**JC Economics Tuition – Q2**

**Question 2: Economic Challenges and Opportunities for Australia, Vietnam and Spain**

**Figure 2: Australia’s Inflation Rate**

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| --- | --- | --- | --- | --- | --- | --- |
|  | **2016 Q2** | **2016 Q3** | **2016 Q4** | **2017 Q1** | **2017 Q2** | **2017 Q3** |
| **Inflation Rate (%)** | **1.0** | **1.3** | **1.5** | **2.1** | **1.9** | **1.8** |

**Source: Reserve Bank of Australia**

**Extract 6: Is Australia’s Employment Situation Improving?**

Australia’s unemployment rate has fallen to a four-year low, with the labour market recording 12 straight months of employment gains – its longest stretch since 1994.

Figures show the unemployment rate fell to 5.5% in September, its lowest rate since March 2013, as the government’s National Disability Insurance Scheme contributes to a surge in health jobs. Other big services sectors such as education, retail, accommodation/tourism and transport had added nearly 400,000 new jobs over the past year. This is a significant turnaround from a few years ago where the downturn in mining led to the loss of jobs in both the mining industry and industries that are involved in the processing of the mining output. The fall in Australia’s key exports led to the government pouring funds towards stimulating investment into the Australian economy.

HSBC chief economist Paul Bloxham said businesses were reporting a sharp jump in their concerns about being able to find “suitable labour”, which is a sign that the labour market is tightening and wages may finally start facing modest upward pressure over the next 12 months. “We expect to see at least another 250,000 jobs added over the coming year,” CBA senior economist Michael Workman said. “The unemployment rate, now at 5.5%, is forecast to move closer to the 5% level.” The employment minister, Michaelia Cash, welcomed the employment figures, saying they proved the Coalition’s policies were pro-growth.

However, critics are quick to point out that unemployment rate has remained fairly unchanged since the election of the current government at 5.5 per cent despite the creation of jobs as many Australians are without the requisite skills for the modern Australia economy. They are calling for the government to provide more resources to vocational skills training, school education and reducing university fees.

Adapted from The Guardian, 19 Oct 2017

**Extract 7: Vietnam benefits from US-China Trade War**

Foreign direct investment in Vietnam climbed 9.1% in 2018 to reach $19.1 billion, the government reports, marking a sixth straight annual record as capital keeps flowing into one of Southeast Asia's fastest-growing economies. Industries such as apparel have been moving production out of China and into Vietnam looking to escape the higher taxes by the U.S. on Chinese exports. A prolonged trade war is expected to accelerate this shift. In addition, apparel companies are shifting their production out of China to countries like Vietnam due to its rising labour costs, making Vietnam the world’s third largest apparel exporter. Apparel accounts for about 10% of Vietnam’s exports.

Vietnam is Asia's biggest beneficiary of the Sino-U.S. trade war, according to Mizuho Research Institute, which estimates the effect will be a 0.5 percentage point boost to its real gross domestic product. Vietnamese real GDP growth is estimated at 7.08%, according to government data.

The central government approved many investment projects last year, including the Hanoi "smart city" project, in which Japanese trading house Sumitomo Corp. takes part, as well as liquid crystal display and camera facility investment by South Korea's LG group in the North-Eastern city of Hai Phong. South Korea's Samsung Electronics accounts for roughly 25% of Vietnam's overall exports by value.

However, with the growth of the garment and electronics industry in Vietnam comes with it a cost to the environment. Research has shown that garment industry is the 2nd most pollutive industry globally, using up precious natural resources and creating a lot of waste products that dirty the land, water and air. Environmental groups are calling for the Vietnamese government to do more to mitigate the environmental effects of the foreign investment. The rapid growth of exports has also caused a widening income gap between those in export-related industries and those who primarily cater to the domestic market.

Adapted from Nikkei Asian Review, 10 Jan 2019

**Extract 8: Spain’s unemployment falls without an active government**

We are continually told that every country must have an activist government that intervenes with a range of policies to achieve its economic goals. No economy or society can be allowed to just bumble along by itself, the firm smack of political control is necessary for the world to continue to turn on its axis. This is not really what the empirical evidence tells us of course. Spain has not really had a government for the past 10 months and yet it is expected to be one of the fastest-growing Eurozone economies this year. Spain's central bank expects the country to expand by 3.2% this year, among the most robust growth rates in Europe, which has created more jobs. And as a result the unemployment rate has just fallen to 18.9%. While inflation is -0.2%, it is an improvement from -0.5% a year ago.

As more Spaniards have gone back to work, they have been spending more, boosting consumer spending and further accelerating economic growth. Spain has been expanding since the economy returned to growth in 2013 after a deep recession.

In addition, the growth may spark off higher migration to Spain in search for job opportunities. While generally welcoming to migrants, some are worried that these migrants may steal jobs from the locals due to their lower asking wage. However, some economists are more optimistic, citing empirical evidence that having an increased inflow of migrants can bring about faster growth.

However, analysts are cautious about the optimism as the better than expected performance is due to the global economic recovery which has led to more tourists in Spain and increasing demand for Spain’s exports. Robust growth may bring with it the harms of high inflation. Without a government, Spain is ill-equipped to deal with any potential recessions and political instability would affect its long-term growth prospects.

Adapted from Forbes.com, 27 Oct 2016

**Questions:**

|  |  |  |
| --- | --- | --- |
| **(f)** | With reference to the case material and/or your own knowledge, discuss the factors that a government should consider when deciding on the policies to achieve its economic goals. | **[12]** |
|  |  |  |
|  | **[Total: 45 marks]** |

**~End of Paper~**

**(a) With reference to Figure 2, describe what has happened to the rate of inflation and price level in Australia.** **[3]**

The inflation rate is increasing [1]. The general price level is increasing at an increasing rate from 2016 Q2 to 2017 Q1 [1] and increasing at a decreasing rate from 2017 Q2 to 2017 Q3 [1].

OR

The inflation rate is increasing [1]. The general price level is increasing [1] at an increasing rate from 2016-2017 [1].

**(b) Explain 2 possible reasons why governments aim to achieve the goals of low unemployment and price stability.** **[4]**

Governments want to achieve low unemployment because of the impact to the government budget. If they are able to reduce the unemployment rate, the government will be required to spend less in terms of unemployment benefits and in turn are able to receive more tax revenue from the incomes of those who are employed. This will thus improve the government budget position.

Governments want to achieve price stability because this can have an impact on economic growth of the economy. If inflation rate is high, there is unpredictability in terms of how the GPL will change and firms will have difficulty predicting their expected returns on investment and thus be reluctant to carry out investment plans. With the cut back in investment, this can result in the fall in AD and NY, ceteris paribus.

This will cause the economy to experience negative actual growth.

*OR*

If this results in a negative net investment, then the capital stock of the economy reduces, which in turn would cause a fall in productive capacity of the economy and thus a leftward shift of the LRAS curve. This would cause the economy to experience negative potential growth.

**(c)**

 **(i)With reference to Extract 6, explain the causes of unemployment in Australia.** **[4]**

It is stated in Extract 6 that there was a downturn in the mining sector, leading to a fall in exports. This would have caused a fall in AD and hence NY, causing firms to employ less labour and thus would have led to cyclical/demand-deficient unemployment. [2]

In addition, the extract also mentions that the residents lack the requisite skills for the economy. This would have caused a skills mismatch between the jobs and workers and thus caused structural unemployment. [2]

**(ii)Discuss whether the implementation of policies with regard to training and education will be sufficient in further reducing the unemployment rate in Australia.** **[8]**

**Introduction:**

As seen from b(i) there is both cyclical and structural unemployment. The problem of cyclical unemployment is being addressed through the creation of jobs in various sectors as stated in the extract. However, the structural unemployment issue is not being addressed.

**Thesis: Implementing the policies would be sufficient**

If the government were to implement education policies to facilitate learning and training, the unemployed workers will pick up new skills which enable them to fill the available jobs in the economy. This will reduce the structural unemployment issue and help reduce the overall unemployment rate. In addition, by going for training, workers become more productive which increases the maximum amount of goods and services Australia can produce and thus causes the LRAS to shift to the right and bring about potential growth. Since such a change in policy can help to bring about the attainment of other macroeconomic goals, thus implementing the policies would be effective in reducing the unemployment rate.

**Anti-thesis: Implementing the policies would not be sufficient**

Implementing the policies would only serve to alleviate the structural unemployment issue but does not address the demand-deficient unemployment issue. The government has undertaken measures to stimulate investment which would have increased AD and thus increased the RNY. This would in turn result in an increased employment of labour and thus reduce the demand-deficient unemployment. As such the Australian government could consider further increasing the allocation of resources towards stimulating investment or consider an alternative policy such as to lower interest rates to stimulate investment and consumption in order to bring about growth and thus increase in the employment of labour, reducing the cyclical unemployment.

Education and training policies does not guarantee effectiveness as it depends on the receptiveness of workers towards training and picking up new skills. If the government provides funding but the workers do not actively learn, the acquisition of skills may be inadequate or at a level which is insufficient for the firms looking for suitable labour.

**Conclusion/Synthesis:**

Even though jobs are being created, the unemployment rate has remained fairly unchanged. This is due to the skills mismatch between the jobs available and the unemployed. Structural unemployment is the main unemployment issue that Australia is facing and this is causing wage pressures which if not addressed, would cause Australia’s goods and services to lose export competitiveness. As such the government should implement the policies. However, there is still cyclical unemployment in the economy and thus the government would need a combination of policies to effectively tackle the unemployment issues.

**(d) “Industries such as apparel are… looking to escape the higher taxes by the U.S. on Chinese exports” and “… shifting their production out of China to countries like Vietnam due to its rising labour costs” (Extract 7).**

**Explain how the abovementioned events have impacted the living standards of the residents of Vietnam. [7]**

Living standards refers to the well-being of an average person in the economy. It consists of material and non-material aspects. With the changes in the global economy such as the US-China trade war, this has brought about impacts to economies around the world like Vietnam.

With US imposing tariffs on Chinese exports, firms have moved its production out of China and into Vietnam. Firms have also moved out of China due to the increasing labour cost and into Vietnam in order to lower costs and maximise profits. These changes result in an increase in FDI into Vietnam and this will increase investment and thus AD for Vietnam. Ceteris paribus, this will increase the real national income for Vietnam. Assuming the percentage increase in population is less than the percentage increase in real GDP, this will lead to a higher real GDP per capita. A higher real GDP per capita indicates higher purchasing power and thus households can enjoy more goods and services, leading to an increase in material standard of living.

In terms of non-material living standard, which measures the quality of life, it is mentioned in the extract that there is an increase in the amount of pollution in Vietnam due to the pollutive nature of the textile and electronics industries. With a higher level of pollution, this will lead to households having poorer health which could result in lower life expectancy and thus a fall in non-material standard of living.

Overall, it is likely that the changes in the global economy would lead to a rise in the living standards of the residents of Vietnam as the pollution is likely to be contained within certain areas and not widespread.

**(e) Extract 8 tells us that Spain’s economy grew without a government. Explain how Spain was able to do so and comment on whether there is a need for an activist government in order to ensure sustainable growth[7]**

The improvement in the economic performance is due to the recovery of the global economy which would have increased household income for foreign households, leading to an increase in the demand for Spain’s exports. With the increase in exports, this will increase the AD and in turn lead to higher RNY via the multiplier effect, ceteris paribus. The increase in RNY, estimated at 3.2% growth, leads to firms employing more FOP such as labour and thus cyclical unemployment falls, contributing to the fall in unemployment rate to 18.9%.

However, while Spain is able to do so without an activist government, the growth in exports may lead to actual growth but not potential growth as seen from the extract about harms of inflation. Firms are unlikely to invest if there is political instability as they may expect low returns on investment. In addition, without any government to regulate the production of goods and services, firms may utilise natural resources at an unsustainable rate which in turn prevents Spain from enjoying sustainable growth. As such, an activist government is needed to implement policies to handle economic crises as well as to promote investment in the economy. Furthermore, the strong demand for exports might not continue in the future. In the event of a global downturn, there might be a fall in demand for Spain’s exports and AD might fall. Government intervention might then be required to boost AD to ensure continued economic growth.

**(f) With reference to the case material and/or your own knowledge, discuss the factors that a government should consider when deciding on the policies to achieve its economic goals.** **[12]**