Raffles Junior College
JC2 Preliminary Examinations 2008

ECONOMICS
Higher 1 — 8816/01

Paper 1

15 September 2008

3 hours

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

Write your name, index number and CT class 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 diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **all** questions.

Section B
Answer **one** question.

Start each question on a fresh sheet of paper. At the end of the examination, securely **fasten** your **work to each question separately**. The number of marks is given in brackets [ ] at the end of each question or part question.

For Section A, you are advised to spend several minutes per question reading through the data before you begin writing your answers.

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

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Developing the Thinker, Leader & Pioneer

Section A

Answer **all** questions in this section.

Question 1: Oil Prices and Government Policies

Figure 1: Oil Prices (£ per barrel)

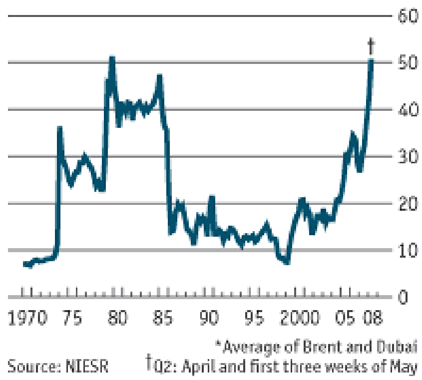
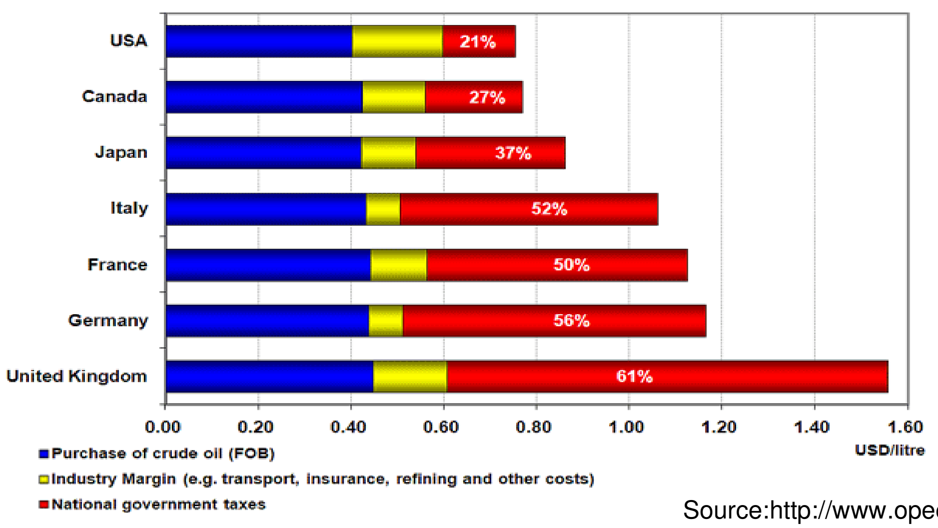


Table 1: Comparing Retail Oil Prices (US$ per litre)	
Singapore	$1.54
Thailand	$1.22
India	$1.19
Vietnam	$0.90
Malaysia	$0.59
China	$0.72
Indonesia	$0.64
UK	$2.29
Belgium	$2.34
Netherlands	$2.63

Source: June 2008, EIA & Reuters

Figure 2: Who Gets What from a Litre of Oil in the G7 in 2007?



Source:http://www.opec.org/

Extract 1: What's Driving up Oil Prices?

There are a variety of factors that have facilitated the run-up of oil prices to US$140 a barrel in the last couple of months, including insufficient investments in exploration and refining activities, soaring energy demand from Asia and a long list of supply disruptions. These factors have left the global oil industry with very little capacity to increase oil supplies.

Source: *The Business Times*, 26 June 2008

Extract 2: Cheaper Petrol Prices in Malaysia

Thousands of Thais and Singaporeans cross the borders daily to fill their tanks and take advantage of subsidised fuel, which is expected to cost the government RM56billion (S$23billion) this year.

Mr Abdul Wahid Bidin, acting president of the Petroleum Dealers Association of Malaysia, said 90% of the usual customers of some fuel stations near the northern border were from Thailand. Regular petrol in Malaysia costs RM1.92 a litre, cheaper than the 31.59 baht (S$1.32) in Thailand and S$2.10 in Singapore.

Source: *The Straits Times*, 3 June 2008

Extract 3: Are Ecotaxes a Good Idea for Europe?

The ambitious goals set by EU leaders in March at the Brussels summit–a 20% cut in greenhouse gas emissions by 2020 and related targets for energy savings, biofuels and other renewable energies–is unlikely to be achieved, at least without the use of environmental taxes to induce changes in businesses' and consumers' behaviour.

In contrast to regulatory or administrative approaches, market-based instruments such as taxes and tradable permit schemes offer several advantages as a means of achieving environmental objectives. Whether by influencing prices (through taxation or fiscal incentives) or setting absolute quantities (via tradable permits), they improve price signals, allow industry greater flexibility in meeting objectives, and give firms a longer-term incentive to pursue technological innovations that further reduce adverse impacts on the environment.

There are a variety of measures that are often proposed in the management of negative externalities. The standard tax theory proposes a carbon added tax which could be implemented in a way similar to a value added tax. Taxation can fall on either consumption or production of a good. This fits with the concept of the tax being targeted directly to reduce production or consumption whereby the polluter pays. However, the regulation and enforcing, especially in developing countries, may result in higher transaction costs

An alternative policy is to cap the emissions limit and allow the trading of pollution permits that is implemented under the Kyoto Protocol. This ensures that the amount of pollution is set at the level desired by the governing bodies. The advantage of such a system is that it is easy to implement for major sources of emissions. However, for multitude of small sources, it may prove difficult. On top of that, it is difficult to decide how to allocate emission rights across countries as well as within countries (corruption).

Source: Various Sources

Extract 4: How Green Taxes Hurt the Poor

As Spanish hauliers and French fishermen have shouted out for the entire world to hear, higher fuel prices are not popular. This is uncomfortable for those who see increased taxation as a way of fighting global warming. Green taxes tend to fall hardest on the poor.

In America the Congressional Budget Office has estimated that a cap-and-trade system, designed to cut emissions by 15%, would reduce the average income of the lowest quintile of the population by 3.3% and the richest quintile by just 1.7%.

The effect on the poor is not uniform; fewer drive cars, for example. However, for those that do, they spend a big part of their income on petrol. In 2007 Britain's Institute for Fiscal

Studies (IFS) estimated that a 5% rise in fuel duty would cut the income of the poorest decile of Britons by 0.27%; the richest decile would lose only 0.11%. And although the poor may not all drive, they must all heat their houses in winter. In addition, the wealthy have more money to spend on products that improve energy efficiency, such as insulation and hybrid cars.

The fundamental problem is difficult to get round. If governments desire people to use less energy, they have to ration supply by price. They can limit frivolous use (gas-guzzling cars, televisions on standby and the like), but there may be a core demand for energy (heat, light, commuting) where consumers will resist cuts. For that part, the rich will always be able to outbid the poor. And that will plague green campaigners.

Source: *The Economist*, 12 June 2008

Questions

(a) Identify and account for the trend in oil prices from 2000 to 2008. **[4]**

(b) **(i)** Compare the price of petrol in Malaysia to that in UK. **[2]**

(ii) Using the information given, identify the different governments' policies that gave rise to the above. **[2]**

(iii) Evaluate the effects behind both governments' policies. **[8]**

(c) With the aid of a diagram, discuss whether there is a need for governing bodies to come together and reduce greenhouse gases. **[6]**

(d) If you are an environment minister in the government, which measure(s) would you use to achieve the greenhouse gas emissions targets set by the EU? Justify your answer. **[8]**

30 marks

Question 2: The Asian Financial Crisis and its Aftermath

Extract 5: The Asian Financial Crisis Ten Years Later

Ten years ago, the Asian financial crisis of 1997–98 began to unfold. Few countries in the region were left untouched, and the aftereffects reverberated across the globe. As private investors were stampeding for the exits, the international community stepped in to help, providing external financing, while governments in the region adjusted policies, and steps were taken to coordinate private sector financing.

Today, Asia is among the star performers in the global economy. The region found strength by turning crisis into opportunity. Although it took time for post-crisis reforms to restore investor confidence, the subsequent recovery was stronger and swifter. The Asian countries are rebounding. Real GDP per capita in the affected countries has passed its pre-crisis level. Production fell sharply in 1997 and 1998 but positive growth resumed almost immediately.

Source: Adapted from '*Asia Ten Years After'* & *The Backgrounder 2007*

Extract 6: Indonesia in the Asian Financial Crisis

In June 1997, Indonesia seemed far from crisis. Unlike Thailand, Indonesia had low inflation, a trade surplus of more than $900 million, huge foreign exchange reserves of more than $20 billion, and a good banking sector.

However, in August 1997, the rupiah suddenly came under severe attack and its managed floating exchange regime was replaced by a free-floating exchange rate arrangement. As the rupiah continued to drop further, the IMF (International Monetary Fund) came forward with a rescue package of US$50 billion in emergency loans. In return, it called for austerity measures such as raising interest rates and cutting public spending as well as liberalizing foreign trade and investment, dismantling domestic monopolies and enhancing the quality of governance.

But the rupiah sank further by over 80 percent against the US$ in January 1998 amid fears over corporate debts, massive selling of the rupiah, and strong demand for dollars.

Source: Adapted from *Reformation (Indonesia)* & *Economy of Indonesia 2007*

Extract 7: Challenges and Tasks Beyond the Crisis

Having grappled with and overcoming the crisis, new challenges are arising which could slow or even derail growth if not handled properly.

Key among these challenges is the 'middle income trap'. While many countries have been able to make it from low income to middle income, relatively few have carried on to high income. By 2010, more than nine in ten East Asian countries will be living in a middle income economy. To move out of the 'middle income trap', a key challenge is maintaining high growth in a sustainable way. Countries have to specialize more in selected areas where they can achieve economies of scale and technological leadership. But this is hard to do when these countries find themselves squeezed between low wage competitors in poor countries and cutting edge innovators in rich countries.

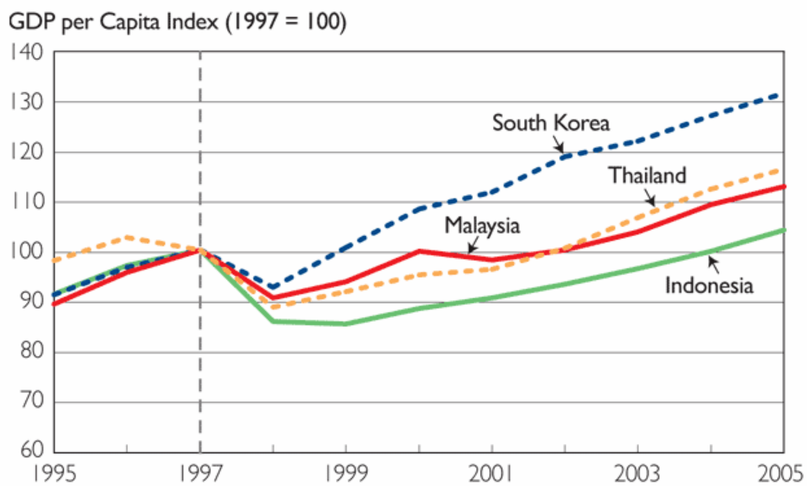
Firms in the East Asian economies rated uncertainty as one the biggest constraints to their operations. This is not surprising given the wrenching competitive challenges from booming economies of China and India as well as the structural adjustments that they need to undergo. Efforts to strengthen the investment climate and raising the skills and innovativeness of the labour force are but two of the keys to creating an environment in which firms can seek out efficient investments and areas of global comparative advantage.

Another challenge is to ensure that the benefits of greater wealth in the region are shared equitably among the people. While poverty continues to fall, income inequality is rising in many East Asian economies. Forces that contribute to rapid growth and regional and global integration are also the forces that create inequality in income. For example, increased technological change and globalization has increased the relative demand for skilled workers, pushing up wages for people with the relevant education and skills.

Added to these vulnerabilities is that East Asia is undergoing the most rapid urbanization the world has seen, with projections indicating that more than 500 million people will move to cities in the region in the next 25 years. This places huge strains on already inadequate transport, electricity, water and sanitation systems.

Source: Adapted from *East Asia 10 Years After the Financial Crisis 2007*

Figure 3: Economic Recovery after the setback



Source: World Bank, *World Development Indicators Online*, at go.worldbank.org/B53SONGPA0 (July 12, 2007; subscription required).

Table 3: Main Economic Indicators of East Asia (%)

	Economic Growth Rate					Inflation Rate				Unemployment Rate				Gini Coefficient
Country	**1996**	**1997**	**1998**	**1999**	**2006**	**1997**	**1998**	**1999**	**2006**	**1997**	**1998**	**1999**	**2006**	**2007**
Singapore	7.0	7.8	1.5	5.5	7.9	2.0	-0.3	0.4	1.0	1.8	3.2	3.7	2.7	0.48
Korea	7.1	5.5	-6.8	9.2	5.0	4.5	7.5	0.8	2.2	2.6	6.8	6.4	3.4	0.33
Thailand	6.7	-0.4	-8.0	4.2	5.0	5.6	8.1	0.3	4.6	3.5	5.3	5.6	1.7	0.42
Malaysia	8.2	7.8	-6.7	4.9	5.9	2.6	5.3	2.1	3.6	2.5	3.9	1.3	3.6	0.49
Indonesia	8.0	4.7	-13.7	-0.1	5.5	10.0	77.6	28.4	13.1	4.7	5.5	6.4	10.3	0.34
Philippines	6.8	5.8	-0.5	3.0	5.4	5.1	9.7	7.3	6.2	8.7	10.0	9.4	7.9	0.46

Source: World Bank East Asia Region 2007 & 9th OECD-ADBI Roundtable on Capital Market Reform in Asia Tokyo, 26-27 February 2008

Questions

(a) **(i)** Using Chart 1, compare the impact of the Asian Financial Crisis on Korea and Indonesia from 1997 to 2006. **[2]**

(ii) Other than GDP per capita, identify two other pieces of evidence that show the harm done to the economy of Indonesia by the Asian crisis. **[2]**

(b) **(i)** What is a flexible exchange rate system? **[2]**

(ii) East Asian currencies fell by 19% to 84% on average in 1998 during the Asian Financial Crisis.

To what extent did the depreciation of the Asian currencies helped in the economic recovery of the Asian countries? **[6]**

(iii) With reference to the data where relevant, discuss how the rescue package by the IMF helped the Indonesian economy to recover from the Asian Financial Crisis. **[8]**

(c) The *Asian Development Outlook Updates* foresees growth in Asia and the Pacific of 8.3% in 2007.

Discuss how Singapore and other Asian countries can continue to sustain such a high rate of growth and an improvement in their standard of living in the next decade. **[10]**

30 marks

Section B

Answer **one** question in this section.

3 **(a)** Explain how the presence of externalities can lead to inefficiency in resource allocation. [12]

(b) Access to education has long been considered an important vehicle for poverty alleviation and tremendous efforts by the government have been made to broaden such access in less developed countries (LDCs).

Discuss whether government intervention will *always* lead to a more efficient outcome. [13]

4 Globalisation has brought both opportunities and challenges. Singapore faces increased volatility and higher risks of both structural as well as cyclical unemployment.

(a) Explain how globalization brings about both opportunities and challenges. [12]

(b) Discuss the view that fiscal policy is the best policy to reduce unemployment. [13]

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