TEMASEK JUNIOR COLLEGE
Preliminary Examination 2011
General Certificate of Education Advanced Level
Higher 2

ECONOMICS 9732/01

Paper 1

Wednesday 14 September 2011
2 hours 15 minutes

Additional Materials: Answer Paper

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 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.

Answer **all** questions.

Begin each question on a separate sheet of answer paper.
At the end of the examination, fasten your work for each question separately.
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 **7** printed pages.

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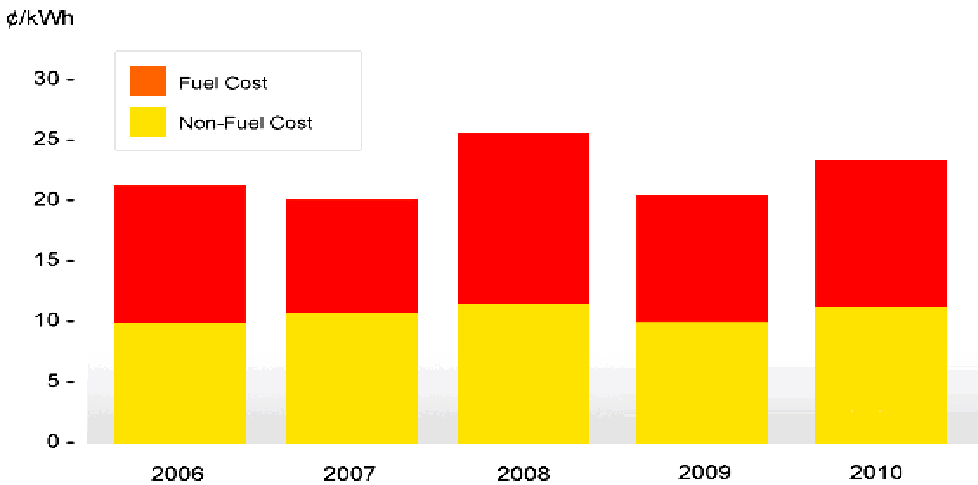
Answer **all** questions.

Question 1

The Energy Market

Figure 1: Fuel vs Non-Fuel Cost Components in Electricity Tariff (Price)



Note:
The fuel cost or the cost of imported natural gas is tied to the price of fuel oil by commercial contracts
The non-fuel cost reflects the cost of generating and delivering electricity to our homes.

www.ema.gov.sg

Extract 1: Singapore Electricity Market

Underscoring the importance of freeing up the electricity market, Minister for Trade and Industry Lim Hng Kiang said that this 'has always helped keep power prices low'. And this is why competitive markets will remain 'a cornerstone' of Singapore's energy policy, added Mr Lim, who was at the opening of the Singapore Electricity Roundtable at the Raffles City Convention Centre.

About a decade ago, the Public Utilities Board was the sole provider of all electricity services in Singapore. The Government then restructured the industry, separating the generating of power from its distribution and also from the sale of power by the electricity retailer to the end consumer.

The business of power generation was first liberalized and this saw the establishment of several privately owned power generation companies such as Tuas Power and PowerSeraya. These companies were free to choose their own means of generating power. And the diversification of energy sources led to lower electricity bills as generation companies looked for more energy-efficient means of power production, explained Mr Lim.

So far, businesses - which account for about 75 per cent of Singapore's total energy consumption - have been reaping the most gains from competition. This is because they can buy their power directly from power companies, whereas Singapore households (in the non-contestable market) must buy their power from one electricity retailer: SP Services.

The next stage of liberalisation will therefore allow consumers to buy from retailers other than SP Services. If successful, the project will see six retailers hitting the market with more competitive prices, spelling lower bills for users. Allowing for multiple retailers will give consumers the ability to pick the electricity plan best suited to their needs, just like picking a mobile phone plan.

Source: The Straits Times 13 Nov 2007

Extract 2: Malaysia Raises Electricity Tariffs

Saddled with a ballooning subsidy bill, the Malaysian government announced electricity tariffs will go up by an average of 7 per cent from June 1.

Many Malaysians are concerned about the increase, despite the assurance that 75 per cent of domestic users will be spared from the tariff hikes. "I think it is a bit optimistic; I think most people will be affected by the price increase." said one Malaysian. "Although they increase one cent or two cents, it affects everything in our country," commented another.

Economists are predicting inflation to breach 4 per cent in June, the highest in more than two years. Commercial and industrial users, they said, will bear the brunt of the increase, particularly exporters that are already hurt by a stronger ringgit that has appreciated nearly 15 per cent against the greenback since last year.

Dr Yeah Kim Leng, chief economist at RAM Rating Services said: "The last increase was about 6 months ago, and they have committed to review in every 6 months. In our view it has to be more frequent given the volatility of the world oil prices, but nonetheless I think we are looking forward. It is better to face the challenge now and bear the pain in the short term so we have a longer term gain. The question now is to balance the economic needs with the political realities."

Source: Intellasia Channel News Asia 02 Jun 2011

Extract 3: Is it time to overhaul Europe's carbon trading scheme?

When it was launched in 2005, the European Union's Emissions Trading Scheme (EU ETS) was hailed as a major step forward in the fight against climate change. Covering 12,000 power plants, factories, and other industrial facilities, it was the world's largest cap-and-trade project to date. EU officials saw it as the first of many carbon-pricing schemes that would eventually cover the globe.

Six years later that vision is looking a little clouded. With the EU ETS accused of failing to reduce carbon emissions and critics charging that the carbon-trading mechanism has opened the door to fraud and profiteering by participants, serious questions have arisen about the future of the EU's grand emissions plan.

As EU members debate the parameters of the next phase, from 2013 to 2020, campaigners are calling for fundamental reforms, or for the EU ETS to be scrapped. Groups such as Friends of the Earth describe carbon trading as a "distraction," and argue that other measures, such as carbon taxes, would be more effective and less susceptible to abuse.

In 2010, 65 percent of EU ETS sites had more permits than they needed according to Sandbag, a London-based group that monitors emissions trading. The effect has been to depress carbon prices — reducing the incentive to invest in cleaner technologies — and lessen the downward pressure on emissions.

To tighten up on allowances, the European Commission has suggested reducing the number of future emissions permits or creating a new target of cutting emissions 30 percent below 1990 levels by 2020. Despite such moves, a growing number of academics argue that Kyoto-era solutions such as carbon trading have had their day.

Source: Yale Environment 360 guardian.co.uk 28 April 2011

Questions

(a) **(i)** Describe the changes of electricity tariff from 2006 to 2010. [2]

(ii) Suggest two possible factors that could have helped cushion electricity tariff against a hike in oil prices. [2]

(b) **(i)** Explain why Singapore electricity market was restructured. [4]

(ii) Assess the impact of the restructuring on domestic firms and households. [4]

(c) Electricity tariffs should be allowed to rise so that the Malaysian economy bears the "short term pain for long term gain". Discuss. [8]

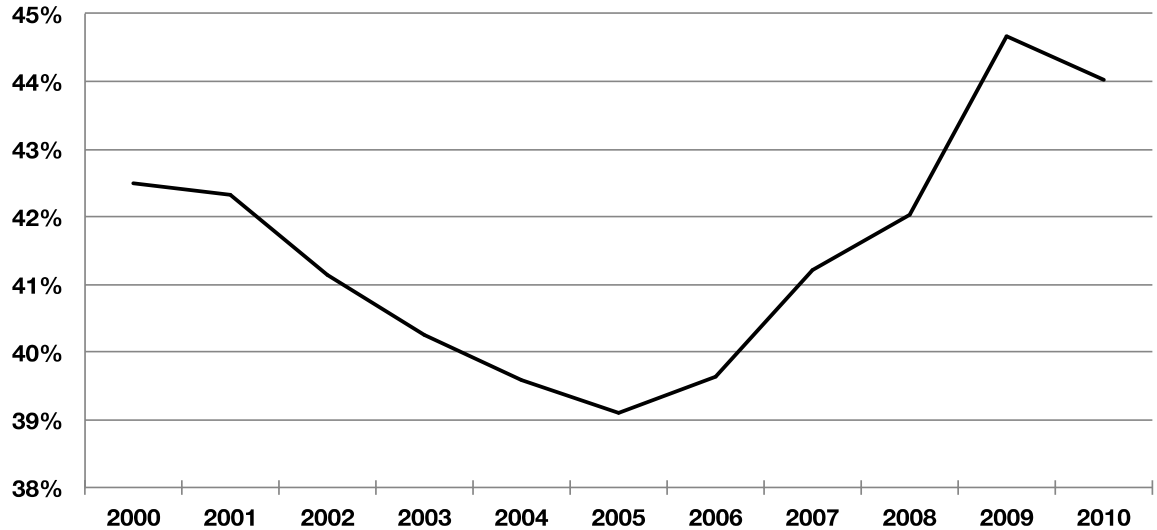
(d) In extract 3, an environmental group argued against carbon trading and supported other measures such as carbon taxes to reduce carbon emissions. Do you agree with their views? [10]

[Total: 30]

Question 2

Trade and the US Economy

Figure 2: U.S. Exports as Percentage of Total Trade



Source: U.S. Census Bureau

Table 1: U.S. Key Indicators

	Real GDP (billions) in 2005 Prices	Monetary Stock, in Billions (M1)	Government Debt as % of GDP
2001	11,347.2	1182.1	32.5
2002	11,553.0	1219.7	33.6
2003	11,840.7	1306.5	35.6
2004	12,263.8	1376.4	36.8
2005	12,638.4	1374.9	36.9
2006	12,976.2	1366.3	36.5
2007	13,228.9	1373.6	36.2
2008	13,228.8	1602.7	40.2
2009	12,880.6	1693.6	53.0
2010	13,248.2	1830.9	63.6 (est)

Source: U.S. Bureau of Economic Analysis,
Federal Reserve & U.S. Bureau of Labor Statistics

Extract 4: US Fed Stimulus Ends with a Whimper

The Federal Reserve's US$600 billion (S$737 billion) plan to boost the ailing United States economy ended yesterday after generating a huge amount of controversy but having little effect on jobs and growth. Critics of the programme, widely dubbed "QE2", say it fuelled surging prices for food and fuel, pumped up asset bubbles in emerging economies like China and Brazil, and devalued the US dollar.

The idea behind QE2 was that the Fed would pump a vast amount of money into the economy by buying US Treasury bonds from banks. Buying the bonds would give banks more cash to lend and push down long-term interest rates. That in turn would encourage companies to borrow cheaply and invest in factories, equipment and workers. Critics say this is the equivalent of printing dollars, but the Fed calls it, "quantitative easing".

Many world leaders, especially in emerging markets, complained that QE2's effect of increasing the supply of dollars devalued the currency, making US exports cheaper and their own exports less competitive.

Source: Adapted from The Straits Times, 1st July 2011

Extract 5: Facts and Figures – The US–Singapore Trade

Exports

- Singapore was the United States' 10th largest export market in 2010. U.S. goods exports to Singapore in 2010 were $29.1 billion, up 31.1% ($6.9 billion) from 2009, and up 124% from 1994.
- The top export categories in 2010 were: Machinery ($5.6 billion), Electrical Machinery ($5.5 billion), Aircraft ($3.8 billion), Mineral Fuel (oil) ($3.5 billion), and Optic and Medical Instruments ($2.1 billion)
- U.S. exports of agricultural products to Singapore totalled $498 million in 2010. Leading categories include: dairy products ($44 million), poultry meat ($43 million), processed fruit and vegetables ($43 million), and fresh fruit ($42 million).

Imports

- Singapore was the United States' 23rd largest import market in 2010. U.S. goods imports from Singapore totalled $17.5 billion in 2010, an 11.3% increase ($1.8 billion) from 2009.
- The five largest import categories in 2010 were: Machinery ($5.3 billion), Electrical Machinery ($2.8 billion), Organic Chemicals ($2.7 billion), Pharmaceutical Products ($1.8 billion), and Special Other (returns) ($1.6 billion).
- U.S. imports of agricultural products from Singapore totalled $117 million in 2010. Leading categories include: cocoa paste and cocoa butter ($55 million), and snack foods (including chocolate) ($21 million).

Source: Office of the United States Trade Representative
http://www.ustr.gov/countries-regions/southeast-asia-pacific/singapore

Extract 6: Managing Risk Vital for Open Economies

Small, open economies like Singapore have benefited enormously from the strong, stable global growth that has been generated over much of the past few decades. But it seems likely that after the relatively benign global economic environment of the previous decades, the global economy is moving into a more volatile and uncertain period. This will have a significant impact on globally exposed economies, and will require policy innovation.

Over the past few years, there has been elevated volatility in trade and capital flows, as well as in gross domestic product, commodity prices and exchange rates. And the recent global financial and economic crisis has reminded countries, particularly those with relatively open economies, that they are significantly exposed to variations in global economic performance.

But this is more than a short-term issue. There are structural forces driving the increased volatility. Globalisation has led to more significant uncertainty for countries, governments, corporations, and households – as well as much increased global inter-connectedness of risks. And there is also the risk and uncertainty associated with the pace of technological change, new sources of global competition, the price and availability of core commodities, and so on.

And there is much less redundancy available to deal with these heightened exposures. Across much of the developed world, monetary and fiscal policy settings are such that governments have little ability to respond to any further economic volatility.

For small countries – say countries with populations of 10 million or less, which tend to be particularly reliant on the global economy – this uncertainty and volatility has the potential to have substantial impacts on their economic performance. At a national level, countries are exposed to changes in investor sentiment and the withdrawal of capital, the security of the supply of food and other commodities, as well as variation in export demand from key markets. And for households, this national risk exposure can cause employment risk and increased financial risk.

Because of this, an increasingly important policy priority will be for governments to build resilience into their economies so that their countries can prosper in a more complex and turbulent world. Although improving growth rates is the primary focus of the current global economic debate, countries will be increasingly focused on the resilience of that growth and the allocation of risk within the economy. The size and nature of a country's risk exposures can be deliberately shaped by the government.

Source: The Straits Times Thursday, January 27 2001

Questions

(a) **(i)** Summarise the trend in the US trade balance from 2000 to 2010. [3]

(ii) With reference to Table 1, comment on the effectiveness of the macroeconomic policies implemented by the U.S. government from 2008 to 2010. [4]

(b) **(i)** Explain briefly how "QE2" devalues the USD. [3]

(ii) As a result of "QE2", world leaders from emerging economies have accused the U.S. of competitive devaluation. Assess the validity of their argument. [4]

(c) Discuss whether the trade patterns between US and Singapore conform to the predictions of comparative advantage theory. [6]

(d) Discuss the extent of the risk posed by globalisation to different countries. [10]

[Total: 30]