ANDERSON JUNIOR COLLEGE

JC2 PRELIMINARY EXAMINATION 2013
Higher 1

ECONOMICS 8819/01

Paper 1 **16 September 2013**

Additional Materials: Answer paper **3 hours**

READ THESE INSTRUCTIONS FIRST

Write your name, PDG and index number in the spaces provided on all the work you hand in.

Write in dark blue or black ink 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.

Section A
Answer **all** questions. Begin your answer to **each question** on a fresh sheet of writing paper.

Section B
Answer **one** question. Begin your answer to **Section B** on a fresh sheet of writing paper.

At the end of the examination, **fasten your answers to each question separately**.

Fasten **this cover page in front of your answers to Question 1**.

Indicate in the table below the **question number** of the question in **Section B** you have attempted.

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

Name ________________________________ (   )

PDG ______/12

Section A	**Marks Awarded**
1	/ 30
2	/ 30
Section B **3 / 4*** ** Delete accordingly*	/ 25
Total Marks	/ 85

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Section A

Answer **all** questions in this section.

Question 1 Fuel prices and the need for renewable energy

Extract 1: Indonesia cuts fuel subsidies, risking social unrest

President Susilo Bambang Yudhoyono is cutting fuel subsidies that threatened to swell to $30 billion in 2013 and pushed the budget deficit well beyond the legal limit of 3% of its Gross Domestic Product. In doing so, he risks sparking street protests and inflation. He has to weigh the threat of social unrest against the risk that international investors will desert the country. Meanwhile, the combination of a mounting budget deficit and a weakening currency - the rupiah has lost 5% of its value in the past 12 months, making it the second worst-performing currency in Asia - has sapped investor confidence.

Adapted from *Business Week,* 27 June 2013

Table 1: Fuel information for Indonesia, 2009 to 2012

	2009	2010	2011	2012
Oil Production (thousand barrels daily)	994	1003	952	918
Oil Consumption (thousand barrels daily)	1,316	1,426	1,549	1,565
Current account (US$ million)	10,628	5,144	1,685	-24,183
Current account (% of GDP)	2	0.7	0.2	-2.8

Sources: *World Bank; BP.com*

Extract 2: Indonesia inflation hits 5.9% after fuel hike

Indonesia's inflation accelerated in June after the government hiked the price of fuel for the first time since 2008. The increase had been expected after the price of fuel rose by up to 44% last month, pushing up the cost of transporting goods and people.

The decision to reduce huge fuel subsidies, seen as a drag on Southeast Asia's largest economy, has sparked angry protests across the country. Economists have warned that inflation will likely accelerate to above 7% in the coming months. The delay in adjusting the price of subsidised fuel will have an immense effect on the economy. Indonesia has posted a current account deficit for three consecutive quarters this year, primarily because of rising import spending on capital goods and oil. Besides aggravating the country's external stability, fuel subsidies were bad for the economy as they would only boost energy consumption. Moreover, it would also widen inequality among Indonesians as the policy was not in effect pro-poor since the fuel subsidies were mostly enjoyed by the upper-middle class.

Adapted from *Channel News Asia,* 1 July 2013 and *Jakarta Post,* 13 July 2013

Extract 3: More subsidies offered to ease fuel price hikes in China

Despite moves by the central authorities here in China to provide more subsidies to fuel-dependent industries, the rise in prices at the pumps this year has many complaining about the impact it is having on their day-to-day lives. Public transport is one of the industries that is worst hit by the price increase. Oil price hikes will also lead to rising expenditure in energy consumption and soaring cost of farming resources and raw materials for agricultural industries. Subsidies will better protect the rights and interests of farmers. However, the artificially low energy prices increase waste and destroy incentives to invest in alternative technologies.

Studies suggest that energy efficient measures can lead to more cost savings. Although renewable energy currently costs more, it may prove viable in the medium term with technological advances.

Adapted from *Global Times (China)*, 29 March 2012

Extract 4: Indonesia told to focus on renewable energy

Indonesia has plentiful supply of accessible energy sources, both from fossil fuels and renewables, and is the largest energy producer and consumer in Southeast Asia. Yet the country is struggling to keep up with its own energy demands. Total energy demand is growing by around 7% per year, as the transport and industrial sectors grow and as households become more affluent. The National Energy Council (DEN) has issued a series of recommendations to reorient the national energy policy to renewable energy by 2050, urging the government to stop exporting gas and coal to preserve depleting fossil energy reserves. With the rise in fuel consumption and a decline in fossil energy reserves, renewable energy must be utilized and exports of gas and coal must be stopped as they could be used as alternatives to oil at home. To achieve the target, the country has to scrap its fuel subsidy and adjust the price to the global market to curb fuel consumption and to disburse more incentives to develop renewable energy.

Adapted from *Jakarta Post,* 13 July 2013

Questions

(a) **(i)** Using Table 1, compare Indonesia's production and consumption of oil between 2009 and 2012. [2]

(ii) Explain whether the above explains the changes in Indonesia's current account balance in Table 1. [4]

(b) Using demand and supply diagram(s),

(i) explain the impact of an introduction of a fuel subsidy on the Indonesian government. [2]

(ii) discuss whether consumers or domestic producers of fuel in Indonesia are more likely to benefit from the introduction of a fuel subsidy. [8]

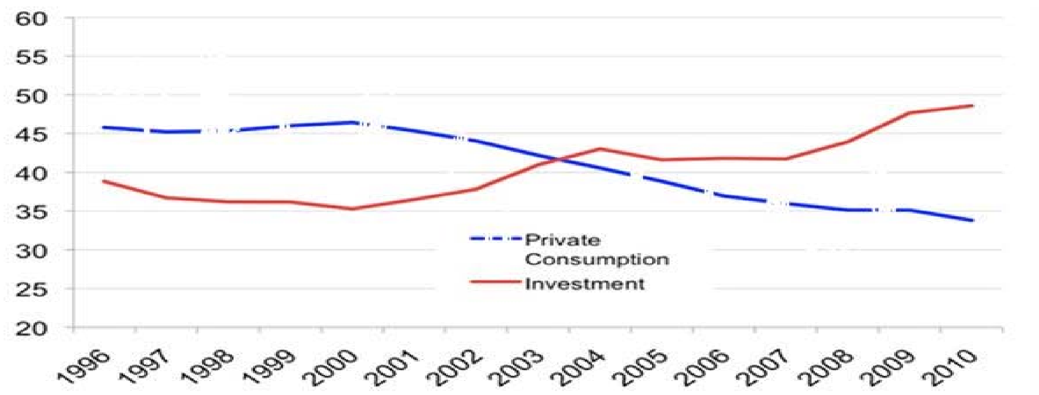
(c) Explain how cutting fuel subsidies can improve the allocation of resources. [6]

(d) Comment on the impact of cutting fuel subsidies on the Indonesian economy. [8]

[Total: 30 marks]

Question 2 Growth and crisis

Figure 1: China's shares of private consumption and investment in GDP (%)



Source: Economist Intelligence Unit, 2010

Table 2: Selected macroeconomic indicators, 2008 to 2012

China	**2008**	**2009**	**2010**	**2011**	**2012**
Unemployment rate (% of total labour force)	4.0	4.3	4.1	4.1	4.1
Inflation Rates (% change)	5.9	-0.7	3.3	5.4	2.7
Current account balance (% of GDP)	9.3	4.9	4.0	1.9	2.3
United States					
Unemployment rate (% of total labour force)	5.8	9.3	9.6	8.9	8.0
Inflation Rates (% change)	3.8	-0.4	1.6	3.2	2.1
Current account balance (% of GDP)	-4.8	-2.7	-3.1	-3.1	-3.0
Singapore					
Unemployment rate (% of total labour force)	3.2	4.3	3.1	2.9	2.8
Inflation Rates (% change)	6.5	0.6	2.8	5.3	4.5
Current account balance (% of GDP)	16.1	17.2	28.6	26.7	18.7

Source: The World Bank, 2013

Table 3: Overview of world output measured in real GDP growth (%), 2008 to 2014

	2008	**2009**	**2010**	**2011**	**2012**	**2013***	**2014***
World Output	3.0	-0.6	5.0	3.9	3.1	3.1	3.8
Advanced Economies	0.5	-3.4	3.0	1.7	1.2	1.2	2.1
United States	0.4	-2.6	2.8	1.8	2.2	1.7	2.7
Euro Area	0.6	-4.1	1.8	1.5	-0.6	-0.6	0.9
Singapore	1.7	-0.7	14.8	5.2	1.3	2.3	4.0
Emerging Market and Developing Economies	6.1	2.6	7.1	6.2	4.9	5.0	5.4
China	9.6	9.2	10.3	9.3	7.8	7.8	7.7

[*Projections]

Source: International Monetary Fund: World Economic Outlook Database, July 2013

Extract 5: Asian exports hurt by European debt crisis and sluggish US economy

The effects of the European debt crisis and sluggish US growth are radiating into Asia's export-driven economies, putting brakes on the rebound from the 2009 global recession. The crisis made it difficult or impossible for some countries in the euro area to repay or re-finance their government debt without the assistance of third parties. Credit rating agency Standard and Poor's (S&P) has said it could downgrade the credit ratings of 15 euro-zone countries.

Singapore, seen as a bellwether of Western demand because of its very high reliance on trade, would likely suffer a sharp slowdown next year as export orders from developed countries wane. Europe's economy is barely growing amid its ever widening debt crisis and sharp government spending cuts might tip the region back into recession. At the same time, the US is dogged by high unemployment, making it difficult for the world's Number 1 economy to stage a healthy comeback from the recession sparked by the 2008 financial crisis. "Although resilient domestic demand in emerging Asia will provide some support to global demand, it will not fully mitigate the effects of an economic slowdown in the advanced economies," Singapore's Trade and Industry Ministry said in a statement.

Adapted from *The Fiscal Times*, 21 November 2011

Extract 6: Singapore will remain open to global investment

Singapore has a relatively small domestic market, and thus has to open its economy to external markets in order for the economy to thrive. Singapore will continue to be "an international hub open to global investments and talent, while being mindful of our physical and social constraints" and "we will maintain sound economic policies that promote growth and improve people's lives" said PM Lee. Apart from these policies, the government has also actively encouraged new industries to develop in Singapore so as to respond to the needs of the global market.

Adapted from www.mfa.gov.sg, 3 April 2013 and www.economywatch.com, 2 August 2011

Extract 7: Becoming number one

US remains the world's biggest economy, but that status is under threat from a resurgent China. Emerging markets keep on growing faster than US and they are likely to account for two-thirds of the world's output by 2030. The combined weight in the world economy of US and the European Union will shrink from more than a third to less than a quarter. China had overtaken Germany four years ago to become the world's third largest economy. During the second quarter of this year, China overtook Japan as the world's second-largest economy.

Behind the spectacular economic growth in China, however, households are more inclined to save than spend the extra income. To sustain its catch-up with US, China needs to rebalance its economy away from exports towards consumer spending, which will require a rise in its real exchange rate. Some of this will come from having a higher inflation rate than its trading partners. The shift towards consumer spending may not be easy though. China may be the second largest economy but it ranks at 119 in terms of average incomes, according to World Bank data.

Adapted from *The Economist*, 24 September 2011 and *The Guardian*, 14 February 2011

Extract 8: Emerging economies to look for inner richness

Rapid growth in the major emerging economies will need to be accompanied by a realignment of growth away from external sources and toward internal sources of growth. Emerging economies that used to rely on technological adaptation and external demand to grow will have to make structural changes to sustain their growth momentum through productivity gains and robust domestic demand.

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For example, in China, there are plans to rebalance its economy towards domestic demand, shifting away from exports. It is in part a reaction to expected weaker imports from the west as consumers there repay their debts rather than spend at previous rates.

At the same time, China is wary of the "middle-income country trap" where few countries join the ranks of the rich because growth slows in the absence of technological and productivity improvements. This means China will want to continue to integrate with the global economy so its firms can learn while competing on the world stage. But it also means that it needs to reform its domestic economy to improve conditions for private firms to invest and remove impediments in the labour market.

These policy shifts suggest China has perhaps begun to realise it can be a major trader even when its economy is largely driven by its own consumers and firms, as is the case in the US and Japan.

Adapted from *The Guardian*, 14 February 2011 and The World Bank, 17 May 2011

Extract 9: Less Optimistic Growth Rates

The global economy is growing more slowly than expected, says the International Monetary Fund (IMF) in an update to its World Economic Outlook (WEO). Growth in emerging markets and developing economies is expected to moderate. The weaker prospects reflect, to varying degrees, infrastructure bottlenecks and other capacity constraints, lower export growth, lower commodity prices, financial stability concerns, and, in some cases, weaker monetary policy support. China's forecast is also adjusted downwards.

There is a need for structural reforms across all major economies, to lift global growth and support global rebalancing. As in the past, this means steps to raise domestic demand in economies with large current account surpluses (such as China and Germany) and measures that improve competitiveness in economies with large current account deficits.

Source: International Monetary Fund, 9 July 2013

Questions

(a) Using Table 3, compare the real GDP growth rates of the emerging economies with that of the advanced economies between 2008 and 2011. [2]

(b) Using AD/AS analysis, explain how

(i) the European debt crisis might lead to a fall in the export revenue of Singapore; [4]

(ii) a rise in China's real exchange rate affects its inflation rate. [4]

(c) With reference to Extract 7, explain the likely change in the size of the multiplier in China. [2]

(d) With reference to Figure 1 and Table 2, explain the possible short term and long term consequences on living standards from a change in investment such as that experienced in China. [4]

(e) How far does Table 2 and Table 3 support the view expressed in the first sentence of Extract 7 that China may overtake US as the world's largest economy? [6]

(f) Extract 8 explained that emerging economies such as China should look for inner richness for growth. With reference to the data, to what extent should countries rely more on internal sources rather than external sources of growth? [8]

[Total: 30marks]

Section B

Answer **one** question from this section.

3 **(a)** Explain how the price mechanism allocates scarce resources in an efficient manner. [10]

(b) Discuss the difficulties of achieving this in practice. [15]

4 **(a)** Explain the likely benefits and costs of globalisation. [10]

(b) Discuss the view that the best way for a government to maximise the gains of globalisation is to adopt discretionary fiscal policy. [15]

End of Paper