

JJC J2H2 Prelim Exam Case Study 2

Suggested Answers

(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: Weak exports

- Export volume weakens and assuming that the price remain constant, export revenue falls. This leads to a fall in demand for renminbi in China.

Factor 2: Short-term capital outflow

- Speculation that renminbi will weaken leads to large capital outflow from the Chinese economy. This leads to an increase in supply of renminbi.

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 allows the RMB to weaken 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 relatively cheaper and its imports become relatively 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 relatively 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 less significant 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
L2	Well-developed answer that analyses how the weakening of the RMB will impact the Chinese economy	4-6
L1	Descriptive answer of how the weakening of the RMB will impact the Chinese economy	1-3
E	Well-justified stand on whether the weakening of RMB will benefit the Chinese economy	1-2

(b) Using data from Table 1, explain the change in standard of living for US from 2013 to 2016. [2]

US has been having positive real GDP per capita growth. This means that real income level has been rising for the average American citizen and this means that more goods and services are available for consumption by the people. 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 8 states that if President Donald Trump spends big on infrastructure, and spark demand for many goods, 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
- This will lead to demand pull inflation in the economy. **[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. Thus prices may not rise. **[2m]**

(d) Explain one consequence to the US economy when prices accelerate from its low levels. [2]

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
- Prices of exports become relatively more expensive and if demand for exports is price elastic, this will cause export revenue to fall. Demand for imports will rise as people switched to the cheaper imports. Import expenditure will rise. Thus net exports fall.

2m for any point explained – Can be any relevant point

(e) Discuss the view that imposing protectionist measures rather than engaging in Free Trade Agreements is a better option to create jobs in an economy. [10]

Introduction

The increased trade movement among countries have not benefited all equally and for some, it actually worsens their economy. For those who benefitted, they experience economic growth which create more jobs for their people, enabling them to earn more income and enjoy a higher standard of living.

Thesis: Protectionist measures is the better option to help an economy protect and create jobs

The justification for protectionism by the US is to protect their domestic industry and to safeguard their employment. As mentioned in Extract 11, the US government intends to impose a tax on imported goods such as steel.

Insert diagram

- Increase in domestic steel production generates employment as seen in diagram.
- Government also gains revenue from the imposition of the tariff - They can then use the tax revenue to implement policies that can help to improve the employment situation.
- At the same time, US steel companies will be discouraged from relocating overseas and then importing steel back to the US due to the tariffs.

However,

- Higher price of imports could 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.
- This also Increase the cost of production of industries that use the product as an input, for example in the case of a car-making industry.
- This makes some industries to experience a rise in cost of production thus making them less competitive.
- Retaliation may also occur which hurts export industries.

Anti-thesis: FTA is the better option to help an economy create jobs

A Free Trade Agreement (FTA) is a legally binding agreement between 2 or more countries to enjoy a myriad of benefits such as tariff concessions, preferential access to certain sectors,

easing investment rules, faster entry into markets and Intellectual Property protection. FTA can bring about both benefits and costs to a country and if benefits exceeds costs, the decision to sign such agreements is supported.

- US will benefit greatly from lowered tariffs in other countries as it means that her exports will be cheaper now due to lower or removal of tariffs. This leads to an enlargement of export market.
- FTA also allows countries to tap on the theory of CA and specialize in goods that she can produce at a relatively lower opportunity cost.
- FTA, can also lead to an increase in foreign direct investment due to preferential treatment or ease of investment rules. Country can also benefit from transfer in technology.

However,

- FTAs often take a very long time to be formed as it is a very complex and contains many details.
- An economy may not necessary gain from being in a FTA in terms of employment. The lower prices of imports can cause inefficient domestic industries to close down.

Conclusion

Whether protectionist measures or FTAs is better depends on the current state of the economy and the problems that she is facing.

- Given the unfair trade practices and the structural rigidities faced in a country such as US, protectionistic measure may be a short-term measure.
- In the longer term, benefits from FTAs is likely to outweigh costs as exports expand according to Theory of CA.

Level	Knowledge, Application, Understanding, and Analysis	Marks
L2	Well-developed explanation how protectionist measures or FTA can help create jobs in the US + evaluation of the 2 policies Good reference made to evidence from the data to support the arguments made.	5 – 7
L1	Descriptive and under-developed explanation how protectionist measures or FTA can help create jobs in the US	1 – 4
Evaluation		
E	Reasoned conclusion and judgment that critically evaluates whether protectionist measures or FTA is better in creating jobs for the US	1 – 3