Candidate Name: ____________________________ CT Group: ______
Index no. : ______

PIONEER JUNIOR COLLEGE
JC 2 PRELIMINARY EXAMINATIONS 2008

ECONOMICS 9732/01

Higher 2

Paper 1

Thursday **11 SEP 2008** **2 hours 15 mins**

Additional materials: Answer paper

INSTRUCTIONS TO CANDIDATES
Do not open this booklet until you are told to do so.

Write your name, CT group and index number in the spaces provided on all the answer papers provided.

Answer **all** questions.

Begin Question 2 on a fresh sheet of paper. At the end of the examination, you will be required to **hand in your answers to Question 1 and Question 2 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.

This question paper consists of 7 printed pages (inclusive of this page)

Answer **all** questions

Question 1: Energy Markets

Extract 1: European energy markets

The European commission yesterday warned the 25-EU countries of the impact of rising prices in the energy market. Some of the challenges raised include climate change and shortage of oil supplies on its energy market.

It said Europe, along with the rest of the world, faced "serious consequences" from global warming as energy consumption and carbon dioxide (CO_2) emissions continued to rise. The Commission has implemented policies like energy taxes. In addition, the commission is placing greater emphasis on greenhouse gas emissions trading in an attempt to meet the targets set in the Kyoto Treaty.

In this system, government issues carbon credits to different firms. Firms can then sell off these carbon credits if their energy usage releases less CO_2 than the designated amount. Firms that cannot reduce their CO_2 emission at a low cost will then purchase the carbon credits in the market. The price of carbon credit is determined by the price mechanism.

According to EU Commissioner for Energy, emissions trading will do the job. Without the market incentives implied in trading, companies would rather pay the hefty tax than reduce emissions. Going through carbon taxes can create funds, but there is not much private sector involvement. “Levels of greenhouse gases would be much higher without current efforts to cut emissions. However, several countries within the EU-15 are not doing enough and could jeopardise the collective effort of the entire EU,” said Executive Director of the European Environment Agency.

The rising concern about the oil shortage has also sparked off an intense debate over its impact on Europe's economy. On the one hand is a longstanding project led by the European Commission designed to liberalise the market and enable producers and distributors to compete freely within and across national borders. On the other is a camp that argues with growing confidence that long-term security and stable prices can best be preserved in managed national markets that are dominated by strong monopolistic companies. It may be no coincidence that many of continental Europe's biggest energy groups favour this argument—after all, the less competition there is, the higher prices can remain.

The EU commission is determined to use its powers as watchdog of mergers, antitrust and state aid to get the market to work in the energy market. The commission can fine firms up to 10% of total sales for anti-competitive behaviour. But so far, despite evidence of infringements, the commission has yet to fine an energy company.

Source: Adapted from The Economist*, Feb 9th 2006 and The Guardian, March 9th 2006, EEA and European Energy Forum website*

Extract 2: France backs Gaz de France, Suez merger

The French government gave its blessing to a merger of state-controlled Gaz de France and private utility group Sue despite being accused blocking a takeover of Suez by Enel, Italy's leading utility.

France's government, which is flying the flag of "economic patriotism" at a time of increasing globalization, risks angering the European Commission and World Trade Organization because of concerns that its action goes against the spirit of free movement of capital.

Defending the strategic value of the merger, Suez chief executive said: "By merging, Suez and Gaz de France would have greater purchasing power in gas in Europe and would thus be in a better position to negotiate with suppliers. Not only would consumers benefit but France would be able to enjoy a stable supply of gas."

Source: Adapted from CNN Money, February 25th 2006 and The Guardian, June 15th 2006

Extract 3: Singapore's Electricity Market

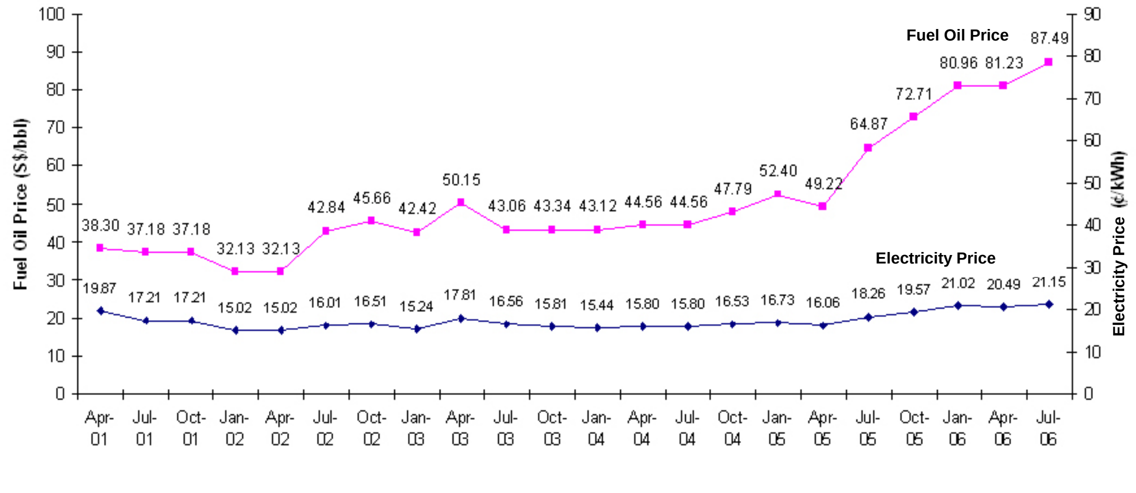
By 2001, the electricity market reforms were completed and the National Electricity Market of Singapore (or NEMS) was launched in 2003 to further enhance competition and market efficiency. NEMS is designed to promote the efficient supply of competitively-priced electricity, opened the energy retail market to full competition and encourage private investment in Singapore's power system infrastructure.

The electricity industry plays a significant role in the Singapore economy. With its history of rapid growth and expanding demand for domestic and commercial energy, Singapore is very reliant on an efficient and modern electricity system. The reliable supply of electricity, at a competitive price, influences the ability of Singapore industry to compete domestically and internationally, which in turn has a direct impact on the national economy.

It was revealed that the government's decision to introduce competition into the electricity market has reaped results. Singapore's ranking for electricity price competitiveness has improved 13 places from 2001 to 2005 in an International Price Competitiveness Ranking. In addition, while fuel oil prices have increased by about 100 percent over the last three years, electricity price in Singapore have risen by only about 27 percent over the same period.

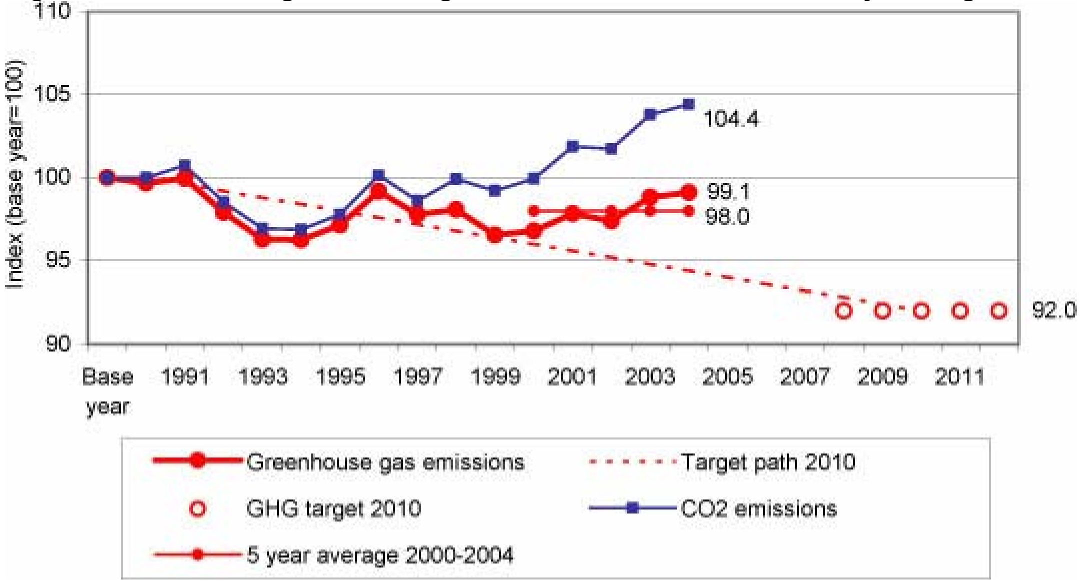
Source: Adapted from Introduction to Singapore New Electricity Market, EMA, Jan 2006 and Speech at EMA FORUM "PLUGGING INTO SINGAPORE", 7 AUGUST 2006

Figure 1: Singapore Market: Fuel Oil (S$) vs Electricity Price



Adapted from Singapore Power Website

Figure 2: Total EU-15 greenhouse gas emissions in relation to the Kyoto target



(Source: European Environment Agency, 2006)

*The Kyoto Protocol is the world's first treaty to attempt to address global warming by limiting greenhouse gas emissions. It is an agreement where most developed countries pledged to reduce their emissions by agreed amounts.
*CO_2 is a dominant greenhouse gas (GHG).

Questions

(a) **(i)** Compare the trend of fuel oil price with the electricity prices in Singapore over the period shown. [2]

(ii) Explain any difference observed in a(i). [2]

(b) In light of Extract 1, use supply and demand analysis to explain the rise of energy prices in EU. [4]

(c) Explain how the carbon dioxide emission is a cause of market failure. [4]

(d) Comment on the policies used by EU to reduce greenhouse gases. [8]

(e) In light of the data provided, critically examine how the different attitudes towards large firm in the energy markets of France and Singapore would affect their households, businesses as well as the economy. [10]

[Total: 30m]

Question 2

Extract 4: ASEAN aims to set up single market by 2015

ASEAN[1] economic ministers aimed to form a single market by 2015, five years ahead of schedule. They are also reviewing ongoing trade liberalisation in goods, and will push for the services sector to be liberalised by 2015 as well. Under a single market, goods would flow freely across borders and curbs on flows of capital and labour would ease, making the region a cheaper place to do business and allowing home-grown businesses to expand and compete globally.

ASEAN began trade liberalisation moves in 1993 under ASEAN Free Trade Area (AFTA), and hopes to become a single market. The single market for the region was originally targeted for realisation in 2020 but increasing competition from China and India has prompted the zeal for speeding up the process. Foreign direct investment into the regional grouping stood at US$38 billion (S$61 billion) last year, its highest levels in more than 10 years but that figure still lags behind China, which attracts around US$50 billion annually.

Source: Adapted from *The Straits Times*, 23/08/2006

Extract 5: Asean Economic Outlook in 2006

The major economies outside of the ASEAN region are expected to perform well and together with improvement in the global demand for IT products, the ASEAN economies, taken together, will be expected to achieve a good steady pace of about 5.5% growth in 2006.

Yet some major economic risks remain. The first is high oil prices remain a threat to the outlook as recent oil price increases have mostly been due to concerns about future supply rather than unexpected increases in demand. Moreover, the effect of fuel price increases on inflation particularly in the ASEAN-4[2] also depends on future decisions to reduce oil price subsidies, which remain significant in Indonesia and Malaysia despite recent domestic price increases. The second is that persistent growing U.S. current account deficit could cause a sharp slowdown in U.S. demand would have significant consequences for ASEAN, which remains dependent on external demand.

Macroeconomic policymakers in the region are facing some broad challenges. First, central banks have responded by raising interest rates to deal with inflationary pressures arising from the surge in international oil prices even as domestic demand is still weak. In some cases, the fact that exchange rates have been strengthening recently has given authorities greater room for manoeuvre on interest rate policy. Second, governments are trying to reduce their debts, while attempting to create the fiscal space needed to meet, among other welfare objectives, the costs of upgrading public infrastructure.

Sources: Adapted from *ASEAN Economic Outlook and Policy Issues*, Speech by Haruhiko Kuroda, President of Asian Development Bank, at the 10th ASEAN Finance Ministers' Meeting on 5 April 2006, and Asia and Pacific Regional Economic Outlook – May 2006 by IMF

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[1] Association of Southeast Asian Nations or ASEAN consists of five original Member Countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand. It was joined later by Brunei Darussalam, Vietnam, Lao PDR and Myanmar.

[2] ASEAN-4 refers to the four middle-income ASEAN members – Indonesia, Malaysia, Philippines and Thailand.

Extract 6: Asean is the key to Singapore's foreign policy

The World Trade Organisation Doha Round negotiations have stalled. If the trade talks fail, protectionism will grow. As an open economy which depends on free flow of trade and investments, Singapore will be very vulnerable.

As a small country, we must accept the world as it is. We must work with our neighbours to deepen our cooperation in Asean, and make South-east Asia a vibrant region which investors cannot ignore. Singapore and the region will benefit hugely from a strong Asean at the centre of an Asia on the move, and this must be the objective of the country's foreign policy. "We must further entrench Asean as the cornerstone of our foreign policy. Building a strong Asean community is an imperative." Foreign Minister George Yeo said.

Source: Adapted from *The Straits Times* 09/08/2006 and *The Business Times* 08/11/2006

Table 1: Selected Macroeconomic Indicators for ASEAN-4, 2004 – 2007

	2004	**2005**	**2006**	**2007**
Real GDP Growth (%)	5.8	5.1	5.0*	5.6*
Rate of Inflation (%)	4.6	7.5	8.7*	4.5*
Current account balance (US$ billion)	24.9	19.6	24.8*	26.7*
Current account balance (% of GDP)	4.0	2.8	3.1*	3.0*
FDI inflows (US$ million)	13 068.2	23 111.8	24 717	NA
Government Fiscal Balance (%of GDP)	NA	-1.2	-1.1*	-0.8*
Exchange Rate (US$ 1 in national currency, end of period)				
Indonesia (Rupiah or Rp)	9290	9830	8995	9419
Malaysia (Ringgit or RM)	3.80	3.78	3.53	3.31
Philippines (Peso)	56.27	53.07	49.13	41.40
Thailand (Baht)	39.06	41.03	36.05	33.70

*Projected Figures

Source: International Monetary Fund and Association of Southeast Asian Nations

Table 2: Selected Macroeconomic data for Singapore, 2003-2006

	2003	2004	2005	2006
Growth of GDP, year-on-year (%)	3.1	8.8	6.6	7.9
Unemployment rate (%)	4.0	3.4	3.1	2.7
Inflation rate (%)	0.5	1.7	0.5	1.0
Balance of Trade (S$ million)	41 262	42 278	49 341	52 635
Intra-ASEAN Trade* (within ASEAN region)	20 310	24 928	32 194	33379
Exports (to ASEAN)	89 071	104 755	118 822	132 259
Imports (from ASEAN)	68 761	79 827	86 628	98 880
Foreign Direct Investment (S$ million)				
Total	246 185.4	276 819.2	323 821.1	363 935.0
ASEAN (by region)	57 755.3	62 252.9	78 253.9	81 475.2
Direct Investment Abroad (S$ million)				
Total	153 572.0	179 742.2	202 072.6	226 266.1
ASEAN (by region)	34 744.2	39 457.1	47 838.1	52 142.4

*Values exclude Myanmar

Source: Statistics Singapore

Questions

(a) **(i)** Identify two challenges faced by Asean. [2]

(ii) Explain how these two challenges affect the aggregate demand and aggregate supply of Asean. [4]

(b) **(i)** Describe the change in the exchange rates of Asean countries shown in Table 1. [2]

(ii) Analyse the impact of the change in the exchange rates on the projected change in current account balance of Asean-4 in 2006. [6]

(c) In the light of Extract 5 and Table 1, assess the use of monetary policy as a tool to control inflation for ASEAN-4 policy makers. [8]

(d) With reference to the data, discuss the macro economic effects of greater Asean integration on the Singapore economy. [8]

[Total: 30m]