Section A

Answer **all** questions in this section.

Question 1 Recession Concerns: Food Prices, Carbon Emissions and BOP

Extract 1: Food prices to stay high, volatile: FAO

Food commodities prices are likely to stay high and volatile in the medium term, while a repeat of the 2007-2008 price spikes is seen as a realistic possibility, the U.N. Food and Agriculture Organisation (FAO) said on Monday.

By mid-2008, food prices on international markets reached their highest level in nearly 30 years. Graphics published in the report showed prices for commodities such as rice, oilseeds, raw and refined sugar were expected to hold above pre-2006 levels through to 2018.

FAO said the global food commodities market was also likely to remain volatile "in the foreseeable future" and a new surge in prices like the one seen in 2007-08 was a "realistic possibility." Insufficient investment in productive capacity, and further demand growth for biofuels were some factors that could keep prices firm in the medium term.

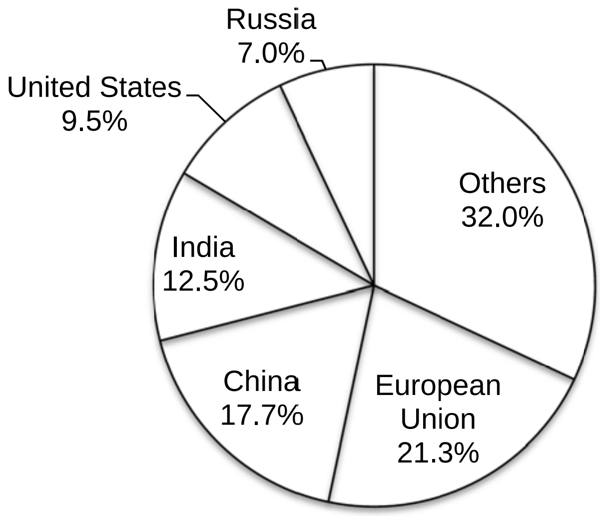
Source: Silvia Aloisi, Reuters, 12 October 2009

Extract 2: Expect flour prices to go up, says importer

The effects of a Russian ban on wheat exports will soon ripple through Singapore: Prima Limited, the largest importer of the grain here, is planning to hike flour prices, a move that will impact a wide variety of industries, from bakeries to noodle-makers, as well as consumers. Its executive director, Mr Lewis Cheng, said that the recent surge in global wheat prices had a 'definite impact' on the company. “With this huge jump in material costs, we have no choice but to increase our flour prices,” he said, adding that prices will go up gradually, and in phases.

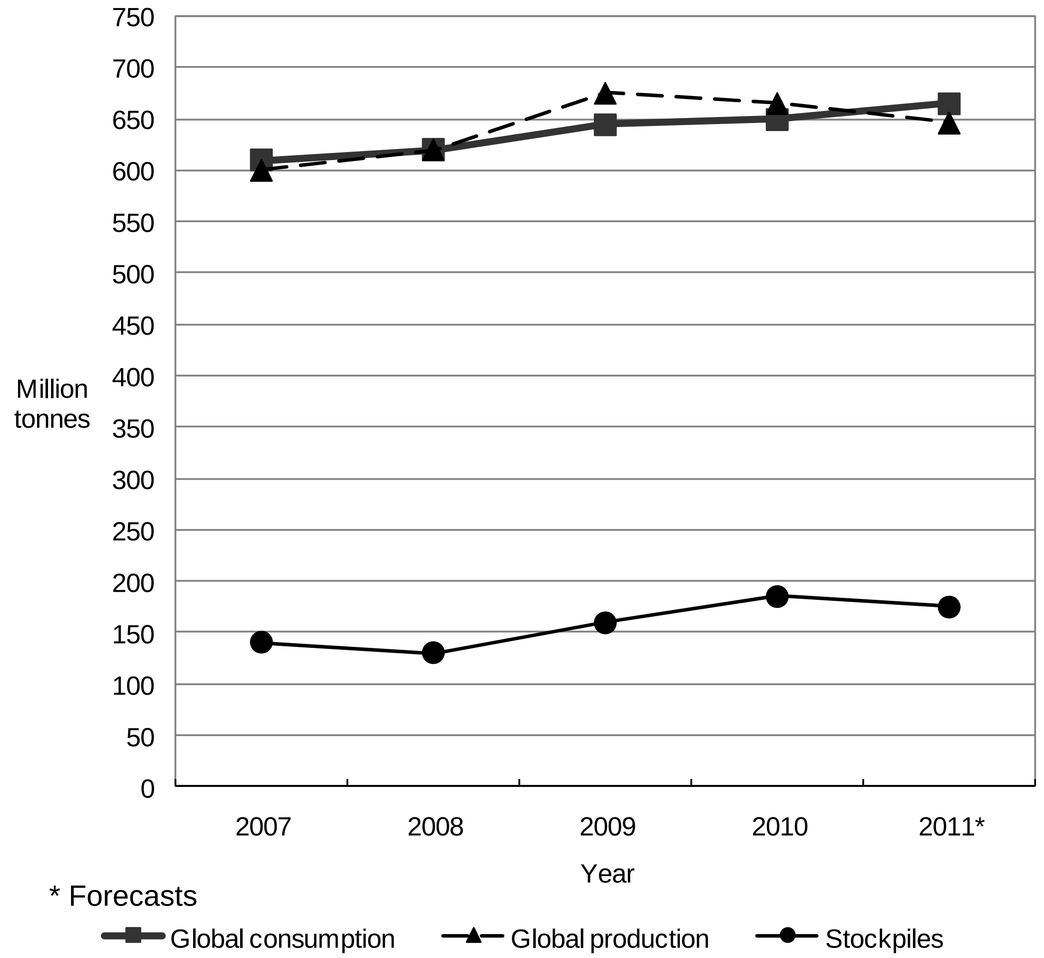
Source: Jessica Lim, *The Straits Times*, 7 August 2010

Figure 1: Top wheat producers (as of August 2010)



Source: *The Straits Times*, 11 September 2010

Figure 2: Wheat production and consumption



Source: *The Straits Times*, 11 September 2010

Extract 3: Australia affirms carbon emissions target amid growth concerns

Australia's government maintained its targets for reducing carbon emissions, resisting calls to delay plans that will detract from growth as the economy heads for a possible recession. Draft legislation to introduce carbon trading aims to cut emissions by between 5% and 15% of 2000 levels by 2020, Climate Change Minister Penny Wong said today. This would help Australia meet its goal of a 60% reduction by the middle of this century, she said.

"This includes a minimal and unconditional commitment to reduce emissions," Wong said in a statement released in Canberra. That includes an emissions trading system, an expanded renewable energy target, investment in green technologies and carbon capture and storage, she said. Carbon trading, which forces companies to pay for excess pollution, is projected to trim Australia's annual economic growth by 0.1% point after the system is introduced in July next year.

The country's emissions from fuel combustion rose 31% in the decade through 2000 and 45% in the 15 years ending in 2005, International Energy Agency data show. The government's estimates for the impact on economic growth assume an initial price of A$25 (US$15.93) a metric ton of carbon when trading begins.

U.S. President Barack Obama has reversed the previous administration's climate-change policy. Obama's budget plan includes US$75 billion in revenue in 2012 from the sale of greenhouse-gas emission permits to polluters. The European Union is seeking to build momentum for a possible UN climate-change agreement, which would succeed the Kyoto Protocol after it expires in 2012.

Source: Gemma Daley, Bloomberg, 10 March 2009

Extract 4: The governor, the markets and the tumbling pound

It started with an innocuous-sounding article in the Bank of England's quarterly bulletin, published last Monday. Called Interpreting Recent Movements in Sterling, it looked at why the pound had fallen so much in the past two years. One reason, it suggested, was the perception in the markets that Britain's economy would be more seriously affected by the global financial crisis than those of other countries.

Britain had, since the 1990s, run a deficit on its balance of payments' current account averaging 2% of gross domestic product. Mervyn King, the governor, said rebalancing the British economy was "very necessary" and that "the fall in the exchange rate that we have seen will be helpful to that process".

The effects of the pound's sharp moves have already been significant for business. Last summer, Jonathan Bellwood took a big gamble. The sudden fall in the value of the pound was making business much more expensive for PeopleVox, the stock-control technology company he had started just three months earlier in High Wycombe. Prices of the components PeopleVox was importing from America had shot up by 26% in just a few months so Bellwood decided that the company would make the equipment in the Midlands. "You naturally look to eastern Europe or the Far East but we found a big pool of talent in central England," Bellwood said. "Their proximity was key because it meant it was quicker to bring products to market."

Not only that, the strengthening of the euro against the pound suddenly presented an opportunity to export to the larger European market. Instead of focusing on a UK customer base, the company switched focus almost overnight and the gamble paid off. "There we were worrying about the recession when actually there was this great opportunity on our doorstep," said Bellwood. While the pound's fall is providing a boost for exporters like Bellwood — though most overseas markets remain weak — it is bad news for importers.

"In the short-run the fall in the pound boosts exports but it also puts upward pressure on the prices of the many things, such as electrical and electronic goods, that Britain imports," said the British Retail Consortium. The BRC also pointed out that the weak pound will increase food price inflation, both through the direct effect on the price of imports but also by increasing the incentive for farmers to sell abroad rather than in the UK, thereby creating potential supply shortages.

Source: David Smith, *The Times*, 27 September 2009

Questions

(a) Using Figure 2,

(i) Summarise the variations in the stockpiles of wheat. [2]

(ii) Account for the abovementioned variations. [2]

(b) With the aid of a diagram, analyse why prices of food commodities are expected to surge and remain volatile. [5]

(c) **(i)** Discuss how the Australian government could intervene to reduce carbon emissions. [8]

(ii) Comment on the impact of reduction in carbon emissions on economic growth. [5]

(d) Discuss the effects of the tumbling pound on the balance of payments position of the UK. [8]

[Total: 30 marks]

Question 2

The Nuts and Bolts Come Apart

Extract 5: As global demand contracts, trade is slumping and protectionism is rising

Trade declined alarmingly in the early 1930s as global demand imploded, prices collapsed and governments embarked on a destructive, protectionist spiral of higher tariffs and retaliation.

Trade is contracting again, at a rate unmatched in the post-war period. The World Trade Organisation (WTO) predicted that the volume of global merchandise trade would shrink by 9% this year. This will be the first fall in trade flows since 1982. Between 1990 and 2006 trade volumes grew by more than 6% a year, easily outstripping the growth rate of world output, which was about 3%. Now the global economic machine has gone into reverse: output is declining and trade is tumbling at a faster pace. The turmoil has shaken commerce in goods of all sorts, bought and sold by rich and poor countries alike.

According to the World Bank, 17 members of the group have taken a total of 47 trade-restricting steps since November. Modern protectionism is more subtle and varied than the 1930s version. In the Depression, tariffs were the weapon of choice. A few tariffs have been raised this time, but tighter licensing requirements, import bans and anti-dumping (imposing extra duties on goods supposedly dumped at below cost by exporters) have also been used. Rich countries have included discriminatory procurement provisions in their fiscal-stimulus bills and offered subsidies to ailing national industries.

There are good reasons for thinking that the world has less to fear from protectionism than in the past. International agreements to limit tariffs, built over the post-war decades, are a safeguard against all-out tariff wars. The growth of global supply chains, which have bound national economies together tightly, have made it more difficult for governments to increase tariffs without harming producers in their own countries.

Source: *The Economist*, 26 March 2009

Extract 6: China and United States head for trade war

Europe and the United States announced co-ordinated action against China for busting WTO rules by restricting exports of essential raw materials, raising fears of a damaging east-west trade war in the depths of the global recession.

Ron Kirk, the US trade representative, accused Beijing of putting a "giant thumb on the scale" by restricting exports of commodities including silicon, coke and zinc, to give Chinese manufacturers an unfair advantage over their international rivals. "It's our job to make sure we remove that thumb from that scale," he said in Washington. "Today's action is proof of our commitment to level the playing field in this area."

The US, with Europe, announced that it would start formal "dispute resolution consultations" at the WTO in Geneva, claiming China has breached the rules of the international marketplace. At a press conference in Washington, Kirk said: "We will enforce the rights of American manufacturers, farmers, ranchers, services providers, and workers using the rules-based global trading system."

Baroness Ashton, Europe's trade commissioner, said: "The Chinese restrictions on raw materials distort competition and increase global prices, making things even more difficult for our companies in this economic downturn. I hope that we can find an amicable solution to this issue through the consultation process."

China imposes restrictions, including minimum export prices, on a range of raw materials of which it is a major producer. The EU claims these not only break general WTO rules on world trade, but specific promises China made when it joined the organisation in 2001, becoming a fully fledged player in global markets. The US said China produced 336m tonnes of coke in 2008 but only exported 12m tonnes.

The raw materials are used in a range of key products, from steel to semi-conductors. Brussels said manufacturers and processors in Europe were at risk of going bust if the flow of exports from China was not restarted.

With oil prices rising rapidly, western governments including Britain have become concerned that higher commodity costs could choke off the fragile economic recovery, and they suspect China of deliberately stockpiling materials – in contravention of WTO rules on free trade.

Given the gloomy outlook of the economy, WTO urges all countries to abolish protectionist measures. Instead, there should be promotion of free trade as it benefits the economy in many aspects, including a swifter recovery from the current recession.

Adapted from *The Guardian*, 23 June 2009

Extract 7: A global economic crisis requires global solutions

The immediate cause of shrinking trade is plain: global recession means a collapse in demand. The credit crunch adds an additional squeeze, thanks to an estimated shortfall of $100 billion in trade finance, which lubricates 90% of world trade.

With the global crisis destroying the trade balance of many countries, it is no wonder that protectionist measures are sprouting once again. What should world leaders do to stop protection fraying the threads that tie the world economy together? This global crisis requires a global response, but, unfortunately, responsibility for responding remains at the national level.

Each country will try to design its stimulus package to maximise the impact on its own citizens – not the global impact. In assessing the size of the stimulus, countries will balance the cost to their own budgets with the benefits in terms of increased growth and employment for their own economies. Since some of the benefit (much of it in the case of small, open economies) will accrue to others, stimulus packages are likely to be smaller and more poorly designed than they otherwise would be, which is why a globally coordinated stimulus package is needed.

Source: *The Guardian*, 11 April 2009

Extract 8: In a recession, it's government's job to lean against market logic

John Maynard Keynes believed that government should enact 'counter-cyclical' fiscal policies, which go against the tide of the business cycle. Most commentators agree that the global financial crisis has prompted an overdue resurrection of the reputation of last century's greatest economist.

Although most individuals would plead guilty to the charge of borrowing in order to build or acquire an asset (like a house), the government – according to this view – must never spend beyond its means. In a recession, when individuals stop spending and investing, and the government's tax revenues therefore decline, the government must also slam on the brakes.

This completely overlooks the responsibility of governments during a recession to lean against the logic of the market. As Keynes saw, a government that behaves in a recession as everyone else behaves will simply make the recession worse. It is the special role of government in that situation not to retrench but to use its huge resources and its responsibility to take the longer view and to act in the common interest, in order to stimulate the level of economic activity so as to shorten the recession and thereby restore its own financial position as soon as possible.

None of this means that government spending should be let rip. If the deficit is to be effective in bringing the recession to an end, the spending must be economically worthwhile. The spending that is undertaken must not be focused on consumption but on encouraging investment, employment and improved productivity.

Source: Bryan Gould, guardian.co.uk, 16 June 2010

Table 1: Selected Indicators for China

	2006	2007	2008	2009
GDP growth (%)	12.7	14.2	9.6	9.1
Final consumption expenditure growth (%)	4.8	7.9	4.6	14.9
Gross capital formation growth (%)	13.8	15.0	11.6	21.2
Government expenditure growth (%)	11.4	11.5	8.9	6.1
Unemployment (%)	4.1	4	4.2[1]	4.3
Exports of goods and services growth (%)	23.9	19.8	8.4	-10.3
Imports of goods and services growth (%)	16.0	13.9	3.9	4.1
Current account balance (US$ billions)	250	372	426	388
Terms of trade index (2000 = 100)	82.6	80.5	73.9	79.7
Exchange rate (per US$)	7.96	7.58	6.93	6.83

Source: Worldbank Data

[1] Source: CIA World Factbook

Questions

(a) **(i)** Compare the value of yuan in 2009 with that in 2006. [1]

(ii) Explain a reason for the observation in (a)(i). [2]

(b) Account for China's terms of trade position despite the changes in the value of yuan. [4]

(c) Discuss whether there "should be promotion of free trade as it benefits the economy in many aspects." [6]

(d) Explain how Beijing's move to put a "giant thumb on the scale" will give the Chinese an unfair advantage over their international rivals. [4]

(e) **(i)** Explain how the recession could affect a government's budget balance. [3]

(ii) As a consultant economist, examine the use of protectionism and counter-cyclical fiscal policies in response to the global crisis. [10]

[Total: 30 marks]

Section B

Answer **one** question from this section.

3 Given the central economic problem, a government has to decide how much subsidies to give to higher education.

(a) With the aid of a production possibility curve diagram, explain the central economic problem. [10]

(b) Discuss whether giving subsidies for higher education is the most desirable measure. [15]

4 **(a)** Explain why a government might be concerned with inflation. [10]

(b) Discuss whether raising interest rate is the most appropriate policy to deal with the problem of inflation. [15]

End of Paper