Script C – Paper 2

1a Vietnam's balance of trade in goods and services between 2009 and 2011 is having a deficit while from 2015 to 2017 is having a surplus.

1bi Relationship between the annual change in the balance of trade in goods and services and the real GDP growth should be positive. The higher the balance of trade on goods and services, the more GDP growth as there is more inflow of money that can lead to an appreciation of currency. Thus, higher national income.

1bii Relationship between the balance of trade in goods and services and real GDP growth is shown in Table 1.1. For example, in 2009, the balance of trade in goods and services is -188557 and the real GDP growth is 5.4 while in 2017, the balance of trade in goods and services is +140282 and the real GDP growth is 6.8. The balance of trade in goods and services increases with real GDP growth.

1c Vietnam experienced 'spectacular economic growth' because of the rising export revenue. With the implementation of supply-side policies, workers get to receive training that polishes up their skills in the method of production for better efficiency and more output produced.

1d Vietnam's increased exports will cause the exchange rate to increase. This is because there are more transactions in international trade. When the demand for Vietnam currency increases, appreciation of currency will occur. One Vietnamese currency unit can exchange for an extra unit of foreign currency. Therefore, a stronger currency can potentially lead to a lower import price which could contribute to lower demand-pull inflationary pressures in domestic countries. However, it may also increase the cost of domestically produced goods that rely on imported inputs, potentially leading to cost-push inflation.

1e Vietnam's economic miracle is known as the situation where its GDP has increased rapidly when the country is one of the poorest countries in Southeast Asia. Due to the weaker currency of the country, the demand of foreign buyers will be high as it is relatively cheaper for them. They can get more goods with the same amount of money. However, this will only last until the term of trade is more than 1. When the ratio index of export price is higher than import, it will cause an appreciation of currency so the internal value

of money will increase. Thus, consumers will have more disposable income and be able to afford imported goods that are relatively more expensive, causing an outflow of money. If there is more money produced by the central bank and import more than export, an 'economic miracle' will no longer exist.

3a Price elasticity of supply (PES) refers to the degree of responsiveness of quantity supplied to the changes in the price of a product. PES is important to help businesses to determine the optimal pricing strategy across their product portfolio. It can be calculated with the formula of the change in quantity divided by the change in price. If the PES value is more than one, it means that consumers are more responsive to price changes. Controversy, if the PES value is less than one, it is said to be inelastic, however, several factors can affect PES.

One of the primary factors affecting PES is the availability of inputs. When inputs are readily available and easily obtained, suppliers can quickly increase or decrease production levels in response to price changes. On the other hand, if the inputs are scarce or difficult to acquire, suppliers may face constraints in increasing production, leading to an inelastic supply. For example, the supply of agricultural products can be inelastic because resources to produce agricultural goods are difficult to obtain.

Moreover, the time period is another crucial factor affecting PES. In the short run, it is hard for suppliers to change the production levels significantly (inelastic) as it takes time for them to build up a robust system and brand loyalty. However, in the long run, suppliers can be more responsive to price changes (elastic) by making adjustments to the production capacities by investing in new technologies, expanding the operation, and specializing in the division of labour to increase efficiency and output.

In conclusion, the price elasticity of supply can be influenced by the availability of inputs, the nature of the product and the time period. Government should increase the number of producers, provide more training and education to the workers, and increase the spare capacity to make the supply of the product to be elastic.

3b In the modern economy, the government plays a very big role in maintaining an equilibrium in supply and demand to avoid fluctuations that will then lead to a shortage or surplus problem. Governments should ensure the supply of necessary goods like agricultural products meet the demand for consumers with the use of the price of elasticity of supply (PES). PES refers to the degree of responsiveness of quantity supplied

to price changes of the product. To make PES of all agricultural products more elastic, there are two government policies that can be implemented which are the subsidization and investment of agriculture infrastructure.

First and foremost, the government should subsidize farmers to lower the cost of production including the machine and equipment needed and labour wages. With that, farmers will have more funds to expand their business and perhaps export the goods to be involved in international trading. As a result, there will be more inflow of money which leads to an appreciation of the currency and real national income (GDP). Other than this, with the support of the government, the income of farmers is protected. Thus, this will encourage more profit-seeking firms to enter the market which increases the competitiveness. Firms will have to work harder to produce better quality agricultural products or carry out research to find a more productive way of producing the crops. This will eventually develop and improve the whole economy as it creates job opportunities that lower the unemployment rate. By reducing financial barriers and costs associated with agricultural production, subsidization encourages farmers to take risks, invest in their operations and increase the supply.

Secondly, the government should invest in agricultural infrastructure that can help improve efficiency and productivity. Traditionally, farmers often rely on manual labour and conventional techniques thus output level can be very dependent on factors such as weather conditions and the availability of labour. With the technology innovation, farmers can now use sensors, drones, satellite imagery and data analysis to measure soil moisture, nutrient levels and pest infestation. For example, smart irrigation systems deliver water directly to plant roots based on real-time moisture data, resulting in water savings and improved efficiency. This will increase the supply of the product.

In conclusion, government intervention is necessary to ensure the PES of all agricultural products is elastic. However, implementation of policies might arise other issues like budget deficit which occur when government spending is greater than government revenue. In other words, subsidization does not guarantee a return on investment (ROI) and also it might cause the supplier to be overly dependent on the support of the government. Thus, it is important for the government to consider which firm and to which extent the government should invest and subsidize.

5a Current account is the record of the total money outflow and the total money inflow of the country. The balance of payment consists current account, capital account and financial account. A high rate of inflation means the persistent raising of prices for a given time will cause various negative consequences that may be linked to the current account.

During high rates of inflation, the internal value of money decreases and thus erodes the purchasing power of consumers. Consumers have less real disposable income so they will tend to look for products or alternatives that are relatively cheaper. However, the cost of production increases as well as the export price due to inflation. This will make export less competitive which leads to a reduction in the inflow of money and depreciation of currency. In some cases, a weaker currency can make export relatively cheaper for foreign buyers and potentially stimulate export growth. Foreign buyers are able to get more goods with the same amount of money so the demand for our currency will increase. Therefore, inflation will not always cause a current account deficit.

In summary, high rates of inflation will cause a current account deficit if the country relies on imported goods for essential goods and services. High inflation in the country can make imports more expensive than exports and if export earnings do not compensate for the increased import costs, it will lead to a current account deficit. However, if the term of trade of the country is more than 1 which means the ratio between the index of export pieces is more than the index of import prices, a current account deficit will not occur. All in all, import dependence and export competitiveness is the key when it comes to inflation and current account deficit.

5b Inflation means a persistent raising of price for a given time while current account deficit refers to a situation whereby the total outflow of money is greater than the total inflow of money. Both situations can have significant implications for an economy.

For inflation, consumers will have less disposable income as the real value of money decreases. So, the demand for inferior goods will increase and the demand for normal goods will decrease, which will showcase a downgrade of standard of living. The decrease in purchasing power will discourage investors due to the unpredictable risk associated. This indicates the AD curve shifts downwards. Besides, exports will become less competitive as the cost of production including raw materials and labour wages increase. A decrease in export will cause a reduction in exchange rates which lead to the depreciation of the currency. Consumers will have to pay more in exchange for the same amount of goods. As a result, there is a risk of inflation that might possibly cause a current account deficit which occurs if the total outflow of money is greater than the total inflow of money.

With the current account deficit, the government will have less funds to subsidize firms so the cost of production will be high, making the export price to be less competitive in international trade. To survive the crisis, firms will usually lay off workers or cut their salaries or wages. This will cause an increase in the unemployment rate which leads to a decrease in real national income, GDP and output produced. Meanwhile, the tax revenue collected from the firms will decrease as the profit earnings decrease. Governments might encounter issues like budget deficits and have to bear the opportunity cost of having to use the funds to invest in other fields or provide direct provisions for social welfare. Instead, borrowing may increase due to some government spending that is unable to be cut down.

In conclusion, inflation and current account deficit can both be handled with either monetary policies or fiscal policies. Monetary policies increase the interest rate and reduce the money supply while fiscal policies reduce government spending and increase tax. It is important to consider the elasticity of imports and export for the effectiveness of the policies. The current account deficit can only be corrected if the sum of the elasticity of import and export is more than 1. All in all, the severity of each issue depends on a specific economic context and requires careful analysis by policymakers to implement appropriate measures for stabilization and sustainable economic growth.

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