Internal Assessment – Economics

Commentary	1
Title of the article	Jute MSP hiked by 6%, move to benefit 4 million farmers
Source of the article	The Financial Express https://www.financialexpress.com/economy/jute-msp-hiked-by-6-move-to-benefit-4-million-farmers/3021694/ Date accessed: April 2, 2023
Date the article was published	March 25, 2023
Date the commentary was written	April 17, 2023
Word count of the commentary	771
Unit of the syllabus to which the article relates	Microeconomics
Key concept being used	Change

Article

Jute MSP hiked by 6%, move to benefit 4 million farmers

Centre and state governments procure 70% of the total production of jute goods for packaging of foodgrain.

The Cabinet Committee on Economic Affairs (CCEA) on Friday approved a 6% hike in minimum support price (MSP) for raw jute for the 2023-24 season to Rs 5,050/quintal compared to the previous season.

The hike is in line with the principle of fixing the MSP at a level of at least 1.5 times all-India weighted average of cost of production as announced in Budget 2018-19, Union minister for information and broadcasting Anurag Thakur said.

Thakur also said a hike in MSP of raw jute would ensure a return of 63.20% over the all-India weighted average cost of production. He said the hike would help 4 million farmers and 0.4 million workers associated with the jute industry.

The Jute Corporation of India will undertake price support operations when prices fall below MSP and the losses incurred, in such operations, will be fully reimbursed by the government, according to an official statement.

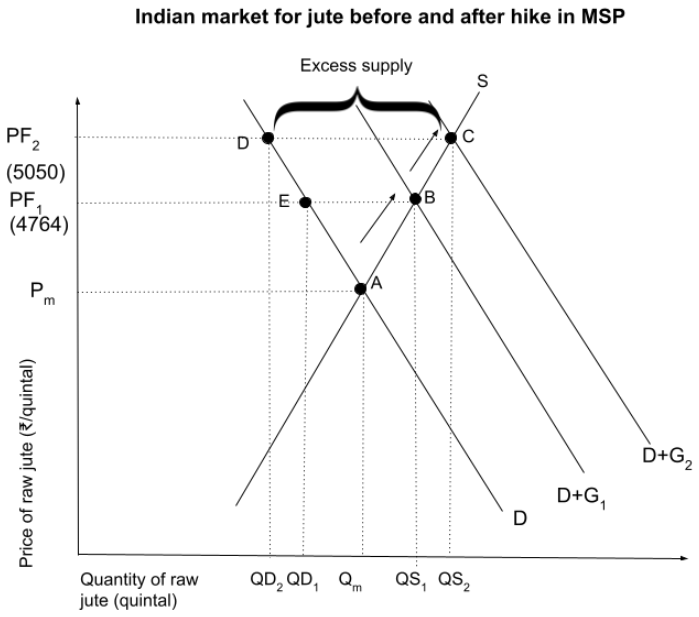
To boost the jute industry, the government has enacted the Jute Packaging Materials (for compulsory use in packaging commodities) Act, 1987, stipulating certain commodities to be packed in jute.

In the last few years, the government has kept reservations of 100% and 20% for food grains and sugar respectively to be packaged in jute bags. Centre and state governments procure 70% of the total production of jute goods for packaging of foodgrain.

Commentary

The government of India has increased the MSP (Minimum support price) for jute by 6%. The MSP is a price floor set by the government, placing a legal restriction on the price of jute so that it is sold at a minimum of ₹5050 per quintal even if the price determined by the market is lower. The government has hiked the MSP in order to help farmers with a stable price since they have unstable and low incomes. Setting the price of jute above equilibrium causes the supply of jute to exceed its demand, thus causing market failure, deadweight loss and overallocation of resources. The government and consumers are negatively impacted by the change. The key concept of **change** is especially prevalent here since the government has responded to changes in the economy by hiking the MSP.

Diagram 1 (self made)



$$Pf_1 + 6\% \times Pf_1 = Pf_2 \Rightarrow Pf_1 = \frac{Pf_2}{1 + 0.06} = \frac{5050}{1.06} \approx 4764$$

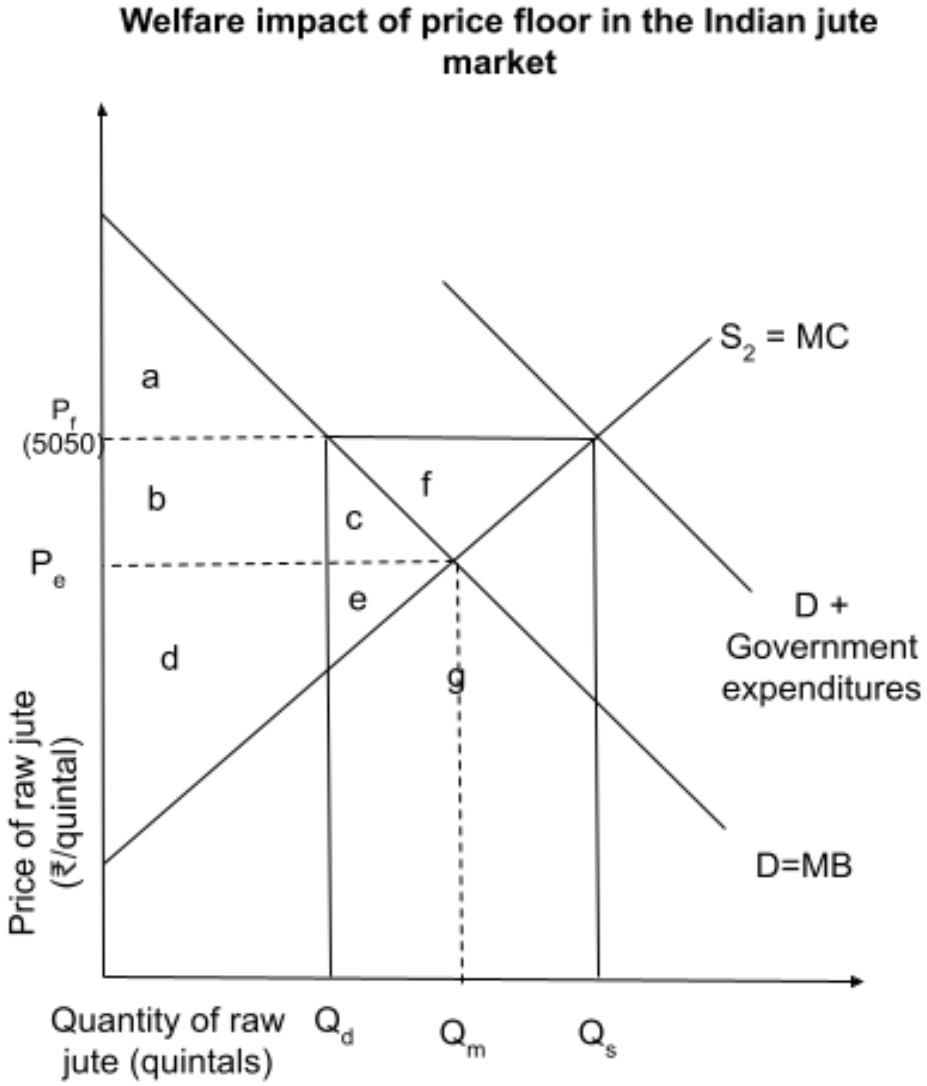
Before the increase in price floor, the economy was producing at point B, with price PF_1, quantity produced QS_1, and quantity demanded QD_1. Because of the disequilibrium, there was an excess supply of QS_1 - QD_1. This excess supply was bought by the government, indicated by the demand curve shifting rightward to $D+G_1$ so that it intersects with the supply curve. As mentioned in the article, the price floor was hiked to keep it above 1.5 times the cost of production. Observing the constant **changes** in the market and economy, such as an increase in cost of production (which could be due to inflation) the government increased the price floor from PF_1 to PF_2. This is because an increase in cost of production would decrease supply and reduce farmer income, thus requiring a hike in the price floor.

After the hike in MSP, quantity demanded fell from QD_1 to QD_2 and quantity supplied increased from QS_1 to QS_2, because of the laws of demand and supply respectively. This results in an increase in the excess supply (QS_2 - QD_2 > QS_1 - QD_1), hence requiring more government expenditure to buy the extra surplus. This is indicated by demand curve shifting from $D+G_1$ to $D+G_2$ where extra jute is being bought by the government.

The PED and PES of jute is low (indicated by the steep supply and demand curves). The lack of cost-effective substitutes and the necessity of jute bags in storing agricultural produce gives Jute a low PED. The PES is low in the short run because of fixed factors of production such as land. This results in enormous price instability when demand changes. The government has hence decided to

use a price floor to mitigate the turbulent **changes** in the price of jute and to give farmers a stable and high price.

Diagram 2 (self made)



Because of the disequilibrium, allocative inefficiency is achieved. Without the price floor, the price mechanism would decide on a price such that the benefit gained by consuming an additional quintal of jute would equal the cost needed to produce an additional quintal. However, with the

price floor in place there is an overallocation of resources, since the marginal cost of producing another quintal of jute is greater than the marginal benefit gained from that production (MC>MB at P_f).

The consumer surplus decreases from a+b+c to a, hence we can see that the policy impacts consumers of jute negatively. The increased price will negatively impact lower-income consumers of jute such as farmers using it to transport crops. Moreover, an increase in price might cause consumers to switch to less environmentally friendly goods such as plastic bags. The producers will be better off since producer surplus goes up to d+e+b+c+f from d+e.

The government expenditure is equal to the rectangle with area f+c+e+g, hence there will be a burden on the government budget. The expenditure has an opportunity cost of developing infrastructure, healthcare, education, etc. instead. There is a deadweight loss created by the policy of g+e+c, which is a loss to society because of market inefficiency and disequilibrium. According to the article, the excess supply is used by the government for packaging of foodgrain which is essential for food security in India in case of drought or other calamities. While the theory refers to this as "deadweight loss", in practice there is no difference between production and consumption hence no deadweight loss present since the jute is being used productively by the government.

Overall, this policy benefits farmers by providing them with a stable and high income isolated from sudden **changes** in the market. However, consumers, society and consumers are worse off due to the allocative inefficiency and deadweight loss caused by the price floor. Moreover, the government needs to spend a larger chunk of their budget on buying excess jute.

Internal Assessment – Economics

Commentary	2
Title of the article	China consumer prices were unexpectedly flat, as economic recovery remains fragile
Source of the article	https://www.cnbc.com/2023/10/13/china-economy-september-cpi-unexpectedly-flat.html Date accessed: October 27, 2023
Date the article was published	October 12, 2023
Date the commentary was written	November 7, 2023
Word count of the commentary	775
Unit of the syllabus to which the article relates	Macroeconomics
Key concept being used	Intervention

China consumer prices were unexpectedly flat, as economic recovery remains fragile

Clement Tan

China's consumer prices were flat in September, while factory gate prices saw annual declines slow for a third month — pointing to the uneven post-Covid recovery in the world's second-largest economy that may require further policy support.

Consumer price index for September was flat on an annual basis, the National Bureau of Statistics reported Friday, below than the median estimate for a 0.2% increase in a Reuters poll. CPI inched up 0.1% in August for the first year-on-year increase in three months.

Core inflation — excluding energy and food prices — however, climbed 0.8% in September from a year earlier, the bureau said in a separate statement. This rate of increase was similar to the one recorded in August.

China's producer price index fell 2.5% from a year earlier, weaker than expectations for a 2.4% decline, after a 3% drop in August. The drop in factory prices, though, was the smallest in seven months.

Tepid prices underscore what China's top leaders labeled as a "tortuous" economic recovery after the country emerged from its draconian zero Covid curbs toward the end of last year. China stands as a stark outlier among the world's major economies that are mostly still battling stubbornly high inflation after the Covid-19 pandemic peaked.

Friday's inflation print may reignite fears that China is tethering on the verge of deflation. Despite narrowing producer prices in September, the decline is still its 12th straight monthly drop on an annualized basis.

"CPI inflation at zero indicates the deflationary pressure in China is still a real risk to the economy," said Zhiwei Zhang, president and chief economist at Pinpoint Asset Management.

"The recovery of domestic demand is not strong, without a significant boost from fiscal support. The damage from the property sector slowdown on consumer confidence continue[s] to weigh on household demand," he added.

Beijing has been rather targeted in its policy support even as rafts of economic data suggested growth remains sluggish. An ongoing debt crisis in two of China's largest real estate developers has further dented consumer confidence.

Weaker food prices

Weaker food prices were a big drag on September's consumer prices, though China's National Bureau of Statistics said this was due to high food prices last year.

On Friday, official data showed China food prices collectively fell 3.2% in September from a year earlier.

In particular, the price of pork — a key staple meat in Chinese diets — tumbled 22% last month from a year ago. That's as the price of livestock and meat collectively dropped 12.8% and the price of fresh vegetables fell 6.4%.
Services inflation was at a 19-month high of 1.3%, Capital Economics said.

"This suggests that China's low inflation rate is not primarily due to domestic weakness," the firm's Zichun Huang said in a note. "Instead, it appears to be related to excess capacity in industry as the pandemic boom in global goods demand has reversed.

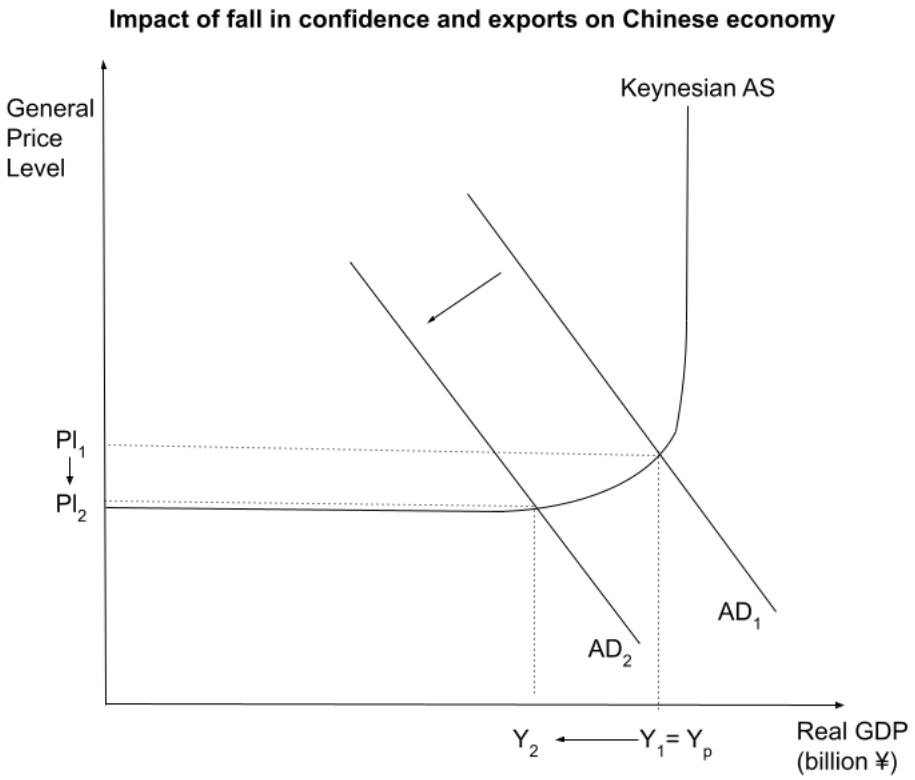
Core goods inflation remained subdued at 0.3% year-on-year, Huang noted.

Month-on-month, consumer prices edged up 0.2% in September, with food prices increasing 0.3% — representing a decrease of 0.2 percentage points from August's print compared to the previous month.
"The market supply is relatively sufficient before the Mid-Autumn Festival and National Day this year, and the food price increase is slightly lower than the historical average for the same period," said Dong Lijuan, chief statistician of the Urban Department of the National Bureau of Statistics, in a statement.
China's Mid-Autumn Festival and National Day were in early October this year.

Commentary

China is on the verge of deflation (sustained decrease of general price level), with China's CPI (consumer price index) remaining constant this year. Government **intervention** in the form of expansionary fiscal policy has been recommended to increase aggregate demand and reduce the risk of deflation.

Diagram 1 (Self-made)

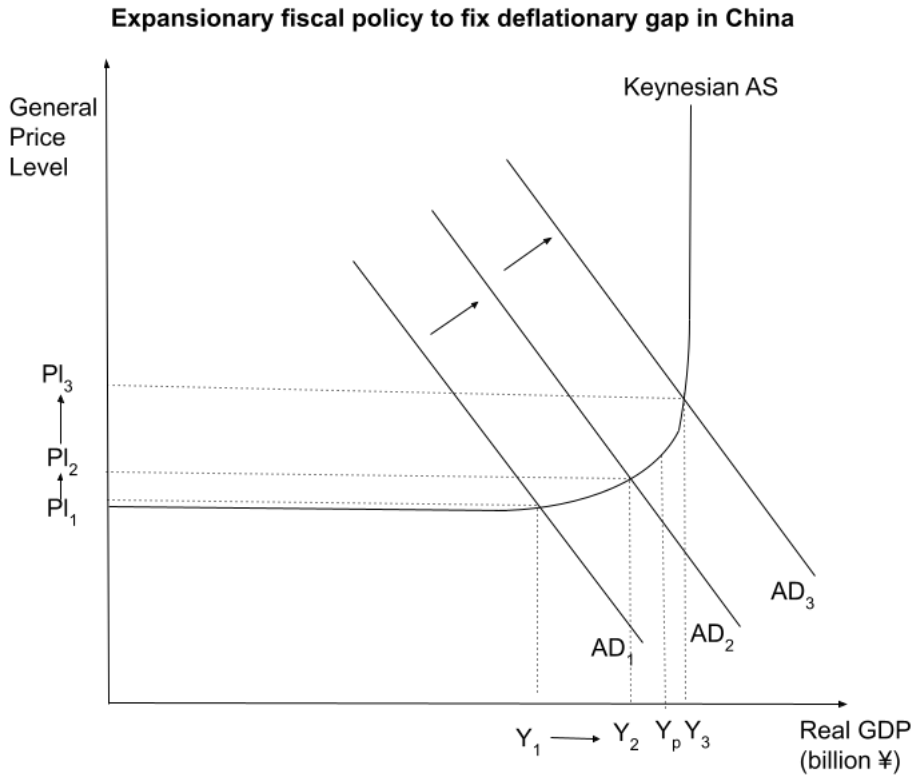


Initially, China was near its potential output Y_p and had a price level Pl_1. The "draconian zero Covid curbs" taken by the government reduced consumer and investor confidence (reducing the C+I component of AD), resulting in the AD curve shifting from AD_1 to AD_2, real GDP falling from

Y_p to Y_2 and prices falling from Pl_1 and Pl_2. Despite COVID curbs being lifted, AD has not recovered back to its original level because confidence has not been restored. This has the consequence of price levels remaining almost constant at Pl_2 instead of increasing at a low and stable rate. Moreover, this keeps China's GDP below its potential output, leading to unemployment of labor and capital and "excess capacity in industry".

As the yearly inflation rate nears zero, China runs the risk of entering deflation. A decrease in price level could encourage consumers and investors to save until prices drop further, which could further reduce AD, leading to a vicious cycle and putting China in a deflationary spiral. Moreover, as the real value of debt increases because the same nominal amount is worth more, this could lead to bankruptcies of firms and banks and lead to an unrecoverable financial crisis. As the economy shows few signs of adjusting automatically without **intervention**, the use of expansionary fiscal policy could increase output and employment, but more importantly to prevent China from entering deflation.

Diagram 2 (Self-made)



Policies such as tax cuts could increase disposable income for consumers increasing the C component of AD. Policies to increase government expenditure could increase aggregate demand directly. These policies could place the economy closer to its full employment level of output Y_p from its current level of output Y_1 by shifting the AD curve from AD_1 to AD_2 as shown in Diagram 2. This policy could also put upward pressure on the price level by increasing it from Pl_1 to Pl_2, eliminating the risk of deflation.

However, this policy also has numerous drawbacks. **Intervention** in the form of tax cuts could also become ineffective once deflation sets in, because of people getting used to the fall in price

level and delaying spending. Hence, policies that increase government expenditure might be more effective.

Another drawback is that unlike monetary policy, fiscal policy cannot be fine-tuned and has large time lags so it could lead to an inflationary gap in the future with price levels increasing drastically to Pl_3, as was the case with most economies battling "stubbornly high inflation after the Covid-19 pandemic". This is because of the multiplier effect: an increase in government spending could lead to extra income for workers that demand more goods and services, increasing AD further from AD_2 to AD_3. Hence, fiscal policy should be accompanied by monetary policy, which has short time lags and can be easily fine-tuned, to ensure **intervention** by the government is suitable for the ongoing problems with the economy and isn't too excessive. Moreover, expansionary fiscal policy could necessitate lower revenue and increased spending, requiring the government to borrow, increasing China's debt-to-GDP ratio.

Low domestic demand may not be the only reason for a slow recovery. Services inflation is at 1.3% indicating a recovery of demand in the service sector. Instead, the article suggests that stagnant prices and demand is because of a fall in foreign demand for manufactured goods, reducing net exports and AD. Moreover, the CPI has also been affected by a sharp fall in food prices, especially pork, which could be due to supply-side factors instead of demand-side ones. This can be demonstrated by core rate of inflation (which excludes prices of energy and food) being 0.8%, significantly higher than the headline rate which is near zero. These factors suggest that the risk of China entering deflation might not be as high, and consumer confidence might be slowly increasing but not being reflected by a rising price level due to temporary supply-side

shocks and a fall in foreign demand. Hence, **intervention** must be planned keeping these factors in mind and not overspending by underestimating current domestic demand.

In conclusion, **intervention** in the form of expansionary fiscal policy could be effective in battling China's economic slowdown by stimulating demand and improving consumer confidence, as well as reducing the risk of China entering deflation. However, the government should keep in mind inaccuracies with the CPI figures, time lags and debt issues while doing so and complement fiscal with monetary policy.

Internal Assessment – Economics

Commentary	3
Title of the article	**GCC-South Korea sign free trade deal in boost to Gulf-Asia economic ties**
Source of the article	https://www.reuters.com/world/middle-east/gulf-cooperation-council-signs-free-trade-agreement-with-south-korea-gcc-2023-12-28/ **Date accessed: January 25, 2024**
Date the article was published	**December 28, 2023**
Date the commentary was written	**January 29, 2024**
Word count of the commentary	**797**
Unit of the syllabus to which the article relates	**The Global Economy**
Key concept being used	**Interdependence**

GCC-South Korea sign free trade deal in boost to Gulf-Asia economic ties

By Rachna Uppal and Ahmed Elimam

The Gulf Cooperation Council (GCC) signed a free trade agreement with South Korea on Thursday, its second trade deal this year, as the six-member bloc intensifies efforts to boost investment ties with major economic partners in Asia.

South Korea will remove tariffs on almost 90% of all items, including liquefied natural gas (LNG), and other petroleum products, according to South Korea's Yonhap news agency, while the Gulf states will scrap tariffs on 76.4% of traded products and 4% of traded goods.

The FTA will also cover trade in goods, services, government procurement, as well as cooperation among small and medium-sized enterprises (SMEs), customs procedures, intellectual property, among others, a GCC statement said.

The GCC has signed few FTAs due to the complications of navigating competing priorities within the bloc, and talks such as those with China, which began in 2004, can take years.

Trade talks have, however, gathered momentum as Gulf states - largely dependent on oil and gas for revenue - seek to diversify their economies and develop new sources of income.

Trade between the Gulf and South Korea jumped to $78 billion from $50 billion between 2021 and 2022, according to data from London-based think tank Asia House, while the bloc's trade with emerging Asia, which includes China, surged to $516 billion last year from $383 billion in 2021.

The GCC-South Korea talks, which began in 2007, were put on hold for almost 13 years before being revived last year.

GCC Secretary General Jasem al-Budaiwi, in the statement, called the agreement "a historic step towards achieving Gulf economic integration and towards strengthening economic and trade relations between the two sides".

South Korea's Trade Minister Ahn Duk-geun also welcomed the deal, saying it would "maximise synergy effects between trade, industry and energy".

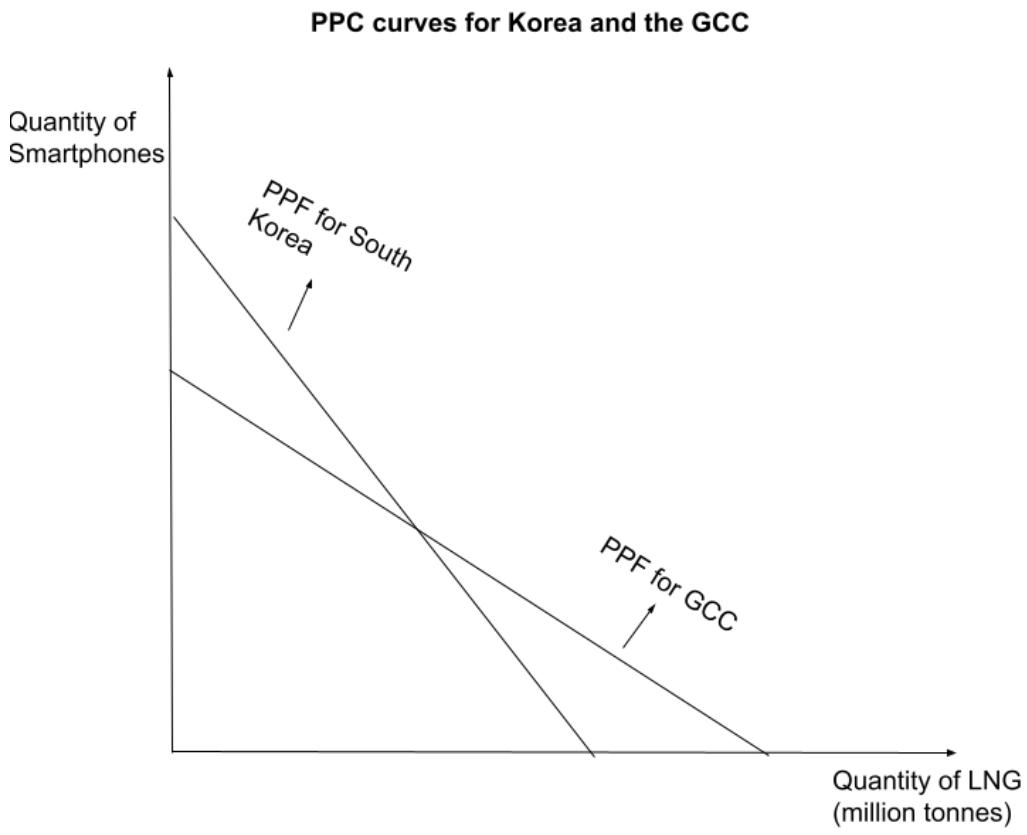
Earlier this year, the GCC - comprising Saudi Arabia, United Arab Emirates, Qatar, Kuwait, Oman and Bahrain - signed a free trade agreement with Pakistan, advanced negotiations with China, and restarted talks with Japan. FTA talks with Britain are also underway.

The UAE has also initiated a raft of bilateral trade deals since 2021, part of a strategy to advance its economic and political priorities amid growing regional competition, particularly with Saudi Arabia. In October, the UAE and South Korea concluded negotiations for a bilateral trade agreement.

Commentary

This article discusses a free trade agreement signed between the regional trading bloc GCC (Gulf Cooperation Council) and the country of South Korea. This FTA will result in tariffs being removed on 90% of all items imported by South Korea (largely petroleum) and 76.4% of all items imported by GCC (largely finished products). This move was made to increase economic **interdependence** between South Korea and the Gulf States, "[maximising] synergy effects between trade, industry and energy".

Diagram 1 (Self-made)



Removing barriers between South Korea and GCC would result in free trade between the countries, with each country producing according to its advantage for mutual benefit. In Diagram 1, South

Korea has both a comparative (steeper slope) and absolute (higher y-intercept) advantage in producing smartphones due to the factor endowment of capital, while the GCC shows similar advantages in producing LNG due to the factor endowment of land. Hence, free trade would result in an optimum allocation of resources towards efficient producers, allow both countries to consume outside their PPC, and provide bigger export markets for both Korea and GCC, increasing their **interdependence**.

Diagram 2 (Self-made)

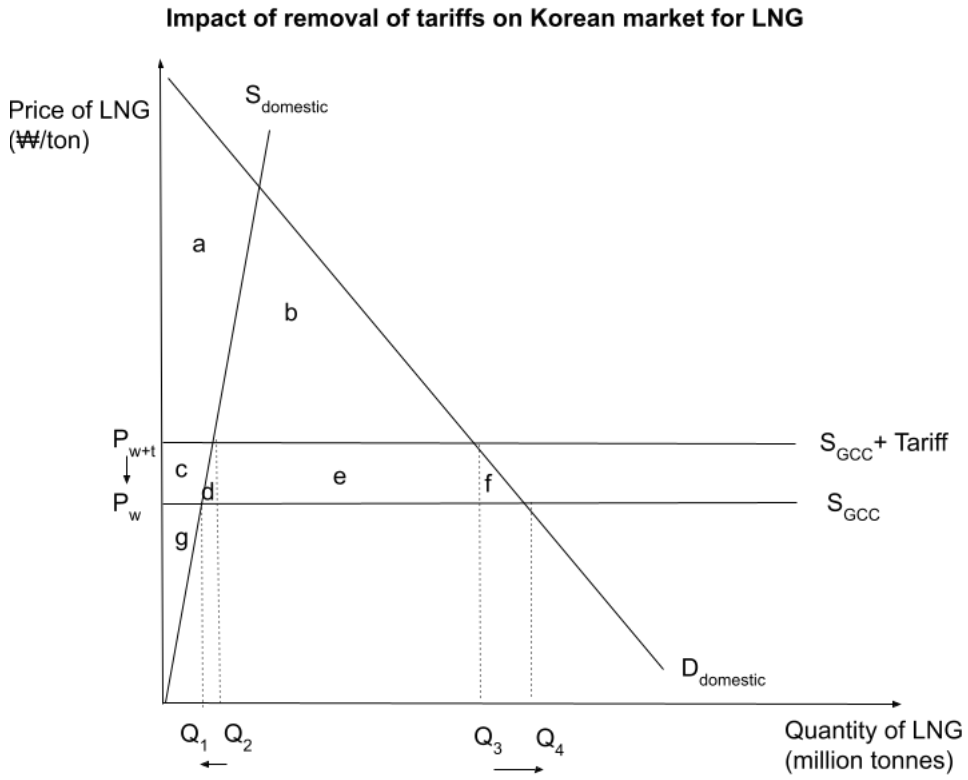
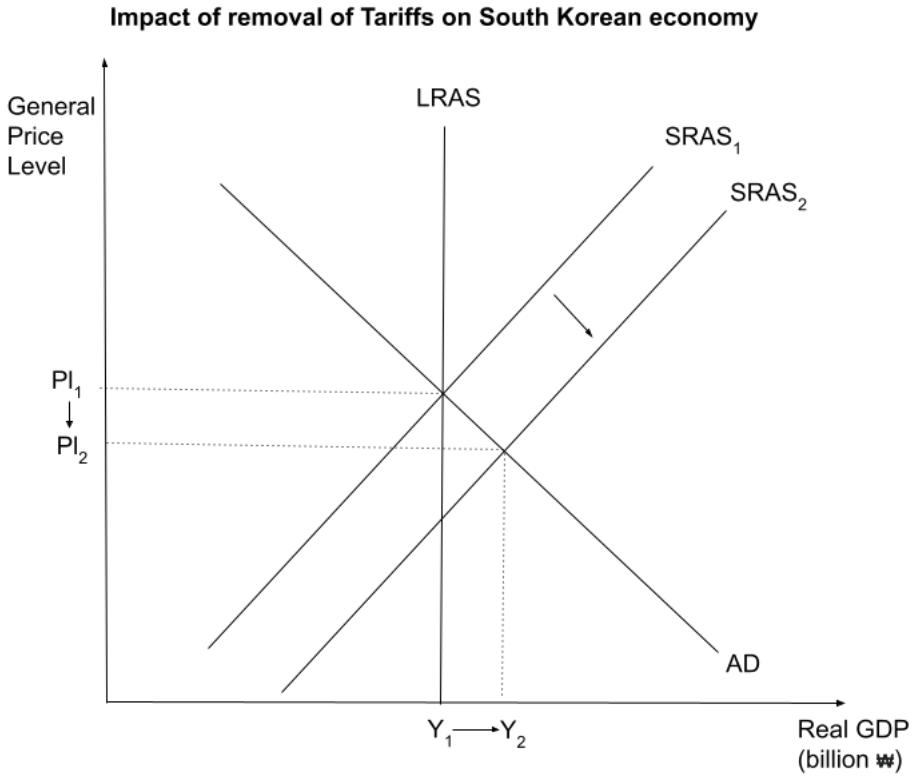


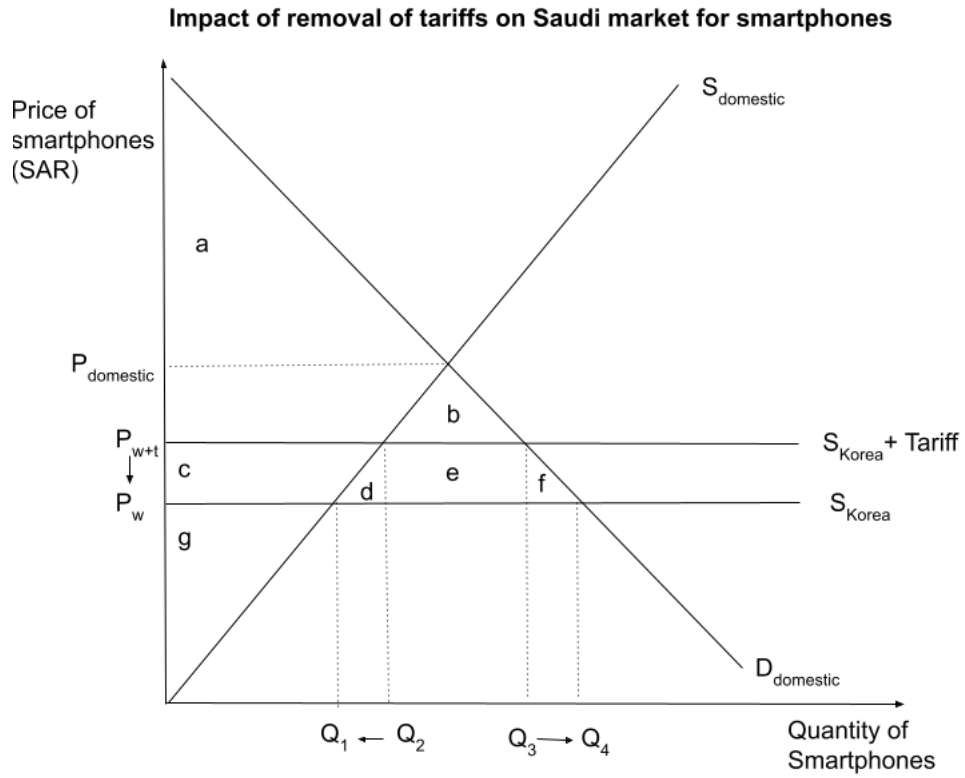
Diagram 3 (Self-made)



Korea removing the tariff on LNG (as well as other goods) will result in the price falling from P_{w+t} to the world price P_w as shown in Diagram 2. At this price, there will be an increase in the quantity of Gulf LNG imported from Q_3-Q_2 to Q_4-Q_1. Consumers benefit since consumer surplus increases by c+d+e+f due to the lower price, but the government loses revenue of e, which could have been used to improve education, healthcare, infrastructure, etc. Domestic producers also lose out, but this is unlikely to be a major concern for Korea as they likely don't have any major domestic industries for petroleum products due to unfavourable factor endowments, showing their **dependence** on the Gulf countries. This is represented by the inelastic supply curve, loss in producer surplus of the comparatively small area c and the tiny decrease in domestic supply of Q_2-Q_1 following the removal of the tariff. Furthermore, a reduction in the price of fuel will reduce

inflationary pressures in Korea by reducing production costs for firms, shifting SRAS from $SRAS_1$ to $SRAS_2$ and reducing the price level from Pl_1 to Pl_2 as shown in Diagram 3.

Diagram 4 (Self-made)



The article mentions that Gulf states will be removing their tariffs on finished products imported from South Korea. This is shown in Diagram 4 (taking the example of GCC member Saudi Arabia), which shows the price of smartphones decreasing from P_{w+t} to P_w, the quantity imported from Korea increasing by Q_4-Q_3+Q_2-Q_1, Saudi consumers being better off with a gain in welfare of c+d+e+f and the Saudi government losing revenue worth e. Overall, there will be allocative efficiency as inefficient Saudi producers are replaced by efficient Korean ones. Domestic producers in this infant industry, however, will be outcompeted by the low prices offered by more efficient Korean firms losing area c. This increased **dependence** on imports from Korea as well as the increase in foreign demand for petrol could hurt the diversification attempts of the Gulf economies that are over reliant on unsustainable exports of oil and gas for revenue. The lifting of trade barriers,

therefore, is likely to benefit Korea more than the Gulf states because the Gulf states have a much greater need for (to promote a sustainable future) and ability to diversify into the secondary sector than Korea diversifying into producing LNG.

The article suggests that this Free Trade Agreement could have a positive impact on the diversification of Gulf economies as well. This is because Gulf firms might remain inefficient under protectionist *import substitution* policies and would face high production costs due to the expensive import of inputs and capital from Korea. The free trade agreement then, with *export promotion* policies instead, might be a better way to promote infant industries and diversification by reducing prices of essential inputs from Korea required by manufacturing and service industries. The free trade agreement is also likely to increase Foreign Direct Investment into the Gulf states with Korean firms preferring to invest in a country with closer economic ties, increasing the **interdependence** of Korea and GCC. An increase in FDI would also allow Gulf countries to expand into the secondary and tertiary sectors as foreign firms build factories and train labour.

The FTA could also introduce tensions within the GCC trading block with some countries benefiting more, with the article mentioning "complications of navigating priorities". Moreover, the GCC is likely disadvantaged in the agreement due to the stronger bargaining power of developed countries in bilateral agreements.

In conclusion, the free trade agreement between the GCC and South Korea increases their **interdependence,** which has both positive and negative consequences for the respective economies and the global economy.