



Case Study Question 2: The Pains and Gains of Economic Restructuring

Suggested Answers

(a)	Explain why the Chinese are 'concerned over the formation of real estate bubbles'.	[2]
	<p>1. If the real estate bubbles were to burst, prices of housing would fall. (1m)</p> <p>2. Consumers would feel less wealthy OR consumers would have to cut down on expenditure to pay their debts, thus cutting consumption and reducing AD, adversely affecting actual growth/national income. (1m) -</p> <p>OR well elaborated point (2), explaining why C decreases and its impact on national income (standard of living is also be accepted) can be given 2m</p> <p>Note: Explanation on macro impact is non-negotiable</p>	
(b)	From Extract 6, comment on the likely change in China's multiplier value after restructuring.	[4]
	<p>The k value can be calculated by $1/(1-MPC)$ or $1/MPW$. Original APC is 0.36. Using this as a proxy (1m), it is likely that the k value is below 2 initially. ($k = 1/(1-0.36) = 1/0.64 = 1.56$.) OR MPS is likely to be high due to high precautionary savings and thus the k value is likely to be low.</p> <p>Explain that MPS is likely to decrease because "improvements in health and pension coverage" will reduce the need for high precautionary savings and hence reduce the necessary savings ratio (APS). Reduction of APS can be used to predict reduction of MPS. This will possibly increase the MPC ($MPC = 1 - MPS$ or students can explain the urbanisation may result in growth of middle class → tends to increase MPC as Y increases from low to middle income level) and thus increase the k value. (3m – ability to explain the change in the value of k)</p> <p>Note: No proxy – max of 3m. Comment – the usage of proxy to comment on the likely value</p> <p>Credit for relevant evaluative comment (but it is not a requirement)</p>	
(c)	'Restructuring for higher productivity will be a risky and painful process for companies'. (Extract 7) Explain the above statement.	[4]
	<p>Students need to show understanding that "risky" and "painful" to companies will be in the form of impact on firms' profits.</p> <p>Cutting foreign manpower growth and imposing higher levies may increase wages and lead to increase in variable cost of production</p> <p>Investment for productivity e.g. using productive capital goods – increased fixed cost.</p> <p>Overall increase in MC/AC → reduce profitability</p> <p>Show understanding that it may not lead to lower marginal costs in future and hence may not increase profits/ uncertainty on the returns on capital equipments (idea of risk)</p> <p>Note: revenue reasons can also be accepted.</p> <p>2m – for well-developed explanation for change in COP 1m – for profitability 1m – idea of risk</p> <p>Note: Very well developed explanation, provided explanation on change in fixed and variable cost (3m) + impact on profits (1m) → up to 4marks</p>	

(d)	Compare the trend of unemployment rate and youth unemployment rate in Eurozone from 2011 to 2014.	[2]
	<p>Similarity – Both unemployment rate and youth unemployment rate generally increase from 2011 to 2014.</p> <p>Or</p> <p>Both unemployment rate and youth unemployment rate rose from 2011 to 2013 and fell in 2014 (acceptable only for comparison question. For describe qn, overall trend is preferable)</p> <p>Difference – youth unemployment rate is consistently higher than that of unemployment rate over the period.</p> <p>OR</p> <p>Increase in youth unemployment rate is higher than that of unemployment rate. [Note: there is difference in % points]</p>	
(e)	To what extent would youth unemployment in the Eurozone adversely affect its current and future economic growth?	[8]
	<p>1. <u>Explain how youth unemployment in Eurozone may affect its actual economic growth</u></p> <p>Table 4 shows that Eurozone's unemployment has been high in 2011 to 2014, ranging between 10% to 12% and youth unemployment rate to be around 23%</p> <p>Loss in production and Income: Loss of jobs brings about reduction in production and income. Scarring effect (where young people may not have a full time stable job and earn lower wages and at greater possibility of unemployment) → reduces purchasing power → low consumer confidence among the youths (expectations) → fall in (autonomous) consumption → fall in AD</p> <p>Excess labour means the economy is not producing on the boundary of PPC and thus actual growth is affected. The longer youths remain unemployed, the more it will hamper the Eurozone's recovery.</p> <p>Note: If students write 'fall in purchasing power' → reduce INDUCED consumption</p> <p>Evidence: launching a career without a job suggests that young people who endure early spells of unemployment are likely to have lower wages and greater odds of future unemployment than those who don't. These scarring effects last throughout the remainder of their 20-30 years of working life.</p> <p>Loss in tax revenue which may affect future govt spending: Lack of income of greater proportion of labour force who are unemployed leads to less tax revenue, compounded over a longer period of working life. Leading to less resources for the government to allocate to expenditure. If the government, especially in Eurozone is already running a budget deficit, the loss in tax revenue could possibly lead to a cut in budget spending which in turn exert a further contractionary effect on the economy's actual growth</p> <p>Loss of social stability Unemployment appears to be linked to greater incidence of crime and violence as seen in some Southern Eurozone nations where jobless youth 'lash out violently'. This in turn lowers investors' confidence in the economy and may reduce FDI in eurozone. Furthermore, the high youth unemployment is also an indication that these youths may be structurally unemployed (mismatch of skills and jobs available), firms may be wary of investing in Eurozone.</p> <p>Evidence: jobless youth... lashing out violently</p> <p>2. <u>Explain how youth unemployment in Eurozone may affect its Potential Economic Growth</u></p> <p>Loss in human capital With a long productive worklife ahead of youths, the lack of opportunities when young will hamper future work life and lead to loss of skills and even dropping out of the labour force – quality and quantity of labour will be adversely affected thus - lower potential growth</p>	

	<p>Lack of tax revenues can also affect the ability of governments to invest in infrastructure etc Since FDI and domestic investment may decline→ lower potential growth</p> <p>3. <u>Evaluate the extent of adverse effects of youth unemployment on Eurozone</u></p> <p>In general, the fact that youth has longer productive lives ahead of them amplifies the consequences of unemployment, with the impact on potential growth particularly pronounced.</p> <p>The impact on economic growth is also not evenly spread out as it seems that Germany and Austria's youth unemployment rate is significantly lower compared to eurozone's youth unemployment.</p> <p>Evidence: Germany and Austria have youth unemployment rates of just 7.6% and 8.2%, respectively.</p> <p>Mark Scheme</p> <table><tr><td>L3 (6-8)</td><td>Balanced and well developed economic analysis based on the case material and evident evaluation and judgment. Students are expected to include the idea of PPC and/or AD/AS in their analysis.</td></tr><tr><td>L2 (4-5)</td><td>Answers tend to be lopsided or insufficient use of economics analysis. Little or no evaluation/judgment. Should students only explain effects of unemployment in general on economic growth or did not consider actual vs potential growth, consider max of 4m.</td></tr><tr><td>L1 (1-3)</td><td>Weak attempt in answering the question requirement i.e. did not address youth unemployment and its effects on economic growth of Eurozone. Major conceptual errors were evident.</td></tr></table>	L3 (6-8)	Balanced and well developed economic analysis based on the case material and evident evaluation and judgment. Students are expected to include the idea of PPC and/or AD/AS in their analysis.	L2 (4-5)	Answers tend to be lopsided or insufficient use of economics analysis. Little or no evaluation/judgment. Should students only explain effects of unemployment in general on economic growth or did not consider actual vs potential growth, consider max of 4m.	L1 (1-3)	Weak attempt in answering the question requirement i.e. did not address youth unemployment and its effects on economic growth of Eurozone. Major conceptual errors were evident.	
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(f)	<p>A Eurozone recession would have a significant contagion impact on other economies. Assess the effectiveness of China's and Singapore's restructuring efforts in mitigating this impact on their economies.</p>	[10]						
	<p>1. <u>Explain contagion impact</u></p> <p>Can impact Sg and China directly through direct trade relationships (Slow growth in Eurozone (see Table 3)) → poor consumer confidence → possible fall in dd for goods and services → fall in DDx from other countries including China and Sg). The extent of the contagion impact depends on the trade relationship between which can be seen in Table 5. It states that the Eurozone is the 2nd most important trading partner of China and the 3rd most important trading partner of Singapore. Ceteris paribus, this implies that China will be more adversely affected.</p> <p>There is also indirect impact on DDx from China and Sg by other countries as the contagion spreads to other parts of the world.</p> <p>2. <u>Identify and explain how Singapore and China restructure their economy</u></p> <p><u>Singapore</u> – Increase Productivity and to move towards Creative economy, from high skilled to even higher skilled industries. Manpower lean – leveraging capital goods for higher productivity and reducing reliance on foreign manpower. + The new competitive advantage thus lies in the ability to carve out new markets and create new markets through the fusion of business, technology and arts. Design, which serves to bring about such a fusion has emerged as the key differentiation strategy for businesses.</p> <p><u>China</u> – structuring to boost growth driven by consumption instead of trade → less affected by contagion effects of Eurozone recession</p> <p>Evidence: Current data of China shows C only takes up about 36% of GDP while (X + I) as % GDP is close to 70%.</p>							

Improvements in health and pension coverage are expected to continue to lower the necessary savings ratio and boost consumption. Planned expansion of urbanization should also improve consumption as China's cities expand and its middle class grows.

3. Discussion on the effectiveness of China's and Singapore's restructuring efforts in mitigating contagion effect on their economies

China:

Restructuring efforts are incomplete and still on-going. Despite the measures to improve health and pension coverage, and urbanisation, there are still significant obstacles e.g. finding its graduates suitable jobs. Exports (as % of GDP) has declined only gradually as seen in Table 2 and consumption (as % of GDP) only increased marginally from 2011 to 2014. However, C as %GDP in China is back to 36%. Since GDP per capita is still rather low at US\$6807, and it takes time for measures to encourage longer term unemployed and new graduates takes time, successfulness in reducing dependence on trade and hence mitigate contagion is yet to be seen.

Singapore:

Still very reliant on exports (176.5% of GDP in 2014). Eurozone recession can have global impact and impact Singapore directly and indirectly. Increased productivity from restructuring efforts can mitigate some of the impact. Movement into the creative economy – e.g. “servicization” of manufacturing, can also help mitigate as the manufacturing is done in low cost countries rather than Singapore. The ability to design, and thus carve out or create new markets to react to the world economic situation can also help Singapore adapt more adequately.

Synthesis (can vary based on student's analysis):

Based on the overall direction of the restructuring efforts and nature of each economy, China may be better able to weather the storm as they leverage the might of their large national market should their measures mentioned above shows success overtime.

Students can also 'rank' whether Sg or China is more effective in mitigating the contagion impact of eurozone recession

Mark Scheme

L3 (7-8)	Balanced and well-developed economic analysis on the effectiveness of China's and Singapore's restructuring efforts in mitigating contagion effect on their economies, based on the case material.
L2 (4-6)	Lopsided or under-developed analysis with insufficient application of case evidence.
L1 (1-3)	Descriptive answer with minimum link to question.
E1	Attempts to synthesize or some judgment
E2	Provide good synthesis and a reasoned conclusion.