Script D – Paper 2

1a Both 2009 to 2011 and 2015 to 2017 had a balance of trade improved. 2009 to 2011 had a balance of trade imports more than export but 2015 to 2017 had a balance of trade exports more than imports.

1bi When the balance of trade in goods and services is surplus, the real GDP growth rate will increase. This is because net export is one of the components in aggregate demand which will lead to increased economic growth.

1bii The relationship is evident in the data in Table 1.1 especially from the year 2012 to 2017. A surplus in the balance of trade will bring positive GDP growth, however, the relationship is not evident from 2009 to 2011 where a deficit in the balance of trade will also bring positive GDP growth.

1c Vietnam experienced "spectacular economic growth" due to the investment of physical capital in the form of infrastructure. This is because the investment in infrastructure will increase the country's productivity. Labours and firms are more convenient to move from one place to another place for working/business.

1d An increase in the demand for Vietnam's export will appreciate the exchange rate for the Vietnamese dong. This will make Vietnamese exports to become relatively more expensive compared to imports causing total revenue from exports to decrease and total expenditure on imports to increase. This would cause a fall in AD and lead to a fall in output/GDP. However, an increase in ER for Vietnamese dong will increase Vietnam's output/GDP. This is because Vietnamese firms would find that the imported raw materials have become cheaper, and this could help to reduce the cost of production causing an increase in AS and output/GDP. In conclusion, to justify whether the appreciation of ER will benefit the country has to depend on the PED of export and imports. It reduces the GDP of the country if the PED for exported goods is elastic, however, it will benefit the country if the PED for imported goods (raw material) are inelastic.

1e Vietnam's "economic miracle" will be able to persist over the next few years as Vietnam has moved towards trade liberalisation. More trade will happen between US and Vietnam. Free trade will increase Vietnam's productivity, shift its production possibility curve outward, and generate more economic growth in Vietnam. However, Vietnam's economic growth cannot be sustainable if Vietnam's economic growth is highly dependent on the US. This will put Vietnam at risk if the US stop importing goods and services from Vietnam or impose high tariffs on Vietnam's goods. In conclusion, the advantages outweigh the disadvantages, therefore, Vietnam's economic miracle is likely to persist over the next few years.

3a Price elasticity of supply measures the responsiveness of quantity supply due to the change in the price of the good itself. The formula for PES = $\%\Delta Qs / \%\Delta P$. The co-efficient of PES is positive because an increase in price is likely to increase the quantity supplied to the market.

The supply is price elastic if the changes in quantity supply are more than changes in price. However, the supply is price inelastic if the changes in quantity supply are lower than changes in price. For example, if the price increases by 5%, the quantity supplied will be increased by 10%, therefore, the price elasticity of supply is 2 (elastic).

A factor in determining the price elasticity of supply is the availability of resources. If the factors of production are easily found or substituted, then the supply will be elastic. However, if the factors of resources are highly specialized, then the supply will be inelastic. Another factor in determining the price elasticity of supply is the length of production. If a good takes a long time to produce, then its PES will be relatively inelastic. For example, the PES for aviation components will be inelastic as producing aircraft takes a long time. Therefore, the producers will not be able to change the quantity supplied for aircraft in the short run following changes in prices. However, if the goods take a relatively short time to produce, PES will be relatively elastic.

Availability of resources is more important than the length of production to determine the price elasticity of supply because if the resources are easy to be substituted or to be found, firms can produce the goods at any time they want. Producers still can't produce any good even though the length of production would be shorter. In conclusion, the availability of resources significantly influences the PES for manufacturing products but the length of production significantly influences the PES for agricultural products as climatic change always impacts agriculture supply.

3b The first government policy to make the PES of all agricultural products more elastic is to focus government spending to increase the spare capacity of the agricultural sector. This means that there will be more adequate space for producers to store their resources such as additional machinery, and fertilisers and to house their workers. This government policy ensures that agricultural producers will have a higher level of spare production capacity that will enable them to produce more agricultural products over a short period of time in order to increase the quantity supplied following changes in the price level. Focusing government spending on agricultural infrastructure can also help improve the quantity and quality of the factors of production that are used in the agricultural sector. For example, better infrastructure can mean better quality capital goods such as machinery and technology which can help boost the efficiency and speed of producing agricultural products, hence making its PES relatively elastic. However, this government policy will have an opportunity cost tied to it. It can be argued that the government spending used on the agricultural sector could have been better utilized in other sectors of the economy that are more essential such as the education sector or the healthcare sector. Not only that, the disadvantages include the government would have to raise a significant amount of tax revenue in order to provide subsidies to the farmers. Citizens may pay higher taxes to provide the money that a government uses for subsidies, hence reducing their standard of living.

The government can also implement a subsidy plan for the research and development of better technology and the training and education of agricultural workers. If the government subsidises, the research and development for the agricultural sector, this can lead to the development and innovation of new technologies that can help make the production process for agricultural products more efficient and shorten the length of production for various agricultural products. This decrease in length of production due to new technology innovation results in the PES for agricultural products to become more elastic as the producers are more able to quickly alter the quantity supplied following a change in the price. The additional worker training and education results in a more skilled labour force and a higher output per worker as they begin to become more efficient and skilled at their tasks. However, there can be problems with subsidizing research and development as there is always a time lag for new innovations, especially technology, to be made. It is not possible to gauge how long the agricultural sector needs to spend both time and resources on research and development in order for them to actually come up with new technology that can cause PES to become more elastic. There is not always a guarantee that research and development will lead to new innovations.

In conclusion, to determine which government policy is most likely to lead the PES of agricultural products to become elastic, we have to consider the time period. If the government wants to make agricultural product more elastic in supply in the long run, the subsidising of research and development is favourable. However, if the government wants to make agricultural product more elastic in supply in the short term then government spending on agricultural infrastructure will be more favourable.

5a A deficit in the current account of a country means that the value of a county's imports exceeds the value of its exports, and this causes the current account of a country to be negative. There are four components in the current account which include visible trade balance, invisible trade balance, primary incomes and secondary incomes. A high rate of inflation occurred when prices go up, money can't buy as much as it used to. This loss of purchasing power hurts everyone's standard of living. When inflation is high, consumers, businesses and investors are uncertain about what their costs will be from one day to the next.

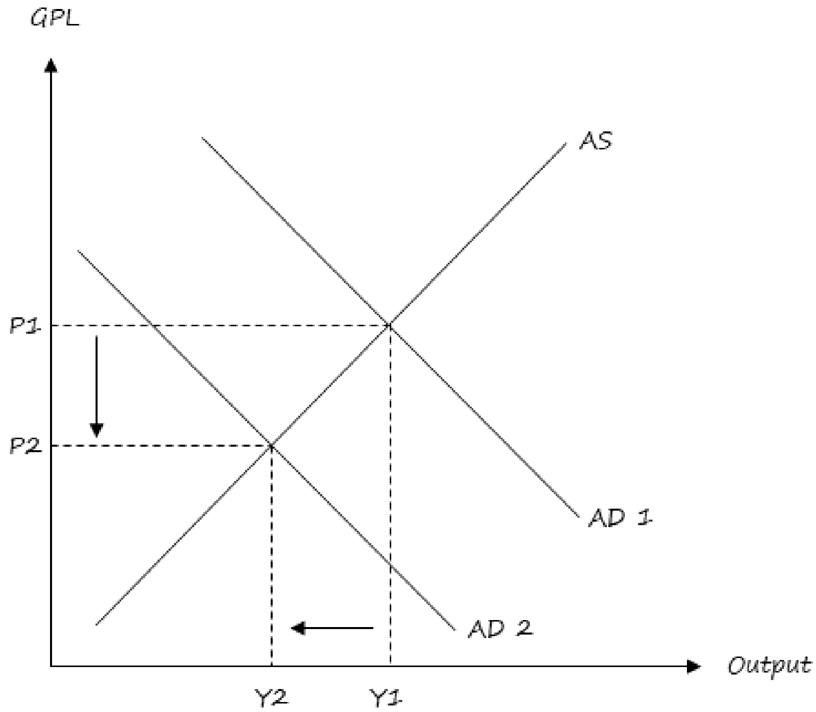
A high rate of inflation will cause a deficit on the current account of an economy if a country's inflation rate is so high that it is relatively higher compared to the inflation rate of other countries. This would cause exports to become relatively more expensive to imports (assuming exports and import are elastic). Therefore, it will lead to a fall in the demand for export and increase demand for import causing a fall in the country's current account and possibly causing it to be in a deficit.

However, there are instances where a high rate of inflation would not cause a deficit on the current account of a country. This would occur if the demand for a country's exports is price inelastic. This would mean that higher prices of a country's export from high inflation would only cause a small % change in the demand for that country's exports. A reason for this could be due to the country being known for having higher quality goods and services compared to other countries and thus foreign consumers are willing to pay higher prices for those higher quality goods.

5b Both a high inflation rate and a deficit in the current account of an economy are serious problems for an economy.

A high rate of inflation would reduce demand for domestically produced goods by domestic consumers. A high rate of inflation would make a country's goods and services become expensive compared to before and the lower-income consumers do not afford to buy more goods and services, especially the necessities. Their purchasing power is eroded and real income decrease, hence living standards reduce leading to greater poverty and inequality in society.

Not only that, a high rate of inflation reduces the country's international competitiveness. Since the exported goods become relatively more expensive than the imported goods, the balance of payment for the country will worsen if the demand for exported and imported goods is elastic in demand. When the demand for a country's exports reduces and imports increase, the aggregate demand for an economy will reduce as net export (x-m) is one of the components that influence the AD. This would then reduce the economic growth and employment level of a country.



On the other hand, a deficit in the current account of a country would mean that the value of imports exceeds the value of exports, and this could mean that a country relies too heavily on imported goods. A country running a large current account deficit is always at risk of seeing the value of the currency fall. If there are insufficient capital flows to finance the deficit, the exchange rate will fall to reflect the imbalance of foreign flows of funds. A depreciation in the exchange rate will cause imported inflation for consumers and firms who rely on imports of raw materials.

Not only that, a current account deficit is usually undesirable for an economy because such a deficit reflects a fall in net exports as well as the AD, indicating a fall in the real national income of the country. The profit of the domestic firms reduces due to the decrease in export revenue, this may lead to more domestic firms will be closed down and unemployment will be increased.

In conclusion, a high rate of inflation is a more serious problem than a deficit in the current account of a country because a high rate of inflation will negatively affect both the internal and external of the economy. Besides, a current account deficit is not always detrimental to the country's economy. In the case of a developing country, a deficit in the current account may be an indication that the country is industrializing and thus importing a great quantity of modern machinery. This helps to increase the productivity of the country and allows it to enjoy potential economic growth in the long run.