Jurong Junior College
2015 JC2 Preliminary Examination

ECONOMICS

Higher 1 **8819/01**

31 August 2015

3 hours

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.

Section A
Answer **all** questions.

Section B
Answer **one** question.

Start each question on a new piece of paper.

Fill in the necessary information on the cover sheet.

At the end of the examination, fasten all your work securely with the **cover sheet at the top.**

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

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

Section A

Answer **all** questions in this section.

Question 1

Steel Production and Protectionism

Extract 1: Steel production in China is closely watched

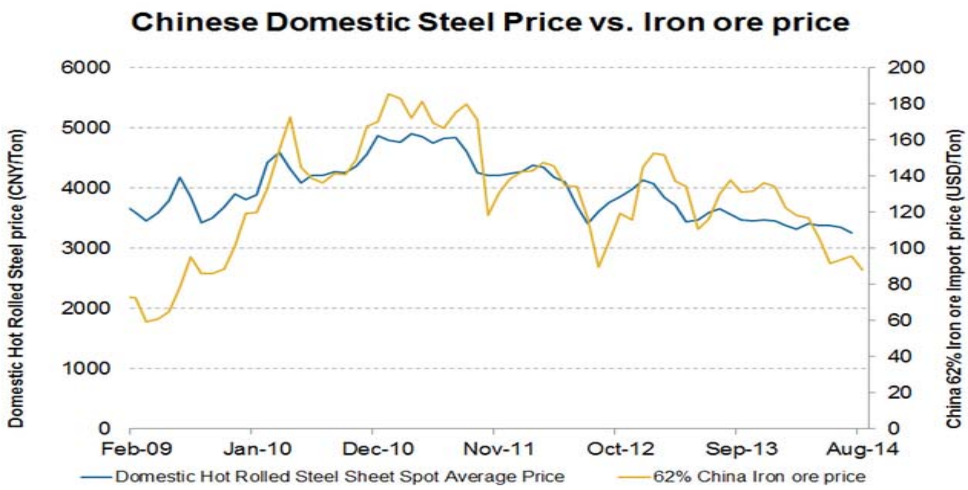
Chinese prices and production of steel are the most closely watched – the country forges almost as much steel as the rest of the world combined – and record-setting production in 2013 made up for persistent softness in the rest of the world, particularly Europe.

However, Chinese steel production growth is likely to slow in 2014 as authorities enforce stricter environment controls in production to clamp down on pollution in the industry and address overcapacity by banning new steel plants, tightening credit and withdrawing stimulus.

Chinese steel mills have been in oversupply since 2004 and efforts by the new leadership to steer the country to a consumption-based economy and away from infrastructure development led growth will also dampen growth of steel production.

Source: www.*mining.com*, 22 January 2014

Figure 1: Steel and Iron Ore Prices



Source: Antaike Information Development Company, The Steel Index

Extract 2: Government expenditure on infrastructure in China

China has been experiencing rapid economic growth over the past two decades. A significant proportion of this growth since the early 1990s has been due to the government increasing its spending on improving the quality of infrastructure.

The rapid development of infrastructure in China over the past few decades is reflected in the improvement in a range of social and economic indicators. Infrastructure can be classified in various ways, but a standard grouping is: municipal infrastructure, utilities, transportation and social infrastructure.

Municipal infrastructure includes water conservation, waste management and urban road maintenance. Over the past decade, this has comprised the largest share of infrastructure spending, accounting for almost 30 per cent of the total.

Utilities have been the second largest component of infrastructure spending over the past decade, comprising around one-quarter of infrastructure spending. This infrastructure is a vital input to industrial production, which requires a reliable energy supply. During the past decade, this spending on utilities infrastructure has resulted in more than 99 per cent of the population now having access to electricity. Access to reliable water sources has also reached 98 per cent of the population in urban areas.

Transportation infrastructure has comprised roughly a quarter of total infrastructure spending. This has seen China's highways and rail networks expand rapidly since 1990.

Social infrastructure has accounted for about 12 per cent of infrastructure spending and it includes cultural infrastructure as well as healthcare and education facilities.

In addition to being employed to advance the longer-term development of the Chinese economy, government expenditure on infrastructure has also been used as a countercyclical policy tool to stimulate economic activity. This was most evident during 2008–2009 in response to the global financial crisis.

However such expenditure on infrastructure is not without its risks. Some of these include the potential for misallocation of resources through inefficient spending. Over-spending on public infrastructure also contributes to the crowding out of private investment and results in excess capacity in some areas.

Infrastructure development in China has proceeded rapidly over the past few decades, contributing significantly to economic growth and improving standards of living. While its scale being undertaken in China today is not without its risks and has contributed to the fiscal deficit, these may be mitigated to some extent by reforms proposed by authorities which include greater participation by the private sector.

Source: Adapted from *Reserve Bank of Australia Report*, 14 June 2014

Extract 3: New tariffs will hurt US manufacturers

Remember when trade policy looked like a potential bright spot on the Obama Administration's economic record? Now with Trans-Pacific and Trans-Atlantic trade talks missing deadline after deadline, Washington is slapping new tariffs on steel imports. This election-year gift to US steel giants and their unions will raise prices for other US firms, handicap domestic energy production and alienate trading partners world-wide.

This week, the Commerce Department imposed duties on millions of dollars in annual trade with South Korea and eight other countries. As punishment for allegedly dumping steel into the US market at unfair low prices, South Korea's exporters will face tariffs of about 10% to 16%, while smaller players from other countries face rates up to 118%.

The US International Trade Commission said in a preliminary review that the commission already found a "reasonable indication" that US steel firms are being "injured" by foreign competitors' low prices.

Hence protectionism is called for as an antidumping enforcement. Low-priced steel from South Korea is good for American buyers but annoying for American producers like Nucor and US Steel that would rather have the market to themselves and charge higher prices. By filing antidumping complaints, these firms lobby Washington to punish foreign businesses for the crime of charging low prices to American consumers.

US Steel CEO Mario Longhi and Steelworkers union chief Leo Gerard complain that steel imports rose 113% between 2010 and 2012, with South Korean products accounting for half the increase. They blame dumping, but low prices also aren't a surprise given the world-wide glut caused by slowing growth in China and excess mill investment in China and US.

When Washington imposes tariffs, it raises prices on the many to benefit the protected few. The injured in this case will include workers, shareholders and customers of US companies that use steel. US firms will have greater incentive to expand overseas, where the tariffs do not apply.

The US move will also encourage other countries to raise trade barriers against American goods. A reputation for beggar-thy-neighbour tactics does not help Mr Obama's goal of growing US exports. Instead protectionism would only result in a significant net loss of economic benefits to US.

Source: *The Wall Street Journal*, 16 July 2014

Questions

(a) Compare the patterns of price changes for Chinese domestic steel prices and iron ore prices from January 2010 to August 2014. [2]

(b) With the help of a demand and supply diagram, explain how the enforcement of stricter environmental control in steel production and the government's effort to steer away from infrastructure development affect the market for steel in China. [6]

(c) Explain the difference in value of the price elasticity of supply of a manufactured good such as cars with that of a primary product such as iron ore. [3]

(d) Discuss whether the expenditure on infrastructure by the Chinese government helps to improve the standard of living of the people. [8]

(e) Using a production possibility curve, explain the opportunity cost incurred when more resources are allocated to the production of steel in a country. [3]

(f) Assess whether you support the view that 'US's imposition of tariffs on steel imports would create a significant net loss of economic benefits to the US economy' (Extract 3). [8]

[Total 30]

Question 2

US and UK Economy

Extract 4: An economic check-up

The US economy is at a critical juncture. The Federal Reserve’s very easy monetary policy during the past few years has been the root of both good and ill: reduced unemployment on the one hand and increased financial risks on the other. The danger now is that the inevitable rise in interest rates over the next few years could in turn weaken the economy and lead to another economic downturn.

With the overall unemployment rate down to 5.4% and the rate among college graduates at only 2.7%, there is little or no slack left in labour markets. As a result, labour costs are now rising at a faster rate. Rising labour costs usually lead to a higher rate of price inflation. This time inflation has temporarily been kept in check by the decline over the past year in the prices of gasoline and other forms of energy and by the rising dollar’s impact on the cost of imported goods.

Although there have recently been some mixed signals about the strength of demand, the economy will remain on a solid growth path for the coming year unless it is upset by events in the financial markets. Real GDP grew at more than 4% in the second half of 2013, driven by the rise of household wealth. Bad weather weakened the economy in the first quarter of 2014, but after that consumer spending and business investment together continued to rise at an annual rate of more than 4%.

Source: *Martin Feldstein, www.time.com,* 28 May 2015

Extract 5: Strong US dollar pressures exporters

The sharp rise in the value of the US dollar is hitting American exporters and forcing layoffs at makers of everything from steel to machinery, taking the shine off stronger job creation across the broader economy.

Exports make up about an eighth of America's economic output and helped power the initial economic recovery from the 2007-2009 recession. But exporters' job losses do raise some concerns about economic growth as the Federal Reserve moves closer to its first interest rate rise since 2006. Among the top exporters, primary metals producers, which include steel making, have shed 1,800 jobs this year, US Labour Department data showed.

One risk for the US economy is that the dollar might be dragging on growth more strongly than policymakers anticipate. Economic growth stalled in the first quarter partly because of plunging exports and surging imports.

Source: *Jason Lange, www.reuters.com*, 8 May 2015

Extract 6: US trade deficit jumps to 6-year high of US$51.4 billion

The US trade deficit in March jumped to the highest level in more than six years as a small increase in exports was swamped by a flood of imports from cars to cellphones. The deficit rose to US$51.4 billion, the largest trade gap since October 2008 and more than 43 percent higher than the February imbalance, the Commerce Department reported Tuesday.

Exports have been hurt by an increase in the value of the dollar against other major currencies over the past year. At the same time, US consumers with more jobs and higher pay may be ramping up demand for foreign-made goods, further exacerbating the trade gap.

For the first three months of this year, the trade deficit was 5.2 percent higher than the same period a year ago. A larger trade deficit acts as a drag on growth because it means more US producers are losing sales to foreign competitors. For March, the deficit with China surged 38.7 percent to US$31.2 billion. The US trade deficit with China is the largest for any country and is on track to set another record this year.

Manufactured goods make up the bulk of US's exports and the competition is especially strong. The manufacturing sector faces significant challenges from the effects of falling export demand and rapidly changing technology. The US Department of Commerce's Manufacturing Council has been working to recommend ways for the US government to help US manufacturers alleviate the lack of export competitiveness. For the export industry, the question is how best to maintain the quality of exports in an increasingly competitive global economy. The competitive pressure on US manufacturers has force them to cut costs, adopt lean manufacturing techniques and implement quality control programs that guarantee zero defects in production. Innovation in products, processes and services will be a key determinant for success.

With barriers to trade falling rapidly over the past decade, President Barack Obama has been pushing the benefits of free trade in an effort to convince Congress that it can help ease the trade deficit. To do so, he needs to complete a trade agreement with 11 other nations, an agreement known as the Trans-Pacific Partnership.

Source: www.*dailymail.co.uk*, 5 May 2015

Extract 7: Widening UK trade deficit highlights challenge for government

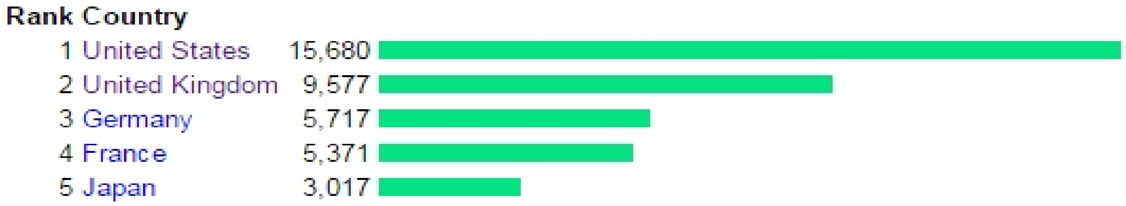
Britain's trade deficit widened in the first three months of 2015, highlighting one of the biggest challenges facing the government over the next five years. The deterioration was driven by weaker exports to the EU, as oil exports to countries such as the Netherlands fell.

"The strong pound is hitting demand for UK goods in overseas markets," said Chris Williamson, chief economist at Markit. "Further export losses look likely in coming months, dealing another blow to hopes that the UK economy is rebalancing away from domestic consumption towards exports." David Kern, Chief Economist at the British Chambers of Commerce (BCC) said "It is disappointing that the trade deficit widened again. While the decline was only slight, the weaknesses in the global economy like the weak Eurozone are still a problem and the challenges facing UK exporters are being made even greater by the strengthening pound."

With the economic recovery set to be fuelled this year by strong growth in consumer spending, it remains more likely that imports will grow at a faster rate than exports.

Source: www.*telegraph.co.uk*, 8 May 2015

Figure 2: External Debt, Top 5 – World (US$ Billion)



Source: *https://www.cia.gov/library/publications/the-world-factbook/,* 1 January 2014

Figure 3: UK's Balance of Trade (in billion US dollars)

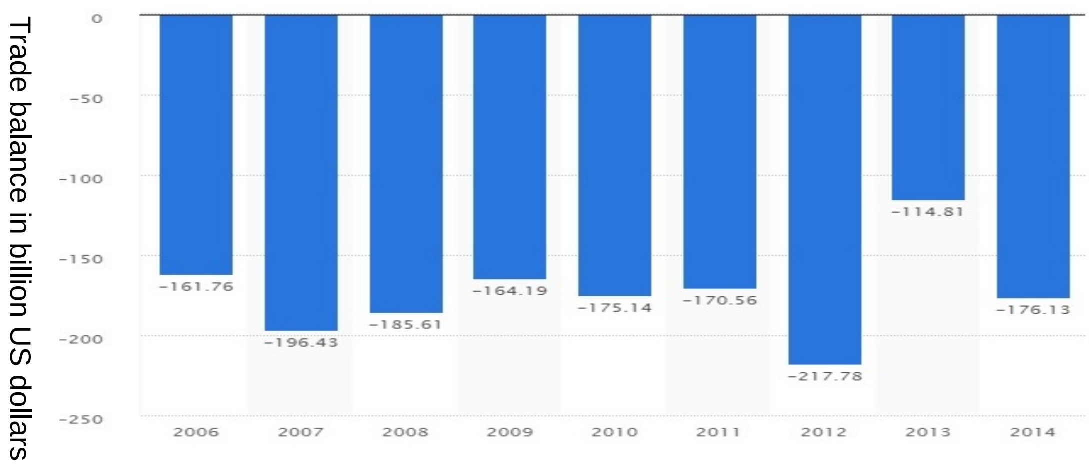
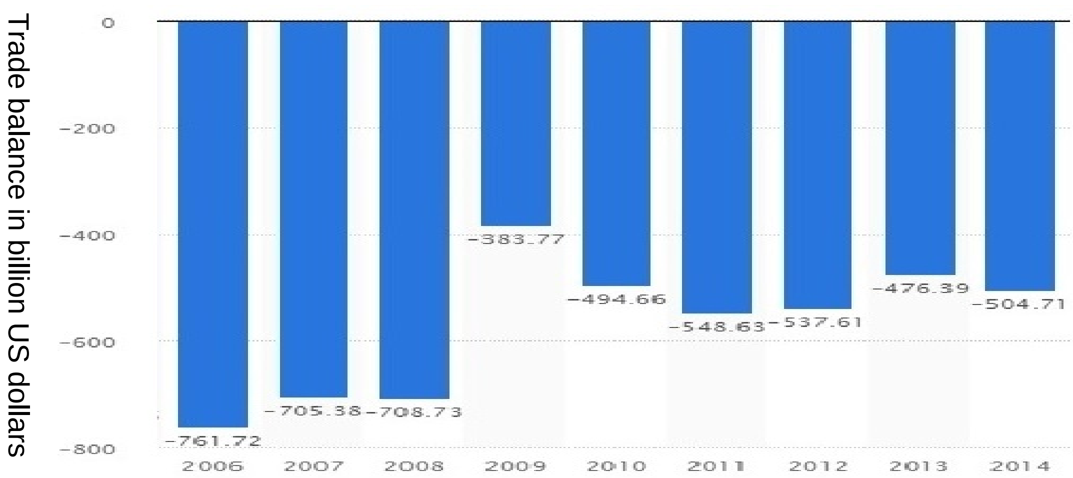


Figure 4: US's Balance of Trade (in billion US dollars)



Source: *www.statistica.com/stats*

Questions

(a) Using Figures 3 and 4, compare the change in the balance of trade of US with that of UK between 2006 and 2014. [2]

(b) Using AD/AS analysis, explain how 'the inevitable rise in interest rates over the next few years could weaken the economy' (Extract 4). [4]

(c) Explain the trade-off between economic growth and inflation. [2]

(d) Compare the causes of the trade deficit in US and UK. [6]

(e) Extract 7 says that UK's widening trade deficit would be a big challenge facing the government over the next five years. Discuss the impact of a worsening trade balance on the UK economy and its living standards. [8]

(f) Assess the view that signing free trade agreements is the most effective policy to correct the trade deficit in the US. [8]

[Total: 30]

Section B

Answer **one** question from this section.

3 **(a)** Explain how the price mechanism allocates scarce resources to address the problem of scarcity. [10]

(b) Some governments are reducing subsidies for retraining programmes citing large fiscal budget deficits as the reason.

Discuss whether the reductions in subsidies are justified. [15]

4 Many countries aim to improve their economic performance which includes internal and external price stability, healthy balance of payments, sustained economic growth and full employment.

(a) Explain the consequences of failing to achieve internal and external price stability. [10]

(b) Discuss the extent to which globalisation can help Singapore improve her economic performance. [15]