

## Question 1

## Suggested Answers

(a) Using Figure 2,

(i) Summarise the variations in the stockpiles of wheat.

- The stockpiles of wheat are expected to increase overall. (1m)
- The stockpiles fell from 2007 to 2008, rose from 2008 to 2010 and are expected to fall thereafter. (Any two variations – 1m)

## Markers' Report

## Data interpretation:

- Candidates need to be more careful with data interpretation. E.g.
  - "There is an overall rise in stockpiles from 2007 to 2010" - this statement is not given full credit because the entire period runs from 2007 to 2011. Hence, the statement should be rephrased as "There is an overall rise in stockpiles from 2007 to 2011".

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

Stockpiles of wheat depend on the global consumption and global production of wheat (0.5m) – For example, when global consumption was less than global production from 2008 to 2010, the stockpiles rose. However, when the global production is expected to dip below global consumption from 2010 to 2011, the stockpiles are expected to fall.

1.5m – 1m for why stockpiles rose (fell) and 0.5m for why stockpiles fell (rose)

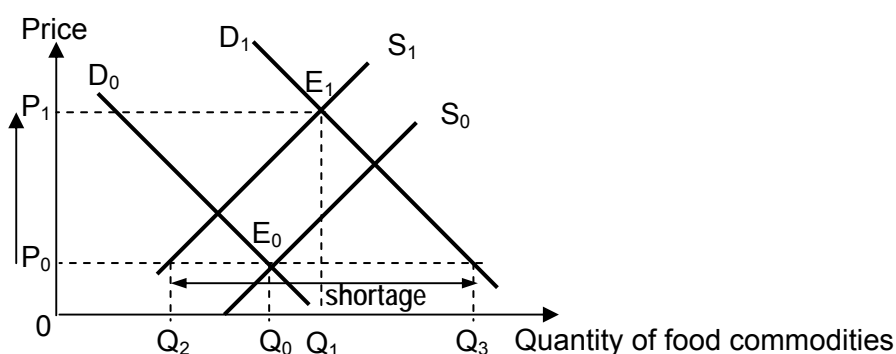
## Markers' Report

## Question interpretation:

- Candidates should take note that they are instructed to use Figure 2 to answer (ii) as given in the question.

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

The export ban by Russia reduces the world supply of wheat (Extract 2). Additionally, Russia is one of the top producers of wheat in the world (Figure 1). Besides that, the rise in demand for biofuels (Extract 1) leads to a rise in the derived demand for food commodities such as rice and wheat which are factors of production for biofuels.



The fall in supply will shift the supply curve to the left from  $S_0$  to  $S_1$  and the increase in demand will shift the demand curve to the right from  $D_0$  to  $D_1$ , causing a huge shortage of  $Q_2Q_3$  at the original price of  $OP_0$ .

Eventually, a new market equilibrium is reached at point  $E_1$  where quantity demanded will once again be equal to the quantity supplied. In this instance, there is a surge in the price of food commodities from  $OP_0$  to  $OP_1$ .

Volatility in the price of food commodities could be explained by the unpredictable changes in the demand for and supply of food commodities. In other words, when the demand for and supply of food commodities fluctuate, the price of food commodities would fluctuate as well.

L2	3-5	<ul style="list-style-type: none"> <li>• Good application of demand and supply analysis with detailed reference made to a diagram</li> <li>• For 4m and above: Detailed explanation that takes into account simultaneous changes in demand for and supply of food commodities or application of relevant elasticity concept</li> <li>• Detailed explanation without accounting for the volatility in prices – max. 4m</li> </ul>
L1	1-2	<ul style="list-style-type: none"> <li>• Smattering answers</li> <li>• Glaring inadequacies are evident, e.g. incomplete diagram and incorrect explanation of the price adjustment process</li> </ul>

#### Markers' Report

##### Question interpretation:

- Some candidates did not respond to the question, i.e. they did not explain why there would be a large rise in price of food commodities. This is despite drawing a diagram that illustrates both a rise in demand for and fall in supply of food commodities. In this case, the candidates should have commented that when demand rises and supply falls, there is a large shortage at the original equilibrium price. Hence, there would be a steep rise in the price of food commodities.

(c) Explain why the members of the Singapore Bakery and Confectionery Trade Association are “unlikely to be able to absorb more than a 10% increase” in the price of flour. [3]

- Flour is an important factor of production in the bakery and confectionery industry and an increase in price of flour will lead to a rise in variable cost of production for this industry. (1m)
- Hence, if price of wheat rises by more than 10%, it is likely that  $TR < TC \rightarrow$  subnormal profits. (1m)
- Additionally, if  $TR < TVC$  in the short run, firms would have to shut down. (1m)

#### Markers' Report

##### Question interpretation:

- Some candidates explained that  $TR$  would rise when price of confectionery rises as demand for it is price inelastic. This is irrelevant because it does not explain why the Association cannot absorb more than 10% increase in price of flour!

- (d) Evaluate the effectiveness of the “back to basics” strategy adopted by firms. [8]

Intro (1m for introduction or conclusion)

Aim of firms: maximise profits during a time when rivals face a fall in demand for their products (Extract 3, paragraph 3)

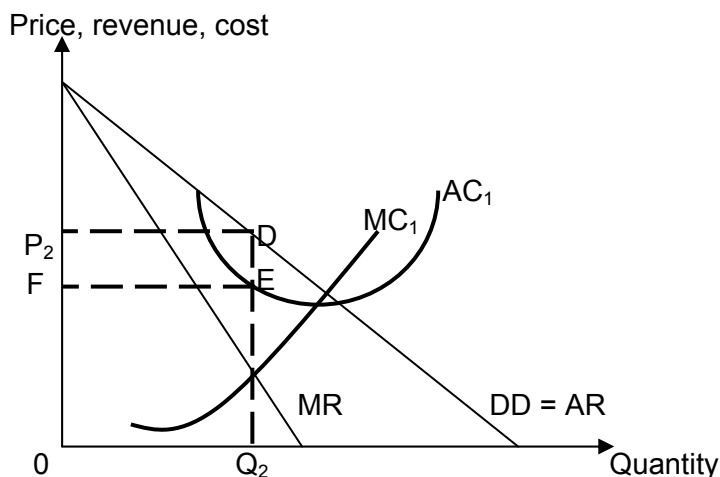
1. 2m

- Produce no-frills items with basic functions – these products could have negative income elasticity of demand and hence sell well in a recession environment → fall in income, rise in demand for these products, *ceteris paribus* → rise in TR → *ceteris paribus*, rise in profits for the firms

2. 2m

- Reducing the variety of items and mass-producing them (Extract 3, paragraph 4) → reap economies of scale, e.g. marketing economies of scale → reduce unit cost of production → Raise profits per unit, *ceteris paribus*

3. 1m



As previously explained, the back to basics strategy could lead to a rise in TR and a fall in TC. As a result the following could happen: the TR is  $OP_2DQ_2$  while TC is  $OFEQ_2$ . Hence the profits is  $FP_2DE$ . In this case, by adopting the back to basics strategy, the firm could earn supernormal profits.

Evaluation (2m):

- Strategy depends on economic conditions: Revert back to following strategy in times of economic growth – When there is economic growth and the incomes of the people increase, we can expect a substantial rise in demand for goods that have high positive income elasticity such as rice cookers and smart phones with more sophisticated functions. Therefore profit-maximising producers can step up production in anticipation of the increase in demand. Hence back to basics strategy may not work in times of economic growth.

Conclusion

The product differentiation evident in the above analysis is borne out of the need to survive in the economic recession. With a threat to profits, firms need to come up with strategies to maintain revenue, if not to raise revenue, and to lower cost.

Level	Marks	Descriptors
L3	6 – 8	<ul style="list-style-type: none"> <li>• Clear explanation of BOTH cost and revenue advantages</li> <li>• Well-explained evaluation</li> <li>• A reasoned conclusion/intro for 8m</li> </ul>
L2	4 – 5	<ul style="list-style-type: none"> <li>• Some explanation of both cost or revenue advantages but not consistently thorough</li> <li>• Some attempts at evaluation</li> <li>• Clear explanation of cost OR revenue advantage only – max 5m</li> </ul>
L1	1 – 3	Smattering of ideas. Some explanation of impact of cost or revenue advantages but lacking economic analysis.

### Markers' Report

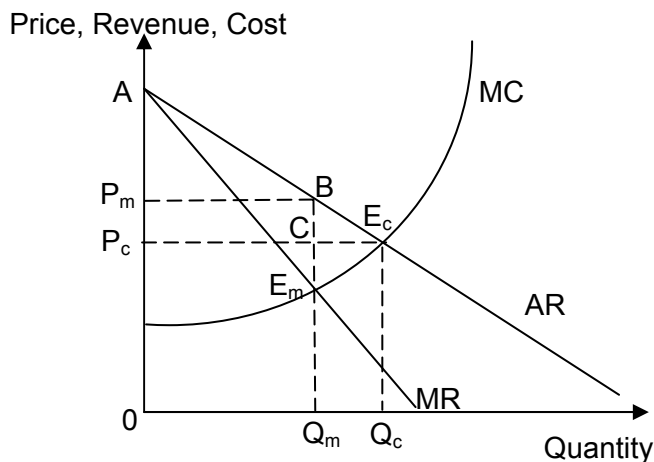
#### Question interpretation

- Some candidates explain the impact of the back to basics strategy on consumers and discuss whether their welfare rises or falls. However, this answer ignores the question requirement of evaluating the effectiveness of the strategy, that is, the impact of the strategy on the firms' profits.
- Some candidates thought that it was a question on evaluating the effectiveness of the price and non-price strategy (i.e. product differentiation) of the various market structure which geared them towards explaining the effects on revenue in detail with no link to costs and profits.

- (e) According to economic theory, Prima's decision to raise the price of flour is justifiable and should not be seen as an example of economic inefficiency.

With reference to the data where appropriate, discuss the validity of this statement.  
[10]

- Rise in price of wheat → significant rise in the cost of production of flour since wheat is the main factor of production for flour (Extract 2, paragraph 3) → fall in profits, ceteris paribus → thus, Prima needs to raise price of flour to commensurate with rise in cost of production
- Only flour mill in Singapore and controls more than 50% of the flour used in Singapore (Extract 2, last paragraph) – hence, it dominates the market for flour in Singapore
  - Explain allocative inefficiency with the aid of a diagram:  
Prima, by virtue of having a high degree of market control, can restrict its output and charge a higher price for its flour than the perfectly competitive industry.



At the profit-maximising level of output  $0Q_m$ , Prima is allocatively inefficient as  $P > MC$  at this output level.

At this output,  $0Q_m$ , the price charged by the firm is higher than his marginal cost of production ( $P > MC$ ). This means that not enough of the good is being produced. This represents a misallocation of resources or allocative inefficiency and society's welfare is not maximized. At  $Q_m$ , there is a deadweight loss of area  $BE_cE_m$ .

- Prima may incur higher costs of production due to X-inefficiency. Being the dominant producer of flour, there is no competitive pressure on profits. Thus, cost control can become lax. In this case, Prima might produce at a point above its LRAC curve, resulting in higher prices for consumers.

### Conclusion

With food prices on the rise, it could be inevitable that firms raise their prices to prevent the erosion of their profits. In this light, it may be justifiable that Prima increases the price of flour. However, the extent of increase in price of flour is a cause of concern.

Level	Marks	Descriptors
L3	7 – 10	<ul style="list-style-type: none"> <li>Both thesis and anti-thesis are addressed</li> <li>Competent explanation of both allocative inefficiency and productive inefficiency, with aid of a diagram</li> <li>A reasoned conclusion is provided</li> </ul>
L2	5 – 6	<ul style="list-style-type: none"> <li>Some balance attempted</li> <li>Adequate explanation of allocative inefficiency and productive inefficiency but not consistently thorough for both</li> </ul>
L1	1 – 4	Smattering of ideas. Some explanation of concept of economic inefficiency but with no reference to case material

### Markers' Report

#### Question interpretation:

- There is no need to explain why the price of wheat has risen. The focus is on the decision by Prima to raise the price of flour. Hence, the explanation should focus on why they want to raise the price of flour.

## Question 2

## Suggested Answers

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

The value of Yuan in terms of US\$ has appreciated.

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

From Table 1, China's GDP has been increasing from 2006-2009
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This increases business optimism. Foreign firms expect the Chinese economy to grow further in the future. This could possibly lead to increasing profits. Thus they would invest more in China. This would increase the demand for Yuan. Thus there would be a shortage and Yuan would appreciate.
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## Markers' Report

## 1. Data interpretation

- A positive percentage growth of imports which is decreasing implies TEm has increased at a decreasing rate. Students incorrectly explained that TEm is falling.

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

$TOT = [\text{Index price of exports} / \text{index price of imports}] \times 100$  (0.5m)

Appreciation of yuan should make China's terms of trade more favourable.

Reason: Appreciation of Yuan

With appreciation of yuan, price of exports in foreign currency increased, whereas the price of imports in yuan has decreased. This will result in a more favourable TOT for China. (1.5m)

However, from Table 1, China's terms of trade has become more unfavourable. (0.5m)

From Figure 1, there is a significant fall in world income in 2008-2009.
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This suggests that there will be a significant fall in demand for China's exports, resulting in a drastic fall in the price of exports. This will lead to a deterioration of China's TOT despite an appreciation of the Yuan.
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## Markers' Report

## 1. Need more depth/rigor

- Many students did not understand the question requirement and gave a one-sided response either explaining why TOT improved due to appreciation of Yuan or why TOT worsen as shown in Table 1.

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

- i. With free trade, there will be removal of trade barriers. Goods which are exported to another country will now be cheaper due to the removal of trade barriers. Assuming demand for the exported goods is price elastic, this will lead to a more than proportionate

increase in quantity demanded for exports, thus increasing export revenue. If the increase in export revenue is greater than the increase in import expenditure, thus  $(X - M)$  increases and improving the current account.

- ii. With free trade, export sector would expand and with that, there could be greater inflow of FDI as the returns of investment in this sector would increase. With such capital inflow → improvement in capital account.

Therefore, there will be an overall improvement in BOP if both current and capital accounts improve.

However, with promotion of free trade, there is increasing competition. Thus countries will produce according to their comparative advantage. Abundance of labour in countries like India and China allows them to produce goods that are labour intensive in production at lower opportunity cost compared to developed countries. Thus, many developed countries have lost their comparative advantage in these industries. Thus there will be structural unemployment in these developed countries.

#### Conclusion

Though countries are mindful of the likely costs that may arise, generally, its benefits outweigh the costs.

#### Marking scheme

L3	5 – 6	Thorough explanation of at least three points on the benefits and costs (e.g. two benefits and one cost) of free trade with supporting evidence from the case study
L2	3 – 4	<ul style="list-style-type: none"> <li>Some explanation of the benefits and costs of free trade but analysis is not consistently rigorous, e.g. did not use AD-AS analysis or <math>Y=AE</math> analysis</li> <li>Thorough explanation of one benefit and one cost of free trade with supporting evidence used for either benefit or cost – max. 4m</li> </ul>
L1	1 -2	Smattering explanation of the benefits and/or costs of free trade

#### Markers' Report

##### 1. Question interpretation

- Students should not write about arguments for and against protectionism. The trigger here is free trade and not protectionism.
- Common and wrong answers include free trade being bad because there is a need to protect infant industry, when intent of question was the merits & likely side effects of free trade.

- (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]

China engaged in protectionism by "restricting exports of commodities such as silicon, coke and zinc" (Extract 5, para 2).

- These restrictions will cause a fall in the world supply of such raw materials since China is a large producer of such commodities (Extract 5, para 5). Hence, there will be an increase in the price of major inputs to Europe and US.
- With an increase in the price of inputs, this will result in a higher cost of production for Europe and US companies, eventually resulting in a fall in supply goods leading to higher price. Hence, this would result in a fall in export earnings and hence a worsening of the balance of trade for Europe and the US while China would enjoy increasing export earnings and an improvement in balance of trade.

Marking scheme:

- Interpretation of “giant thumb on the scale”: 0.5m
- Explanation of rise in market price of steel: 1m
- Explanation of fall in net exports for China’s trading partners: 2.5m

Markers’ Report

Need more depth/rigor

- Answer should not be confined to rise in COP to other countries when China restricts their output. Students need to link their answer to how China can gain more TRx and improve their balance of trade (unfair advantage) while the rest of the countries may experience a fall in TRx and worsen BOT.

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

- With a recession, consumers would “stop spending” (extract 7, para 2). Thus there would be a fall in production and derived demand for labour. Hence, there is less income tax revenue collected by the government.
- In addition, government spending should be let rip. Government has to increase spending on infrastructure so as to get the economy out of recession.

Marking scheme:

- Shows understanding of components of budget balance: 0.5m
- Explanation of fall in tax revenue: 1m
- Explanation of rise in government expenditure: 1m
- Conclude that there could be budget deficit (in the case where tax revenue falls and G rises): 0.5m

Markers’ Report

1. Clarity in answer

- To state the final status of the budget balance as deficit (likely to be a budget deficit). Vague to say budget balance worsen.

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

To raise the net exports, countries may decide to impose protectionist measures (e.g. “extra duties on goods supposedly dumped at below cost by exporters” (Extract 4, para 3) which are tariffs) on imported goods.

When an import tariff is imposed, the price of the imported good in the country will rise. Assuming that the demand for imports is price elastic, this would lead to a more than proportionate fall in the quantity demanded for imports. This would reduce the import expenditure.

At the same time, the tariff makes the domestically produced goods, which are substitutes for the imported good, relatively cheaper. The demand for domestically produced goods will increase, i.e. consumption expenditure rises.

An increase in X-M and C would lead to an increase in AD. There would be a multiplied increase in national income. The actual economic growth and fall in unemployment would help the country recover from a recession.



### Evaluation

- Europe and the US announced co-ordinated action against China that has restricted exports of essential raw materials, raising fears of a damaging trade war in the global recession. (Extract 5, para 1)
- Given the current conditions, this can only be a temporary measure to increase economic growth and reduce unemployment. As shown from Extract 5, other countries like Europe and US may retaliate by imposing trade barriers on the China's exports too.

Government should consider the use of “counter-cyclical” fiscal measure, which is an expansionary fiscal policy.

- This policy could address the cause of the recession due to a lack of AD as the government can either increase government expenditure, e.g. spending on road improvement works, or reduce taxes to increase AD
- This will lead to an increase in AD causing an increase in real national output and hence level of employment increases. There will be a multiple increase in national income, hence achieving actual growth and lowering unemployment.

### Evaluation

Effectiveness of fiscal policy to boost economic growth depends on size of the multiplier. For small open economies like Singapore, the multiplier size is small due to high marginal propensity to withdraw (MPW) arising from high marginal propensity to save (MPS) and marginal propensity to import (MPM). Hence, expansionary fiscal policy is not very effective to boost economic growth in Singapore. Therefore, government may have to spend even more or reduce tax further in order to achieve the desired outcome.

Rise in government expenditure on education, training and healthcare would lead to a rise in labour productivity (Extract 7, last para), which would bring about an increase in AS. The rise in AS makes it possible for the economy to have sustained economic growth with low inflation and full employment. Hence, achieving the macroeconomic goals.

### Conclusion

In conclusion, protectionism is not ideal to counter the effects of an economic crisis and it would not be able to solve the root cause of the problem. It would create more problems instead.

### Marking scheme

L3	7 – 10	<ul style="list-style-type: none"> <li>• Good discussion of the 2 policies which are well-supported by economic analysis and case information</li> <li>• Policies clearly link to improvement in economic growth and lowering unemployment (the global crisis)</li> <li>• For 9m and above: Informed conclusion that includes a reasoned judgement</li> </ul>
L2	5 – 6	<ul style="list-style-type: none"> <li>• Some discussion of the 2 policies that are supported by some economic analysis and case information</li> <li>• Some links to increase economic growth and lowering unemployment</li> <li>• Only discussed protectionism which is well-supported by economic analysis and case information – max. 5m</li> </ul>
L1	1 – 4	<ul style="list-style-type: none"> <li>• Smattering of points; mere description of protectionism</li> </ul>

## Markers' Report

### 1. Question interpretation

- This is a policy question. Students are to explain how the 2 policies work to lift an economy out of recession and reduce unemployment followed by an evaluation of the 2 policies. There is no need to explain another policy since the question only asks for these 2 policies.
- This is not a question on arguments for and against protectionism (reasons for protectionism). As explained above, it is a question on how the 2 policies work to bring an economy out of a recession thus reducing unemployment.