

INNOVA JUNIOR COLLEGE JC 2 PRELIMINARY EXAMINATION 2 in preparation for General Certificate of Education Advanced Level **Higher 1** 

# ECONOMICS

# 8819/01

Paper 1

17 September 2013

3 hours

Additional Materials: Writing Paper and Cover Page

# READ THESE INSTRUCTIONS FIRST

Write your name and class on all the work you hand in. Write in dark blue or black pen on both sides of the paper. You may use a soft pencil for any diagrams, graphs or rough working. Do not use staples, paper clips, highlighters, glue or correction fluid/tape.

# Section A: Case Study

Answer **all** questions.

# Section B: Essays

Answer one out of two questions.

At the end of the examination, fasten all your work securely together.

You are to submit your answers for Section A and Section B separately.

The number of marks is given in brackets [] at the end of each question or part question. You are advised to spend several minutes reading through the data before you begin writing your answers.

This document consists of **9** printed pages and **1** blank page.

You are reminded of the need for good English and clear presentation in your answers.



#### **Section A**

Answer **all** questions in this section.

### **Question 1** Rare Earths Market

Rare earths are a group of 17 chemical elements that are used widely in hightechnology and clean-energy products because they impart special properties of magnetism, luminescence, and strength. Some of these products include magnets, lasers, nuclear reactors, plasma TVs, energy-saving light bulbs, wind turbines, hybrid cars and even guided missiles.

#### Extract 1: Rare earths prices

The demand for rare-earths is rising rapidly as they are increasingly being used in a wide range of high-technology products. Production of wind turbines is expected to climb sharply amid the clamour for cleaner energy alternatives that reduce dependence on fossil fuels blamed for global climate change.

China, supplier of 95% of the 17 elements known as rare earths, has shut-down many of its rare earths mining sites and cut its export quotas of rare earths. The government may further reduce export quotas.

Hitachi Metals Ltd, which uses rare earths to make magnets used in hybrid cars, said that it has become increasingly difficult to procure rare earths. Toshinori Hata, a spokesman for Hitachi Metals, said that the company would have no choice but to pass on some of its costs to the consumers.

Adapted from Bloomberg, 17 June 2011



Figure 1: Rare Earths Price Index: 2002 – 2010

### Extract 2: The Chinese consolidate the industry

Beijing authorities are creating a single government-controlled monopoly, Bao Gang Rare Earth, to mine and process ore in northern China, the region that accounts for two-thirds of China's output. The government is ordering 31 mostly private rare earths processing companies to close this year in that region and is forcing four other companies into mergers with Bao Gang.

Chinese officials say that the government is worried about the external costs from the rare earths industry such as polluted water, polluted air and radioactive residues, particularly among many small and private companies, some of which operate without the proper licenses. While rare earths themselves are not radioactive, they are always found in ore containing radioactive thorium and require careful handling and processing to avoid contaminating the environment.

Rare earths ore has to be refined before it can be used commercially. The waste generated from this process is both acidic and radioactive. The refining process leaves behind a radioactive sludge laced with toxic chemical compounds that is stored in artificial lakes. Due to lax regulations, this radioactive waste material often seeps into the water supply, adversely affecting the health of residents in the area.

Adapted from The New York Times, 15 September 2011

# Extract 3: The Chinese government steps-up regulation on the rare earth industry

The local governments of three regions where most of China's light rare earths metals exist will jointly crack down on the illegal exploration and production of light rare earths, the Ministry of Land and Resources said in a statement on its website. The operation aims to "promote the protection and rational development of the country's rare earths resources and further regulate their production," said the ministry.

The country has stopped issuing new licenses for rare earths mining. It has also imposed production caps, enforced export quotas and announced tougher environmental standards for rare earths production in order to control environmental damage and protect the resources. The taxes and quotas China had in place to restrict rare earths exports caused many companies to move their factories to China from the United States and Europe so that they could secure a reliable and inexpensive source of raw materials.

Earlier this year, the government released a statement announcing that it would impose a tax on rare earths minerals. According to the statement released, the tax rate of mined light rare earths would be 60 yuan (US\$ 9.1) per tonne, while that of medium and heavy rare earths would be set at 30 yuan (US\$ 4.5) per tonne. The government will use the tax to support research on rare earths processing, set up environmental compensation funds and build rare earths reserves.

Adapted from China Daily, 27 September 2011

# Extract 4: Will China continue to dominate the rare earths market?

China has only 37% of the world's proven rare earths reserves but accounts for 95% of global production. This is not only due to the country's good geographical location but also its willingness to do dirty, toxic and often radioactive work that the rest of the world has long shunned.

Even so, the costs of mineral extraction are increasing because of lower ore grades and increasing capital costs. China's costs of production are likely to rise as environmental and social costs and the potential for rising labor costs begin to be incorporated into China's rare earths production and processing operations. China would likely be unable to increase production significantly to drive prices down.

While limited production and processing capacity for rare earths currently exists elsewhere in the world, additional capacity is expected to be developed in the United States, Australia, and Canada within two to five years, according to some experts. 34 Chinese producers are also seeking to expand their production capacity or seek long-term supply agreements in areas around the world, particularly in Africa and Australia. There are only a few exploration companies that develop the resource, and because of long lead times needed from discovery to refined elements, supply constraints are likely in the short term.

Adapted from The New York Times, 29 October 2010

# Questions:

- (a) (i) With reference to Figure 1, describe the trend in the world price for [2] rare earths between 2002 and 2010.
  - (ii) Explain how the trend in world price for rare earths would impact [4] the market for hybrid cars.
- (b) (i) With reference to Extract 2, explain how the existence of 'external [4] costs' leads to market failure.
  - (ii) With reference to Extract 3, explain how China can reduce these [6] 'external costs' through the imposition of a tax on rare earths minerals.
- (c) Assess the impact of export quota of rare earths on China's Balance of [6] Payments.
- (d) Using information from the data where appropriate, discuss what may [8] happen to the world price of rare earths in the future.

[Total 30 marks]

# **Question 2** Rising Youth Unemployment in Europe

Countries throughout the world had experienced a sharp economic slowdown due to 2008 Global Financial Crisis. These challenges are expected to prolong as the European Debt Crisis unfolds and there is an urgent need for governments to address the high unemployment rate, especially among the youth.

		2007	2008	2009	2010	2011
Spain	Export	253	281	227	254	307
	Import	389	421	293	327	377
Germany	Export	1321	1446	1120	1259	1474
	Import	1055	1185	926	1055	1255

 Table 1: Trade Figures for Spain and Germany (US\$ Billions)

Source: World Trade Organisation, Statistic Database

# Table 2: Spain's GDP value (€Billions)

	2007	2008	2009	2010	2011
GDP at constant price	1,078.2	1,087.8	1,047.1	1,043.7	1,048.1
GDP at current price	1,053.2	1,087.8	1,048.1	1,048.9	1,063.4

Source: International Monetary Fund, World Economic Outlook Database, October 2012

# Table 3: United Kingdom's GDP value (£ Billions)

	2007	2008	2009	2010	2011
GDP at constant price	1,474.2	1,459.9	1,401.8	1,427.1	1,437.9
GDP at current price	1,412.1	1,440.9	1,401.8	1,466.6	1,516.2

Source: International Monetary Fund, World Economic Outlook Database, October 2012

# Table 4: Unemployment Rate (%)

	2007	2008	2009	2010	2011
Spain	8.3	11.3	18	20.1	21.7
United Kingdom	5.4	5.6	7.5	7.9	8.0

Source: International Monetary Fund, World Economic Outlook Database, October 2012

### Extract 5: Spain, hostage to the Eurozone

Spain's problems are mostly associated with the euro and its recovery is being delayed as a result of decisions made by the European authorities. When Spain decides to adopt a common currency with other Eurozone countries that have much higher levels of productivity, it cannot be as competitive in terms of exports and domestic industries that compete with imports. If Spain had its own currency, it could let the value of its currency falls and help the economy to grow again.

To help Spain resolves her economic woes, European authorities have prescribed what is called an "internal devaluation" – where a country seeks to regain competitiveness through lowering wage costs and increasing productivity and not reducing value of exchange rate. In practicing internal devaluation, Spain has reduced public sector wages to put pressure on other wages to decrease as there is much pressure to cut government spending and pursue fiscal austerity. These measures will shrink the economy and raise unemployment enough so that the country can become competitive, through lower prices and wages, without changing the exchange rate (i.e., without leaving the euro). Hence, it allows Spain's economy to grow over time with increased competitiveness.

Spain also needs expansionary policy to boost the economy. But monetary policy is controlled by the European Central Bank, which, just announced that it may raise interest rates, despite Europe's anaemic recovery and growing unemployment in the eurozone's weakest economies. Expansionary fiscal policy is prohibited by pressure from the European authorities, which are actually pushing Spain to do the opposite due to her borrowing from IMF to finance the huge government debt.

It is the strong economic link between Spain and the other countries within the Eurozone that prohibits it from using any of the three most important macroeconomic policies. Spain should refuse to accept any policies that prolong its slump and prevent it from reducing unemployment. If that means leaving the euro, then these options should be on the table in any negotiations with the European authorities.

Adapted from Various Sources

#### Extract 6: Overseas workers preferred over "unskilled" school leavers

School leavers are being pushed to the back of the jobs queue as Britain's employers turn to migrant labour to fill vacancies. The Chartered Institute of Personnel and Development said demand for workers from overseas had reached record levels because companies felt that young people in the UK lacked the skills to make them employable.

Its quarterly survey of the labour market found that the government's cap on non-EU workers had been ineffective since firms had switched to employing staff from within the European Union, where there are no barriers to labour mobility. Employers seem eager to take full advantage of this, to make use of the EU older workers' positive attitude and skills. The perception among many companies is that too many young people in the UK do not have these qualities, which may explain why fewer of them are being hired. The government therefore needs to redouble efforts to ensure that

the education and skills system is fit for purpose so that young people can find a foothold in an increasingly competitive jobs market.

Adapted from The Guardian, 23 August 2011

# Extract 7: World youth unemployment on the rise

The International Labour Organisation (ILO) estimates that there are 75 million 15-to-24-year-olds looking for work across the globe. Youth unemployment has increased by 30% across the Organisation for Economic Co-operation and Development (OECD), and in Spain it has doubled to 20%.

The effects of youth unemployment can persist for years. The economic loss can be substantial, too, and not just in the form of higher welfare payments. Part of these losses may be due to missing out on training and experience accumulation that typically occurs with young workers as they tend to change jobs at much higher rates than their older counterparts. Realising this problem, governments are trying to address the no match and mismatch between skills and jobs.

Source: Adapted from The Economist, 8 May 2013

# Extract 8: The youth unemployment bomb

What makes rising youth unemployment extra-worrisome is the fact that the world is aging. In many countries the young are being crushed by the social phenomenon where older workers are determined to cling to the better jobs for as long as possible. When the older workers retire, they demand impossibly rich private and public pensions that the younger generation will be forced to shoulder. In addition, Britain is reducing subsidy to university education in an attempt to reduce government debt thus resulting in a rise of the university tuition fees.

In Britain, Employment Minister Chris Grayling has called the chronic unemployment a "ticking time bomb." The only surefire cure for youth unemployment is strong sustained economic growth that generates so much demand for labour that employers have no choice but to hire the young. In the absence of a growth panacea, economists have been working on microscale solutions, such as training programs to smooth the transition from school to work. These days, there is a newfound appreciation in such apprenticeship, because it greases the transition from learning to doing. Germany and Austria experienced milder youth unemployment in the global downturn partly because of apprenticeship programmes. More youths in Netherlands, Italy and Portugal are gaining work experience while in school.

Chronic youth unemployment may not be fixable. But there is evidence it can be reduced through the concerted efforts of government, labour, business, education, and young people themselves. The spike in youth unemployment should also ease in the West as the after-effects of the 2008 Global Financial Crisis diminish. Eventually, growth will resume in the U.S., Europe, Japan, and other nations. The retirement of the baby boomers will increase demand for younger workers.

Source: Business Week, 2 February 2011

# Questions

- (a) (i) Describe the trend of Spain's balance of trade between 2007 and [2] 2011.
  - (ii) Compare this trend with changes in Germany's balance of trade [2] during the same period.
- (b) From Table 2,
  - (i) Identify the base year for Spain's GDP value. [1]
  - (ii) Explain the difference between GDP at constant price and GDP at [3] current price.
- (c) Explain why governments should be concerned with rising youth [4] unemployment in recent years.
- (d) (i) To what extent was the "2008 Global Financial Crisis" a cause of [8] the increase in youth unemployment in both Spain and UK?
  - (ii) Internal devaluation will allow "Spain's economy to grow over time with increased competitiveness".

To what extent is internal devaluation the best policy for the Spanish government to resolve its rising youth unemployment [10] problem.

# [Total 30 marks]

### **Section B**

Answer **one** question from this section.

- 3 (a) Explain how the price mechanism may allocate resources efficiently. [10]
  - (b) Discuss the view that government intervention in situations when the [15] market fails will always result in more efficient outcomes.
- **4 (a)** Explain how rising global protectionism may affect Singapore's [10] circular flow of income.
  - (b) Discuss the view that globalisation is likely to support an economy's [15] recovery from the global economic slowdown.

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