

YISHUN JUNIOR COLLEGE JC2 PRELIMINARY EXAMINATION 2011

H2 ECONOMICS

9732/01

Paper 1

22 AUGUST 2011

TIME: 2 hours 15 mins

Additional materials: Answer paper



READ THESE INSTRUCTIONS FIRST

Write your name and CTG 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 highlighters or correction fluid.

Answer **all** questions.

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

The number of marks is given in brackets [] at the end of each question or part question.

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

Answer **all** questions.

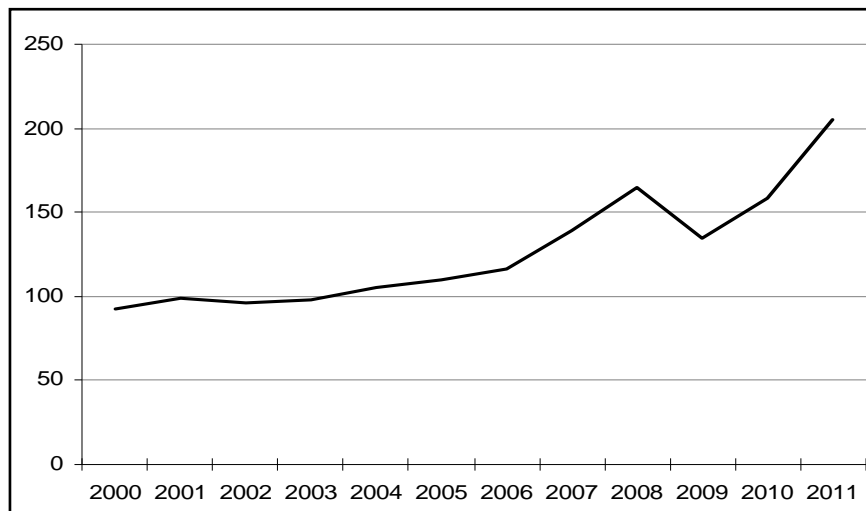
Question 1

Food Inflation

Extract 1: Global food crisis forecast

Global food prices are on the rise again. According to the UN Food and Agricultural Organisation (FAO), its overall food price index rose by 5% alone between July and August in 2010, although this is 38% down from its peak in June 2008 (see Figure 1).

Figure 1: Food Price Index (2002-2004 =100)



Source: Food and Agriculture Organisation of the United Nations (FAO)

However, opinions are sharply divided over whether these prices signal a world food crisis like the one in 2008 that helped cause riots in 25 countries, or simply reflect volatility in global commodity markets as countries claw their way through recession.

Source: Adapted from *guardian.co.uk*, 25 Oct 2010 & *bbc.co.uk*, 1 Sept 2010

Extract 2: World food prices hitting dangerous levels

Millions of Asia's poor are being hit both in the pocket and stomach, as global food prices rise relentlessly towards 'dangerous levels', according to the World Bank.

Asian inflation is among the most sensitive in the world to food price shocks, and in a report released recently, the World Bank said that higher food prices have already pushed another 44 million people in developing countries into extreme poverty since June last year. Typically, poor families suffer the most because they spend more than half their household income on food.

The root causes of food price inflation are hotly debated, with explanations varying from country to country. Analysts have put the blame on the extreme weather events that are occurring more frequently, political instability and Asia's growing middle classes. Other economists say higher energy prices also play a role, not only through higher transport and fertiliser costs, but also by encouraging farmers to use more of their land to grow crops for biofuel.

Source: Adapted from *The Straits Times*, 17 Feb 2011

Extract 3: Biofuels and food prices

New analysis suggests that the biofuel revolution launched by former President George Bush in 2007 to cut oil imports and reduce carbon emission is impacting on world food supplies. One-quarter of all the maize and other grain crops grown in the US now ends up as biofuel in cars rather than being used to feed people.

The 2009 figures from the US Department of Agriculture shows ethanol production rising to record levels driven by farm subsidies and laws which require vehicles to use increasing amounts of biofuels.

"There is a direct link between biofuels and food prices. The needs of the hungry must come before the needs of cars," said Meredith Alexander, biofuels campaigner at ActionAid in London.

Source: *guardian.co.uk*, 22 Jan 2010

Extract 4: More countries gambling on subsidies

China

China's government has said it will provide poorer households with subsidies in response to double-digit food price inflation. The government also said it had not ruled out price controls if current grain and vegetables shortages worsen.

The latest move comes after premier Wen Jiabao said the government was 'formulating measures to curb the overly fast rises of prices'.

"Great attention should be paid to market supply and demand and prices because they are related to the public's basic interests," added Premier Wen in his statement.

Source: *bbc.co.uk*, 17 Nov 2010

Middle East

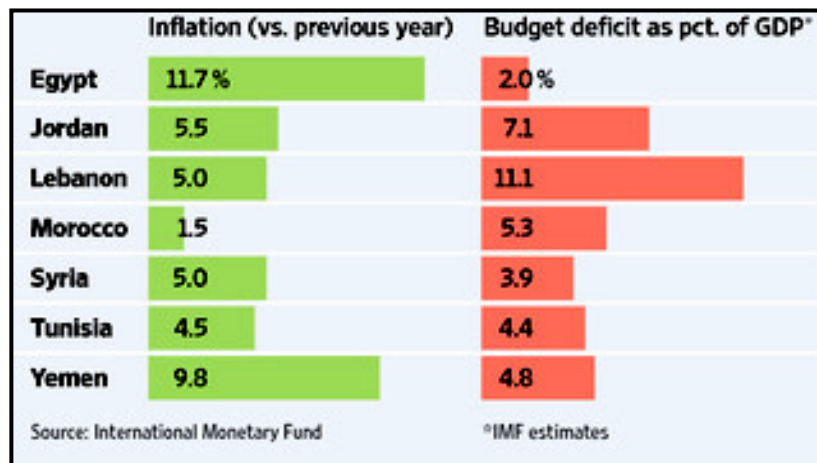
Spooked by a gathering popular revolt, Arab rulers across the Middle East are seeking to spend their way to safety - boosting subsidies, increasing wages and in some cases, guaranteeing jobs for disaffected youth.

In the past two weeks, the Jordan government has announced a \$125 million package of subsidies for fuel and staple products like sugar and rice. Algeria and Libya have also moved to relax food taxes or cut prices of staple foods. Morocco's government, which heavily subsidises food and gas, has vowed to keep food prices at affordable levels "at any price."

Oil-producing economies such as Saudi Arabia, Qatar and Bahrain face less pressure because they largely run fiscal surpluses and will see their spending power boosted by an increase in oil prices. But even in oil-rich Kuwait, the government has introduced generous stipend and free food for its citizens until March 2010 to ease the burden of higher costs.

Source: *The Wall Street Journal*, 5 Feb 2011

Figure 2: Selected Countries Data, 2010



Questions

- (a) (i) Describe the trend in food prices from 2000-2011. [2]
- (ii) Using demand and supply analysis, account for the trend observed in (a)(i). [4]
- (b) According to Extract 3, to encourage the use of biofuel which is considered a source of clean energy, farm subsidies were given to ethanol production.
- Comment on whether such subsidies given by the US government have affected efficiency in resource allocation. [6]
- (c) Using relevant economic analysis, discuss the possible impact on developing economies in Asia if “world food prices rise relentlessly towards dangerous levels”. [8]
- (d) With reference to the data provided, assess the policy approach taken by China and the Middle East countries to deal with rising inflation. [10]

[Total: 30]

Question 2

The Threat of De-globalisation

Extract 5: The nuts and bolts come apart

Trade is contracting again, at a rate unmatched in the post-war period. This week 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.

It is too soon to talk of a new protectionist spiral. But protectionism seems to have become a growth industry, with numerous nations – including the US – opting for various direct and indirect barriers to trade since the global financial meltdown of September 2008. The World Bank notes nearly 90 new restrictions on trade since October 2008. Of the G-20 nations, 17 countries have implemented some type of trade protectionism since pledging not to in November 2008.

All these have led to growing concerns about de-globalisation. Many fear that it has already arrived, pointing to the recent collapse in global trade, the plunge in foreign direct investment, and the steep fall in global remittances.

But not all are equally pessimistic. Some see these trends as largely cyclical in nature and reflect more of a battered global economy that has slowed or halted the pace of virtually everything (capital, goods, services and people) that moves across borders. Moreover, there are also 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.

Nonetheless, the risks of de-globalisation should not be lightly dismissed. History has shown that protectionism begets protectionism. As the jobless ranks swell around the world in coming months, the backlash against globalisation will grow. The alternative may be de-globalisation or the unbundling of a tightly wrapped global economy that has yielded widespread growth and prosperity for rich and poor nations alike. This may sound far-fetched and alarmist. But it wasn't that long ago that US subprime loans were considered benign and contained to the US.

Source: Adapted from *economist.com*, 26 Mar 2009 & *FT.com*, 21 July 2009

Extract 6: US accuses China of manipulating its currency

Incoming US treasury secretary, Tim Geithner, has fired the first shot in what could be a new protectionist battle between America and China. He told US senators that Obama believes that China has been manipulating its currency, the yuan - an accusation that is likely to hurt relations between the two countries.

While it is an open secret that Beijing does take steps to manage the value of its currency, analysts warned that Geitner's comments risk disrupting the delicate balance between the two countries.

There was as yet no official response from the Chinese government to Geithner's comments. However, America is a hugely important market for China's factories, which have already suffered from the US economic slump. The flow of goods from east to west has meant China built up huge reserves of dollars.

But Geithner's remarks may find favour with the American manufacturers, unions and politicians who have claimed that Chinese firms have an unfair edge over foreign competitors.

Source: Adapted from *guardian.co.uk*, 23 Jan 2009

Extract 7: China, Protectionism and India's Vitamin C Shortage

Don't catch a cold in India. The country has reported a shortage of vitamin C for the past 3 months.

Due to curbs on raw material imports from China, drug manufacturers in India are finding it unviable to produce the medicine whose retail price is controlled by the government. They have cut down production of vitamin C tablets, leading to an acute shortage of the medicine prescribed to pregnant women, asthmatic patients and children with dental problems.

Companies from China produce most of the world's vitamin C as well as the key ingredients in many other vitamins, antibiotics and painkillers. However, India has imposed an anti-dumping tariff on Vitamin C imported from China for the last five years. This was recently extended by New Delhi for another five years, after it was deemed that the performance of domestic industry had not improved during this period.

Source: adapted from *news.gaeatimes.com*, 19 June 2009
& *businessweek.com*, 16 Sept 2009

Table 1: Selected Economic Indicators of USA

	2006	2007	2008	2009
Real GDP growth (Annual %)	2.7	1.9	0.0	-2.6
Current account balance (US\$m)	-802,640	-718,095	-668,858	-378,434

Source: The World Bank

Table 2: Selected Economic Indicators of China

	2006	2007	2008	2009
Real GDP growth (Annual %)	12.7	14.2	9.6	9.1
Current account balance (US\$m)	253,267	371,832	436,107	297,142
Currency exchange rates * (Chinese yuan / US dollar)	7.97	7.61	6.95	6.83

* Average per period

Source: The World Bank & OECD

Table 3: Selected Economic Indicators of India

	2006	2007	2008	2009
Real GDP growth (Annual %)	9.3	9.8	4.9	9.1
Current account balance (US\$m)	-9,299	-8,075	-30,953	-26,625
Currency exchange rates (India rupee / US dollar)	45.31	41.35	43.51	48.41

* Average per period

Source: The World Bank & OECD

Questions

- (a) Compare the change in USA's balance on current account between 2006 and 2009 with that of India over the same period. [2]
- (b) How does the value of the Yuan in 2009 compare to its value in 2006? [1]
- (c) With reference to the data, analyse the impact of a change in the exchange rates of China and India on their respective current account balances. [5]
- (d) Using AD-AS analysis, explain how China's manipulation of its currency has impacted the US economy. [4]
- (e) Discuss whether the Indian government's policy of imposing anti-dumping tariffs on imported Vitamin C from China can be justified in terms of economic theory. [8]
- (f) Extract 5 refers to the 'growing concerns about de-globalisation'. In the light of the issues raised in the extracts and using your own relevant knowledge, assess whether 'de-globalisation' is a cause for concern. [10]

[Total: 30]