SERANGOON JUNIOR COLLEGE
JC2 Preliminary Examination

ECONOMICS **8819/01**
Higher 1

PAPER 1 14 September 2016

3 hours

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your name and civics group 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.

Sections A
Answer **all** questions.

Section B
Answer **one** question.

Start your answers to each case study question and essay question on a new sheet of writing paper.

Fasten your answers to all three questions separately.

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

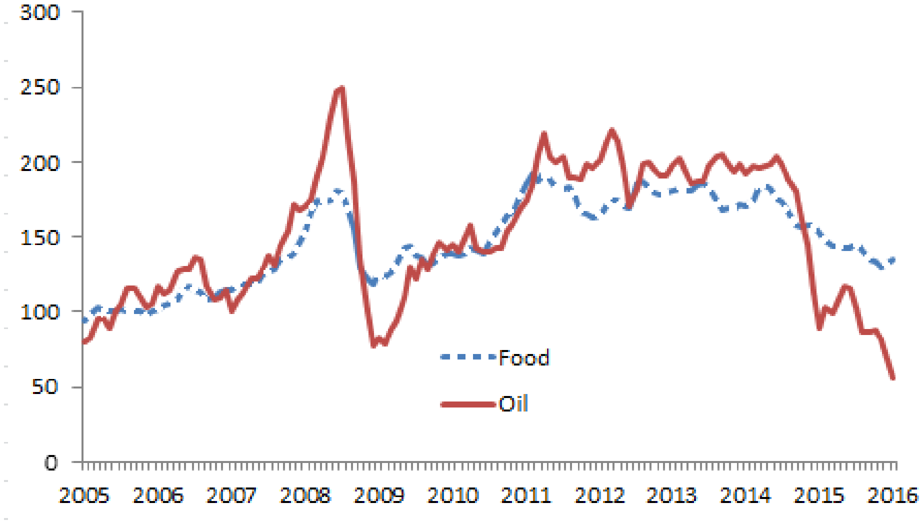
This document consists of **8** printed pages.

Section A

Answer **all** questions in this section.

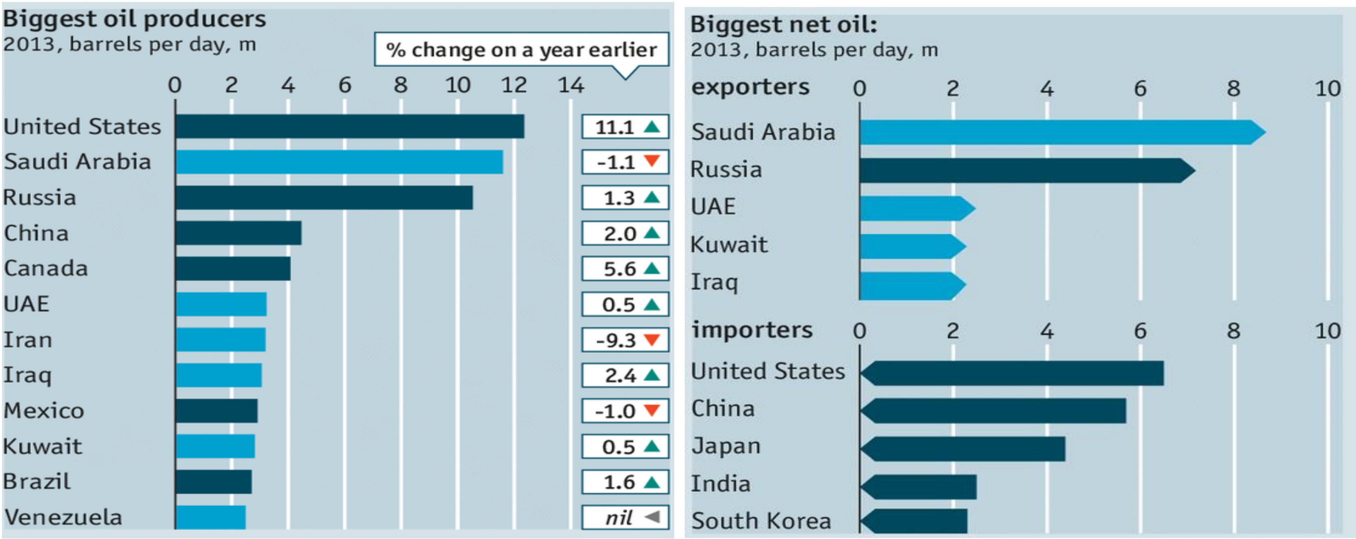
Question 1 **Oil Prices Lower Amid Global Uncertainty**

Figure 1: Crude Oil vs Food Price Indices



Source: http://materials-risk.com/crude-returns-how-low-oil-prices-have-broken-the-relationship-to-food-prices/, accessed August 2016

Figure 2: Unsettled outlook of economies



Source: *The Economist*, 25 October 2014

Extract 1: What's driving the plunge in oil prices?

The Organisation of Petroleum Exporting Countries (OPEC) at its latest meeting in Vienna in December decided to keep oil production at its current levels despite the recent drop in oil prices. The result is there is now no supply discipline at a time when global demand, particularly from China, appears to be dropping.

Although all producers would benefit from a higher price, no one will unilaterally cut output to make it happen. Saudi Arabia is no longer prepared to act as a lone swing producer, reasoning that it will just lose market share if it does so.

Much of the growth in supply has come from the U.S., where high prices made producing oil and gas using hydraulic fracturing profitable. Between 2009 and 2014, global crude oil supply increased by almost 5 million barrels per day, of which 3.3 million barrels came from the U.S., according to the Energy Information Administration. It looks like U.S. shale production will finally ease in 2016, though perhaps not until the second half of the year, but that prospect is more than offset by the possibility of Iran returning to the market next year.

On top of that, the United Nations Climate Change Conference in Paris seemed to suggest that world leaders were more committed than before to switch their economies away from oil and other fossil fuels.

Source: Adapted from various sources

Extract 2: Corporate winners and losers amid the oil price crash

The latest collapse in oil is having an enormous impact. Even though the price has rebounded in 2016, it is still about 60 per cent down since mid-2014.

Conventional wisdom says cheap fuel is good news for airlines, makers of oil-guzzling cars, and other companies able to produce cheaper goods for shoppers with wallets fattened by lower pump prices. Conversely, a low price is supposed to be bad news for power generators using renewable energy and electric carmakers.

Sales of fuel-hungry sport utility vehicles have jumped, but government incentives have to some degree protected the much smaller electric car industry. Monthly sales of electric cars and other vehicles in the US have fallen since the oil price started to decline in mid-2014, but they have risen in Europe, according to figures from Jato Dynamics, an automotive research firm.

Airline executives finally have a smile on their faces. After seeing fuel become their single biggest cost in the era of high oil prices, carriers are now celebrating the plunge. But while airlines are natural winners, how quickly they can reap the full benefits from cheap oil has varied significantly across the industry. This largely comes down to an airline's hedging contracts. Fuel typically accounted for about one-third of carriers' operating costs before the oil crash. Thus many airlines opt to reduce their exposure to volatile and potentially rising fuel costs by turning to hedging which allows them to lock in a guaranteed amount of fuel for future consumption at a fixed price.

Source: *Financial Times*, 13 April 2016

Extract 3: Who are the winners and losers?

China should gain from falling prices. However, lower oil prices won't fully offset the far wider effects of a slowing economy. In Japan, lower prices are a mixed blessing because high energy prices had helped to push inflation higher, which has been a key part of Japanese Prime Minister Shinzo Abe's growth strategy to combat deflation. India's analysts say falling oil prices will ease its budget and current account deficit. At the same time, the cost of India's fuel subsidies could fall by $2.5bn this year - but only if oil prices stay low. The halving of global oil prices since mid-2014 has allowed the Indian government to raise diesel and petrol fuel taxes and cut diesel prices by 25-30 per cent - a windfall gain for households as well as businesses, and dampening inflationary pressures in the economy.

With oil at $115 a barrel, Saudi Arabia earns $360 billion in net exports a year; at $85, $270 billion. Its budget has almost certainly gone into the red. Prince Alwaleed bin Talal, an influential businessman, called lower prices a "catastrophe" and expressed astonishment that the government was not trying to push them back up. But Saudi Arabia's long-term interest may in fact be served by a period of cheaper oil. It can afford one, unlike most other exporters. Though public spending has risen in recent years, its foreign reserves have risen more. Net foreign assets were 2.8 trillion riyals ($737 billion) in August—over three years' current spending.

Source: *BBC News*, 19 January 2015

Questions

(a) **(i)** Using Figure 1, describe the trend of oil prices from 2005 to 2016. [2]

(ii) Using relevant case material, account for the trend in oil prices from 2014 onwards. [4]

(b) Explain the relationship between oil prices and food prices as seen in Figure 1. [3]

(c) Account for the value of price elasticity of supply for oil. [2]

(d) Using Extract 3, explain the likely effects of the 'growth in supply' (Extract 1) on producers' revenue in the markets for oil and one other related product. [6]

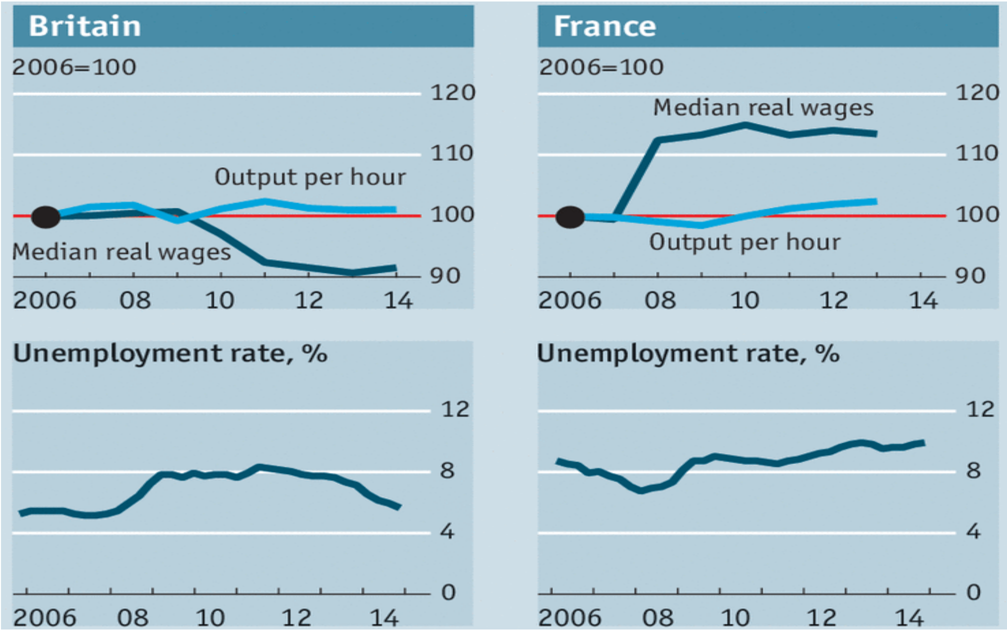
(e) In the light of Extract 1, explain why 'world leaders are more committed to switch their economies away from oil' to achieve efficiency in resource allocation. [5]

(f) How far do you agree that the oil price slump will bring about more benefits than costs to an economy? [8]

[Total: 30]

Question 2 The Global Economy Pre and Post Crisis: Heading for another recession?

Figure 3: Labour and unemployment statistics



Source: *The Economist*, 2 May 2015

Extract 4: The economics of low wages

In most places, the recession that followed the 2009 financial crisis had dire effects on wages. In America, workers have been demonstrating for higher pay and stronger union rights in the profitable but poorly paying food industry. Britain's Labour Party has plans to punish "predatory" capitalists that exploit the low-paid. In Japan Shinzo Abe has sworn to lift salaries.

Across rich countries, household consumption ranges from 55% (France) to 68% (America) of GDP. While it makes sense for an individual boss to hold down pay, low pay across the economy as a whole threatens to put a lid on the growth that one would otherwise expect after a recession.

Meanwhile, scholars seeks to explain this decline in the labour share. One is that the income from capital has been increasing more than the income from labour. Another is that, in many industries, capital goods have become a lot cheaper and/or better. Bosses can choose whether to spend money on machinery or people, and declines in the price of the capital goods required for a given amount of output reduce demand for labour.

Globalisation can also reduce the demand for less skilled toward more skilled labour, driving income inequality between them. Competition from imports alter the profit opportunities facing firms. Firms respond by shifting resources toward industries in which profitability has risen and away from those in which it has fallen. And the decline of trade unions reduces labour's bargaining power. In addition, rapid technology change seems to have led to relative price declines in skill-intensive industries as well.

Source: Adapted from *The Economist*, 2 May 2015 & www.imf.org, accessed July 2016

Table 1: Economic data of selected countries, 2014

	GDP growth (%)	Consumer Price Index (base year: 2000)	Unemploy-ment rate	Current Account ($US billion)	Budget Balance (% of GDP) *[2015 estimates]*	Gini Coefficient *[2010-2014 estimates]*	Pollution Index (PM10 ug/m3)
Singapore	3.3	99.9	3.2	53	-0.5	0.4	32
China	7.3	119	4.1	277	-2.6	0.5	98
United States	2.4	101.6	7.2	-389	-2.4	0.45	18
India	7.2	111	3.8	-27	-4.6	0.5	109
Brazil	0.1	106.3	4.8	-104	-0.6	0.5	40

Source: *World Bank Data*; www.tradingeconomics.com, accessed July 2016; *IMF* website accessed July 2016

Extract 5: Global economy faces low growth

The world economy appears to be suffering a slowdown in growth that will stretch through 2016, according to a report by the Organisation for Economic Cooperation & Development (OECD).

Despite a secular stagnation that is associated with higher health and pension costs of an ageing population that impedes other investment and improved productivity in western countries, stimulus efforts appear to have had an impact with the US economy showing signs of recovery of late. That has seen the Federal Reserve, US' central bank, scale back its key stimulus measure of increasing money supply. However in its latest policy decision, the Federal Reserve said it would look at multiple factors before approving any rise in its interest rates. It has previously hinted at doing so once jobless rate fell to 6.5%.

The OECD said in its interim economic forecast that the prospect of higher interest rates in the US and UK had exposed the vulnerability of emerging market economies to higher borrowing costs. It urged the US Federal Reserve to maintain its course for higher interest rates, but called on its officials to signal that the pace of increases will be slow, allowing those countries that have borrowed heavily in dollars to adjust to the jump in costs. Brazil is expected to be one of the hardest hit by the slowdown in China and by its exposure to higher borrowing costs following a US interest rate rise.

The World Bank has cut its forecasts for growth across emerging economies, warning that they face a double whammy from rising US interest rates and lower commodity prices in the oil and energy markets. The World Bank said that emerging economies should prepare themselves for a future beyond cheap money and the commodities boom by investing in infrastructure. "We believe that countries that invest in people's education and health, improve the business environment, and create jobs through upgrades in infrastructure will emerge much stronger in the years ahead," it said. "These kinds of investments will help hundreds of millions of people lift themselves out of poverty."

Source: Adapted from *The Guardian*, 16 September 2015 & www.bbc.com, March 2014

Extract 6: The economics of infrastructure development

The development of highways, ports, bridges, public transport, railways, telecommunications, fisheries, harbours and irrigation are important for an economy's rapid development. These constitute essential economic infrastructure whose development is vital as the efficiency of investment is determined by the state of infrastructure.

Nevertheless the economics of infrastructure development, especially the methods of financing, priorities and returns to investment require serious evaluation. Infrastructure investments are large, could put a strain on balance of payments, and their economic returns take a long period of time. However beneficial investments in infrastructure are, if they lead to large fiscal deficits these would lead to inflationary pressures. Furthermore, there is a large import content in many infrastructure investment projects. In many cases it is even difficult to determine precise benefits of infrastructure investment. One current misconception is that all infrastructure investments are beneficial to the country's economic and social development. Several large infrastructure projects can only be described as White Elephants, while others will bring in only small benefits.

Future infrastructure designs will need to be anticipatory and proactive to be truly sustainable. One examples of this type of next-generation monitoring is in Songdo, South Korea where everything from traffic flow to household waste is highly responsive and networked. These smart-grid networks will become increasingly responsive to allocating electricity in response to demand, or public transport systems that respond to congestion by allocating buses where people are congregating or changing lights automatically based on traffic patterns.

Source: www.sundaytimes.lk, 27 July 2014 & www.bbc.com, 23 November 2013

Questions

(a) **(i)** What is meant by real wages? [1]

(ii) Based on Figure 3, compare the changes in output per hour and median real wages for Britain and France between 2009 and 2014. [2]

(iii) With reference to the data, explain a factor that could have contributed to the change in UK's real wages after 2009. [2]

(b) **(i)** Explain why a rise in a country's wages might not be evidence of a narrowing income gap in the country. [3]

(ii) Extract 4 suggests that low pay across an economy as a whole threatens to put a lid on its growth. Using economic analysis and a relevant diagram, explain and comment whether this threat is valid. [6]

(c) Explain why maintaining a rise in the US interest rate is good news for the US but bad news for countries like Brazil. [4]

(d) **(i)** Analyse how infrastructure investment by emerging economies will 'put a strain' on their balance of payments (extract 6). [4]

(ii) Extract 5 states that "these kinds of investments will help hundreds of millions of people lift themselves out of poverty".

Based on the data and your own relevant knowledge, assess whether a country should then focus on infrastructure investment to achieve growth or pursue other economic goals as its priority. [8]

[Total: 30]

Section B

Answer **one** question from this section.

3 **(a)** Explain why the price mechanism might not lead to efficient allocation of resources. [10]

(b) Discuss the measures that the Singapore government can put in place to bring about efficient allocation of resources in different markets. [15]

4 The rising threat of worldwide protectionism and low labour productivity are posing considerable downside risks for Singapore's highly open economy.

(a) Explain how the above factors pose challenges to Singapore's economic performance. [10]

(b) Evaluate the policies used by the Singapore government to address these challenges. [15]

[End of paper]