INNOVA JUNIOR COLLEGE
JC 2 PRELIMINARY EXAMINATION 2
in preparation for General Certificate of Education Advanced Level
Higher 1

ECONOMICS 8819/01

Paper 1 **10 September 2012**

3 hours

Additional Materials: Writing Paper and Cover Page

READ THESE INSTRUCTIONS FIRST

Write your name and class 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/tape.

Section A: Case Study

Answer **all** questions.

Section B: Essays

Answer **one out of two** questions.

At the end of the examination, 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 advised to spend several minutes reading through the data before you begin writing your answers.

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

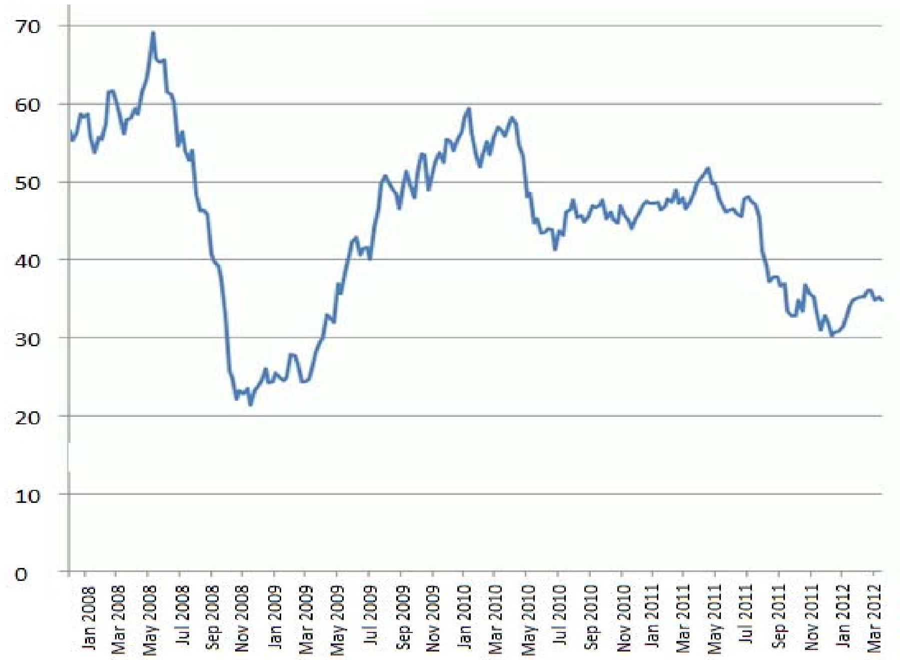
This document consists of **8** printed pages.

Section A

Answer **all** questions in this section.

Question 1 **The market for steel**

Figure 1 Global composite steel price index



Note: Global composite steel price is a weighted average of the lowest transacted cost of all steel products converted into US dollars. 2004 = 100.

Source: www.bloomberg.com

Extract 1: Global steel market

The recent Eurozone sovereign debt crisis has created a lot of uncertainty in the steel market. This uncertain macroeconomic environment – with distressed financial markets and large government budget deficits – has led to countries implementing a number of austerity measures. In fact, certain parts of the world have suspended investment in large-scale infrastructure projects. As a result, steel demand has not rebounded as strongly as predicted.

Meanwhile, growth in Chinese steel production has changed the country from a net steel importer to a net steel exporter. Other emerging economies, such as South Korea and Taiwan, are also installing newer steel capacities. There is now significant over-capacity in the global steel sector.

Source: Global steel outlook 2011 and 2012; Ernst & Young's Global Mining & Metals Center

Extract 2: Environmental aspects of steel production

The primary process of steel production from iron ore involves three basic steps: First, the heat source used to melt iron ore is produced. Next the iron ore is melted in a furnace. Finally, the molten iron is processed to produce steel. This production of steel from ore is the most energy intensive and emits the most carbon dioxide. The main source of pollution comes from the use of coke - a solid carbon fuel – to melt and reduce iron ore. Water pollution also comes from the water used to cool coke after it has finished baking.

Source: www.steel.org and www.oecd.org

Extract 3: The Kyoto Protocol

The Kyoto Protocol is an international agreement to reduce greenhouse gas (GHG) emissions. The major features of the Kyoto Protocol are summarised below:

1. Binding targets are set for 37 industrialized countries and the European community to reduce GHG emissions by an average of 5.2 per cent (based on 1990 levels) by the year 2012.
2. Recognising that developed countries are principally responsible for the current high levels of GHG emissions in the atmosphere, the Protocol places a heavier burden on developed countries.
3. Countries must meet their targets primarily through national measures. However, the Kyoto Protocol offers them an additional means of meeting their targets by way of Emissions Trading – known as “the carbon market". The countries are allowed to trade amongst themselves rights to emit six greenhouse gases. If a country reduces emissions below its agreed limit, it will be able to sell the additional reduction as a credit. So if a country is finding it difficult to cut emissions, it will be able to buy these credits from other countries.

Source: United Nations Framework Convention on Climate Change and
J. Sloman, Economics

Extract 4: Is emissions trading effective?

Some of Europe's largest industrial companies gained billions of euros from the carbon emission rules they lobbied fiercely against, new analysis reveals today. Europe's top 10 steel and cement companies have amassed 240m carbon pollution permits from generous allocations. The free permits, granted to companies with a market value of €4 billion, can be sold or kept for future use. The European commission estimates that the entire energy-intensive sector will have accumulated allowances worth €7 billion to €12 billion by the end of 2012.

The European Union emissions trading scheme (ETS) puts a cap on the carbon pollution emitted by energy and industrial companies. Those reducing their emissions can sell their spare permits to those who do not. But a combination of initial over-allocation by national governments and the economic decline has left the steel, cement, chemical, ceramic and paper sectors with many more permits than they need. For instance, it was estimated that if the steel sector did not sell any of its surplus, it would not have a need to purchase emissions until 2023.

Analysis also revealed that 9 of these top 10 steel and cement companies bought between them 24.4m permits from the cheaper international market, mainly from companies in China and India. These can be used within the EU's trading scheme, enabling companies to retain the more valuable European ETS permits. Furthermore, despite the European companies claiming that tougher emissions rules would drive business overseas, some were paying overseas steel and cement companies for their international carbon permits.

Source: *The Guardian*, 19 June 2011

Extract 5: US Protectionism of steel industry

Steel has traditionally been among the most protected sectors, especially because of the political and regional clout it commands in many countries and intense lobbying that often takes place by steel companies. For instance, the American Iron and Steel Institute (AISI) had, on several occasions, successfully lobbied for the introduction of protectionist measures. It is estimated that these measures cost the US steel consumers around US$16.8 billion between 2000 and 2007. Analysis further revealed that these measures were meant to save a dying industry in the US rather than countering unfair trade, which was the reason often advanced by the US when restricting steel imports.

Source: Indian Institute of Management

Questions

(a) **(i)** Summarise the trend in the global composite steel price from 2008 to 2011 as shown in Figure 1. [1]

(ii) Extract 1 refers to recent changes in the global steel market.

Using a supply and demand diagram, explain how you would expect the recent Eurozone sovereign debt crisis and the growth in steel production in emerging economies to have impacted the world market for steel. [4]

(b) **(i)** Explain what is meant by negative externality. [2]

(ii) With reference to the data, explain how the production of steel gives rise to negative externality. [4]

(c) Discuss the extent to which emissions trading can curb global greenhouse emissions. [8]

(d) **(i)** Comment on the case for the use of protectionist measures by the US government to protect its steel industry. [3]

(ii) In the light of the issues raised in the extracts, assess the extent to which the removal of such protectionist measures will be beneficial to an economy such as China. [8]

[Total: 30 marks]

Question 2

Economic Priorities

Extract 6: Financial crisis could turn the tide against unrestricted capital flows

The theory says that free capital flows allow savings to be directed – by the invisible hand of the financial markets – to wherever they will be most profitably employed. In this way, savers get a better return on their nest egg, while underdeveloped economies receive the financial leg-up they need.

Except that isn't what's been happening: instead, for the past decade and more, savings have been pouring uphill from poor countries to rich. Far from nurturing development and improving the standard of living of the poorest, these vast flows of money have created a repeated pattern of boom, bust and financial crisis.

In recent years, several countries have quietly begun erecting breakwaters against the latest tidal wave of capital, driven by low interest rates in the west. Brazil, Argentina and Costa Rica have used various measures, including taxes on purchases of shares and bonds and insisting that short-term investors deposit funds with the central bank for a year, to dampen the stop-go cycle.

One unlikely recent champion of the reintroduction of regulations on capital flows is the Bank of England. The shock of being caught unawares by the vulnerability of the UK's financial system in 2007 and 2008 caused soul-searching in Threadneedle Street, and recent papers and speeches have helped build the case for new thinking.

Adapted from: *The Observer*, 8 January 2012

Extract 7: Counter-cyclical policy responses

An important lesson from the severity of the recent world financial crisis is that policy in various areas will have to be more prudent during upswings and to build in greater safety margins to be able to react to large adverse shocks. For instance, the room for fiscal policy to react to a downturn is constrained by budget deficits and debt at the outset. In general, the poorer the fiscal position the less reactive governments have been and can be in their response to adverse shocks.

Adapted from: Organisation for Economic Cooperation and Development (OECD), 2010

Extract 8: IMF cuts UK economic growth forecast for 2011 to 1.75%

The International Monetary Fund (IMF) has cut its 2011 growth forecast for the UK economy to 1.75%, its third downgrade in a year. The cut cements the widely held view that Britain faces a year of low growth and rising unemployment with little prospect of a job-creating recovery until later in 2012.

The report warns that the downside risks to UK growth have increased as the potential for policy mistakes in the eurozone have risen. The cost of oil and other raw materials, which have jumped 32% over the last year according to the IMF's own index, also pose extra risks.

Source: *The Guardian*, 11 April 2011

Extract 9: South Korea economy

One of the major threats to the Korean economy is the global economy facing a patchy recovery due to continued stiff head winds, such as high-flying commodity prices and currency disputes among advanced economies.

Global economies will continue to fall into two distinctive camps dubbed the "two-speed world." Western economies and Japan will undergo a slow recovery mode, while developing economies, including emerging market economies, will continue to enjoy robust growth.

Under this new trend, the Korean economy and companies should shift their focus to emerging economies from developed countries to capitalize on the upcoming change triggered by the outcome of the global financial crisis.

"We expect the global recovery to remain a two-track one, with the emerging economies growing much faster than the developed world economies," Nomura Securities said in its 2011 outlook report. "For the developed economies, the post-crisis world likely means prolonged anemic growth."

Source: *The Korea Times*, 31 Dec 2010

Table 1: Youth Unemployment Rates, December 2007 to March 2012 (Percentage of total youth labour force (15-24)

Country	**December 2007**	**March 2012**
Greece	21.6	51.2
South Korea	8.7	9.5
UK	13.6	21.9

Source: *The Guardian*, 16 May 2012

Table 2: Labour Productivity Annual Growth Rate

Country	2007	2008	2009	2010	2011
Greece	2.8	-1.5	-0.3	-2.8	-0.9
South Korea	5.5	4.3	1.2	6.5	1.8
UK	2.2	-0.8	-2.3	1.8	1.9

Table 3: Gross Domestic Product Annual Growth Rate

Country	2007	2008	2009	2010	2011
Greece	3	-0.2	-3.3	-3.6	-7.2
South Korea	5	2.3	0.3	6.1	3.6
UK	3.4	-1.1	-4.5	2.1	0.7

Source: OECD, 2012

Extract 10: Innovation

Much of the rise in living standards is due to innovation. Today, innovation performance is a crucial determinant of competitiveness and national progress. Moreover, innovation is important to help address global challenges, such as climate change and sustainable development. But despite the importance of innovation, many OECD countries face difficulties in strengthening performance in this area. Indeed, many OECD countries have seen little improvement in productivity performance in recent years despite the new opportunities offered by globalisation and new technologies, especially the information and communication technologies.

Source: OECD, *Innovation and Growth Rationale for An Innovation Strategy*, 2007

Questions

(a) **(i)** State the economic relationship that exists between labour productivity growth and economic growth in UK and South Korea. [1]

(ii) Account for the above economic relationship in South Korea. [2]

(b) Explain the case for the use of regulations by UK government to manage huge ‘capital floods’. [4]

(c) **(i)** Compare the youth unemployment rates in Greece, South Korea and UK. [2]

(ii) Explain the impact in both the short run and the long run of the above situation in Greece or UK. [3]

(d) Extract 10 suggests that ‘much of the rise in living standards is due to innovation.’ Discuss the validity of this argument. [8]

(e) “An important lesson from the severity of the recent world financial crisis is that policy in various areas will have to be more prudent during upswings and to build in greater safety margins to be able to react to large adverse shocks.”

Assess the extent to which the UK government’s economic priorities may be adjusted in response to growing youth unemployment? [10]

[Total 30 marks]

-End of Paper-

Section B

Answer **one** question from this section.

3 **(a)** Explain, using examples, what is meant by public good and demerit good. [10]

Singapore did not fare well in three areas – availability, affordability and quality of preschool services. The Lien Foundation called for pre-school education to be provided free for all children nationwide.

Adapted from Straits Times, 21 July 2012

(b) Discuss whether Singapore government should take charge of pre-school education, and offer it free to all children. [15]

4 **(a)** Explain the key economic aims of a country. [10]

(b) It is said that globalisation comes at the cost of the macroeconomic objectives, environment and equity. Discuss the policies currently adopted by the Singapore government to deal with the impact of globalisation. [15]

-End of Paper-