

TEMASEK JUNIOR COLLEGE
Preliminary Examination 2016
General Certificate of Education Advanced Level
Higher 1

ECONOMICS

Paper 1

8819/01

Wednesday 31 August 2016

3 hours

Additional Materials: Answer Paper, Cover Page

READ THESE INSTRUCTIONS FIRST

Do not turn this page over until you are told to do so.

Write your name and CG 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 HB pencil for any diagrams or graphs.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A

Answer **all** questions.

Section B

Answer **one** question.

Begin each question on a separate sheet of answer paper.
Fasten your work for Section B and the cover page together.
Write the question that you attempted for Section B on the cover page.
Hand in your answer to each question **separately**.
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 Flooding: the problem that will not go away

Table 1: Commodity Prices, 2005 – 2014

The table below shows an index of the world commodity prices over the period 2005-2014.

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Index	70.2	75.7	85.0	99.4	92.6	100	111.6	106.4	100.2	97.0

Source: World Bank, 2016

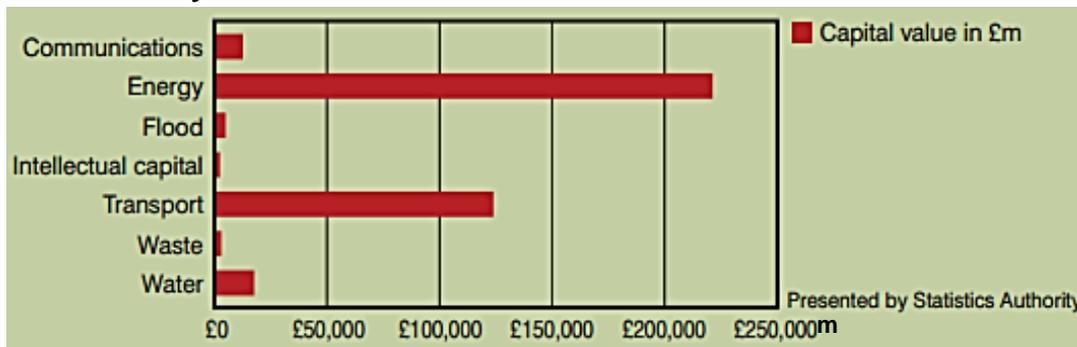
Extract 1: U.S. grain prices soar as floods shut waterways, threaten crops

U.S. grain farmers scrambled to find shelter for their crops and handlers hunted for alternative transportation routes, as widespread floods shut waterways from Illinois to Missouri and spurred a surge in physical prices of corn and soybeans.

Cash premiums for soybeans in the U.S. market, jumped to as high as 70 cents per bushel, their loftiest since mid-November as the rapidly rising waters forced the Coast Guard to shut a five-mile section of the Mississippi River. Surcharges for corn hit 49 cents on Wednesday, up almost a third from 37 cents a week ago and the highest in nearly three weeks.

Source: Reuters, 31 December 2015

Figure 1: Government spending on UK infrastructure (2013) presented by Statistics Authority



Adapted from *The Times*, 08 February 2014

Extract 2: Budget 2014 – Key climate and energy announcements

Chancellor George Osborne today delivered his fifth budget. Among a few pre-election treats for voters were some important changes to the government's energy and climate policies.

The chancellor was widely expected to freeze the UK's carbon tax imposed on firms at £18 per tonne of carbon dioxide emitted until the end of the decade. He hopes that will cut industry energy costs, and help the UK's manufacturing sector.

Energy intensive industries will not have to pay the costs of two policies designed to support renewable energy generation. This could save companies £50,000 per year on their energy bills, the chancellor claimed. The chancellor hopes that the measures are enough to stop

companies moving abroad, where operation costs are lower – which would be bad for the economy overall, he argues. In doing so, Osborne prioritised the UK's short term “economic security” over curbing the manufacturing industries' considerable greenhouse gas emissions – with the latter potentially providing economic benefits in the long run.

Osborne today announced £140 million of new funding to go towards flood repairs and maintaining existing flood defences. The announcement comes months after Prime Minister David Cameron told parliament that the UK could expect more of the same in coming years.

Source: Carbonbrief.org, 19 March 2014

Extract 3: Does flood defence merit government intervention?

Annual flood damage in the UK costs around £1.1 billion, and could rise to £27 billion by 2080. In 2014, the Balkans saw the worst floods in 120 years, with over 4 months rainfall in one day, and flood water rising to over 7 metres. Over 40% of Bosnia and Herzegovina was flooded causing huge landslides (raising fears of old landmines being triggered). Over a quarter of the population in the country were displaced, with at least 100,000 homes now uninhabitable. In 2005, Hurricane Katrina in the United States caused the flood system to be breached at more than 50 places in New Orleans, killing more than 1,800 people; others stranded for days without food.

Livelihoods are destroyed as agricultural land is abandoned. 80% of New Orleans was underwater for weeks. The areas hit by floods in the UK in 2013/14 accounted for 13% of the UK's economic output, hitting key economic heartlands, wiping up to £14 billion off GDP. Disruption to transport links harms productivity. There is a danger that the Balkan floods will risk power shortages and rising electricity prices.

Flooding causes more payouts by insurance firms, which lowers profits, and thus raises insurance premiums for everyone. In 2012, flooding caused damage worth £4 billion. The loss of property value for those living in flooded areas has knock-on effects on banks who have offered mortgages. As the value of their collateral plummets, negative equity issues arise with the wealth of households being wiped out.

Adapted from *Economics Today*, September 2014

Extract 4: The cost of inaction vs. the cost of action

In 2009 the Environment Agency (EA) published a study warning £20 billion of investment was required over the next 25 years to address rising flood risks. However, the UK government has been prioritising fiscal austerity.

Government provision of public goods is but one solution. Government provision has its dilemmas – even if we agree that out of all the market failures, public goods is the biggest, we still have to decide whether flood defences are the most important public good to finance, and even then every decision has an opportunity cost. The Chairman of the EA, Lord Smith, stated: “Flood defences cost money; and how much should the taxpayer be prepared to spend? There's no bottomless purse, and we need to make difficult choices about where and what we try to protect.”

It has been estimated that maintaining existing levels of flood defences would require flood defence spending to increase to £1 billion per year by 2035. Is this a good use of the government's scarce money and resources? The benefits of providing the flood defences must exceed the costs of provision.

A cost-benefit analysis (CoBA) is important in this regard. CoBA allows different flood defence projects to be ranked according to those that provide the highest expected net gains in social welfare. But CoBA assume that the correct costs and benefits have been identified, as well as what discount rates to use for future uncertain costs and benefits. The distribution of them must be taken into account too. Flood defences by their nature are only a pure public good on a localised level, whilst on a national level, the benefits and costs are unequally distributed. And it's not as simple as just building flood defences – what type of flood defence system should the government use? Flood defences or flood water storage areas: In the Netherlands, water management is incorporated into urban planning, taking into account parks and wetlands that could function as safety reservoirs.

Crucially, government provision is not the only solution. There are cost savings from large scale state provision but a subsidy to the private sector is another approach. However some areas could get more subsidies if their members of parliament are more aligned with the EA (some scope for political lobbying). The conclusion that free markets fail to provide public goods stems from the key assumption that people adhere to *homo economicus* or self-interested individualistic behaviour. But there is evidence that in small communities people can agree to split the cost of public goods. It is not inconceivable that if the government decides to commit to not providing flood defences, local communities will contribute to their own flood defences. The fact that the government is often willing to provide these for free at the point of consumption at least, encourages irresponsible behaviour and an unwillingness to fund it collectively. But, when the public good becomes more national, the coordination problem becomes much harder.

Adapted from *Economics Today*, September 2014

Questions

- (a) Using Table 1, compare the overall change in world commodity prices between 2005 and 2010 with that of 2010 and 2014. [2]
- (b) With the help of a diagram, explain how floods caused the prices of grains like corns and soybeans to soar in Extract 1. [4]
- (c) Explain how the freeze on the carbon tax and more savings for polluting industries might benefit the UK economy in Extract 2. [6]
- (d) Comment on how the climate and energy initiatives highlighted in Extract 2 could affect the UK's budget position. [4]
- (e) (i) With reference to the data, to what extent do you agree with the statement that "out of all the market failures, public goods is the biggest"? [6]
- (ii) Flood defence should be directly provided by the government. Discuss. [8]

[Total: 30]

Question 2 Economic growth and policies

Extract 5: The reshaping of the world

The Annual Meeting 2014 aims to increase global economic risk resilience, in the wake of acute structural unemployment and widening income inequality. At the top of leaders' minds will be how to manage the consequences of expected changes in monetary policy and financial regulation in the face of slower global growth.

Resilient dynamism means tackling immediate problems and long-term challenges at the same time. Valdis Dombrovskis, Prime Minister of Latvia, described how, confronted by the crisis, his government had to implement an austerity programme while also taking steps that would improve the economy's competitiveness over time. Aiming for resilient dynamism goes hand in hand with the never-ending missions to achieve sustainability and competitiveness. Countries must restructure at home so they can compete in the world.

Source: Adapted from *World Economic Forum* 2013 and 2014

Table 2: Key economic indicators of China

	2009	2010	2011	2012	2013	2014
Real GDP Growth, % change	9.2	10.6	9.5	7.8	7.7	7.3
Unemployment, % of total labour force	4.3	4.2	4.3	4.5	4.6	4.7
Inflation, % per year	-0.1	6.9	8.1	2.4	2.2	0.8
Current Account Balance, US\$ billion	192.3	217.4	179.8	228.5	237.3	279.5

Source: World Bank, 2016

Table 3: Components of GDP (% of total), 2014

	Exports of Goods and Services	Household Final Consumption Expenditure
Japan	17.7	60.7
USA	13.5	68.4
China	23.9	37.4
Singapore	192.1	36.8

Source: World Bank, 2016

Extract 6: Premier Li says China economy is resilient and has space to grow

The eighth Annual Meeting of the New Champions opened with an address by Chinese Premier Li Keqiang. Resilience in the economy and reform measures will sustain China's medium-to-high GDP growth, Li said. In other words, despite stresses in the global economy, China will avoid any sharp drop in growth.

"The Chinese economy is highly resilient and has ample space to grow," he said. "The reform measures we have taken are good for now and make a hard landing less possible." In the first half of this year, China's economy grew by 7.4%, with inflation at 2.3%, Li said. "While we have seen growing downward pressure on the economy, more jobs have been created thanks to reforms that have been taken."

In his address, the premier told participants that important reforms are in progress, including the simplification of business registration, streamlining administration and targeted tax reductions. These measures will spur growth, particularly in the services sector, agriculture and private enterprises, he said. Recognising the theme of the Annual Meeting of the New Champions – Creating Value through Innovation – Premier Li underscored the importance of innovation in driving the transformation of China's economy from its focus on manufacturing for export and fixed-asset investment to a more balanced and sustainable consumption-driven model.

"China's reform and opening up over the past three decades has itself been a great innovation drive," the premier observed. "Just imagine how big a force it could be when a working population of 900 million all become enthusiastic about entrepreneurship, innovation and creation. The blood of innovation can flow unhampered in society." Small and medium-sized enterprises must have easier access to capital, he added. "We need to be sure there are adequate financial services to meet this need to encourage innovation."

Responding to a question from Klaus Schwab, Founder and Executive Chairman of the World Economic Forum, about the Shanghai Free Trade Zone, which was launched a year ago, Premier Li said that the pilot initiative is showcasing the progress of China's reforms and is a clear statement that China wants to open up more to foreign investment. "I want to emphasise that all types of enterprises will be treated as equals and that China's doors will open even wider," he pledged.

Earlier, in introducing the premier, Schwab said that "the world has changed so much over the past 35 years, and China's leadership has consistently shown the vision, the determination and the innovation required to master the challenges which it has faced." He concluded: "China has a significant influence in shaping the world today and will continue to have a tremendous role in strengthening our collective global future."

Source: World Economic Forum, 10 September 2014

Extract 7: Singapore's economic growth slowed to 2.8% in 2014

"Singapore's economic growth cooled in 2014 and the nation will experience slower expansion than it's used to," Prime Minister Lee Hsien Loong said.

Singapore's gross domestic product rose 2.8 per cent in 2014, compared with a forecast of about 3 per cent, and an expansion of 3.9 per cent in 2013. "Our economy has performed moderately well in 2014," Lee said. "However, our productivity performance has been disappointing" and the country must intensify efforts to help companies and workers upgrade, he said.

Export-dependent Singapore is experiencing the effects of a faltering global economy, with China set to record its weakest growth in almost a quarter century and the economies of Europe and Japan struggling to gain momentum. Government efforts to curtail the inflow of cheap foreign labour have also pushed up business costs.

“Our growth will be slower than we are used to,” Lee said. “One reason for this is that we have been tightening policies, including on foreign workers, to get our economy onto a path of sustainable, productivity-driven growth.”

The government has forecast an expansion of 2 per cent to 4 per cent in 2015 as China, its largest trading partner, seeks to deleverage its economy without a hard landing. In contrast, the U.S., among the top markets for Singapore’s exports, grew at the fastest pace in more than a decade in the third quarter as consumer and business spending surged.

While economic growth is slowing, it is important to still create expansion, the Prime Minister said. “Growth also gives us the resources to improve social well-being and sustain our social safety nets,” Lee said. “Because of these new schemes, social spending is rising steadily. We have been prudent in the past so we can afford the new programmes we are launching.”

Singapore’s population has jumped by more than 1.4 million since 2000 to about 5.5 million with more foreign labour, leading to voter discontent over congestion and competition for housing.

Source: *Bloomberg News*, 31 December 2014

Questions

- (a) From Table 3, identify how China differs from the other economies. [2]
- (b) What conclusion would you draw from Table 2 about the overall economic performance of China in 2014 compared with 2009? [4]
- (c) When a government tackles an immediate problem, it could lead to a challenge in the long term. Explain with **two** examples. [4]
- (d) Given the economic objectives announced in Extract 6, discuss how China’s reform measures contribute to resilience in her economy and sustained economic growth. [8]
- (e) Extract 7 mentions Singapore has been ‘tightening policies, including on foreign workers’ to get her economy ‘onto a path of sustainable, productivity-driven growth’.
- (i) Explain how ‘government efforts to curtail the inflow of cheap foreign labour’ is a tightening policy. [4]
- (ii) Discuss the view that the tightening policy helps to get the Singapore economy ‘onto a path of sustainable, productivity-driven growth’. [8]

[Total: 30]

Section B

Answer **one** question from this section.

- 3 (a) Using appropriate examples, explain the concepts of price elasticity of demand and price elasticity of supply. [10]
- (b) Discuss the usefulness of elasticity concepts in helping governments achieve their economic goals. [15]
- 4 (a) Explain how countries can benefit from trade. [10]
- (b) Discuss the extent to which trade is the most important factor that determines the external value of Singapore dollar. [15]