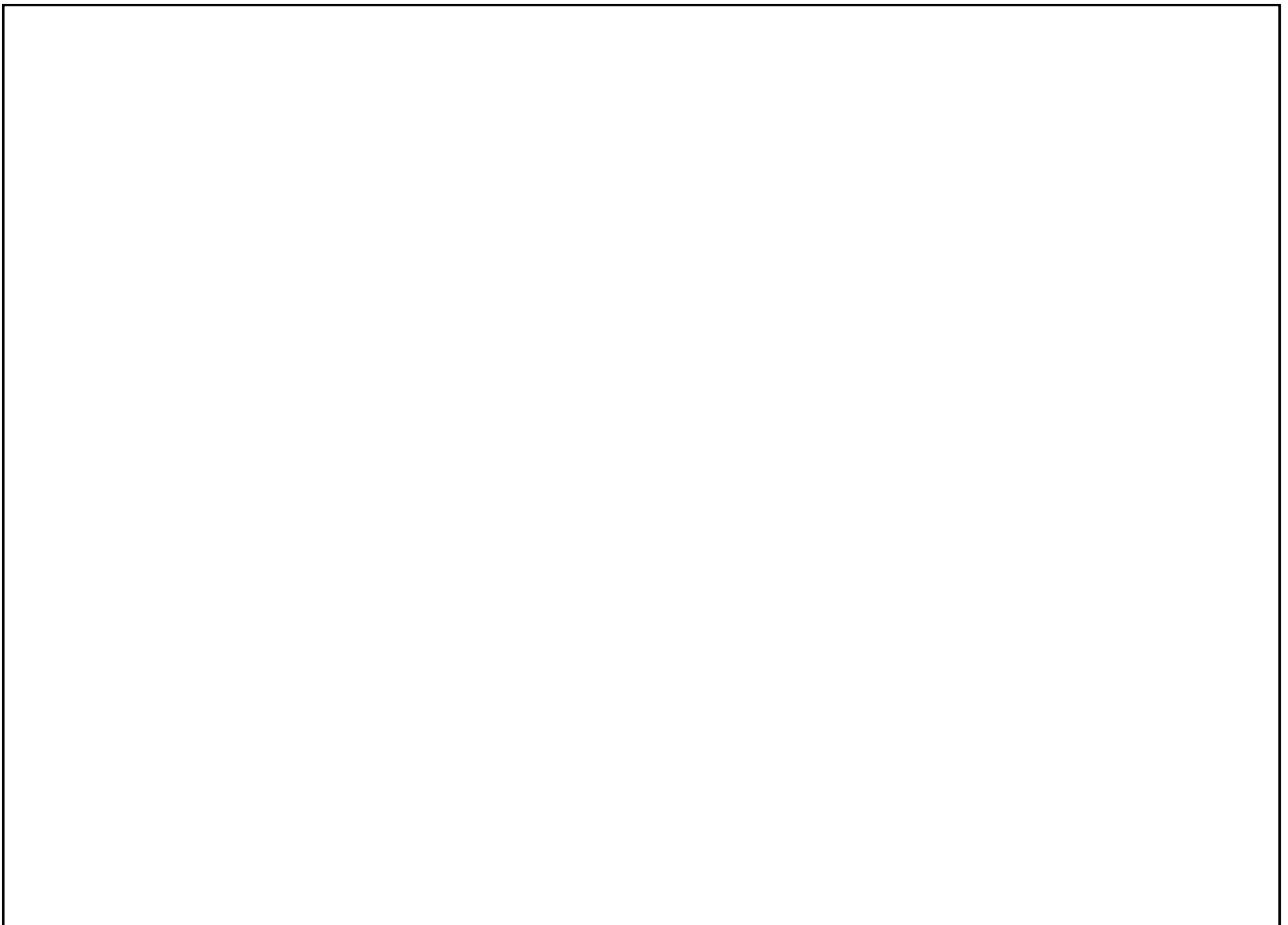




Answer **all** questions.

Question 1

Recession and Prices

Extract 1: Food prices to stay high, volatile: FAO

Food commodities prices are likely to stay high and volatile in the medium term, while a repeat of the 2007-2008 price spikes is seen as a realistic possibility, the U.N. Food and Agriculture Organisation (FAO) said on Monday.

By mid-2008, food prices on international markets reached their highest level in nearly 30 years. Graphics published in the report showed prices for commodities such as rice, oilseeds, raw and refined sugar were expected to hold above pre-2006 levels through to 2018.

FAO said the global food commodities market was also likely to remain volatile "in the foreseeable future" and a new surge in prices like the one seen in 2007-08 was a "realistic possibility." Insufficient investment in productive capacity, and further demand growth for biofuels were some factors that could keep prices firm in the medium term.

Source: Silvia Aloisi, Reuters, 12 October 2009

Extract 2: Expect flour prices to go up, says importer

The effects of a Russian ban on wheat exports will soon ripple through Singapore: Prima Limited, the largest importer of the grain here, is planning to hike flour prices, a move that will impact a wide variety of industries, from bakeries to noodle-makers, as well as consumers.

Prima, the main supplier of flour to businesses here, declined to say when prices would rise, or by how much. But its executive director, Mr Lewis Cheng, told The Straits Times yesterday that the recent surge in global wheat prices had a 'definite impact' on the company. "With this huge jump in material costs, we have no choice but to increase our flour prices," he said, adding that prices will go up gradually, and in phases.

Industry players, such as Singapore Food Manufacturers' Association president Wong Mong Hong, think the increase will be 'substantial'. "Flour is totally made from wheat," he said. "The increase in the price of wheat will have a direct and significant impact on flour prices. The increase is unlikely to be small."

In Singapore, businesses are bracing themselves for the aftershocks of Prima's impending price hike, and said they would have little choice but to raise their prices too once this happens. The chairman of the Singapore Bakery & Confectionery Trade Association, Mr Liow Kian Huat, said the grouping's 150 members are unlikely to be able to absorb more than a 10% increase. "Any more than that and it gets difficult. There is nothing we can do about it. We cannot hoard flour now because it will just go bad," said the baker in Mandarin, adding that he currently pays about \$27 for a 25kg bag of Prima's flour. Mr Leong Han Hin, the owner of Hung Wen Noodle Manufacturer, agrees. He supplies noodles to hawker centres and coffee shops around Singapore. "If prices go up, what can we do? We will try to absorb until we can't," he said.

Prima is Singapore's only flour mill, and accounts for more than 95% of the wheat imported into Singapore. Industry players say that more than half of all the flour used here is from Prima. The rest is imported from countries like Malaysia and Indonesia.

Source: Jessica Lim, *The Straits Times*, 7 August 2010

Extract 3: Asian consumers go back to basics in downturn

Forget about bells and whistles. Asians have gone back to basics in the economic slowdown and are opting for no-frills, lower-priced products rather than brand names and items with fancy features that rarely get used. From laptops without standard accessories such as CD-ROMs, to rice cookers with minimal functions, brands such as Samsung and LG Electronics are quickly introducing basic items that can be sold at lower price points.

It's all about surviving the slowdown which has dealt a severe blow to Asia's export-dependent economies such as South Korea which saw exports drop 25% in the first quarter of the year alone. Buoyant sales from these products are providing relief, and much needed cash flow, to companies that posted heavy profit falls or swung to quarterly losses early this year such as Samsung Electronics.

Some companies such as LG Electronics are introducing new products to capture market share during a time of uncertainty. Late last year, it introduced the Cookie, a smart phone that sells for 590,000 won (US\$475) 20-40% cheaper than other smart phones with price tags of US\$600-US\$800. "Our Cookie phone is designed to fit in the recession environment," Skott Ahn, President and CEO of LG Electronics' Mobile Communications unit. Doing away with redundancies in functions and rationalising product line-ups help companies cut back on costs.

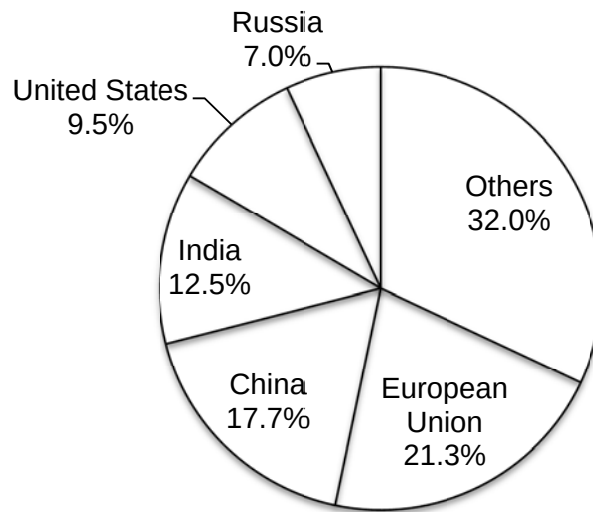
"It is a matter of efficiency," Park Jean, an analyst for Woori Investment & Securities in Seoul said. "Mass production of a few core products can lower production costs rather than producing a variety of models on a small scale."

Making profits is tough in a difficult economy with the International Monetary Fund predicting that private consumption in Asia will remain subdued as long as rising unemployment, weak confidence and low asset prices weigh on household spending.

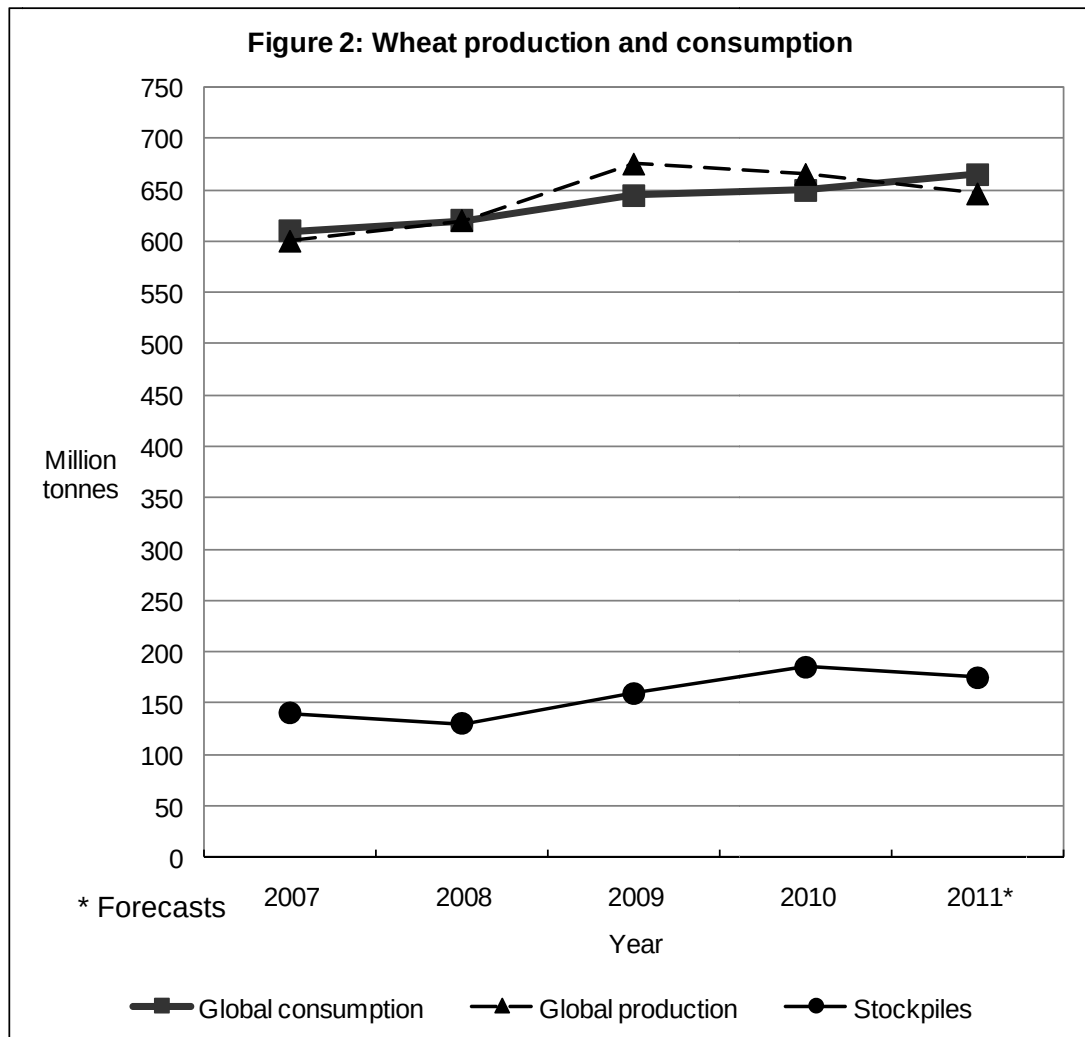
Kim Rando, a consumer science professor at Seoul National University, said the trick is to differentiate products and cut production costs by designing easy-to-use products that retain the functions that consumers most want and need. Streamlined products may be the rage for some time if consumer preferences for simple, easy-to-use products prevail once Asian economies begin to accelerate again, he said. "If the divergence trend is more about removing redundancies and simpler but stylish design than about lowering prices, it then would last even after the economy rebounds," he said.

Source: Kim Yeon-hee, Reuters, 17 May 2009

Figure 1: Top wheat producers (as of August 2010)



Source: *The Straits Times*, 11 September 2010



Source: *The Straits Times*, 11 September 2010

Questions

- (a) Using Figure 2,
- (i) Summarise the variations in the stockpiles of wheat. [2]
 - (ii) Account for the abovementioned variations. [2]
- (b) With the aid of a diagram, analyse why prices of food commodities are expected to surge and remain volatile. [5]
- (c) Explain why the members of the Singapore Bakery and Confectionery Trade Association are “unlikely to be able to absorb more than a 10% increase” in the price of flour. [3]
- (d) Evaluate the effectiveness of the “back to basics” strategy adopted by firms. [8]
- (e) According to economic theory, Prima’s decision to raise the price of flour is justifiable and should not be seen as an example of economic inefficiency.
- With reference to the data where appropriate, discuss the validity of this statement. [10]

[Total: 30 marks]

Question 2

The Nuts and Bolts Come Apart

Extract 4: As global demand contracts, trade is slumping and protectionism is rising

Trade declined alarmingly in the early 1930s as global demand imploded, prices collapsed and governments embarked on a destructive, protectionist spiral of higher tariffs and retaliation.

Trade is contracting again, at a rate unmatched in the post-war period. The World Trade Organisation (WTO) predicted that the volume of global merchandise trade would shrink by 9% this year. This will be the first fall in trade flows since 1982. Between 1990 and 2006 trade volumes grew by more than 6% a year, easily outstripping the growth rate of world output, which was about 3%. Now the global economic machine has gone into reverse: output is declining and trade is tumbling at a faster pace. The turmoil has shaken commerce in goods of all sorts, bought and sold by rich and poor countries alike.

According to the World Bank, 17 members of the group have taken a total of 47 trade-restricting steps since November. Modern protectionism is more subtle and varied than the 1930s version. In the Depression, tariffs were the weapon of choice. A few tariffs have been raised this time, but tighter licensing requirements, import bans and anti-dumping (imposing extra duties on goods supposedly dumped at below cost by exporters) have also been used. Rich countries have included discriminatory procurement provisions in their fiscal-stimulus bills and offered subsidies to ailing national industries.

There are good reasons for thinking that the world has less to fear from protectionism than in the past. International agreements to limit tariffs, built over the post-war decades, are a safeguard against all-out tariff wars. The growth of global supply chains, which have bound national economies together tightly, have made it more difficult for governments to increase tariffs without harming producers in their own countries.

Source: *The Economist*, 26 March 2009

Extract 5: China and United States head for trade war

Europe and the United States announced co-ordinated action against China for busting WTO rules by restricting exports of essential raw materials, raising fears of a damaging east-west trade war in the depths of the global recession.

Ron Kirk, the US trade representative, accused Beijing of putting a "giant thumb on the scale" by restricting exports of commodities including silicon, coke and zinc, to give Chinese manufacturers an unfair advantage over their international rivals. "It's our job to make sure we remove that thumb from that scale," he said in Washington. "Today's action is proof of our commitment to level the playing field in this area."

The US, with Europe, announced that it would start formal "dispute resolution consultations" at the WTO in Geneva, claiming China has breached the rules of the international marketplace. At a press conference in Washington, Kirk said: "We will enforce the rights of American manufacturers, farmers, ranchers, services providers, and workers using the rules-based global trading system."

Baroness Ashton, Europe's trade commissioner, said: "The Chinese restrictions on raw materials distort competition and increase global prices, making things even more difficult for

our companies in this economic downturn. I hope that we can find an amicable solution to this issue through the consultation process."

China imposes restrictions, including minimum export prices, on a range of raw materials of which it is a major producer. The EU claims these not only break general WTO rules on world trade, but specific promises China made when it joined the organisation in 2001, becoming a fully fledged player in global markets. The US said China produced 336m tonnes of coke in 2008 but only exported 12m tonnes.

The raw materials are used in a range of key products, from steel to semi-conductors. Brussels said manufacturers and processors in Europe were at risk of going bust if the flow of exports from China was not restarted.

With oil prices rising rapidly, western governments including Britain have become concerned that higher commodity costs could choke off the fragile economic recovery, and they suspect China of deliberately stockpiling materials – in contravention of WTO rules on free trade.

Given the gloomy outlook of the economy, WTO urges all countries to abolish protectionist measures. Instead, there should be promotion of free trade as it benefits the economy in many aspects, including a swifter recovery from the current recession.

Adapted from *The Guardian*, 23 June 2009

Extract 6: A global economic crisis requires global solutions

The immediate cause of shrinking trade is plain: global recession means a collapse in demand. The credit crunch adds an additional squeeze, thanks to an estimated shortfall of \$100 billion in trade finance, which lubricates 90% of world trade.

With the global crisis destroying the trade balance of many countries, it is no wonder that protectionist measures are sprouting once again. What should world leaders do to stop protection fraying the threads that tie the world economy together? This global crisis requires a global response, but, unfortunately, responsibility for responding remains at the national level.

Each country will try to design its stimulus package to maximise the impact on its own citizens – not the global impact. In assessing the size of the stimulus, countries will balance the cost to their own budgets with the benefits in terms of increased growth and employment for their own economies. Since some of the benefit (much of it in the case of small, open economies) will accrue to others, stimulus packages are likely to be smaller and more poorly designed than they otherwise would be, which is why a globally coordinated stimulus package is needed.

Source: *The Guardian*, 11 April 2009

Extract 7: In a recession, it's government's job to lean against market logic

John Maynard Keynes believed that government should enact 'counter-cyclical' fiscal policies, which go against the tide of the business cycle. Most commentators agree that the global financial crisis has prompted an overdue resurrection of the reputation of last century's greatest economist.

Although most individuals would plead guilty to the charge of borrowing in order to build or acquire an asset (like a house), the government – according to this view – must never spend

beyond its means. In a recession, when individuals stop spending and investing, and the government's tax revenues therefore decline, the government must also slam on the brakes.

This completely overlooks the responsibility of governments during a recession to lean against the logic of the market. As Keynes saw, a government that behaves in a recession as everyone else behaves will simply make the recession worse. It is the special role of government in that situation not to retrench but to use its huge resources and its responsibility to take the longer view and to act in the common interest, in order to stimulate the level of economic activity so as to shorten the recession and thereby restore its own financial position as soon as possible.

None of this means that government spending should be let rip. If the deficit is to be effective in bringing the recession to an end, the spending must be economically worthwhile. The spending that is undertaken must not be focused on consumption but on encouraging investment, employment and improved productivity.

Source: Bryan Gould, guardian.co.uk, 16 June 2010

Table 1: Selected Indicators for China

	2006	2007	2008	2009
GDP growth (%)	12.7	14.2	9.6	9.1
Final consumption expenditure growth (%)	4.8	7.9	4.6	14.9
Gross capital formation growth (%)	13.8	15.0	11.6	21.2
Government expenditure growth (%)	11.4	11.5	8.9	6.1
Unemployment (%)	4.1	4	4.2 ¹	4.3
Exports of goods and services growth (%)	23.9	19.8	8.4	-10.3
Imports of goods and services growth (%)	16.0	13.9	3.9	4.1
Current account balance (US\$ billions)	250	372	426	388
Terms of trade index (2000 = 100)	82.6	80.5	73.9	79.7
Exchange rate (per US\$)	7.96	7.58	6.93	6.83

Source: Worldbank Data

¹ Source: CIA World Factbook

Questions

- (a) (i) Compare the value of yuan in 2009 with that in 2006. [1]
- (ii) Explain a reason for the observation in (a)(i). [2]
- (b) Account for China's terms of trade position despite the changes in the value of yuan. [4]
- (c) Discuss whether there "should be promotion of free trade as it benefits the economy in many aspects." [6]
- (d) Explain how Beijing's move to put a "giant thumb on the scale" will give the Chinese an unfair advantage over their international rivals. [4]
- (e) (i) Explain how a recession could affect a government's budget balance. [3]
- (ii) As a consultant economist, examine the use of protectionism and counter-cyclical fiscal policies in response to the global crisis. [10]

[Total: 30 marks]**End of Paper**