TEMASEK JUNIOR COLLEGE

PRELIMINARY EXAMINATION 2008

ECONOMICS: **9732/01**

PAPER 1

Wednesday 17 September 2008 1400-1615 Hours

READ THESE INSTRUCTIONS FIRST

Do not turn 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.
You may use a soft pencil for any diagrams, graphs or rough working.
Do **not** use staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.

At the end of the examination, fasten your work for each question **separately**. Hand in each CSQ separately.

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

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Answer **all** questions.

Question 1 The Sugar Industry

Extract 1: The UK Sugar Market

Sugar, a sweet substance is obtained from the juices of various plants. Due to differences in climatic conditions, sugar **beet** that thrives well in temperate countries is processed into white sugar while sugar**cane** that proliferates in the tropical areas is processed into raw and white sugar.

British Sugar (BSC) is a firm in an enviable position. As the sole processor of the sugar beet grown in the UK, it enjoys a large share of the market for refined white sugar. In addition it receives a guaranteed price from the European Union (EU) for the sugar it produces.

Tate and Lyle (T&L) is a company that also processes sugar in the UK, but uses sugar cane, which is imported from countries outside the EU such as Brazil, Australia and the Caribbean countries. Imports of sugar cane are limited by quotas, which restrict the supply and ensure that BSC faces little competition.

Neither BSC nor T&L has any incentive to cut prices. BSC has its production quota set by the Common Agriculture Policy (CAP) of the EU while T&L's ability to increase sales is limited by the sugar cane import quota. The EU subsidises the export of all surplus sugar and this helps to keep prices in the world market low.

In the past BSC has more than once been found guilty of abusing its market power. It has twice been fined by the EU, on the first occasion for blocking the entry of another firm into the market, and later for colluding and price fixing.

BSC's profits have exceeded 20% in every year but one since 1994. In 2001, the margin was 21% compared to the overall profit margin of its parent company (Associated British Foods) of just 6%. It has been estimated that if the guaranteed price were reduced by 11%, profits of 10% could still be earned. The reduction would transfer 123m euros from the company to its consumers.

Extracted from GCE 'A' Level Examination, November 2004

Extract 2: The EU Sugar Regime[3]

In operation for the last forty years, the sugar regime has insulated the beet farmers and sugar processors from low prices and vagaries of the world market through intervention. Cane-sugar producers enjoy lower cost of land and labour. Brazil's cost of producing sugar is four cents per pound[1] while EU producers incur 25 cents per pound. With world prices never rising beyond 15 cents per pound, the EU producers would have been wiped out of existence. Yet they have been able to make substantial profits. This is made possible with import restrictions. The 2004 import tariff stood at 324 per cent.[2] Excess supply makes export subsidies necessary.

Attracted by the glitter of profit, refiners produce above the quota ceiling. This non-quota sugar is not eligible for price support or subsidies and is not to be sold domestically.

However, under the African, Caribbean and Pacific (ACP) Sugar Protocol some 18 sugar exporting countries that are former European colonies have been given special access to the

EU markets. These ACP countries include Mauritius, Barbados and Fiji. Similar duty-free access to EU has been accorded to least developed countries such as Mozambique, Ethiopia and Malawi under the Everything But Arms (EBA) initiative.

Left out of such preferential trade, Brazil, Australia and Thailand lodged a formal complaint to World Trade Organisation (WTO) that EU engaged in 'cross-subsidisation' of non-quota sugar exports, and indirect and direct subsidies of quota sugar. EU's claim that its sugar regime was non-subsidising and self-financing export regime and that its trade preferences for developing countries were consistent with 'waiver' from the WTO rules was overturned.

Extract 3: Reform of EU Sugar Regime[3]

With the aim of securing a competitive sugar beet industry in the EU, short and long-term planning has gone underway.

To reduce the glut created by subsidized profit, minimum sugar price will be reduced by 36 per cent without compensation and minimum beet price to be cut by 39 per cent with compensation for 60 per cent of the price reduction. Levies on the sugar industry will be deployed as restructuring fund to incentivise uncompetitive producers to leave the industry. This is complemented by reduction in EU sugar production by 6 – 7 million tones (mt) with a substantial halt to EU sugar exports. However, external protection remains limiting the rise in imports by protective clauses.

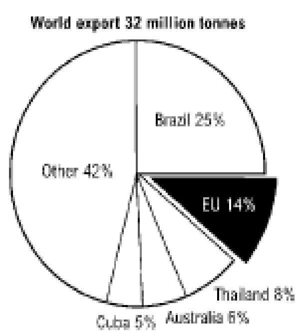
As the EU unveiled its plans to reform the sugar sector, loud protests were heard. Mixed response was received from the rest of the world.

Extract 4: The Global Sugar Market[3]

Owing to favourable weather condition on the one hand and owing to the need to earn foreign exchange on the other hand, world sugar production is estimated to expand rapidly reaching 150.6 mt by 2006. The bulk of this increase will come from developing countries. Brazil which is the world's leading sugar producer will put even more land under cultivation.

A more favourable trade agreement with USA coupled with higher yields will see Mexico expanding its production to reach 6.1 mt. Total output in Pakistan, the Philippines, China, Thailand and Vietnam is expected to reach 22.3 mt.

Figure 1: World market shares (2001-03)



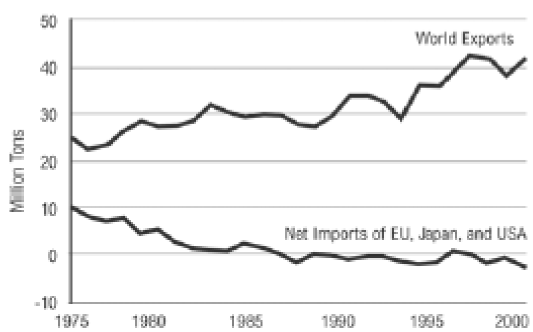


Figure 2: World sugar exports and net imports of selected countries

Source: Oxfam Briefing Paper based on International Sugar Organisation and World Bank data

World consumption is expected to rise to 149.7 mt. the bulk of which is accounted for by developing countries. Developing countries is estimated to consume 101 mt, driven by growth in population and income. Consumption in the EU, the US and South Korea is expected to remain stable. World interest in ethanol as an alternative fuel has whetted the appetite for sugar.

Like other primary-produce exporters, sugar exporters face great market uncertainty which spells trouble for many of the world's least developed countries where abject poverty is the order of the day.

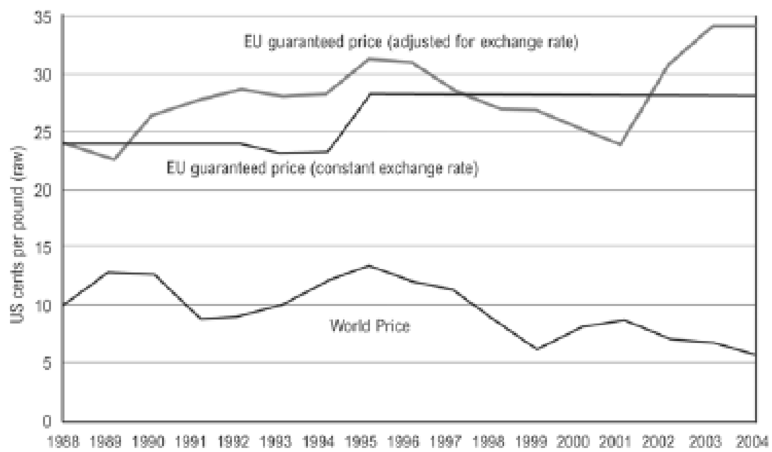


Figure 3:
EU guaranteed prices and world prices

Source: Oxtam Briefing Paper based on data from World Sugar Organisation, World Bank, European Commission

[1]World Bank, Landell Mills Commodities, and national data; Oxfam Briefing Paper
[2]International Sugar Organisation and European Commission; Oxfam Briefing Paper
[3]Extracted from various sources

Questions

(a) **(i)** Compare the EU price of sugar with the world price of sugar over the period shown. [3]

(ii) Explain the differences observed and the implication for the EU commission. [4]

(b) **(i)** Identify two characteristics of BSC that suggest that it has strong market power. [2]

(ii) Explain another way by which BSC might have prevented the entry of another firm into the market. [2]

(c) **(i)** With the aid of a diagram, explain what the impact would be on BSC's profits if free trade were allowed in the European sugar market. [3]

(ii) Discuss the view that the advantages of monopoly outweigh the disadvantages. [6]

(d) Examine the possible impact of the European sugar sector reform on sugar producers. [10]

[Total: 30]

Question 2 EU – A Model for Asean

Extract 5: **A regional free trade area**

The Asean Charter (which includes advancing the creation of a regional free-trade zone to 2015) is supposed to take Asean a great stride towards becoming a European Union-style integrated economic and political grouping. This will help Asean to make progress and remain relevant in the face of the rise of China and India. Asean's major economic co-operation initiatives thus far include the development of the Asean Free Trade Area (AFTA) which started in 1992.

Asean's overall progress has been modest. For 15 years it has been phasing in a supposed free-trade zone. But this remains riddled with persistent tariffs, exemptions, and non-tariff barriers. Trade within the block grew by 129% in 2000-06. Nevertheless, Asean countries still do more of their trade with non-members.

Whereas the EU has exclusive rights to strike trade deals on behalf of its members, Asean's progress in negotiating as a block has been limited. A proposed pact with Australia is behind schedule, prompting Indonesia to announce that it was exploring a bilateral trade deal. Other Asean members also continue actively seeking bilateral deals.

Source: Adapted from *The Economist*, 2 August 2007

Extract 6: **Asean-EU free trade agreement**

'Globalisation today is the biggest driver for...increased regional integration. And I think this is in the interest of the countries themselves,' said Mr Barroso the European Commission president. 'The important point to make…is that it is not detrimental to the national interests of the countries. On the contrary, it can add value for a country, namely small countries. They can have more capacity if they work together in regional integration. This is the key.'

Given that the EU is Asean's second largest trade partner, Mr Barroso added that there was great trade potential to be tapped if obstacles to bilateral trade were removed. Both EU and Asean pledged to 'enhance economic relations by expeditiously negotiating the Asean-EU Free Trade Agreement'.

Source: *The Straits Times Singapore*, 23 November 2007

Extract 7: EU-Singapore free trade agreement

Singapore's Minister for Trade and Industry urged companies to push for an EU-Singapore free trade agreement (FTA) within the framework of the regional Asean-EU FTA as it would produce benefits such as tariff concessions, faster market entry for EU companies as well as intellectual property (IP) protection.

The EU, which is Singapore's second largest trading partner after Malaysia, chalked up a record $97.5 billion in bilateral trade with Singapore last year, 6.3 per cent higher than in 2006. Europe is also the largest source of foreign investment - over a third of incoming foreign direct investment (FDI) - in Singapore. Over 7,000 European companies have established a presence in Singapore.

Source: *Business Times Singapore*, 10 May 2008

Extract 8: **Rise of the two Asian titans**

China's export competitiveness will ease with rising wages and an appreciating currency. India has yet to get its physical infrastructure up to speed and faces a shortage of skilled labour. Such indicators give Asean a window of opportunity to regain the initiative in the race for investments and markets, but whether it does so will depend a lot on how rapidly it can build up the regional integration envisioned in the Asean Charter and the Asean Economic Community (AEC) blueprint.

Unlike China and India, where high-value exports and imports grew faster than those of low-value, four of the six Asean countries studied saw low-value exports grow faster than high-value exports, possibly because of a boom in commodity prices and demand.

However, as China's population ages, pointed out the head of Asia and Global Agency for the World Economic Forum, it will face demands for a social security net. While India has one of the youngest populations in the region, skill sets are often inadequate for it to ramp up its manufacturing sector. 'Asean has the benefit of youth and an educated, skilled and able workforce. It still has an opportunity to leverage its youth,' he said.

Source: *The Straits Times Singapore*, 18 November 2007

Table 1: European Union Trade Balance with Asean

Year	Imports (million euro)	Share of total EU imports	Exports (million euro)	Share of total EU exports
2001	70 791	7.20	43 842	4.91
2002	67 731	7.19	40 513	4.50
2003	65 770	6.99	39 247	4.47
2004	69 084	6.69	42 880	4.45
2005	70 809	6.02	44 966	4.23

Source: EUROSTAT 2006

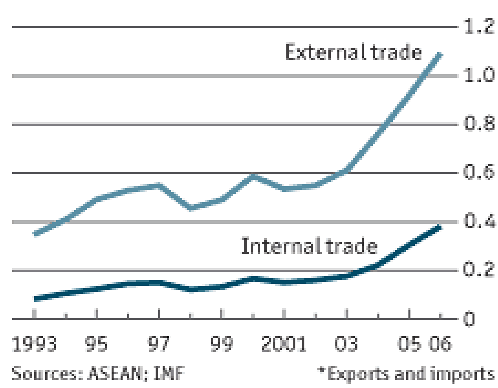
Table 2: Asean's Trade with Main Partners in 2005

Partners	Imports + Exports (million euro)
World	968 484
USA	125 026
Japan	121 395
EU	117 004
China	96 803
India	18 729
Asean	261 645

Source: IMF 2006

Figure 4: Asean Trade (1993 – 2006)

ASEAN's trade*, US$trn



Questions:

(a) **(i)** Compare the trends of Asean's internal and external trade between 1993 and 2006. [2]

(ii) Explain possible reasons to account for the trends observed. [4]

(b) **(i)** Identify 2 'obstacles to bilateral trade' mentioned in the extracts. [2]

(ii) Explain how these can act as obstacles to Asean trade. [4]

(c) Using economic concepts, explain how economic integration can help Asean 'remain relevant in the face of the rise of China and India'. [8]

(d) As the Minister for Trade and Industry of Singapore, how would you convince Asean to push ahead for an EU-Asean FTA. Use the case material to help justify your answer. [10]

[Total: 30]