

YISHUN JUNIOR COLLEGE
PRELIMINARY EXAMINATION 2008

H1 ECONOMICS

8816/01

19 AUGUST 2008
TUESDAY 1400h – 1700h

Additional materials :
Answer booklet



TIME 3 hours

READ THESE INSTRUCTIONS FIRST

Write your name and CTG 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 highlighters or correction fluid.

Section A

Answer **all** questions.

Section B

Answer **one** question.

At the end of the examinations, hand in Section A and Section B **separately**.
The number of marks is given in brackets [] at the end of each question or part question.

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

Section A

Answer **all** questions in this section.

Question 1 Oil and Petrol**Extract 1: Rising demand fuelling global energy crisis**

With oil prices approaching US\$100 (S\$144) a barrel, the world is headed towards its third energy shock in a generation. But today's surge is different from previous oil crises, with broad and longer-lasting global implications.

Just as in the energy crises of the 1970s and 1980s, today's high prices are causing anxiety and pain for consumers and igniting wider fears about the impact on the economy. But unlike past oil shocks, which were caused by sudden interruptions in exports from the Middle East, this time prices have been rising steadily as demand for petrol grows in developed countries, as hundreds of millions of Chinese and Indian climb out of poverty and as other developing economies grow at a sizzling pace.

For oil companies, high prices have sparked a frenzied search for new sources around the world. The trouble is that these big new developments take a long time, and companies have been hobbled by higher costs. The cost of drilling rigs, for example, has doubled in recent years. Supplies have also been hampered by political tension in the Persian Gulf, the war in Iraq, devastating hurricanes in the oil producing Gulf of Mexico and violence in Nigeria's oil rich province.

Source: *The Sunday Times*, 11 November 2007

Extract 2: US airline catastrophe looms under record oil prices

The United States airline industry is set to crash as record oil prices threaten to push several carriers into bankruptcy, an industry study said.

According to a study issued by AirlineForecasts and the Business Travel Coalition, at current oil prices, several large and small US airlines will default on their obligations to creditors, beginning at end-2008 and early 2009. The grim industry snapshot comes as US airlines cut fleets, jobs and capacity and add fees as they struggle with spiralling jet fuel costs and a weak domestic economy.

The study shows that oil at US\$130 will increase yearly airline costs by US\$30 billion, while airlines will be able to generate only US\$4 billion in fare increases and incremental fees. Recently introduced bag-checking charges and other fees would only yield US\$1 billion to US\$1.5 billion at the industry level.

'Stabilising this ailing industry must become a national policy priority,' the study said, calling on the White House, Congress, federal regulators and state officials to take action. 'Absent direct policy intervention, the likelihood is several airlines will fail. The consequences will be devastating to US jobs, families, businesses, communities and our American way of life.'

Source: *www.straitstimes.com*, 14 June, 2008

Extract 3: Tax rise fuels petrol price fears

Petrol prices could surge to near record highs following a 2p rise in fuel duty. The Petrol Retailers Association said the rise would put an undue "strain on motorists and petrol retailers alike". It has criticised the government's move, highlighting that petrol prices have risen steeply in line with the oil price.

However, Stephen Joseph, executive director of the Campaign for Better Transport, said the rise was welcome, provided the extra money raised was used to improve public transport and "other measures that will give people real travel choices". A Treasury spokesman said the tax rise sent "the right environmental signals in our fight against climate change".

Source: *BBC News*, 01 October 2007

Extract 4: Indonesia inflation set to surge after fuel price hike

Inflation in Indonesia is set to soar in response to a government plan to hike the price of subsidised fuel, imperilling growth in Southeast Asia's biggest economy, experts said.

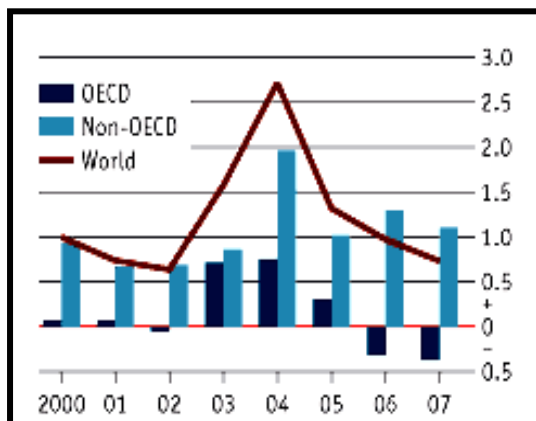
The country's government announced recently that it planned to raise the fuel price due to record-high global oil prices, which are causing the cost of the multi-billion-dollar subsidy scheme to balloon. The increase comes on top of the fallout from high global food prices.

Budget committee chairman Haris Azhar Azis said the fuel price hike was necessary to prevent even greater damage to the economy in future. Fuel subsidies have become increasingly expensive as the price of oil has surged, and are projected to nearly triple this year to 126.8 trillion rupiah (\$19 billion dollars), amounting to about 12 per cent of the state budget.

However, there are fears that a fuel price rise could trigger unrest in Indonesia. Small protests have already started over the latest plan. Police and students clashed in two cities, while peaceful rallies have cropped up around the sprawling archipelago.

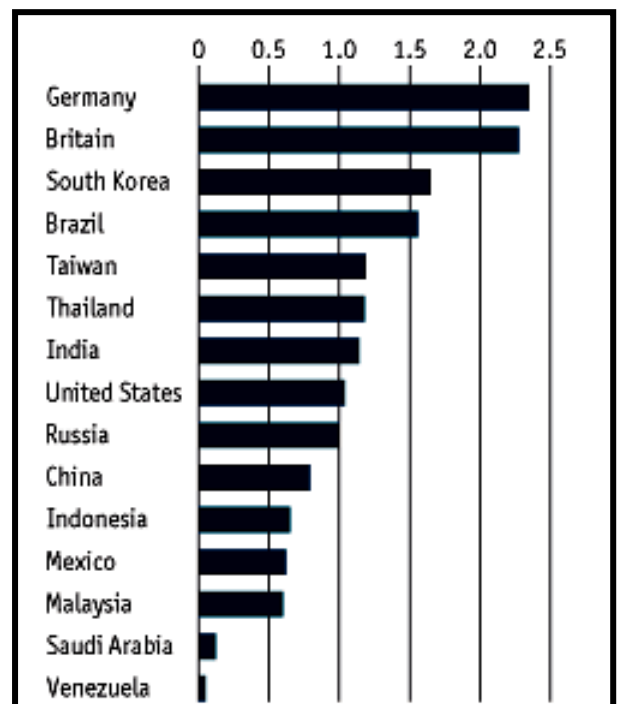
Source: *www.straitstimes.com*, 8 May 2008

Chart 1:
Annual Change in World Oil Consumption
(million barrels per day)



Source: *The Economist*, 29 May 2008

Chart 2:
Retail Petrol Prices, US\$ per litre
(latest figures)



Source: *The Economist*, 29 May 2008

Questions:

- (a) Describe the trend in overall world oil consumption levels between 2004 and 2007. [2]
- (b) (i) With reference to Extract 1, use **a** market demand and supply **diagram** to explain the causes of “today’s high oil prices”. [4]
- (ii) Analyse the likely effects of an increase in oil price on the US airline industry. [4]
- (c) (i) Based on the extracts given, account for the large disparity in retail petrol prices between Britain and Indonesia as seen in Chart 2. [2]
- (ii) Using the data and your economic knowledge, discuss whether the imposition of a 2p fuel duty in Britain will lead to a better allocation of resources. [10]
- (iii) In the light of high global food prices, assess whether the Indonesian government should go ahead with the fuel hike. [8]

Case Study 2 Singapore's Economic Performance

Extract 5: Ready for the Future, Ready for the World

In his Budget Statement for the Financial Year (FY) 2007, Second Minister for Finance, Mr Tharman Shanmugaratnam announced a 2 percentage point reduction in the corporate income tax rate to 18% to sharpen Singapore's competitive edge; a 1.5 percentage point increase in the employer CPF contribution rate to add to the financial security of Singaporeans; a new Workfare Income Supplement (WIS) Scheme to help older low-wage workers; and an increase in the GST rate from 5% to 7% from 1 Jul 2007 to provide critical additional revenues, together with a \$4 billion GST Offset Package to help Singaporeans adjust to the GST increase.

Mr Shanmugaratnam said that Singapore's prospects for the next 5 to 10 years were excellent. With increasing globalisation, capital, enterprise and talent are flowing to countries where government can be trusted, where the workforce is well-educated and skilled, and where the quality of life is high. Companies and enterprising individuals from around the world were coming to Singapore, and Singaporeans were seizing opportunities abroad. However, like other countries, Singapore was facing a widening income gap and slow wage growth at the lower end despite healthy economic growth. Mr Shanmugaratnam emphasised that the solution was not to go for slower economic growth because that would only make everyone worse off, especially those at the bottom. He said that Singapore's strategy had to be to focus on growth while maximising opportunities for all Singaporeans.

Source: Adapted from the *Singapore Budget, Ministry of Finance Media Release*, February 2007

Extract 6: Singapore Dollar Strengthens to 10-Year High

The Singapore dollar rose to a 10-year high on speculation inflation will accelerate, giving the central bank reason to allow faster gains in its currency. The Singapore dollar advanced to S\$1.4650 against the US dollar yesterday from S\$1.4744 the week before, according to data compiled by Bloomberg. It was as strong as S\$1.4610, a level unseen since 1997.

The Monetary Authority of Singapore, which manages the exchange rate within a trading range against a basket of currencies, "will continue with the policy of a modest and gradual appreciation," it said in a semi-annual report this week, adding it will "increase slightly the slope of the policy band" in which the currency is allowed to trade. Inflation will be between 1.5 percent and 2 percent this year and as much as 3 percent in 2008, the MAS said.

Source: Adapted from *www.bloomberg.com*, 12 October 2007

Extract 7: Singapore's economy grows 7.5%

Singapore's economy has grown 7.5 percent for the whole of 2007, said Prime Minister Lee Hsien Loong in his 2008 New Year Message. The high growth has benefited all Singaporeans - a record 172,000 jobs have been created between January and September and unemployment is down to 1.7%, the lowest in almost a decade. In 2007, the Economic Development Board drew in a record S\$16 billion of fixed asset investments in manufacturing and projects generating S\$3 billion of total business spending in services.

For 2008, Mr Lee said he is cautiously optimistic. The US may go into a recession because of the financial market problems and a US downturn would affect Asia too. But he believes the impact on Singapore would be offset somewhat by the strong momentum in the dynamic Asian economies. For Singapore, 2008 will see the realisation of several major projects, among them the inaugural F1 Singapore Grand Prix. All things considered, Mr Lee expects the Singapore economy to grow by 4.5 percent to 6.5 percent in 2008.

He however noted that inflation has picked up in recent months and this has caused concern to Singaporeans. But, while tackling immediate cost issues, Prime Minister Lee reminded Singaporeans of the need to continue to focus on long term strategies.

Source: Adapted from *www.channelnewsasia.com*, 31 December 2007

Table 1: Selected Economic Indicators of Singapore (2004-2007)

	2004	2005	2006	2007
Change in real GDP (%)	9.0	7.3	8.2	7.7
GDP at 2000 market price (S\$ million)	183,271.0	196,645.6	212,711.5	229,123.1
Current account (S\$ million)	30,821.1	37,075.5	47,295.0	59,013.9
Inflation rate (%)	1.7	0.5	1.0	2.1
S\$ / US\$: Average for each year	1.6903	1.6646	1.5889	1.5071
Unemployment Rate (%)	4.4	4.1	3.6	3

Source: Singapore Department of Statistics, www.singstat.gov.sg

Questions

- (a) (i) Describe the trend of current account balance. [1]
- (ii) Based on Table 1, explain how the change in the exchange rate (S\$/US\$) affects current account balance. [3]
- (b) To what extent does Table 1 suggest that the living standard of Singapore residents has improved between 2004 and 2006? [6]
- (c) (i) Explain the meaning of inflation. [2]
- (ii) Comment on the effectiveness of the policy adopted by the Singapore government to control inflation. [4]
- (d) (i) With the help of data provided, discuss the challenges that Singapore might face in the light of globalisation and financial market problems in the US. [8]
- (ii) Assess whether the measures announced in the 2007 budget are sufficient to tackle the challenges. [6]

Section B

Answer **one** question from this section.

- 3 (a)** Analyse the causes of unemployment in Singapore. [10]
(b) Discuss the effectiveness of fiscal policy in solving unemployment. [15]
- 4** Discuss whether protectionism is an effective measure to achieve economic growth. [25]