Name:____________________ Centre No. / Index No.:______/______ Class:__________

PIONEER JUNIOR COLLEGE, SINGAPORE
JC2 PRELIMINARY EXAMINATION 2016
Higher 1

ECONOMICS 8819/01

Paper 1 15 September 2016

3 hours

Additional Materials: Answer Paper

*PJC/8819/Paper 1/ 2016

READ THESE INSTRUCTIONS FIRST

Write your Centre number, index number and name 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.

Section A
Answer **all** questions.

Section B
Answer **one** question.

Please begin your answer to each question on a fresh piece of writing paper.
At the end of the examination, fasten your work for Questions 1, 2 and 3 or 4 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 and **3** blank pages.

Pioneer Junior College

Ministry of Education

Blank Page

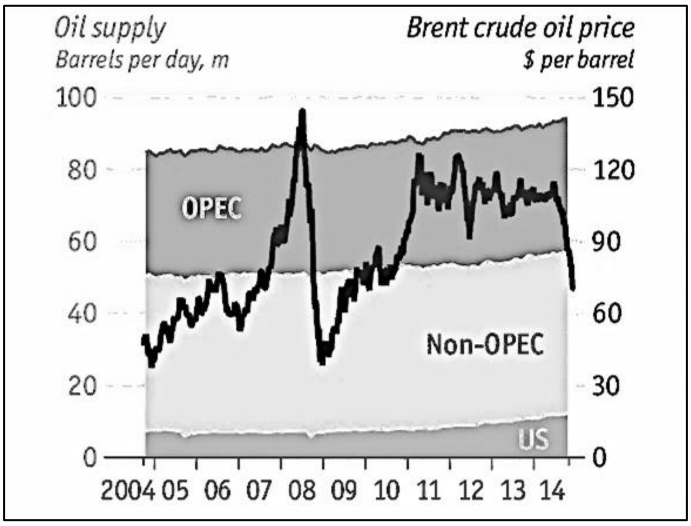
Section A

Answer **all** questions in this section.

Question 1 **Issues of Falling Oil Prices**

Extract 1: The falling oil price

Figure 1: Supply and Price of Brent Oil



Source: IEA, Bloomberg

The oil price has fallen by more than 40% since June, when it was $115 a barrel. It is now below $70. This comes after nearly five years of stability. At a meeting in Vienna on November 27th the Organisation of Petroleum Exporting Countries (OPEC), which controls nearly 40% of the world market, failed to reach agreement on production curbs, sending the price tumbling.

The oil price is partly determined by actual supply and demand, and partly by expectation. Demand for energy is closely related to economic activity. It also spikes in the winter in the northern hemisphere, and during summers in countries which use air conditioning. Supply can be affected by weather (which prevents tankers loading) and by geopolitical upsets. If producers think the price is staying high, they invest, which after a lag boosts supply. Similarly, low prices lead to an investment drought. OPEC's decisions shape expectations: if it curbs supply sharply, it can send prices spiking. Saudi Arabia produces nearly 10m barrels a day - a third of the OPEC total.

Demand is low because of weak economic activity, increased efficiency, and a growing switch away from oil to other fuels. Second, turmoil in Iraq and Libya—two big oil producers with nearly 4m barrels a day combined—has not affected their output. Thirdly, America has become the world's largest oil producer. Though it does not export crude oil, it now imports much less, creating a lot of spare supply. Finally, the Saudis and their Gulf allies have decided not to sacrifice their own market share to restore the price.

Source: The Economist, 8 December 2014

Extract 2: Falling oil price on Russia economy

Russia is one of the world's largest oil producers, and its dramatic interest rate hike to 17% in support of its troubled Russian currency, the Rouble, underscores how heavily its economy depends on energy revenues, with oil and gas accounting for 70% of export incomes.

Russia loses about $2bn in revenues for every dollar fall in the oil price, and the World Bank has warned that Russia's economy would shrink by at least 0.7% in 2015 if oil prices do not recover. Despite this, Russia has confirmed it will not cut production to shore up oil prices. "If we cut, the importer countries will increase their production and this will mean a loss of our niche market," said Energy Minister Alexander Novak.

Falling oil prices, coupled with western sanctions over Russia's support for separatists in eastern Ukraine have hit the country hard. The government has cut its growth forecast for 2015, predicting that the economy will sink into recession. Because of the twin impact of falling oil prices and sanctions, Prime Minister Dmitry Medvedev said the government had had to cut spending. "We had to abandon a number of programmes and make certain sacrifices." Russia's interest rate rise may also bring its own problems, as high rates can choke economic growth by making it harder for businesses to borrow and spend.

Source: BBC News, 19 January 2015

Extract 3 Fossil-fuel subsidies

Most economists agree that fossil-fuel subsidies are a bad idea. They promote a misallocation of resources in the economy, namely, the over-consumption of fossil fuels. They can be a burden on the public finances. What's more, this waste increases global carbon emissions.

Some countries have already wised up to the foolhardy nature of energy subsidies and have sought to trim them back. Over the past year or so, Jordan, Morocco, Indonesia and Malaysia have all cut subsidies and raised fuel prices. Globally, the cost of government subsidies for fossil fuels increased from $311 billion in 2009 to $544 billion in 2012, the IEA estimates. Much of this spending is wasted; overconsumption of energy does not lead to higher levels of economic output but instead lower levels of efficiency.

Other research suggests that most of this spending leads to big "deadweight losses", meaning lost economic efficiency as a result of government intervention. In the case of fuel subsidies for road transport, worth $110 billion globally in 2012, these losses reached $44 billion, reckons Lucas Davis at the University of California, Berkeley, in a new paper. This waste is a shame. For scrapping fossil-fuel subsidies can provide part of the answer to a question gripping much of the developed world: how to reduce global carbon emissions without damaging economic growth or living standards. But, unfortunately, subsidy policies cannot be abolished entirely overnight. Public opinion across the world is hostile to higher energy prices, however highly taxed or subsidised they may already be.

Source: The Economist, 10 January 2014

Extract 4: How low oil prices may impact greenhouse gas emissions

Low crude oil and gasoline prices have a direct effect on greenhouse gas emissions and climate change. The cheaper gasoline is, the more people drive and use fuel, leading to more and more greenhouse gas emissions. There are economic benefits to that, especially if it means, for example, that it costs less to transport goods across the country. But with the increased oil consumption, the climate suffers.

But as for how that impacts greenhouse gas emissions, a few months of low gasoline prices aren't likely to inspire people to rush out to buy gas guzzling cars right away. Low oil prices that remain stable are what drive increased demand for oil — and which in turn could then have a bigger role in emissions, said Peter Erickson, senior scientist at the Stockholm Environment Institute in Seattle. "If it really is a short-term effect, it may not be that significant," he said. "It's when the oil price stays stable for a long time and when gasoline prices stay stable for a long time when investors and especially consumers notice and make decisions based on that."

Source: Climate Central, 25 October 2014

Questions

(a) **(i)** With reference to Figure 1 and Extract 1, explain how changes in demand and supply have affected the price of oil in recent years. [4]

(ii) With reference to Extract 1, explain the likely value of price elasticity of supply of oil. [2]

(b) **(i)** With reference to Extract 2, explain the relationship between the change in oil price and exchange rate of Russia currency. [3]

(ii) Using AD/AS analysis, explain how the change in oil price has affected the economic growth of Russia. [4]

(c) **(i)** Explain what determines the impact of a fuel subsidy on government expenditure. [4]

(ii) Comment on the factors that government may consider in the removal of energy subsidies. [5]

(d) Low crude oil and gasoline prices have a direct effect on greenhouse gas emissions and climate change. The cheaper gasoline is, the more people drive and use fuel.

Discuss whether falling oil price will lead to a more inefficient allocation of resources. [8]

[Total: 30]

Blank Page

Question 2 **Growth and Economic Challenges**

Extract 5: ECB under pressure to boost growth

Stagnation in Eurozone growth has put pressure on the European Central Bank (ECB) to take measures to stimulate the European economy, analysts say. Growth in the Eurozone flatlined in the second quarter, and inflation also dropped, according to official figures. The Eurozone saw 0.0% growth compared with the first quarter, according to Eurostat figures. Economists said that the figures would add to calls for the ECB to take action to boost growth. That is likely to increase the pressure on the ECB to follow other central banks by introducing a programme of quantitative easing.

Source: BBC News, 14 August 2014

Extract 6: Loose monetary policy to boost growth

The United Kingdom:
The Bank of England's Monetary Policy Committee (MPC) kept interest rates at the record low of 0.5% at its meeting in February. It also left the £375bn quantitative easing stimulus programme unchanged. But the continued fall in the UK unemployment rate has sparked a debate about when interest rates may need to rise. In August last year Bank governor Mark Carney said that interest rates were unlikely to be raised before the jobless rate falls to 7%. But in mid-February he adjusted that stance, saying a wider range of indicators would be taken into account, meaning interest rates could remain at low levels for some time even as unemployment falls further.

Source: BBC News, 18 February 2014

Eurozone:
The European Central Bank (ECB) will inject at least €1.1 trillion (£834bn) into the ailing Eurozone economy. The ECB will buy €60bn bonds each month from banks until the end of September 2016, or even longer, in what is called quantitative easing (QE). QE in theory increases the supply of money, something that keeps interest rates low and encourages borrowing and therefore spending.

Source: BBC News, 22 January 2015

Extract 7: British GDP growth beats rest of G7 in the second quarter of 2014

The UK economy grew slightly more strongly than expected in the second quarter of the year, widening the gulf between Britain and the struggling Eurozone. The UK growth in the three months to June was 0.8 per cent, in line with its initial estimate last month. The Office for National Statistics (ONS) highlighted the comparison between growth in Britain and the rest of the G7 industrialised nations in the second quarter, pointing out that on an annual basis the US grew by 2.4 per cent, Germany 1.3 per cent and France just 0.1 per cent. Japan was flat while Italian GDP shrank by 0.3 per cent. The International Monetary Fund has forecast that the UK will have the strongest growth in the G7 over the year. The UK's modest upward annual revision was a consequence of a better than previously estimated performance from the construction sector in the second quarter. However, this was offset by the statistics agency revising down its estimate for production growth. Services once again showed strong growth, with total output up by 3.3 per cent year on year.

The Bank of England said this week in its quarterly Inflation Report that the level of slack in the economy had been larger than it initially believed, suggesting interest rates do not need to rise imminently to avoid a pick-up in inflation.

Source: www.independent.uk, 16 August 2014

Table 1: Unemployment rate (annual data)

	2009	2010	2011	2012	2013	2014
Germany	7.6	7	5.8	5.4	5.2	5
United Kingdom	7.6	7.8	8.1	7.9	7.6	6.1

Source: Eurostat

Table 2: Rates of growth of Real GDP (percentage change on previous year)

	2009	2010	2011	2012	2013	2014
Germany	-5.6	4.1	3.7	0.4	0.3	1.6
United Kingdom	-4.3	1.9	1.5	1.3	1.9	3.1

Source: Eurostat

Extract 8: UK productivity gap with developed nations now widest for 20 years

Britain's productivity gap with its main developed country rivals is at its widest in 20 years, following the flat-lining of the economy after the deep recession of 2008-09. International comparisons released by the Office for National Statistics (ONS) show that output per hour worked in the UK is 21% lower than the average for the other six members of the G7 – the US, Germany, France, Italy, Japan and Canada. Poor productivity has been blamed for the lack of earnings growth and the squeeze on real incomes in Britain over the past five years, though the Bank of England is expecting output per worker to pick up during 2014. The Bank of England has cited improved productivity as a key factor in whether wage growth surpasses inflation in the second half of the year, which would ease the pressure on household budgets.

Data published this week shows that wage growth rose from 0.9% to 1% in January, narrowing the gap with the CPI rate of inflation, which dipped from 2% to 1.9%. Some economists said the latest inflation figures indicated a downward trend in prices that could mean above- inflation wage growth for the first time since 2010. According to ONS figures published last month, living standards have suffered their most prolonged decline since 1964. Productivity was again cited as an important component of the consistent fall in real wages since 2010.

Source: The Guardian, 20 February 2014

Extract 9: WTO warns of creeping protectionism

G20 economies have introduced more measures to restrict trade than encourage it over the past six months even as the global economy has seen a faltering recovery in both growth and trade.

A report released on Wednesday by the World Trade Organisation (WTO) as part of its remit to monitor any post-crisis trade restrictions by G20 members offers a picture of creeping protectionism even as the global economy continues its struggle to recover from the crisis.

The report details moves taken by the vast majority of G20 members including the US, China and the EU. They range from the launching of anti-dumping investigations to the introduction of special licensing requirements that discriminate against foreign businesses. Also included are domestic support schemes for domestic industry that are frowned upon within the WTO. The WTO said it had identified 112 trade restrictive measures introduced by members of the grouping of leading advanced and developing economies between mid-November 2013 and mid-May 2014.

Source: FT.com, 18 June, 2014

Questions

(a) **(i)** With reference to Table 1, compare the unemployment rate between Germany and the United Kingdom from 2009 to 2012. [2]

(ii) Economic growth tends to reduce unemployment rate in the economy.

Comment on whether the data in Table 1 and Table 2 support this view. [4]

(b) Extract 6 mentioned that European Central Bank plans to lower interest rate while the Bank of England plans to hold back a rise in interest rate.

Discuss the factors that a government should consider in using interest rates to manage its economy. [8]

(c) **(i)** With reference to Extract 8, explain whether poor productivity may reduce the living standards in the UK economy. [4]

(ii) Explain and evaluate **one** method of raising productivity growth in the UK economy. [4]

(d) In view of the faltering recovery in the global economy, discuss whether countries should adopt trade restrictive measures. [8]

[Total: 30]

Section B

Answer **one** question from this section.

3 **(a)** Explain why government intervenes in the market with regard to public good and merit good. [10]

(b) Discuss the view that the economic activities of the government should be restricted to the provision of public good. [15]

4 Economic globalisation impacts on trade in goods and services and foreign direct investment.

(a) Explain the trend towards globalisation. [10]

(b) Discuss the view that for Singapore the problems of increasing globalisation have outweighed the benefits. [15]

Blank Page