ANDERSON JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATIONS 2011
HIGHER 2

ECONOMICS | 9732/01

Paper 1

13 September 2011

2 hours 15 minutes

Additional Materials: Answer paper

READ THESE INSTRUCTIONS FIRST

Write your name, PDG and index number 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.

Answer **all** question parts.

At the end of the examination, **fasten your answers to each question separately**.

Fasten **this cover page in front of your answers to Question 1**.

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

Name ____________________________( )

PDG ______/10

	Marks
Question 1	**/ 30**
Question 2	**/ 30**
Total Marks	**/ 60**

This document consists of **8** printed pages, including **1** "blank page".

[Turn over

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Answer **all** questions.

Question 1 **A look at Korea and Japan**

Extract 1: Korea

Following the severe contraction in late 2008, Korea has achieved one of the earliest and strongest recoveries in the Organisation for Economic Co-operation and Development (OECD) area, led by exports and its stimulus package. The sustained pick-up in exports, together with a rebound in domestic demand, is projected to help boost output growth to 5 to 6 per cent in 2010.

Extract 2: Japan

The severe recession triggered by the global crisis has bottomed out, thanks in part to a rebound in exports, although production remains well below capacity. Growth is projected to pick up gradually to around 3 per cent in 2010. Nevertheless, the unemployment rate is likely to stay around 5 per cent through 2010 and deflation will persist, indicating that consumers will be reluctant to spend and business confidence will remain weak.

Table 1: Korea's Macroeconomic Indicators

	2006	2007	2008	2009	2010*
GDP (US$ billion, PPP)	1191	1287	1344	1375	1459
Real GDP Growth (annual % change)	5.2	5.1	2.2	0.2	6.1
Inflation rate (%)	2.2	2.5	4.7	2.8	4.1
Unemployment rate (%)	3.8	3.3	3.2	3.7	2.9
Current account balance (% of GDP)	0.6	0.6	-0.7	3.1	2.5

[*Projected]

Table 2: Japan's Macroeconomic Indicators

	2006	2007	2008	2009	2010*
GDP (US$ billion, PPP)	4080	4297	4358	4146	4310
Real GDP Growth (annual % change)	2.0	2.4	0.7	-6.3	2.9
Inflation rate (%)	0.2	0.1	1.4	-1.4	-0.7
Unemployment rate (%)	4.1	3.5	4.0	5.1	5.2
Current account balance (% of GDP)	3.9	4.8	3.2	3.4	3.8

[*Projected]

Source: Organisation for Economic Co-operation and Development, Economic Outlook 2010

Extract 3: South Korea in dispute over withdrawal of stimulus

South Korea's finance ministry and central bank appear on a collision course over when and how to exit economic stimulus measures, with signs of a growing recovery in Asia's fourth-biggest economy. The Ministry of Strategy and Finance, which is leading the country's crusade to emerge from the global slowdown, cautions against ending economic stimulus measures, citing a fragile recovery and unemployment.

But the Bank of Korea (BOK), which makes taming inflation its top priority, insists on raising benchmark interest rates in order to curb consumer price hikes and prevent bubbles in the asset markets. Bowing to the government pressure, however, the committee decided to keep its key interest rate unchanged at a record-low 2 per cent for an 11th month, a move welcomed by the finance ministry. The bank slashed the policy rate by a total of 3.25 percentage points over four months from October 2008 to a record low of 2 per cent to shield the export-driven economy from the fallout of the global financial crisis. For its part, the government has taken a series of stimulus measures, highlighted by a 28.4 trillion won (US$25.1 billion) supplementary budget and tax cuts aimed at bolstering consumption and corporate investment.

“Given the expected strength of output growth in 2010, it is important that the Bank of Korea not fall behind in withdrawing monetary stimulus given the risks of keeping the benchmark interest rate too low for an extended period of time. Also, the prompt withdrawal of fiscal stimulus in 2010 will help the government meet the medium-term fiscal plan of reducing budget deficits”, added Kim Sang-jo, an economics professor at Seoul's Hansung University.

Source: United Press International Asia, 08 January 2010

Extract 4: Hitachi, Mitsubishi edge towards groundbreaking merger

Hitachi Ltd and Mitsubishi Heavy Industries Ltd have begun talks to merge, a move that would bring much needed consolidation to corporate Japan. A combination of two of Japan’s oldest, most established conglomerates would mark a deeper embrace of mergers as a tool for corporations to squeeze costs, combat a surging yen and gain competitive scale. Bolstering global competitiveness has become a more urgent task as Japanese companies lose market share to companies from elsewhere in Asia. Their low profitability in particular makes it difficult for them to engage their Asian rivals in price competition.

Both companies have been weighed down for years by high cost structures, a shrinking domestic market and excess capacity, making it a struggle to make a profit for years. Hitachi, Japan’s biggest industrial electronics firm, turned its first net profit in five years in the year ended in March and is still trying to reduce the size of its sprawling empire of 900 group firms. It has lost $14.3 billion in the last 10 years, compared with rival General Electric, which generated net profit of $160 billion in the same period. Mitsubishi Heavy, the nation’s leading heavy machinery maker, remains saddled by losses on its jet and shipbuilding operations. A merger would create a $150 billion revenue infrastructure firm second globally only to GE, and could provide impetus for cost cuts essential if the two companies are to thrive in an environment with the yen trading at around 77-79 yen to the dollar.

However, it is not all cheer at the companies. Managers will likely have to seek the understanding of their workers before any agreement is reached because doing so could result in the closure of some units. Some skeptics believe that combining the businesses, if it comes to pass, will simply create a muddle. Hitachi has some of the world's most impressive green-energy technologies, but they are lost in a corporate structure ill-equipped to exploit them. Yet the moves are too little too late; the company holds on to poorly-performing units for far too long, and only takes action when there is a crisis.

Source: Reuters, 4 August 2011

Questions

(a) **(i)** Identify the trend in unemployment rate for Korea and Japan from 2006 to 2010. **[2]**

(ii) Account for the projected change in Korea's unemployment rate. **[4]**

(b) Extract 2 mentioned that "deflation will persist". Explain the term "deflation" and how it can affect Japan's economy negatively. **[6]**

(c) With reference to the case study, discuss the view that Korea should change its existing macroeconomic policies. **[8]**

(d) With reference to the data provided where appropriate, discuss whether the proposed merger of Hitachi and Mitsubishi should be encouraged. **[10]**

[Total: 30 marks]

Question 2 **Freer trade and investment: Beneficial or not?**

Figure 1: Brazil's Current Account

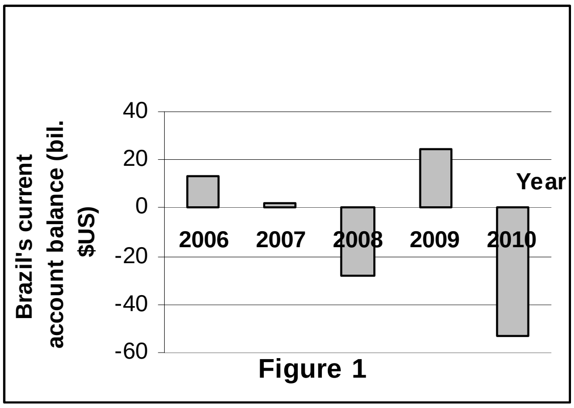
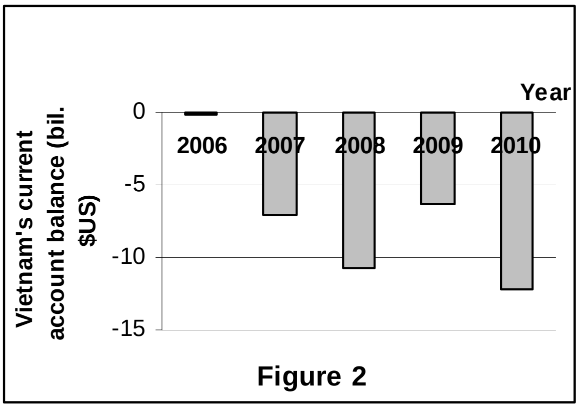


Figure 2: Vietnam's Current Account



Source: The World Bank

Extract 5: Trade and investment between Singapore and Brazil

Trade ties between Singapore and Brazil will get a boost, after the two countries signed an agreement on trade. Singapore is Brazil's sixth trading partner in Asia. Trade between both sides has grown steadily over the years, benefitting consumers in both countries as they are able to buy greater variety of goods. In the past five years, trade volume has surged by 230 per cent, making Brazil Singapore's largest trade partner in South America. Meats continued to contribute with the greatest number of products exported among the ten leading ones, with four categories. This was due, mostly, to a growing effort of Singapore to diversify its markets towards new continents, with the aim of curbing the restrictions of the regional supply. There were also significant efforts on the Brazilian side to expand its market, which comes to amount in some months to over 80 per cent of the chicken consumed in the island.

Singapore is also looking towards Brazil for its expertise in areas such as renewable clean energy. The science and technology agreement will see both sides collaborating in areas such as microbiology and dengue control, with a view to develop a vaccine against the disease.

It is known that Singapore is the second largest investor from Asia in Brazil, after Japan. In recent years, these investments have expanded, notably with the acquisition of the national shipyards by Singaporean companies. Keppel Offshore & Marine acquired the former Verolme shipyard, with facilities in Niterói and Angra dos Reis, employing more than five thousand workers. In addition, there are significant investments in the area of paper and pulp, electric and electronic items as well as shipment and storage of commodities, which will boost Brazil's export sector in the future. Although these investments created more job opportunities, there are concerns that the local workers are not used to the different working cultures such as the hectic and long working hours.

Recently, Temasek, holding for governmental assets with a portfolio superior to US$100 billion, announced that it will open a branch in Brazil in June 2008. In addition, there is also a growing number of Brazilian companies that have their regional office based in Singapore, covering the operations in Southeast Asia or in the overall Asia-Pacific region.

Adapted from Channel NewsAsia, 26 November 2008 and Embassy of Brazil in Singapore, 2008

Extract 6: Coffee prices expected to jump

Coffee prices may jump as much as 26 per cent in 2009 as Brazil, the biggest producer and exporter, harvests less of the bean and boosts consumption. A global credit crunch prompted Brazilian farmers to use less fertilizer after prices for the additive surged, worsening the outlook for a coffee crop that is already likely to be lower because of a slower growth cycle and dry weather. The decline will come just as Brazil runs out of stocks, while domestic demand grows to match sales in the United States, the biggest consumer of the beverage, as early as next year.

Output may drop as much as 20 per cent this year as most trees enter the slower half of a two-year growth cycle and farmers use less fertilizer to cut costs, according to the government. Coffee growers will harvest between 36.9 million bags and 38.8 million bags, down from 46 million last year. Brazil's consumption of coffee will likely rise to 21 million bags in 2010, up from 19.2 million this year, matching little-changed demand in the United States.

Coffee is a very popular drink in Asia and many consumers from Vietnam and Singapore are wondering how this might affect the price of a cup of coffee.

Adapted from Bloomberg, 14 January 2009

Extract 7: Vietnam trade deficit drops

Vietnam's trade deficit dropped to an estimated US$2.1 billion ($3 billion) for the first half of 2009 as imports dived, according to official figures released Thursday. Vietnam's trade deficit hit a record of US$17 billion in 2008. In the first six months of 2009, exports fell by 10.1 per cent year-on-year to US$27.61 billion, while imports totalled US$29.72 billion, down by 34.1 per cent. In the six-month period, Vietnam - a low-income but booming economy where the gross domestic product grew by 6.18 per cent last year - spent US$2.12 billion on steel imports, down more than half compared with the same period last year.

Source: Agence France-Presse, 25 June 2009

Extract 8 : Fostering Vietnam-Singapore relationship

Relations between Vietnam and Singapore have fared well since both countries established diplomatic ties in 1973. During a visit to Singapore in March 2004 by the then Prime Minister Phan Van Khai, the two countries signed a joint statement on the framework of comprehensive cooperation in the 21st century, laying the legal foundations for promoting bilateral friendship and cooperative ties.

Singapore is Vietnam's third largest trading partner, with two-way trade in 2008 reaching US$12 billion, up 23 per cent against 2007. However, from January to October 2009, bilateral trade only fetched US$4.9 billion due to the adverse effects of the global economic recession. In addition, Vietnam is one of Singapore's key investment destinations in Southeast Asia. By November 2009, Singapore had invested in 763 operational projects amounting to US$17 billion in Vietnam, ranking fifth amongst foreign investors in the country. These projects, which focus mainly on industry, infrastructure construction, services and real estate, have paid off, helping Vietnam to generate jobs, increase exports and stimulate its economy. The Vietnam-Singapore Industrial Park in the southern province of Binh Duong has also become a role model for investment and cooperation between Vietnam and foreign businesses. However there is a growing concern about how the deteriorating quality of air might affect residents who are staying within the vicinity. In addition, some economists are concerned that the pace of growth in Vietnam may be too fast such that there may be overheating, impacting the lives of the low-wage workers.

The Singapore economy depends heavily on exports and services, which make up 40 per cent of its GDP. The manufacturing industry is well-diversified and includes electronics, petroleum refining, chemicals, mechanical engineering and biomedical science sectors. Singapore is taking the lead in shifting its economy to a knowledge-based one and the country aims to become a diverse economic hub globally in 2018. This will ensure that Singapore's export sector is able to remain competitive and continue to grow, hence allowing her citizens to enjoy greater job opportunities and higher income.

Adapted from Voice on Vietnam, 12 January 2010

Questions

(a) **(i)** Compare the change in the current account balance between 2006 to 2010 for Brazil and Vietnam. **[2]**

(ii) With reference to Figure 2 and Extract 7, account for the difference between trade balance and current account balance in Vietnam in 2008. **[2]**

(b) "Singapore had invested in 763 operational projects amounting to US$17 billion in Vietnam."

(i) Explain how this investment may affect Vietnam's current and capital account balances. **[4]**

(ii) Analyse how Vietnam's national output and inflation rate may be affected by this investment. **[6]**

(c) Using demand and supply analysis, explain why coffee prices are expected to "jump". **[6]**

(d) With reference to the data provided and your own relevant knowledge, discuss whether the increasing trend towards freer trade necessarily improves standard of living. **[10]**

[Total: 30 marks]

– End of Paper –