**PJC 2017 H2 Prelim Exam Paper 1**

**Question 2: Economic Performance, Prospects and Lessons**

**(a)** Compare China's GDP growth between 2010 and 2015 with that of India over the same period. **[2]**

Suggested answer:
Both experience positive GDP growth between 2010 and 2015. While China GDP growth fell throughout the whole period, India GDP growth fell till 2012 and rises thereafter.

(b) Extract 5 suggests an increase in China investment overseas.
(i) Explain one reason why Chinese firms are buying competitor firms overseas. **[2]**

Suggested answer:
(Candidates need to focus only on one advantage – revenue advantage or cost advantage)
When two companies come together by acquisition, the joint company benefits in terms of cost efficiency. An acquisition is able to create economies of scale which in turn generates cost efficiency. As the two firms form a new and bigger company, the production is done on a much larger scale and when the output production increases, there are strong chances that the cost of production per unit of output gets reduced. This benefits the firms in terms of profits gain.
Or
By buying a competitor firm overseas, the joint company enjoys tremendous amount of revenue advantages due to their large size and market share. A large firm has the resources to engage in non-price competition such as advertisement of their products to make their goods more cross-price inelastic relative to their rivals. Hence, they are better able to withstand the competition from the rivals. They could even possibly set a higher price for their products without losing many of their customers given an inelastic demand, leading to rising TR.

(ii) Comment on the likely effects of this on China's balance of payments. [4]

Suggested answer:
An increase in China investment overseas will lead to a deterioration of her capital account in the short run as this is recorded as a debit entry in the long term capital account. Ceteris paribus, her BOP will deteriorate. However, in the long run her balance of payment may improve as investment overseas reap returns in the form of investment income such as profits and dividends. These are remitted back to China and are recorded as credit entry in China's Current account in her Balance of Payment.

**(c)** Explain the trade-off between inflation and growth in view of the action taken by the Indian government to deal with the weakening of the Indian Rupee. [4]

Suggested answer:
To deal with the weakening of the Indian Rupee, the Indian government need to increase interest rate to increase net capital inflow. A strong rupee will result in a fall in price of imports and helps to mitigate the effect of imported inflation which India is susceptible to as her growth is driven main by her reliance on imports of cheap oil. However, an increase in interest rate will increase the cost of borrowing and hence reduce C on big ticket items and I as at the same expected returns, some investment projects are no longer profitable. A reduction in C and I will reduce AD and hence reduce GPL. But an increase in i/r will at the same time retard growth as a fall in AD will reduce real GDP through the reverse multiplier process.

(d) Discuss whether the data provided are sufficient to compare China's standard of living with [8] that of India in 2015.

Suggested answer**:**
**Define SOL**
Standard of living of a country refers to the social and economic well-being of a country which includes both the material and non-material aspects of life. The material well-being is determined by the quantity and quality of goods and services for consumption while the non-material well-being is the quality of life and environment which ones lives determined by the intangible factors such amount of leisure and life expectancy.

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| GDP is the purchasing power parity (PPP) value of all final goods and services produced within a country in a given year divided by the population for the same year.<br><br>The GDP per capita, PPP is higher in China than India. | GDP per capita, PPP is a commonly used national income statistic to compare living standards between countries.<br><br>International comparisons have to be undertaken in a common unit of measurement for example, the US dollar. The market exchange rate, however is not a good indicator of the relative domestic purchasing powers of the two currencies. Thus, the GDP per capita is converted using Purchasing Power Parity (PPP) exchange rate which is the rate of exchange that would allow a given amount of money income country to buy the same amount of gods in another country after exchanging it into the currency of the other country.<br><br>Thus, since GDP per capita in PPP in China is higher than GDP per capita in PPP, it meant that average citizens in China have more goods and services available for consumption than in India. This indicates a higher level of material standard of living in China.<br><br>Additionally, a higher level of good and services led to an increase in demand for labour, resulting in an increase in wages. A higher wage means Chinese households was earning higher income and disposable income and they had higher purchasing power to buy more and better quality goods and services compared to India | The difference in GDP per capita, PPP could lie in the non-availability of important data in some countries and in the nature and reliability of the data collected.<br><br>Underground economy such as a cleaner who is paid in cash and does not declaring this earning are not accounted for in the statistical figure but contribute to the income and therefore material SOL of the residents. The size of underground economy differs between China and India. This meant that India could have a higher standard of living than China if there is a large underground economy.<br><br>Additionally if the higher GDP per capita is due to longer working hours of workers, this meant that the Chinese had less leisure time and rest than India. This could lead to worse health condition and higher stress level. As a result, the Chinese workers could have experienced a fall in a quality of life.<br>Need to know working hours to determine whether the China workers have a lower quality of life than India.<br><br>Despite the higher GDP per capita, it does not reflect the income distribution in China and India. It is merely an average figure indicating the amount of goods and services available to each citizen in the country. |

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| | The higher GDP per capita also enables China's government to earn higher tax revenue and hence able to increase their spending on merit goods such as better healthcare and education services. This is evident from the **higher healthcare expenditure per capita (US$)** for China than India. This leads to improvement in non-material SOL such as higher life expectancy and literacy rates. | |
| Gini coefficient varies from a value of 0 to 1. The larger the Gini coefficient, the less equitable is the income distribution.<br><br>As seen from the data, the Gini Coefficient for India is lower than the Gini Coefficient in China. | China's higher Gini coefficient indicates that the income distribution in China is more unfair than India. Thus, even though India has a lower GDP per capita, standard of living of the general population could be higher in India. | - |
| Human Development Index (HDI) is considered as a composite indicator of SOL, taking into consideration economic, social and demographic aspects. It is a composite index designed by the United Nations comprising three elements: an index for life expectancy, and index for school enrolment and the adult literacy and an index for real GNI per capita (in PPP$). Each country receives an HDI value of O to 1 and the countries are ranked according to their HDI values. The country which has the HDI value closest to 1 is considered to have highest living standard based on HDI. | China's higher HDI ranking indicates that standard of living in China is higher than India since HDI seek to account for population health and life expectancy, knowledge, education and material SOL respectively. Together they account for both material and non-material aspects of welfare. | However, HDI only looks at one criterion of each aspect of economic, social and demographic aspects. Thus, it may overlook other aspects of human development such as income distribution, gender inequalities and political participation, which are all factors that also affect economic and human development. Thus, affecting the reliability of this HDI as a measure of standard of living. |

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| China has a higher HDI ranking than India. | | |

Given data is necessary but not sufficient to compare China's standard of living with that of India. E.g. the higher GDP per capita, PPP may not necessarily lead to higher SOL if there is larger underground economy and worst income distribution. To have better assessment of SOL, more indicators such as size of underground economy and working hours are required. Composite index such as HDI indicate change in material and non-material SOL. However, there are also limitations of it such as using one criterion per aspect. Negative externalities, income distribution and gender inequalities are not taken into account. Thus, the data given are insufficient to compare China's standard of living with that of India, more data is required.

(e) In view of the anti-globalisation sentiments, discuss whether globalisation should be the driver of growth for emerging economies such as China and India. [10]

**Suggested answer**

Globalisation should be the driver of growth for emerging economies such as China and India.

Globalisation is the greater integration of the global economies due to greater trade and capital flows. With globalisation, China can gain access to more markets and can export more of its goods that it has comparative advantage (CA) in to the rest of the world resulting in higher export earnings (X). This causes her AD to rise in resulting in her NY rising by a larger extent via k effect. This can be seen in the positive economic growth rates averaging 6% - 10% as shown in Figure 1. In addition, greater flow of investment resulted in transfer of knowledge and technology from foreign MNCs to China's firms, and subsequently expands China's AS. As stated in Extract 5, China firms like Haier and ChemChina are now able to produce better quality products as they obtained improved manufacturing facilities and talents through increased outbound FDI. Capital flows also allow China to gain presence in new markets, which will benefit the economy as an additional source of export earnings. Lastly, as China struggles with rising wage rates and cost of production, globalisation and ease of capital flows will allow firms to tap on pools of resources in other developing countries with more competitive cost of production such as India. This brings about economic benefits to India as it attracts more inbound FDI, bringing about multiplied increase in it's NY and at the same time creating more employment in the economy. The Indian government is working towards higher economic growth that is driven by I, as seen in the many deregulatory measures in attracting FDI in its major sectors.

As a whole, globalisation should be the driver of growth for developing economies as it brings about increases in AD and AS leading to a sustained economic growth.

However, while increased trade and capital flows due to globalisation helps an economy achieve sustained economic growth, it has also led to greater interdependence among countries. If China focuses on globalisation as a driver of growth, China will be vulnerable to changes in the level of economic activities in the global economy. As mentioned in Extract 5, in the face of shrinking external demand, rising trade disputes and protectionism as well as other factors that result in China losing its competitiveness in low cost of production, the Chinese government wants to move the economy towards a consumption and innovation driven one. Similarly in India, these factors had hurt the growth dynamics of its economy. As globalisation speeds up economic restructuring, it threatens the employment of jobs that are in direct competition with developing countries, particularly low-skilled jobs. Even though China is also a developing country, it is a fact that the economy is suffering from rising wage rates and overall cost of production. This puts its low-skilled workers in a vulnerable position as they may lose their jobs if firms decide to outsource the production to economies with lower cost of production. In light of rising cost of production, China's government needs to focus on improving the economy's productivity so as to improve its competitiveness in the global economy. Lastly, globalisation led to rapid urbanization of China, exposing the country to various environmental and income distribution challenges. The Chinese government has implemented many relevant initiatives and plans to tackle these issues. Ease of capital flows may also hurt the balance of payments and bring about other of some countries. For instance, rising interest rate in the US coupled with appreciation of the US Dollar led to short-term capital outflow from India, causing the Rupee to depreciate. A depreciation of the Rupee could result in imported inflation in India. As a policy measure to tackle inflation, short-term measures such as contractionary demand management policies may lead to other economic problems for India. As stated in Extract 6, India government's plan to increase interest rates is likely to conflict with its macroeconomic aims of economic growth.

Despite the challenges, globalisation should still be the driver of growth for emerging economies such as China and India. The economy will benefit from increased trade and capital flows, as long as the government put in place appropriate policies to minimize the negative impacts of globalisation and must not be complacent and should regularly review their policies. In the long run, China needs to balance its dependence on external and internal demand as drivers of economic growth. Similarly, India should look towards implementing policies that would better allow the economy to reap the benefits of globalisation. The government should also retrain their workers and reallocate their resources to industries where they have CA, this would enable them to promote greater growth and welfare than if they had resisted globalisation through putting up more protectionistic barriers.