**CSQ Practice Test – ASAD Analysis / Economic Growth**

**Question 1:**

**Imbalances in the United Kingdom and China economies**

**Table 2: Government debt (percentage of GDP)**

|  |  |  |
| --- | --- | --- |
| Year | China | UK |
| 2010 | 33.7 | 76 |
| 2011 | 33.6 | 81.6 |
| 2012 | 34.3 | 85.1 |
| 2013 | 37 | 86.2 |
| 2014 | 39.9 | 88.1 |
| 2015 | 42.6 | 89 |

Source: IMF

**Table 3: GDP Composition breakdown by percentage in 2015**

|  |  |  |
| --- | --- | --- |
|  | China | UK |
| Consumption Expenditure | 37% | 65% |
| Government Expenditure | 14% | 19% |
| Gross Capital Formation | 45% | 17% |
| Export Revenue | 22% | 28% |
| Import Expenditure | 18% | 29% |

Source: World Bank

**Extract 5:** **Is the game up for China’s much emulated growth model?**

From the early 1990s, China adopted an export-led strategy that delivered continuously increasing shares of the world market, fed by relatively low wages and very high rates of investment, enabling massive increases in infrastructure. It led to big increases in inequality and even bigger environmental problems, but the strategy seemed to work – until 2008-09, when exports were hit by the global financial crisis.

Yet even then, China, India and other large emerging markets continued to grow. The talk at the time was that they were already dissociated from the west. In reality, China (and much of developing Asia) had simply shifted to a different engine of growth without abandoning the focus on exports. The Chinese authorities could have generated more domestic demand by stimulating consumption through rising wage shares of national income, but this would have threatened their export-driven model. Instead they put their faith in investments to keep growth rates buoyant.

So the “recovery package” in China essentially encouraged more investment, which was already nearly half of GDP. Provincial governments and public sector enterprises were encouraged to borrow heavily and invest in infrastructure, construction and more production capacity. To utilise the excess capacity, a real estate and construction boom was instigated, fed by lending from public sector banks. Total debt in China increased fourfold between 2007 and 2014, and the private debt-GDP ratio nearly doubled to over 280%.

All this comes in the midst of an overall slowdown in China’s economy. Exports fell by around 8% in 2014. Stimulus measures such as interest rate cuts do not seem to be working. As such, the recent devaluation of the yuan is clearly intended to help revive the economy.

However, it will not really help. Demand from the advanced countries – still the driver of Chinese exports and indirectly of exports of other developing countries – will stay sluggish. Meanwhile, China’s slowdown infects other emerging markets across the world as its imports fall even faster than its exports.

A weaker yuan is bad news for export-oriented economies like Singapore, Hong Kong, South Korea and Taiwan as their exports will be more expensive to Chinese buyers. Their exports to other countries will also have to compete against Chinese rivals who have the advantage of a weaker currency.

This is not the end of the emerging markets, but is – or should be – the end of this growth model. Relying only on exports or debt-driven bubbles to deliver rapid growth cannot work for long. For developing countries to truly “emerge”, a more inclusive strategy is essential.

Sources: The Guardian, 23 August 2015 and The Straits Times, 7 January 2016

**Extract 6:** China: Domestic Demand on the Rise

**Rising domestic demand from retail sales**

Since the introduction of cross-provincial travel within China, we have seen retail sales recovering strongly to 0.5%YoY growth in August from -1.1%YoY a month ago. Spending on cosmetics and jewellery rose 19.0%YoY and 15.3%YoY, respectively in August. The tourism business has also brought back jobs in the service sector. The spending power of the population has improved. The favourite spending item, telecommunication products, experienced a jump in sales of 25.1%YoY.

Covid-19 is still having some impacts on spending. For example, catering still experienced a contraction of 7%YoY in August. Though this was an improvement on -11% in the previous month.

**New and old infrastructure led investment growth**

China’s new-infra plan and traditional infrastructure projects in transportation have led overall investment spending. Fixed asset investment (FAI) shrank only -0.3%YoY YTD in August from -1.6%YoY YTD in July. The "computer, telecommunication" category, which represents new-infra investment plans, grew 11.7%YoY YTD, which results in part from China’s push towards self-reliance in technology. Rail transportation investment also grew 6.4%YoY YTD.

These growth numbers are high compared to the headline growth rates, which means these are the engine of investment growth in China currently. We believe this situation will change gradually to a broader growth picture as these engines bring growth to more industries, which will then start to plan their own investment upturn.

**Wider growth in industrial production**

Industrial production growth also picked up to 5.6%YoY in August from 4.8%YoY in July. This was brought about by improvements in production across a broader range of categories than in previous months.

Integrated circuits grew 14.6%YoY and industrial robots grew 13.9%YoY, which again nods towards China‘s increasing self-reliance on advanced technology.

But industrial production shows that growth in manufacturing is still uneven. For example, the production of vehicles remained in a contraction of 9.0%YoY in August, only slightly improved from -9.7%YoY in July.

**External environment is a challenge to growth**

We can see that domestic demand has brought back growth, mainly in retail sales and infrastructure projects, which have in turn led to growth in industrial production. This growth has brought some jobs back to the market. This is indeed the internal growth circulation that China is promoting.

But the dual circulation, that is, both domestic and external growth, is yet to be seen as Covid-19 cases seem to be rebounding in some places outside China, and there is more political tension too, weighing on external demand.

Our forecasts for China's GDP is currently at 0.7%YoY for the whole of 2020, which we are not changing now. We will probably not do so unless there are big improvements or deteriorations in external circulation that would change economic growth materially.

Source: https://think.ing.com/snaps/chinadomestic-demand-on-the-rise/

Question

1. (i) Compare the change in government debt as a percentage of GDP in China and UK from 2010 to 2015. (2)

(ii) Explain how the increase in government debt as a percentage of GDP in China leads to economic growth (8)

1. Based on table 3 and extract 5, it can be observed that the Chinese government is trying to shift the economy from an external-based economic growth model to a domestic economic growth model.
2. Account for the rationality for such a shift on the focus of sources of economic growth. (4)
3. Identify and evaluate the three key factors that determines the success of the shift in the economic shift or focus. (4)

( C) Identify and explain the factors that determines long-term economic growth of an economy. (12)