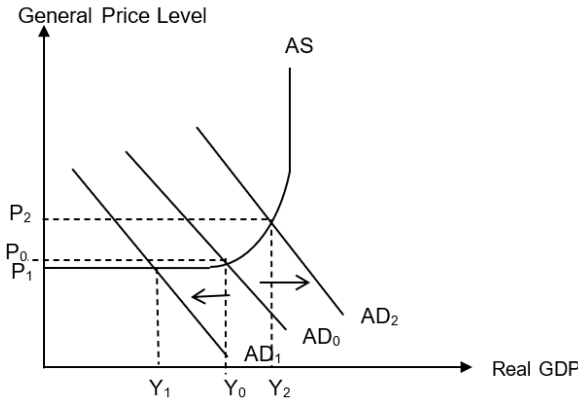


N2021 H1 CSQ 2 – Economic issues in Malaysia

(a)	(i)	Explain the meaning of 'real' in the term 'annual percentage change in real GDP'.	[2]
		Real GDP means that inflation has been accounted for [1m] and it refers to the change in total money value of all final goods and services produced within a country's geographical boundary during a period of time measured by actual change in the volume of output [1m].	
	(ii)	Using Table 1 and Table 2, identify the main features of Malaysia's economic growth performance, both over time and compared with the other given Asian economies.	[4]
		Overall, Malaysia registered positive economic growth from 2007 to 2018, except for the year 2009 when it experienced negative growth. [1m] However, although growth was positive, real GDP had increased at a decreasing rate from 6.3% to 4.7%. [1m] Based on Table 2, Malaysia's economic growth was forecasted to be higher than Thailand and the advanced economies in Asia, such as Japan, Korea and Singapore [1m], but lower than the other developing economies in Asia. [1m] OR Based on Table 2, Malaysia's economic growth rate was forecasted to slow down from 2018 to 2019, along with other Asian economies [1m], except for Indonesia where economic growth rate was expected to increase [1m]. In fact, Malaysia and Japan's economies were projected to fall in the most among the Asian economies.	
(b)		Using AD/AS analysis, explain how variations in consumption could cause variations in the levels of unemployment and inflation in Malaysia during the period 2008–2010.	[6]
		From 2008-2009, there was a rise in unemployment and a fall in inflation rate. This could be due to the conflict that exists between economic growth, employment and inflation. When consumption falls due to pessimistic outlook in the economy, there will be a fall in AD from AD_0 to AD_1 . This causes a rise in surplus or unplanned stock accumulations. Firms will produce lower output in the next period, causing production and real national output to fall from Y_0 to Y_1 . Derived demand for workers fall, resulting in a rise in demand deficient unemployment. The unplanned stock accumulation will cause producers to drive down prices in order to clear surpluses, leading to a fall in demand-pull inflation from P_0 to P_1 , as seen in the levels of unemployment and inflation in Table 1 during the period from 2008 to 2009.	

	 On the other hand, unemployment rate fell but inflation rate rose from 2009-2010. This could be due to an increase in consumption as a result of economy recovery that causes a rise in AD from AD_0 to AD_2. The resulting shortage and unplanned stock depletion incentivises producers to increase output and production in the next period. Real national income rises from Y_0 to Y_2 via the multiplier process, causing a rise in derived demand for workers during the period and demand-deficient unemployment fell as shown in Table 1. Furthermore, the shortage due to the rise in AD when economy is near full employment causes Malaysia to compete for factors of production which are increasingly scarce to carry on production. This increases cost of production and drives up prices which leads to an increase in demand-pull inflation from P_0 to P_2. 3m: Explanation of how a change in C affects AD, national output and demand deficient employment in both direction with clear adjustment process. 2m: Explanation of how a change in C affects demand-pull inflation in both direction with adjustment process. 1m: Clearly labelled diagram.	
(c)	Extract 7 states that Malaysia had a lower-than-forecast growth performance in 2018. Explain how supply-side policies could have been used to bring about a greater rate of growth in living standards in Malaysia after the relative slow-down of 2018.	[7]
	The relative slow-down of 2018 in Malaysia is primarily caused by a decrease in net exports where there was a ‘negative contribution from net exports.’ However, the slowing down of the economic growth from the decrease in net exports is mitigated by a rise in private consumption, investment and government spending (Ext 7) causing overall economic growth rate to fall from 5.9% to 4.7% in 2018. The Malaysia government may thus implement supply-side policies such as removal of existing tariffs on selected imports (trade liberalisation) (e.g. for key FOP) to reduce prices of imported factors of production. Cost of production falls for firms. Profitability and hence SRAS rises which causes real national income to increase. Part of the increase in real NY is due to net export rising when export competitiveness increases due to lower cost of producing exports. The purchasing power and ability to consume more goods and services rise, leading to an increase in current material	

	standard of living, assuming the population growth does not outstrip real GDP growth. In the long run, to increase productivity and factor quality, Malaysia can further educate its workforce with deep skills. Increase in productivity via investing heavily in human capital upgrades workers' skills which reduces cost of production due to the lower unit cost of labour input. With a rise in productivity due to education, it will increase productivity capacity. There will be a rightward shift of LRAS, that represents an increase in potential output of the economy. This increase in productivity capacity will ensure that the rise in AD can be accommodated without inflationary pressures. As there is a sustained increase in real national income, the quantity of goods and services available for consumption per person has increased, therefore allowing for a greater satisfaction of the needs and wants of the people, increasing future material standard of living for the average citizen if population growth does not outstrip real GDP growth. At the same time, the implementation of supply-side policies via education increases the literacy rate of the population, hence increasing non-material standard of living. In addition, improving productivity through skills training may allow workers to work shorter hours and have more leisure time to spend with family, thus raising their non-material SOL. Alternative: Another supply-side policy could be for the Malaysian government to give subsidies to encourage greater adoption of technology. With more utilisation of technology such as digitalisation and mechanisation in the production process, the country's productivity increases, lowering cost of production and SRAS rises, leading to a rise in short term actual economic growth and material SOL. At the same time, adoption of technology raises the productive capacity of the country, leading to a rise in full employment level of output and potential growth, bringing about a rise in material SOL in the future.	
(d)	Extract 6 suggests that a possible concern arising out of Malaysia's good economic prospects was that the ringgit 'would likely strengthen'. Discuss how a strengthening of the ringgit might result in 'undesirable short-term consequences', with particular reference to the standard of living in Malaysia.	[8]
	Strengthening of ringgit will result in an appreciation of the exchange rate. There will be an increase in the price of exports in foreign currency and a decrease in the price of imports in domestic currency. Assuming that the Marshall-Lerner condition holds, $sum\ of\ PED_x\ and\ PED_m > 1$, there will be a decrease in net exports which explains the 'undesirable short-term consequences on some sectors of the economy' such as those that focuses on exports. With a decrease in net exports, there will be a decrease in AD. The decrease in output leads to a decrease in income and sets off the reverse multiplier process whereby one man's spending creates another man's income. The initial decrease in AD leads to many successive rounds of reduction in induced consumption as households receiving lower incomes will spend a smaller portion of this income on domestically	

	produced goods and services. However, each round of induced C diminishes in magnitude as some of the reduction in household income is leaked out as taxes, savings and expenditure on imported goods and services. This process stops when the initial decrease in autonomous AD is equal to the sum of leakages. RNY decreases more than proportionately via the reverse multiplier, representing a multiple decrease in actual growth. Hence, there is a decrease in material standard of living. Moreover, there may be increase in stress level due to loss of income, affecting quality of life and hence decreasing non-material standard of living. However, with the appreciation, imported inflation may be reduced if the economy is heavily dependent on imports or in sectors that are reliant on imports of raw materials for production. When the price of imports decreases in domestic currency, it will lead to a lower cost of production due to cheaper imported factors of production. There will be an increase in profitability, thus leading to an increase in SRAS, bringing about lower GPL and an increase in real national income. This gives rise to an increase in material standard of living due to lower cost of living and real purchasing power rises. <u>Evaluation</u> In the short-term, strengthening of the ringgit may result in undesirable short-term consequences such as a fall in real national income due to direct loss of export competitiveness, but it could also reduce imported cost-push inflation. Hence, whether the impact of appreciation brings about more costs or benefits on standard of living due to fall in national income or impact on reducing imported inflation depends on how import reliant Malaysia is. If the country is heavily imported reliant, the fall in national income is limited as there will be a rise in real national income due to a fall in cost of production. <table border="1"> <tr> <td>L2</td><td>Two-sided thorough explanation of the cost and benefit of the strengthening of the ringgit on SOL.</td><td>4-6m</td></tr> <tr> <td>L1</td><td>One-sided explanation of the cost of the strengthening of the ringgit on SOL.</td><td>1-3m</td></tr> <tr> <td>EV</td><td>A further 2 marks to address whether the effect of strengthening of the ringgit might or might not result in 'undesirable short-term consequences' depending on a specific criteria.</td><td>2m</td></tr> </table>	L2	Two-sided thorough explanation of the cost and benefit of the strengthening of the ringgit on SOL.	4-6m	L1	One-sided explanation of the cost of the strengthening of the ringgit on SOL.	1-3m	EV	A further 2 marks to address whether the effect of strengthening of the ringgit might or might not result in 'undesirable short-term consequences' depending on a specific criteria.	2m	
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(e)	Using Figure 2 and Figure 3, comment on the perception in Extract 8 that 'the gap between the rich and the poor in their country (Malaysia) is getting wider and is a big problem'.	[8]									
	The Gini coefficient measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. Its value lies between 0 and 1. A Gini coefficient of zero reflects perfect equality, where every household has the same income. A Gini coefficient of one represents perfect inequality, where one household has all of the income and the rest have none. Thus, the greater the value of the Gini coefficient, the greater is the income inequality. R1: The perception is true And whether the problem is considered 'big', we would need to consider the Gini coefficient for income in selected ASEAN countries in Figure 3. In Figure 3, Malaysia Gini coefficient is ranked 3rd highest compared to the										

	rest of the ASEAN countries (9 countries). From this data, it can be inferred that Malaysia has a relatively larger income gap compared to the other countries. The income disparity could lead to sense of being left out in the country's economic growth and this dissatisfaction amongst the lower income group could lead to social unrest and reduce social cohesion. This can result in a general fall in the quality of living for all residents in Malaysia and have detrimental effects on the non-material SOL. R2: The perception is not true In Figure 2, Gini coefficient has decreased over time from 1970 to 2015. This illustrates that the gap between the rich and the poor in their country (Malaysia) is getting smaller and not wider. This could be a result of the lower income group of households in country experiencing a rise in their income due to better skills and being paid higher wages. It could also be a result of government policies implemented such as the progressive income tax where the higher income pays more taxes than lower income earners. The tax revenue which is collected from the higher income earner can be redistributed as subsidies to make healthcare, education and housing affordable to lower income family, thereby increasing income equity and reducing the Gini-coefficient. With higher income, there is an increase in the purchasing power for the lower income group and higher material SOL. Better access to necessity like education will also allow them to pursue their career aspirations and enhance their quality of life and non-material SOL. Hence, the perception in Extract 8 that 'the gap between the rich and the poor in their country (Malaysia) is getting wider and is a big problem is not true. <u>Comment</u> However, to assess whether if this is a big problem, we need to consider the limitations of Gini coefficient in Figure 3. The Gini coefficient in Figure 3 did not state explicitly whether if it is before taxes and transfers. Malaysia could have a lower Gini Coefficient compared to other countries if they have included the after taxes and transfer. Furthermore, the calculations do not reflect the full range of Government policy interventions that are unique to the Malaysia context, for example, heavily subsidised healthcare. If we were to include these subsidies, the Gini coefficient may be relatively lower and hence may not be a 'big' problem. All in all, the gap between the rich and the poor in Malaysia is not getting wider and may not be a big problem. In Extract 8, it is pointed out that only 0.61% of the Malaysian people are deemed to live below the national poverty line. This suggests that the percentage of Malaysian living below the poverty line is relatively low. Hence, it should not be constituted as a significant problem if the government focus more on targeted subsidies and scheme tilted towards supporting the lower income groups. 6m – Detailed explanation on the perception that the gap between the rich and the poor in Malaysia was getting wider and was a big problem with reference to Figure 2 and 3.	
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		2m – Further 2 marks for a valid and relevant comment considering that the gap between the rich and the poor in Malaysia was not getting wider and was not a big problem.	
(f)		Using material about Malaysia in the case to illustrate your answer, discuss the view that more inclusive but slower economic growth is preferable to growth that is at a higher rate but is less inclusive.	[10]
		R1: Benefits of inclusive but slower economic growth R2: costs of higher economic growth rate but less inclusive economic growth Inclusive economic growth indicates a rate of growth that is sustained over a period of time, is broad-based across economic sectors, and creates productive employment opportunities for the majority of the country's population. It takes income distribution into consideration and does not contribute to worsening income inequality. [R1 Benefits of more inclusive but slower economic growth] One of the benefits of inclusive growth is to reduce poverty and income inequality to increase material and non-material SOL. By ensuring broad based employment across all groups of people including the lower-skilled workers via training and retraining or upskilling, there will be a rise in income and purchasing power of the lower income group of people in the country, thus increasing material SOL of this group of lower income group of individuals. This reduces the 'serious financial hardship for those at the lower end of the income distribution' and 'those who live below the national poverty line' such that they can enjoy 'more nutrition, clothing and shelter' and material SOL rises. Ensuring inclusive growth will also reduce 'social unrest' due to productive employment of all groups of individuals in the society and reduction in unhappiness especially among the lower income group. Greater economic stability and peace in turn increase non-material SOL and quality of life and attracts more investments for future economic growth and employment. A larger group of skilled labour also allows for potential investors to be more willing to invest in the economy, which will eventually lead to more sustained growth (actual and potential growth). This could reduce the reliance on support scheme for low wage workers and hence the tax revenue could be used in other areas of development for the economy. However, the government could implement the progressive income tax system where higher income earners pay a higher marginal tax rates than the lower income earners to achieve inclusive growth. The rise in tax rates has a recessionary and deflationary impact on the economy where the rise in personal income tax rates reduces disposable income and purchasing power and thus consumption. The fall in AD and NY could result in slower economic growth and lower rates of inflation. And since the economy is unlikely to experience demand-pull inflation ensuring that cost of living is kept affordable and hence, benefitting those who are at the lower end of the income distribution. More inclusive but slower growth also allows for people in the economy to 'catch up', including those in sectors which may be neglected by strong growth. Thus despite the trade-off between inclusive and a rapid economic	

	growth rate that exist, there could still be benefits of striving for inclusive growth even if it is at the expense of achieving a rapid economic growth rate. [R2 Costs of higher economic growth but less inclusive growth] On the other hand, higher rates of economic growth as a result of a rise in production and output in sectors that do not hire the lower skilled and lower income group of worker could leave the latter group of individuals behind, resulting in less inclusive growth. Extract 6 states that “some sectors of the economy have not been benefitting from growth as much as others”, referring to sectors such as the agriculture industry which produces necessities. With higher economic growth rate, demand for these products rises less than proportionately and the workers in these industries do not enjoy a large increase in income and standard of living. In contrast to those in the ‘construction industry, owners of capital and high income earners’ who benefit from the high rate of economic growth due to the nature of their products being more luxurious. The rise in income, purchasing power and material SOL of those in these industries juxtapose against those in the lower skilled industries, results in higher income inequality and hence less inclusive growth. Thus, it is crucial for a big economy like Malaysia to consider growing at an appropriate rate to ensure workers in all sectors in the economy gain productive employment and higher wages for inclusive growth. This is especially so in the context of Malaysia where she has a high population who are in the primary industries. [EV of R1: Costs of more inclusive economic growth] On the other hand, less inclusive but higher economic growth may be preferred. Higher inclusivity may mean that people may be complacent and “there would be a serious lack of incentives to drive the increase in productivity which is the main engine of economic growth” (Extract 8). If productivity capacity falls or remains stagnant, output per unit of worker falls causing a rise in unit cost of production and fall in SRAS. This worsens price stability which may impact the lower income group. The fall in productivity leads to a fall in wages, coupled with the rise in inflation rate, real wage of workers fall, reducing purchasing power and worsening income inequality and further reducing inclusivity. [EV of R2: Benefits of higher economic growth] In addition, it is also important to focus on higher economic growth, especially when the country is developing and may require generating a pool of income and tax revenue. In this way, the government could use the tax revenue generated to redistribute to the lower income group. This would also help the poor break out from the vicious poverty cycle and have the means to meet basic material needs, for both low and high skilled groups of workers. [Summative conclusion -EV] All in all, inclusivity and economic growth are often related and could affect each other. Whether more inclusive but slower economic growth is preferable to growth that is at a higher rate but is less inclusive depends	
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	on the current situation of the economy or stage of economic growth and the government policies implemented. For example, if the country currently does not have a large income inequality, then they may want to focus on higher economic growth to reap the benefits and at the same time, generate tax revenues that could be used to support the lower income groups. For example, Malaysia's income equality situation is not severe (as shown in Figure 2 and 3), hence they may want to focus on higher economic growth while implementing measures such as transfer payments or continue to subsidise petrol cost to support the lower income groups and those in the primary industries such that they reap the benefits of both higher economic and inclusive growth. On the other hand, developed countries that have accumulated budget surplus and achieved a healthy level of SOL due consistent years of positive and rapid economic growth could consider to slow down their economic growth rate and pivot to inclusive growth such that they can fully reap the benefits of the latter. <table border="1"> <tr> <td>L3</td><td>A 2-sided answer that elaborates on the benefits of achieving more inclusive but slower economic growth AND costs of higher economic growth which is less inclusive.</td><td>5-7m</td></tr> <tr> <td>L2</td><td>An answer that elaborates on the benefits of achieving more inclusive but slower economic growth OR costs of higher economic growth which is less inclusive.</td><td>3-4m</td></tr> <tr> <td>L1</td><td>A vague, descriptive answer with gaps in explaining benefits or costs of inclusive and economic growth.</td><td>1-2m</td></tr> <tr> <td>EV</td><td>Up to a further 3 marks for a valid evaluative comment that considers which is a 'preferable' case.</td><td>1-3m</td></tr> </table>	L3	A 2-sided answer that elaborates on the benefits of achieving more inclusive but slower economic growth AND costs of higher economic growth which is less inclusive.	5-7m	L2	An answer that elaborates on the benefits of achieving more inclusive but slower economic growth OR costs of higher economic growth which is less inclusive.	3-4m	L1	A vague, descriptive answer with gaps in explaining benefits or costs of inclusive and economic growth.	1-2m	EV	Up to a further 3 marks for a valid evaluative comment that considers which is a 'preferable' case.	1-3m	
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