

YISHUN JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATION 2013

H1 ECONOMICS
PAPER 1

8819/01
23 August 2013

TIME: 3 hours

Additional Materials: Answer Paper



READ THESE INSTRUCTIONS FIRST

Write your name, CTG and SG 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.

Section A

Answer **all** questions.

Section B

Answer **one** 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.

Section A

Answer **all** questions in this section.

Question 1 Rising Prevalence of Obesity

Extract 1: The Economics of Obesity

Obesity rates are continuing their relentless climb in developed and developing countries. It is more common among the poor and the less educated. A group of economists believes that the problem can be solved by making healthy eating a low-cost option.

There is a lot of evidence that economics plays a large part in the epidemic. Obesity rates among the poor, who are more likely to depend on high-fat, high-sugar foods for their meals, are substantially higher than the rates seen in higher income groups. Healthy diets are more expensive. There is a huge difference in cost per calorie between high-sugar, high-fat foods and fresh fruits and vegetables. To improve the diets of people on low income, fruits and vegetables should be subsidised.

Source: The Lancet 18 December 2004

Figure 1: Obesity rate and Health costs

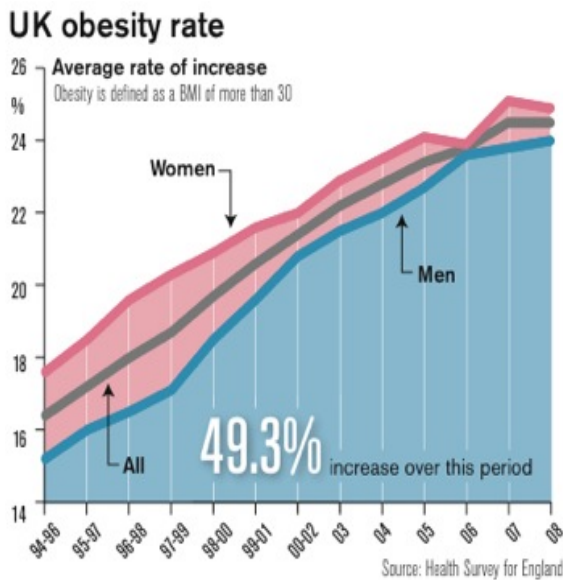
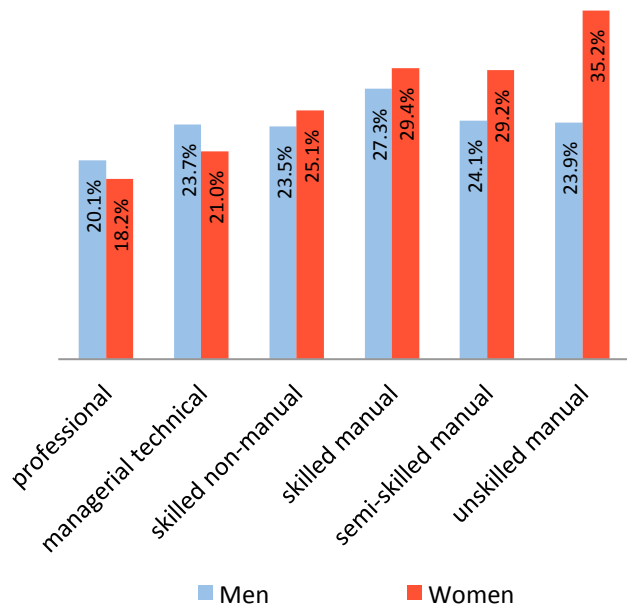
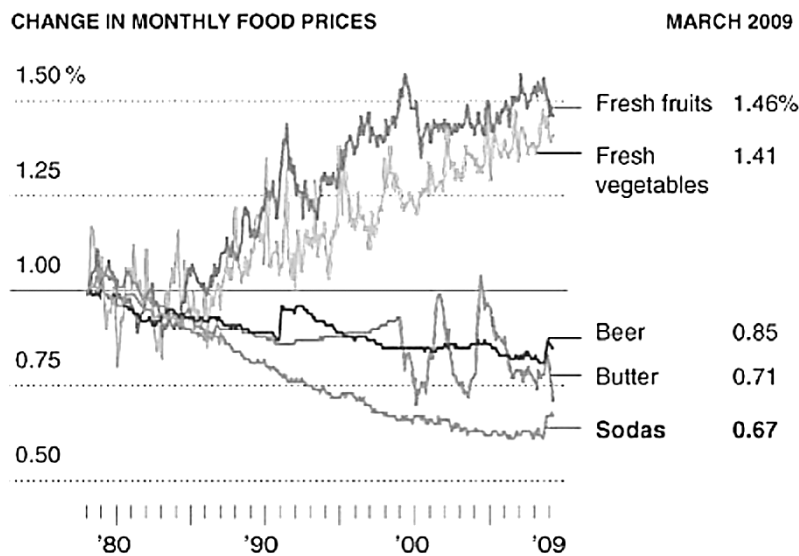


Figure 2: Prevalence of obesity in adults (aged 16 & over) by social class by occupations, 2005 – 2009



Source: National Obesity Observatory September 2012

Note: the percentage given in Figure 2 is an average figure over 2005-2009.

Figure 3: The Cost of Healthy Eating

Note: Lines show change in price of items since 1978, relative to overall inflation as measured by the Consumer Price Index.

Source : Bureau of Labour Statistics

Extract 2: Britain's obesity death rate

More people are dying in Britain due to being overweight or obese than anywhere else in Europe, a study revealed yesterday.

Experts also warned that the number of fatalities due to obesity may soon, for the first time, exceed those caused by smoking.

In around 70 per cent of overweight-linked cases, the final cause of death was heart disease and in 20 per cent, it was cancer. Overall, around 12 per cent of heart disease deaths in Britain were due to being overweight, and 5.7 per cent of total deaths from cancer were also directly caused by being overweight or obese.

Obesity costs £2.6billion a year in NHS bills and indirect losses to the economy. The consequences of obesity are not just for the individuals concerned but also for world food supplies, productivity and government finances. This demands action.

Source: www.dailymail.co.uk, accessed on Aug 8 2013

Extract 3: Containing Obesity

For those who believe that the state should generally keep its nose out of people's private affairs, obesity presents a quandary. If people get great pleasure from eating more than is good for them, should they not be allowed to indulge themselves? After all, individuals bear the bulk of the costs of obesity, quite literally. They suffer at work, too. Obese colleagues are perceived to 'lack self-discipline, be lazy, less conscientious, less competent, sloppy and emotionally unstable.' The existence of hiring prejudices, lower wages, and few promotional prospects relative to non-obese employees may be the result of these perceptions.

Yet in most countries the state covers some or most of the costs of health care, so fat people raise costs for everyone. In America, for instance, a recent paper estimated that obesity was responsible for a fifth of the total health-care bill, of which nearly half is paid by the federal government. And there are broader social costs. The Pentagon says that obesity is shrinking its pool of soldiers. Obesity lowers labour productivity. Hence, state intervention is justified. But how?

Drugs and surgery can help in the most extreme cases. They do not, however, offer a solution to the wider problem. Economists, faced with behaviour they don't like, tend to favour imposing "sin" taxes. But eating fatty and sugary foods is not a "sin", even in the fiscal sense, for unlike cigarettes, fatty foods are not uniformly unhealthy. Moreover, since poor people spend a higher proportion of their income on food than rich people do, such a tax would be regressive. It would also be an administrative nightmare, as the fat content of each item of food would have to be measured.

In the absence of a single big solution to obesity, the state must try many small measures. Governments should ensure that schools should serve nutritious lunches, teach children how to eat healthily and give them time to run around. Urban planners should make streets and pavements friendlier to cyclists and pedestrians. Much will depend on whether food companies will continue to push junk food or speed up the shift to healthier products. They have no incentive to stop making junk foods until consumers stop buying them, but consumers will not renounce such foods until companies make healthy ones more attractive.

Insurers and governments, for their part, will need to find new ways to nudge people into better behaviour. Policymakers now have a better understanding of why people make poor decisions about their health, and mobile technology can help them to make better ones. As such experiments continue, there will be more evidence of what works, and whether it can be made politically acceptable.

There is a limit, however, to what the state can or should do. In the end, the responsibility and power to change lie primarily with individuals. Whether people go on eating till they pop, or whether they opt for the healthier, slimmer life, will have a bigger effect on the future of the species than most of the weighty decisions that governments make.

Source : Adapted from The Economist, 15 September 2012

Questions

- (a) (i) Summarise what happened to the obesity rate of women and men in the UK between 1994 and 2008. How do they compare with each other? [2]
- (ii) Using data given, account for the difference in the obesity rates between men and women. [2]
- (b) (i) In the light of Extract 1, using supply and demand analysis and diagrams, explain how you would expect subsidies for fruits and vegetables to change the diet of the people. [6]
- (ii) Explain whether the data shown in figure 3 support the call for subsidies for healthy food. [3]
- (c) (i) Suggest **one** negative externality claimed to arise from obesity. [2]
- (ii) What are the implications of rising prevalence of obesity on the macroeconomic performance of an economy? [4]
- (d) Extract 3 suggests that obese workers are being discriminated at work place. [3]
- Comment on how the existence of obesity hinders the ability of labour markets to optimally allocate resources.
- (e) As a consultant economist, what options would you present to the UK government as possible responses to the rising obesity, and what would you recommend? Justify your answer. [8]

[Total : 30 marks]

Question 2 Trade Imbalances: US and China

Extract 4: US – China trade deficit grows to record

The US trade deficit between China has hit a record high, fuelling tensions between the countries over currency imbalances.

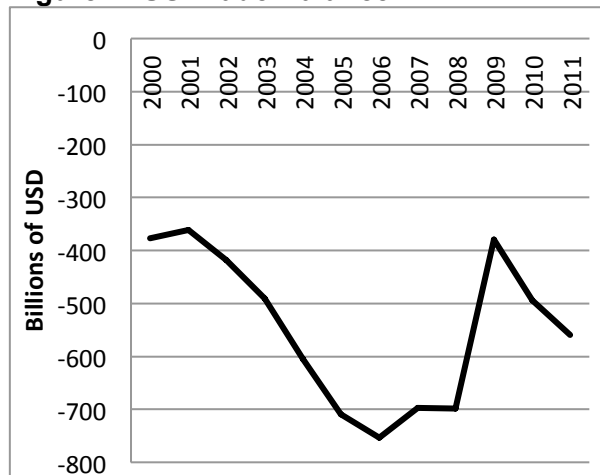
The gap between US imports from China and what it sold to the country rose to \$273.1bn last year, the largest trade imbalances the US has ever recorded with a single country. While US exports to China grew by a third last year to an all-time high of \$91.9bn, imports worth \$364.9bn travelled in the other direction, an increase of 23.1%.

Some US politicians blame Beijing for the size of the trade gap between the nations, claiming it unfairly keeping the yuan's value too low. A bill was proposed to allow the US to impose emergency tariffs against China if its currency was found to be undervalued.

China has long denied that it is responsible for American exports lagging so far behind its imports.

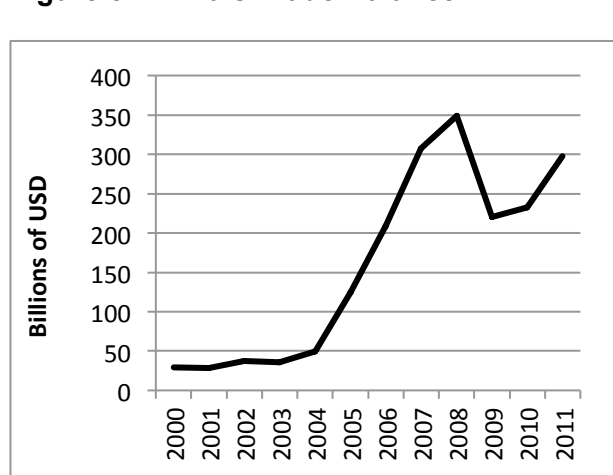
Source: The Guardian, 11 February 2011

Figure 4: US Trade Balance



Source: United States Census Bureau,
US Department of Commerce

Figure 5: China's Trade Balance



Source: The World Bank

Extract 5: Don't Blame China's Currency for US Trade Deficit

To focus on China's currency is to miss the real story behind the country's trade surplus. The truth is that China's surpluses are not driving America's deficits.

Three phenomena largely explain the emergence of China's trade surpluses: surging American consumption and fiscal deficits that fuelled import demand; a maturing East Asian production network centered on China; and the ratcheting-up of China's savings rates.

Indeed, rather than complaining about China's exports of relatively labour-intensive products, Americans should ask themselves why their country isn't able to produce the high-tech, capital-intensive components coming to the US from the North Asian trio via China. These activities command the skills and salaries more appropriate for American workers.

Extract 6: Two cheers for a big US trade deficit

There's nothing to fear about trade imbalances. They only mean more investment in US industries and businesses.

While a "deficit" in trade sounds bad, no real deficit exists. Most trade statistics simply fail to account for foreign investment. Foreign investors do not sit on their dollars. They invest in dollar-denominated assets like stocks and bonds, real estate, or even government debt.

The trade deficit has helped the US maintain the highest level of foreign direct investment in the world by far. In 2010, foreigners invested almost \$2.6 trillion in US banks, businesses, real estate and, to a lesser extent, the government — more than 4.5 times the level of foreign investment in China last year. Companies invest this foreign capital in research and development, factories, and workers, which creates new wealth and jobs.

Phony fears over trade deficits lead to phony "solutions" that end up doing harm. Protectionists who harp on trade deficit fears often propose to subsidize exports, restrict imports, or both. Tariffs and quotas keep inexpensive foreign goods out, driving up prices for consumers and costs for businesses. In response to the US import restrictions, for example, candy makers like Hershey and Lifesavers were forced to move their operations outside the US.

Trade quotas raised steel prices by almost 30% in the United States, which forced the US container industry to close factories. As the container industry bought less steel from abroad, overseas firms had fewer dollars to buy US products or to invest in the US economy. This damages all aspects of the economy.

While export subsidies help American car manufacturers like General Motors and Chrysler, American consumers who incur the costs through taxes have less money for other products.

Furthermore, export subsidies prevent labour and capital from relocating to other industries where they could better serve consumers. Subsidies for GM and Chrysler keep consumers from buying as many foreign cars, so Koreans, Germans, and Japanese have fewer dollars to buy US products and invest in U.S. companies.

Such protectionist voices are wrong. Imports, as much as exports, are good for American jobs and prosperity.

Source: Adapted from www.forbes.com, 18 August 2011

Extract 7: China is working towards rebalancing its trade

Ways to rebalance China's trade:

- China plans to cut tariffs on imports.
- Structural reforms have been taken to strengthen the social safety nets and boost wages to encourage domestic consumption. The problem is China's high saving rates, which might be dynamically welfare-optimising for its citizens.
- A cut in income tax is introduced to give more disposable income to Chinese consumers and workers.

Extract 8: China's economic white elephant

Funds wasted by local governments in China are a drain on the economy and badly hamper urgently-needed reforms.

Massive investment projects led by local governments are going from one city to another to reclaim land, flatten hills, redirect rivers, and remove entire villages and townships.

All the investments have a doubly dampening effect by channeling society's money away from consumers and by supporting often excessively large projects that offer little use to small private companies.

As for the government, officials need to realize that some things are more important than just big money and big numbers. They also have to create jobs without building new factories, generate prosperity (and tax revenue) without spending a lot of public funds and, perhaps, sell some of their useless projects to turnaround managers from the private sector.

Source: My Paper, 30 July 2013

Questions

- (a) Compare the change in the US's and China's trade balances between 2000 and 2011. [2]
- (b) Explain how the revaluation of the yuan can reduce the trade imbalance between US and China? [4]
- (c) "There's nothing to fear about trade imbalances. They only mean more investment in US industries and businesses."
 - (i) Explain this statement. [4]
 - (ii) Using AD-AS analysis, explain the possible impacts of FDI on the US economy. [6]
- (d) Comment on the view that "phony 'solutions' by the US to solve its trade deficits could end up doing harm". [6]
- (e) Discuss the extent to which China's attempt to rebalance its economy could reduce its trade imbalance with US. [8]

[Total : 30 marks]

Section B

Answer **one** question from this section.

- 3** 'Relative scarcity is the basic economic problem. The nature of this problem that is faced by all societies is the same. The seriousness of this basic problem, however, can be reduced by countries trading with each other.'
- a)** Explain the nature of the basic economic problem faced by all societies. [10]
- b)** Discuss the extent to which trade between countries can reduce the seriousness of the basic economic problem. [15]
- 4** Singapore is facing significant challenges in the new era of slow growth, quantitative easing and rock-bottom interest rates in the US and UK that will have knock-on effects on the general price level.
- a)** Explain the effects of 'quantitative easing and rock-bottom interest rates in the US and UK' on the general price level in Singapore. [10]
- b)** Discuss the effectiveness of the exchange-rate centred monetary policy in Singapore to overcome the twin challenges of slow growth and inflation. [15]