothing retailers’ relocation to Bangladesh is likely to lead to a long-term improvement in the workers’ standard of living. [8]

The standard of living (SOL) of a country refers to the level of economic and social well-being of the population within the country. SOL includes the quantitative and qualitative aspects of living. The quantitative aspect refers to the amount of goods and services available for consumption. On the other hand, the qualitative aspect includes infant mortality rates, quality and quantity of health care and leisure, quality of the environment, quality of the public transport system, crime rates and educational level etc

Thesis: Large clothing retailers’ relocation towards Bangladesh will lead to a long-term improvement in the workers’ standard of living

- As seen in Table 1, GDP growth of Bangladesh has been increasing since 2011 > Increase GDP > Link to higher material SOL
- Generate more jobs > Higher employment > Link to higher material SOL
- Employment and rising income > workers to provide education for themselves and their children, > enhance their skills and increase their literacy rate > Improve long-term SOL in terms of higher productivity and better prospect of a higher wage job.

Anti-Thesis: Large clothing retailers’ relocation towards Bangladesh will not lead to a long-term improvement in the workers’ standard of living

- However, as seen in Extract 2, many of these garment factories are not treating their wastewater before dumping into the rivers > Further worsen the water pollution problem in the country > Affect non-material SOL especially in the long-term with health problems like suffocation and dizziness resulting from the water pollution.
- Income inequality is widening > Workers might not have benefited from the increase in real GDP as the increase in income is concentrated on the hands of the minority producers > In the long run, it may lead to social unrest due to unequal opportunities which may further worsen the long-term standard of living.

- In order for the worker's long-term standard of living to be improved > Current trend of large clothing retailers relocation towards Bangladesh must persist > Seems unlikely as the large clothing retailers are motivated by profits and would relocate to any countries that has lower wages

Conclusion

- Large clothing retailers are shifting towards Bangladesh because of the lower wages and that the minimum monthly wage has remained since 2013 > Long-term standard of living is not likely to improve as the wages might remain the same and might even decline if the retailers were to relocate away from Bangladesh in future.
- Need for government intervention to force these retailers to provide education opportunities or adhere to a form of structural training programmes > Workers will be able to acquire new skills to move onto other higher paying jobs .

L3	Well-developed explanation of how large clothing retailer shift towards Bangladesh will affect the long-term standard of living for the workers together with strong use of case study evidence and a reasoned assessment.	6-8
L2	Under-developed explanation of how large clothing retailer shift towards Bangladesh will affect the long-term standard of living for the workers together with use of case study evidence and a weak assessment. <u>Maximum 4 marks</u> for answers which explain only the quantitative or the qualitative aspect of standard of living <u>Maximum 5 marks</u> for answers without reference to long-term standard of living	3-5
L1	For an answer that show descriptive knowledge of how large clothing retailer shift towards Bangladesh will affect the long-term standard of living for the citizens	1-2

J2 H1 Suggested Answers for Case Study Q2

(a)(i) With the aid of a diagram, explain the factors which could lead to the weakening of the renminbi in China. [4]

Factor 1: Government policy

- The Chinese government have devalue the renminbi (RMB) to rise their export price competitiveness.
- Speculators will expect RMB to be weaker
- Demand for RMB fall

Factor 2: Short-term capital outflow

- capital outflow from the Chinese economy
- the capital outflow from China leads to a rise in supply of RMB on Forex.

Insert diagram

Explanation of factors – 3m Diagram – 1m

Max 2m if factors are not from extract + correct diagram

(ii) Discuss whether the weakening of the renminbi is beneficial to the Chinese economy. [8]

Introduction

The weakening of the RMB would have both positive and negative impact on the Chinese economy. In this case, the Chinese government devalue the RMB to boost their export price competitiveness.

Thesis: Weakening of the renminbi is beneficial to the Chinese economy

- When the RMB depreciates, the prices of Chinese exports become cheaper and its imports become more expensive
- Given that demand for China's exports and imports are price elastic
- This will result in an increase in export revenue and a decrease in import expenditure.
- The rise in net exports will lead to an increase in AD
- In addition, a depreciation could lead to an increase in foreign direct investment inflow as investors find it relatively cheaper to invest.

Overall, the improvement in both the current and capital account may lead to a BOP surplus. The rise in (X-M) and I will lead to an increase in NY through the multiplier process .

Anti - thesis: Weakening of the renminbi is not beneficial to the Chinese economy

- Weakening of RMB would make imports more expensive.
 - increase the cost of production for firms
 - Short-run aggregate supply falls and result in cost-push inflation.
 - However, this is likely to be a small problem for China as she is well-endowed with resources and is not heavily dependent on imports.
-
- A weaker RMB can also quicken the withdrawal of short-term capital from China
 - Further worsening of capital account.

- The scenario of competitive devaluation might also happened.
- As such, weakening of the RMB may not be beneficial to the Chinese economy.

Conclusion

In conclusion, whether the weakening of RMB is bad or not for China depends on the nature of economy, the magnitude and the causes of the weakening as well as the priority of the government at that particular point of time.

- Make use of CS evidence to support stand

Level	Knowledge, Application, Understanding, and Analysis	Marks
L3	Well-developed answer that analyses how the weakening of the RMB will impact the Chinese economy, with strong use of case study evidence and a reasoned assessment.	6 – 8
L2	Under-developed answer that analyses how the weakening of the RMB will impact the Chinese economy. Max 4m for a one sided answer	3 – 5
L1	For an answer that show descriptive knowledge of how the weakening of the RMB will impact the Chinese economy	1 – 2

(b) Using data from Table 3, explain the change in standard of living for US from 2013 to 2016. [2]

US have been having positive real GDP per capita growth. This means that real income level have been rising for the average American citizen and they have an increase in their ability to purchase goods and services. With this, they are able to enjoy a higher quantitative standard of living.

Any relevant point on either quantitative or qualitative SOL – 2m

(c) Extract 6 states that if President Donald Trump ‘spends big on infrastructure’, it would ‘cause prices to accelerate from its low levels’.

Comment on the validity of this statement. [4]

- Aggregate demand in the country increases.
- Given that the US economy is already close to full employment
- Producers will have to compete for the use of the scarcer resources
- The higher cost of production will be passed on to consumers in the form of higher prices **[2m]**
- However, infrastructure spending by the government has benefits on the US economy as it increases the quantity of capital goods in the economy.

- In the long run, productive capacity of the US economy will rise, causing LRAS to increase.
- Sustained economic growth is achieved and US economy is able to achieve non-inflationary economic growth. [2m]

(d) Explain the consequences to the US economy when prices accelerate from its low levels. [4]

Fall in C, I, EG and employment

- When inflation is high and moves in an erratic manner, business uncertainties about future costs of production and revenues increase
- Producers are less willing to make long-term commitments and this discourages investments
- Fall in investment which decreases aggregate demand leading to a fall in national income and hence economic growth. + This will mean that the employment opportunities in the US will fall

Healthy BOP

- Higher export prices – leading to fall in export revenue (assuming $PED > 1$)
- On the other hand, imports become relatively cheaper than US domestic goods. Thus demand for imports rises, resulting in a rise in import expenditure.
- Fall in export revenue and a rise in import expenditure
- current account balance worsen and this may cause a BOP deficit.

2m for each relevant point explained

(e) Discuss the appropriateness of President Trump’s proposed protectionist policy in protecting and creating jobs for the people in US. [8]

Introduction

US is currently having high unemployment rate of 4.9% and a persistent trade deficit.

Thesis: Tariff is appropriate in protecting and creating jobs for the people in US.

- The justification for protectionism by the US is to protect their domestic industry and to safeguard their employment.
- Using the US steel industry as an example, when a tax is imposed on imported steel, it would make the price of imported steel more expensive.
- Hence, US resident will switch to domestic sources of steel.
- The increase in domestic steel production generates employment.
- This also helps to buy time for the US to restructure its economy more gradually and allows time for the effects to be observed.
- Hence, US export can grow to be more competitive in price and/or quality in the international market.

In the case of the US, it was mentioned in Extract 7 that she is facing unfair trade practices that is hurting her domestic companies and employment.

Anti- Thesis: Tariff is inappropriate in protecting and creating jobs for the people in US.

- Higher price imports will lead to inflation in the economy and raise the cost of living for the people.

- Such an approach also does not solve the root cause of unemployment if it is due to structural weaknesses. For example, as stated in Extract 8, it says that there is a mismatch of skills between the US workers and the new jobs being created.
- Increase in the cost of production of industries that use the product as an input, for example in the case of a tariff on steel.
- This makes some industries to experience a rise in cost of production thus making them less competitive.
- Hence, jobs are lost instead of created.
- Furthermore, protectionist policies breed complacency in protected firms and they will be discouraged to be more cost efficient and also to be more innovative.
- Protectionism by the US will also make her trading partners poorer as their export revenue falls.
- With a falling income, the trading partners' consumption and demand for imports will fall which leads to the demand for the US exports falling too.
- US action may also invite retaliation from her trading partners in the long run.

Conclusion

President Trump's proposed protectionist policies is appropriate for helping to protect and create jobs in the US but is only so in the short run in the face of unfair trade practices. This is because the cost far outweigh the benefits of doing so in the long run.

- Support with CS evidence

Level	Knowledge, Application, Understanding, and Analysis	Marks
L3	Well-developed explanation of whether tariff can help protect and create jobs in the US or not, with strong use of case study evidence and a reasoned assessment.	6 – 8
L2	Under-developed explanation of whether tariff can help protect and create jobs in the US or not. Max 5m for answers that do not link to the protection and creation of jobs Max 4m for a well-developed one-sided answer.	3 – 5
L1	For an answer that show descriptive knowledge of how tariffs can help protect create jobs in the US.	1 – 2

J2H1 Prelim Essay Question 3

A resurgent US shale oil industry will see global crude oil supply growing faster than demand in 2018, dealing a blow to OPEC and other rival producers that have cut output hoping to boost prices. The slowdown of the global economy has brought further shocks to the crude oil market.

- (a) Using the concept of elasticity, explain how each of the above events impact the crude oil market. [10]
- (b) In the oil-rich nations such as Venezuela and Iran, the production of crude oil is heavily subsidized. In contrast, in countries such as Germany and Australia, crude oil production is heavily taxed.

Assess the economic case for these two different approaches. [15]

Suggested Answer

Intro:

Both increase in the production of shale oil and slowdown of global economic growth has impacted the price and quantity of crude oil. The extent of the impact brought above by each of the above event is caused by price elasticity of demand and supply of crude oil respectively.

Body

Event 1: Increase production of shale oil:

With US increasing production of shale oil at a large scale → Increase SS

Increase SS + PED concept → draw graph to explain the impact on the crude oil market.

Event 2: With the slowdown of global economy

Slowdown of global ec → fall in dd for crude oil

Fall in SS + PES concept → draw graph to explain the impact on the crude oil market.

Conclusion

In conclusion, the individual impact of the above event is different on the crude oil market, assuming ceteris paribus assumption. However, often time, the governments would intervene in the crude oil market to bring about intended microeconomic and macroeconomic objectives.

Marking Scheme (a)

Knowledge, Application, Understanding and Analysis		
L3	Well-developed explanation of both the individual event and elasticity concepts impact the crude oil market.	7 – 10

L2	Under-developed explanation of both the individual event and elasticity concepts impact the crude oil market.	4 – 6
L1	For an answer that shows descriptive knowledge of the impact.	1 – 3

(b) In the oil-rich nations such as Venezuela and Iran, the production of crude oil is heavily subsidized. In contrast, in countries such as Germany and Australia, crude oil is heavily taxed.

Assess the economic case for these two different approaches. [15m]

Introduction

As shown in the preamble, governments from different economies intervene with different economic policies in the crude oil market. This is due to these governments having different macroeconomic and microeconomic objectives.

Germany’s and Australia’s approach

- Explain negative externality using the diagram below
- Explain how indirect tax would correct the negative externality.

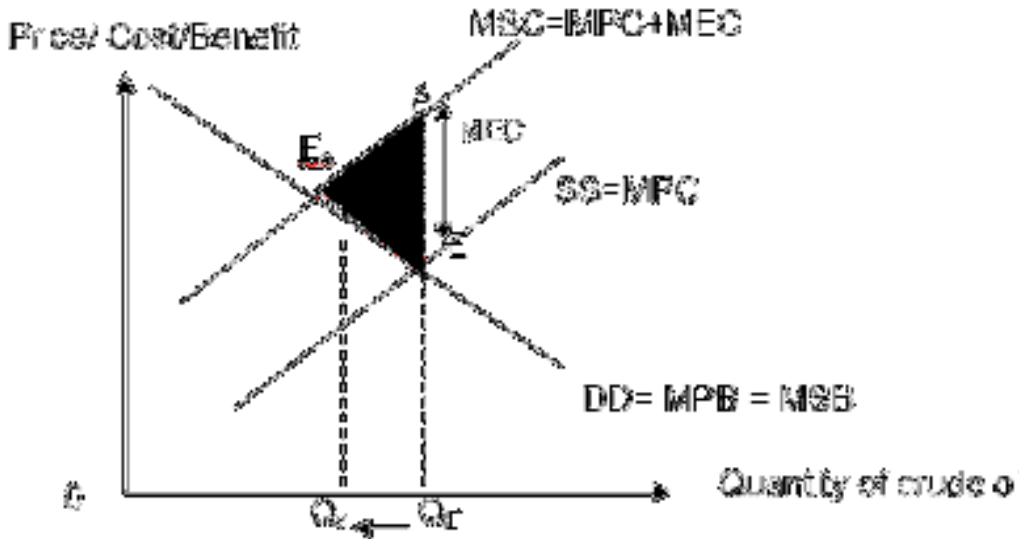


Figure 1: Negative externality in production resulting in over-production

Venezuela’s and Iran’s approach

Explain how the policies help Venezuela and Iran to achieve their macroeconomic and microeconomic objectives. Some macroeconomic objectives which the government want to achieve are economic growth, low unemployment, etc.

Some of the objectives which can be covered are: economic growth, unemployment and income inequality.

Conclusion

- A stand to conclude the economic analysis behind the two different approaches taken by different government.
- Justify on your stand and further evaluate on the two different approaches using time period.

Marking Scheme (b)

Knowledge, Application, Understanding and Analysis		
L3	For a well-developed explanation for these different government approaches in the crude oil market.	9 – 11
L2	For a descriptive explanation for these different government approaches in the crude oil market.	6 – 8
L1	For an answer that shows a descriptive knowledge for these different government approaches in the crude oil market.	1 – 5
Evaluation		
E2	For an evaluative assessment based on economic analysis.	3 – 4
E1	For an unexplained assessment or one that is not supported by economic analysis	1 – 2

(a) Explain why current account deficits might be harmful for some economies but not others. [10]

(b) Discuss the view that appropriate changes in exchange rate are more useful than supply-side policies in correcting a current account deficit. [15]

Part (a) Answer Outline

- Define a current account deficit in an economy.
- Explain internal and external consequences of a current account deficit.
- Explain the considerations as to why some current account deficits may not be harmful

Marking Scheme

Level	Knowledge, Application, Understanding, and Analysis	Marks
L3	Well-developed analytical explanation why current account deficits might be harmful for some economies but not others.	7 – 10
L2	Descriptive explanation why current account deficits might be harmful for some economies but not others.	4 – 6
L1	For an answer that shows descriptive knowledge of the limitations of economic indicators.	1 – 3

(b) Discuss the extent to which appropriate changes in exchange rate is more useful than implementing supply-side policies when achieving a healthy balance of payment. [15]

Part (b) Answer Outline

Introduction

- Governments often seek to correct a current account deficit due to the adverse consequences that it could bring as mentioned in part (a). Thus governments try to correct it by implementing supply-side policies or exchange rate policies in order to improve it.
- However, adopting appropriate changes in exchange rate is more useful for some governments while others prefer to implement supply side policies, and the usefulness of each policy to achieve a healthy current account would depend on the time period, root cause of the initial CA deficit and constraints faced by the government.

Body

- To correct the CA deficit, the government can allow its currency to depreciate by selling its currency in the foreign exchange market. With **depreciation of the exchange rate**, exports would be relatively cheaper in terms of foreign currency. If demand for exports is price elastic, there would be a more than proportionate increase in quantity demanded of exports. This would lead to a rise in export revenue. On the other hand, imports would be relatively more expensive in terms of domestic currency. If demand for imports is price elastic, there would be a more than proportionate decrease in quantity demanded of imports. This would lead to a fall in import expenditure. Overall,

the rise in export revenue and fall in import expenditure would mean a rise in net exports. *Ceteris paribus*, the current account would improve, allowing a government to correct a CA deficit.

- However, managing the exchange rate has some challenges as the government needs to know when to intervene, what exchange rate they should aim to maintain, and how persistently they should try to maintain that rate. However, they may not have up-to-the-minute and reliable information about the state of the global economy and the various interactions in the foreign exchange market.
- If a currency weakens, it can lead to higher prices of imports and bring about imported inflation in an economy. The increase in prices of imported raw materials will increase COP and assuming producers pass on the cost increase to consumers in terms of higher prices, cost push inflation will occur. This increase would also partially offset any fall in price of exports due to depreciation.
- Some governments may choose to implement **supply-side policies** in order to improve CA by either (a) reducing the cost of production of exports or (b) increasing the demand for the country's exports by improving the quality of exports.
- Governments can use interventionist approach by increasing spending on education and skills training in order to increase labour productivity, which would in turn reduce unit labour costs and allow exports to be priced lower and more competitively internationally. Assuming the demand for exports is price elastic, the decrease in price will lead to a more than proportionate increase in quantity demanded of exports. Hence, export revenue rises. *Ceteris paribus*, net exports will increase, resulting in an improvement in the current account.
- For example, India introduced its Skill India campaign in 2015 with an aim to train over 400 million people in India in different skills. By training and re-skilling workers, workers would have skills relevant for the workplace, thus increasing their productivity.
- The government can also use supply-side policies that increase and encourage R&D and innovation that help to improve the quality of goods and services produced by firms. This would improve the non-price competitiveness of exported goods and services, resulting in a rise in demand for exports and a rise in export revenue. *Ceteris paribus*, net exports will increase, resulting in an improvement in the current account and correcting any deficit.
- The Productivity and Innovation Credit Scheme was introduced in Singapore's Budget 2010 to encourage businesses to invest in productivity and innovation by providing cash pay-outs or tax deductions for spending in these areas. In Budget 2017, it was announced that more than \$80 million would be made available for programmes to strengthen corporate capabilities, particularly in promoting digitalisation for small- and medium-sized enterprises (SMEs). These include industry digital plans on the technologies to use at each stage of growth, as well as advice and funding support when piloting emerging information and communications technology (ICT) solutions

- However, the success of skills retraining or knowledge upgrading depends on the level of education, age and personal inclination. The less educated or older workers may not have the ability to learn new skills or they are not receptive towards the need for re-training. Some may just be resistant to the idea of a job change. Supply side policies usually take effect in the long run and can be costly to finance.
- In order to assess the usefulness of each policy, the government would need to consider various criteria. Firstly, if a government's objective is to boost long-term export competitiveness, supply side policies would be more useful instead of exchange rate policies as the productivity gains from supply-side policies tend to lower costs of production for firms in the long run due to production processes being made more efficient.
- In contrast, exchange rate policy in which the currency is devalued often leads to a currency war in which a country's trading partners retaliate by devaluing their countries as well, as seen in the example of Vietnam and China above. Furthermore, depreciation of a currency would mean that imported raw materials would be more expensive, and this would in turn increase the cost of production for firms. This would limit the long-term effectiveness of exchange rate policies in boosting export competitiveness.
- However, if a government's objective is to boost export competitiveness in the short-term, such as when a government faces a substantial CA deficit that needs to be addressed quickly then appropriate changes in the exchange rate policy would be more useful than supply side policies in order to bring about a more immediate positive impact on net exports. In contrast, supply-side policies tend to face significant time lags in implementation. For example, improving the quality of human capital through education and training is unlikely to yield quick results. In addition, the benefits of deregulation can only be seen after new firms have entered the market, and this may also take a long time.
- Another criterion would be the root cause of a country's CA deficit. If the deficit is due to loss of comparative advantage, then supply-side policies to promote innovation and the design of new products and improvement of technology can be rather important.
- However, if the initial CA deficit was due primarily to competitive devaluation of currency in trading partners, exchange rate policies may be preferred over supply-side policies since there would be less of a need to boost quality of exports.

Conclusion and Evaluation

- In conclusion, whether **exchange rate are more useful than supply-side policies in correcting a current account deficit** depends on the characteristics and conditions of an economy.
- Supply side policy is more useful for governments if they are unable to weaken their currency. Elaborate. Another constraint that is faced in implementing exchange rate policy would be the trilemma that exists between the ability to set interest rates, the ability to fix exchange rates as well as free capital movement. Elaborate.

- However, appropriate changes in the exchange rate would be more useful over supply-side policies if they have a weak fiscal position resulting from large and persistent budget deficits in the past. Supply-side policies such as subsidies or tax incentives for R&D or even spending on skills upgrading tend to be very costly; such policies would worsen a government's fiscal position or may even require a government to borrow extensively to fund its spending, which would impose a burden on future generations.

Marking Scheme

Part (a)

Level	Knowledge, Application, Understanding, and Analysis	Marks
L3	Well-developed analytical explanation why current account deficits might be harmful for some economies but not others.	7 – 10
L2	Descriptive explanation why current account deficits might be harmful for some economies but not others.	4 – 6
L1	For an answer that shows descriptive knowledge of the harmful effects of current account deficits.	1 – 3

Part (b)

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	For a well-developed explanation of how supply-side policies and exchange rate policies may help a government to correct current account deficit. Answer uses well-reasoned criteria of judgment to assess the reasons why some governments prefer to implement supply-side policies while others choose to adopt appropriate exchange rate policies in order to correct current account deficit.	9 – 11
L2	For a descriptive explanation of how supply-side policies and exchange rate policies may help a government to correct CA deficit. Answer compares the effectiveness and limitations of supply-side policies with those of exchange rate policies.	6 – 8
L1	For an answer that shows a descriptive knowledge of supply-side policies and exchange rate policies.	1 – 5
Level	Evaluation	Marks
E2	For an answer that makes some attempt at an evaluative appraisal about the other considerations of a government.	3– 4
E1	For an unsupported judgment about the other considerations of a government.	1 – 2

