
H2 Economics

9732/01

Case Study Questions

15 September 2016

2 hours 15 minutes

Additional Materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

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

Write your name, class and register number in the spaces at the top of the answer sheets.

Write in dark blue or black pen.

You may use an HB pencil for any diagrams or graphs.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A

Answer **all** questions.

Begin each question on a fresh sheet of paper.

At the end of the examination, fasten all your work securely to the cover sheet with the string provided.

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

[Turn Over]

Question 1 Who is winning the chocolate war?

Extract 1 Higher costs bite chocolate makers

Hershey Co.'s rebuff of a \$23 billion bid by Mondelez International Inc. this month comes as rising commodity prices are making it more expensive to produce a chocolate bar. Cocoa-butter prices are at multiyear highs as cocoa-bean processors struggle with unusually small cocoa beans in West Africa, where about 70% of the world's cocoa is grown. Still, the bulk of the costs of making chocolate are in transportation and marketing costs.

The cocoa crop in Ghana, the world's second-largest producer, experienced an unusually high drop in 2015, after farmers applied key pesticides late in the crop's development. Moreover, it takes a cacao tree five years before it produces its first beans. Hershey reported that price increases had hurt demand and was in part to blame for a 3.6% drop in sales volume in the second quarter of 2016.

Retail prices are expected to rise 2.2% this year in the U.S., the lowest year-over-year percentage increase in a decade. That modest price increase is because chocolate makers feel they have to absorb rising costs because they can't pass them on to consumers, analysts say.

Source: *Wall Street Journal*, 11 July 2016

Extract 2 Retailers appeal anti-trust call

Buyers accused the three confectionery giants, Nestle, Hershey and Mars, of conspiring to raise chocolate prices in US between 2002 and 2007 during discussions at trade shows and association events. However, the case was dismissed because they failed to provide evidence that the firms' actions were concerted and collusive. In light of the court's ruling, over 20 pharmacies and food retail chains filed appeals against the judgment.

Jeff Beckham, spokesperson for Hershey, said that the company had expected the appeal but it was pleased the court recognised that there is no basis for the case and misconduct. The chocolate firms said that any pricing increases were due to rising ingredient, manufacturing cost and denied price fixing.

Source: *William Reed Business Media*, 22 May 2014

**Table 1: Confectionery market share in the United States, 2015
(by value of total sales)**

Company	Share of confectionery sector (%)
Hershey's	31.3
Mars	29.1
Mondelez	5.4
Lindt	5.4
Nestle	5.0
Others	24.0

Source: Statista, 2015

Extract 3 Sales pressure could bolster case for merger of Mondelez and Hershey

Rival snack makers Mondelez International Inc. and Hershey Co. are both expected to show sales pressure when they report quarterly earnings this week, bolstering some arguments that the two giants could benefit from joining forces. Both Mondelez and Hershey are grappling with changing consumer tastes toward healthier and more natural foods, and in some cases the trend has sent a few companies in search of deals that help them reduce overall costs. Revenue is expected to be \$6.34 billion, down 17% from the same period last year, according to consensus estimates from Thomson Reuters.

Last year's megamerger of Kraft Foods Group Inc. and H.J. Heinz Co. helped the packaged food conglomerates save on overhead expenses and distribution costs. The combined company, Kraft Heinz Co., has posted double-digit increases in profits in recent quarters, despite continued sales decline. Analysts said the appeal for Mondelez to buy Hershey lies in the money the combined company could save by pooling resources and ingredient purchasing. Mondelez could also profit from expanding the Hershey brands overseas, which include Reese's peanut butter cups and Twizzlers, as they are heavily concentrated in the U.S. In fact, many of Hershey's brands have global brand recognition and distribution upside.

However, Bernstein analyst Alexia Howard feels that an acquisition of Hershey would be "strategically unsound" for Mondelez. "Our strongly held view that health and wellness trends will play a key part in the U.S. food industry's future makes us naturally skeptical of this transaction," she said. Hershey has said its sales and profit for the year will be lower than expected as its chocolate bars struggle to compete with newer snacks like fruit-and-nut bars considered by many consumers to be healthier.

Source: *Wall Street Journal*, 26 July 2016

Extract 4 Not so sweet if Mondelez buys Hershey

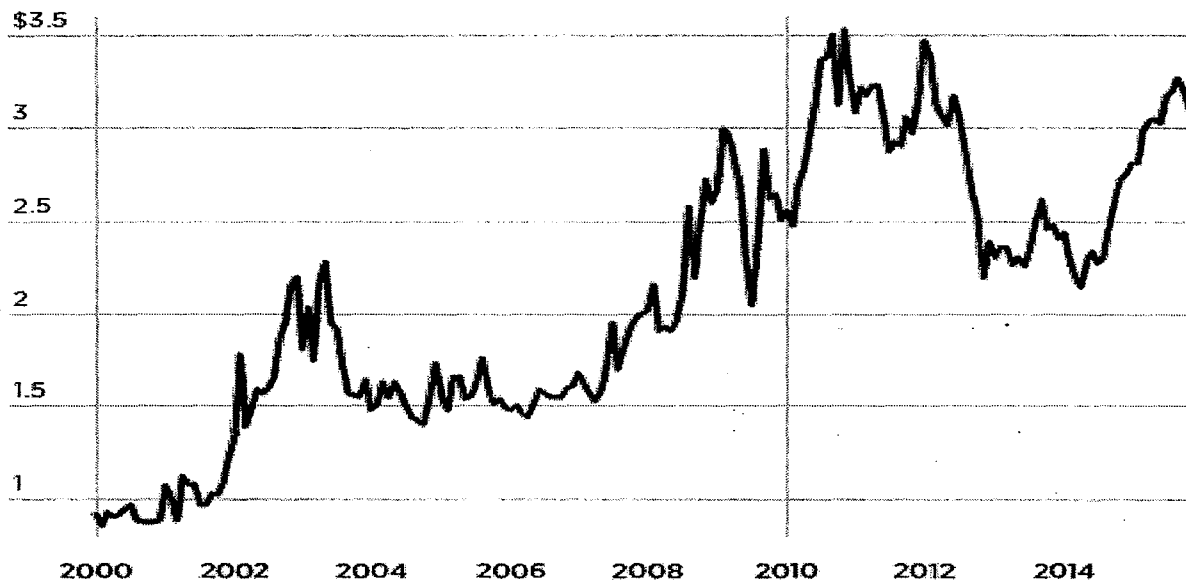
While Hershey has a strong U.S. presence, Mondelez has a global network. A marriage of the two would create the world's largest confectionery company with an estimated 18 percent of the market share, said market research firm Euromonitor International Ltd. In addition, because almost 75% of Mondelez's business is concentrated outside of U.S., a potential Hershey takeover may not raise many antitrust concerns within the U.S.

However, while Mondelez has vowed to keep Hershey's name and preserve jobs, some said such promises would ring empty. U.S. food giant Kraft drew controversy in 2010 after it shut a factory in southwest England following its takeover of Cadbury, now owned by Mondelez, going back on an earlier promise to keep the factory open.

Mondelez's bid for Hershey to create the world's largest cocoa buyer, could also hand the bargaining chips in the volatile niche market back to the candy makers. With more buying power, candy makers could demand lower prices from traders already operating on thin margins. The consolidation among chocolate makers creates larger buyers of commodities including cocoa and sugar, worrying middlemen who have already seen their margins squeezed. Mondelez is already the world's largest cocoa consumer, and after a tie-up with Hershey it would consume 650,000 tonnes per year, 50 percent more than the No. 2 consumer, Nestle.

Adapted from: *Reuters 2016 and Fortune 2016*

Figure 1: Cocoa Prices from 2000-2014



Source: CNBC, 13 Feb 2015

Questions

- (a) (i) With reference to Figure 1, describe the trend in cocoa prices. [2]
- (ii) With reference to Extract 1, use a diagram to explain how an increase in demand for chocolate affects the market for cocoa. [3]
- (b) (i) Identify and justify the type of market structure operating in the confectionery sector. [2]
- (ii) Explain how the firms in this market structure compete against one another. [2]
- (c) Explain why food retail chains are concerned with price fixing by the three confectionery giants mentioned in Extract 2. [3]
- (d) With reference to Extract 3 and 4, discuss the impacts of Mondelez and Hershey "joining forces". [8]
- (e) Assess the options open to the government to manage the possible detrimental effects that could result if Mondelez successfully takes over Hershey. [10]

[Total: 30]

Question 2 Rebalancing to generate growth

Extract 5: China's economic growth misses target

China's economy grew 7.4 percent in 2014, at its slowest pace in 24 years as property prices cooled and companies and local governments struggled under heavy debt burdens, keeping pressure on Beijing to take aggressive steps to avoid a sharper downturn.

A further slowdown in China could hinder the chances of a revival in global growth in 2015, given the major role it plays, in particular for commodities and high-tech. China's property market - a major driver of demand across a range of industries - has proven stubbornly unresponsive to policy support, and lending data from the banking system shows enduring weakness. At the same time, there may be a looming fiscal crisis among debt-sodden local governments, which depend on land sales for most of their revenue. And more companies, especially small property developers, could flirt with default.

Policymakers also are concerned about the potential onset of a deflation aggravated by plummeting energy prices, industrial overcapacity and sluggish demand. Systemic deflation is an economically toxic cycle in which investors and consumers hold off on fresh spending on the assumption prices will drop further in the future. This is cited as a major reason why Beijing will need to put more money into the system.

Nevertheless, the International Monetary Fund's chief economist Olivier Blanchard said slower growth seen for 2015 reflects a welcome decision by the Chinese government to rebalance the economy away from a heavy reliance on investment and exports to a more consumption-based growth model.

Source: Kevin Yao and Pete Sweeney, *Reuters*, 20 Jan 2015

Extract 6: Why China's economy is slowing

Structurally, China's economy faces headwinds. In the long run, growth is a function of changes in labour, capital and productivity. When all three increase, as they did in China for many years, growth rates are superlative. But they are all slowing now. China's working-age population peaked in 2012. Investment also looks to have topped out. Finally, China's technological gap with rich countries is narrower than in the past, implying that productivity growth will be lower, too.

Another important development has been its credit binge. Total debt, including government, household and corporate, has climbed to about 250% of GDP, up 100 percentage points since 2008. This debt allowed China to power its economy through the global financial crisis but also saddled it with a heavy repayment burden. Most worrying, much of the credit flowed to property developers. China's inventory of unsold homes sits at a record high. The real-estate sector, which previously accounted for some 15% of economic growth, could face outright contraction. From this vantage point, the abruptness of China's current slowdown looks more cyclical than structural.

Whereas previous leaders propped up growth whenever it slowed, Xi Jinping, China's president since 2013, has instead spread the gospel of the "new normal", by which he means less emphasis on growth and faster structural reform. As a result, the central bank has been hesitant to ease monetary policy. Changes to fiscal rules have also made it harder for local governments to spend money

Extract 7: Fears mount that UK's plan to rebalance the economy is failing

Britain's recovery remained on track in the third quarter but fresh figures revealed growth was heavily reliant on the consumer, leaving the government's much hoped-for rebalancing of the economy elusive. Companies have become increasingly concerned about the economic outlook and falling business investment once again leaves the economic upturn in the hands of the consumer.

Exports fell by 0.4%, while imports increased by 1.4%, worsening Britain's trade position. The UK's trade deficit with the rest of the world widened to £11.2bn in the third quarter from £8.9bn in the second. Business investment, which the government is banking on to drive a sustainable recovery, actually fell by 0.7% or £300m compared with the second quarter. On the other hand, household spending, increased by 0.8% over the third quarter, extending the run of growth to 13 consecutive quarters. Services sector output was revised up to 0.8% from an initial estimate of 0.7%, reinforcing the picture of a UK recovery reliant on the consumer.

A spokesman for the Treasury repeated its persistent line that growth in the third quarter was a sign the government's long-term economic plan is working, and that the UK economy was under threat from factors abroad. "The UK is not immune to weakness in the euro area and instability in global markets, so we face a critical moment for our economy. We need to carry on working through our economic plan that is securing a resilient economy and a better future."

Source: Angela Monaghan, *The Guardian*, 26 November 2014

Extract 8: Deflation in the Euro zone is all too close

The euro area is on the verge of tipping into its third recession in six years. The zone's overall inflation rate has slipped to 0.3% and may well go into outright decline next year. A region that makes up almost a fifth of world output is marching towards stagnation and deflation.

Some price falls are welcome. Tumbling oil prices, in particular, have given consumers' incomes a boost. But slowing prices and stagnant wages owe more to weak demand in the economy and roughly 45 million workers are jobless in the rich OECD countries. Worse, short-term interest rates are close to zero in many economies, so central banks cannot cut them to boost spending.

If Europe is to stop its economy getting worse, it will have to stop its self-destructive behaviour. France and Italy should be allowed to slow the pace of their fiscal cuts; in return, those countries should accelerate structural reforms. Reducing the fiscal deficits has been difficult to achieve because reductions in government spending and increases in taxes depress economic activity. Lower economic activity causes increased transfer payments and reduced tax revenue, offsetting the original fiscal contraction. A cheapening euro would be an important boost for eurozone countries such as Spain, Italy and France that have very large fiscal deficits. Although the lower euro would not change the relative prices among the eurozone countries, it would have a powerful effect because nearly half the trade of the eurozone countries is with countries outside the eurozone.

Table 2: GDP growth rates (Annual % change at constant prices in local currency)

	2010	2011	2012	2013	2014
China	10.6	9.5	7.8	7.7	7.4
UK	1.5	2.0	1.2	2.2	2.9
Euro Area	2.1	1.6	-0.9	-0.3	0.9

Table 3: Inflation rates (Annual % change in consumer price index)

	2010	2011	2012	2013	2014
China	3.3	5.4	2.6	2.6	2.0
UK	3.3	4.5	2.8	2.6	1.5
Euro Area	1.5	3.3	2.5	1.4	0.2

Source of Tables 2 & 3: *World Bank*

Table 4: Government Budget Balance (% of GDP)

	2010	2011	2012	2013	2014
China	-2.5	-1.1	-1.5	-2.1	-2.1
UK	-9.7	-7.7	-8.3	-5.6	-5.6
Euro Area	-6.2	-4.2	-3.7	-3.0	-2.6

Source: *www.tradingeconomics.com*

Questions

- (a) Which economy in Table 2 shows the least variation in its growth rate? [1]
- (b) (i) Besides the balance of trade in goods and services, state one other component of the current account on the balance of payments. [1]
- (ii) With reference to Extract 5, explain how a trading partner's current account on the balance of payments is affected by China's slowdown. [2]
- (c) How might UK's multiplier size change with the rebalance of the UK's economy? [4]
- (d) Comment on the usefulness of GDP growth rates in measuring UK's standard of living. [4]
- (e) Discuss whether policymakers should be concerned about the onset of deflation. [8]
- (f) Both UK and China are experiencing slow growth and have plans to rebalance their economies. In light of the data, assess the most appropriate policy approaches their governments can adopt to achieve high and sustained growth. [10]

[Total: 30]

H2 ECONOMICS

Section A: Case Study Question 1

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

15 September 2016

READ THESE INSTRUCTIONS FIRST

Write your name, civics group, register number and tutor's name in the spaces at the top of this cover page and on all the work you hand in.

At the end of the examination, fasten this cover sheet to your answer scripts for Case Study Question 1 with the string provided before submission.

QUESTIONS ATTEMPTED		MARKS
(a)	(i)	
	(ii)	
(b)	(i)	
	(ii)	
(c)		
(d)		
(e)		
TOTAL		/30

JC2 PRELIMINARY EXAMINATION 2016

9732/01

COVER SHEET

H2 ECONOMICS

Section A: Case Study Question 2

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

15 September 2016

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At the end of the examination, fasten this cover sheet to your answer scripts for Case Study Question 2 with the string provided before submission.

QUESTIONS ATTEMPTED		MARKS
(a)		
(b)	(i)	
	(ii)	
(c)		
(d)		
(e)		
(f)		
TOTAL		/30



H2 Economics

9732/02

Paper 2 Essay Questions

19 September 2016

2 hours 15 minutes

Additional Materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

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

Write your name, class and register number in the spaces at the top of the answer sheets.

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 **three** questions in total, of which **one** must be from Section A, **one** from Section B and **one** from **either** Section A or Section B.

Begin each essay question on a fresh sheet of paper.

At the end of the examination, fasten all your work securely to the cover sheet with the string provided.

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

[Turn Over]

Answer three questions in total.

Section A

One or two of your three chosen questions must be from this section.

- 1 Many different types of holiday travel ranging from budget to high-end luxury packages are available in Singapore. A large fall in the cost of producing holiday packages in the midst of a global slowdown are likely to affect the sales of different categories of holiday packages in Singapore.

Critically examine the likely impact of a large fall in cost of production of holiday packages and a global slowdown on the sales volume and revenue earned from the sales of different categories of holiday packages. [25]

- 2 Sugar consumption contributes to increasing obesity rates in Singapore, where around 1.7 million Singaporeans are at risk of obesity-related diseases such as diabetes. There are calls for a tax on sugared drinks and soda to reduce sugar consumption, following in the footsteps of countries like Mexico, the UK and the city of Berkeley in California.

(a) Explain how the consumption of sugary drinks is likely to cause market failure. [10]

(b) Discuss the view that a sugar tax represents the best option by a government to tackle obesity-related diseases such as diabetes. [15]

- 3 (a) Differentiate between the key features of the economic models of perfect competition and monopoly, illustrating your answer with examples. [10]

(b) Discuss whether the determination of a firm's price and output is more dependent on the competition that it faces or the firm's objectives. [15]

Section B

One or two of your three chosen questions must be from this section.

4 Governments in economies worldwide solve unemployment problems through the use of loose monetary policy and investment in human capital.

(a) Explain why reducing unemployment is a key macroeconomic objective in many countries. [10]

(b) Discuss the view that Singapore would be better off reducing unemployment through the use of exchange rate policy. [15]

5 During 2009 the Bank of England engaged in what is known as 'quantitative easing' by pumping more than £200 billion into the economy. Record low levels of interest rates have also been maintained within the UK economy. Quantitative easing and low interest rates were also adopted by the US.

Discuss the likely impact of quantitative easing and low interest rates on an economy and its trading partners. [25]

6 Economists warn of the rising waves of protectionism around the world although some governments are opening markets and improving competitiveness.

(a) Explain why protectionism exists. [10]

(b) A country wishes to improve its export competitiveness in producing manufactured goods. What does this mean and how might this be achieved? [15]

- End of Paper -

JC2 PRELIMINARY EXAMINATION 2016

9732/02

COVER SHEET

H2 ECONOMICS

Section A & B: Essay Question

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

19 September 2016

2 Hours 15 Minutes

READ THESE INSTRUCTIONS FIRST

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WRITE down the question number you have attempted.

At the end of the examination, fasten this cover sheet to your answer scripts for the essay with the string provided before submission.

QUESTION ATTEMPTED	MARKS
Question _____	/25

JC2 PRELIMINARY EXAMINATION 2016

9732/02

COVER SHEET

H2 ECONOMICS

Section A & B: Essay Question

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

19 September 2016

2 Hours 15 Minutes

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Question _____	/25

JC2 PRELIMINARY EXAMINATION 2016

9732/02

COVER SHEET

H2 ECONOMICS

Section A & B: Essay Question

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

19 September 2016

2 Hours 15 Minutes

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Question _____	/25

Question 1

Chocolate battles out

Extract 1 Higher costs bite chocolate makers

Hershey Co.'s rebuff of a \$23 billion bid by Mondelez International Inc. this month comes as rising commodity prices are making it more expensive to produce a chocolate bar. Cocoa-butter prices are at multiyear highs as cocoa-bean processors struggle with unusually small cocoa beans in West Africa, where about 70% of the world's cocoa is grown. Still, the bulk of the costs of making chocolate are in transportation and marketing costs.

The cocoa crop in Ghana, the world's second-largest producer, experienced an unusually high drop in 2015, after farmers there applied key pesticides late in the crop's development. Moreover, it takes a cacao tree five years before it produces its first beans. Hershey said in its last earnings call that the price increases had hurt demand and were in part to blame for a 3.6% drop in sales volume in the second quarter.

Retail prices are expected to rise 2.2% this year in the U.S., according to Euromonitor International, the lowest year-over-year percentage increase in a decade. That modest price increase is because chocolate makers feel they have to absorb rising costs because they can't pass them on to consumers, analysts say.

Source: *Wall Street Journal*, 11 July 2016

Extract 2 Appeals for anti-trust laws for Nestle, Hershey and Mars

Buyers accused the three confectionery giants of conspiring to raise chocolate prices in US between 2002 and 2007 during discussions at trade shows and association events. However, the case was dismissed because they failed to provide evidence that the firms' actions were concerted and collusive. In light of the court's ruling, over 20 pharmacies and food retail chains filed appeals against the judgment.

Jeff Beckham, spokesperson for Hershey, said that the company had expected the appeal but said it was pleased the court recognised that there is no basis for the case and misconduct. The chocolate firms said that any pricing increases were due to rising ingredient, manufacturing cost and denied price fixing.

Source: *William Reed Business Media*, 22 May 2014

Table 1: Top five US confectionery brands: share of confectionery sector

Share of confectionery sector (%)	2015
Hershey's	31.3
Mars	29.1
Mondelez	5.4
Lindt	5.4
Nestle	5.0

Source: Statista, 2015

Extract 3 Sales Pressure on Mondelez, Hershey Could Bolster Case for Merger

Rival snack makers Mondelez International Inc. and Hershey Co. are both expected to show sales pressure when they report quarterly earnings this week, bolstering some arguments that the two giants could benefit from joining forces. Both Mondelez and Hershey are grappling with changing consumer tastes toward healthier and more natural foods, and in some cases the trend has sent a few companies in search of deals that help them reduce overall costs. Revenue is expected to be \$6.34 billion, down 17% from the same period last year, according to consensus estimates from Thomson Reuters.

Last year's megamerger of Kraft Foods Group Inc. and H.J. Heinz Co. helped the packaged food conglomerates save on overhead expenses and distribution costs. The combined company, Kraft Heinz Co., has posted double-digit increases in profits in recent quarters, despite continued sales decline. Analysts said the appeal for Mondelez to buy Hershey lies in the money the combined company could save by pooling resources and ingredient purchasing. Mondelez could also profit from expanding the Hershey brands overseas, which include Reese's peanut butter cups and Twizzlers, as they are heavily concentrated in the U.S. In fact, many of Hershey's brands have global brand recognition and distribution upside.

However, Bernstein analyst Alexia Howard feels that an acquisition of Hershey would be "strategically unsound" for Mondelez. "Our strongly held view that health and wellness trends will play a key part in the U.S. food industry's future makes us naturally skeptical of this transaction," she said. Hershey has said its sales and profit for the year will be lower than expected as its chocolate bars struggle to compete with newer snacks like fruit-and-nut bars considered by many consumers to be healthier.

Source: *Wall Street Journal*, 26 July 2016

Extract 4 Not so sweet if Mondelez buys Hershey

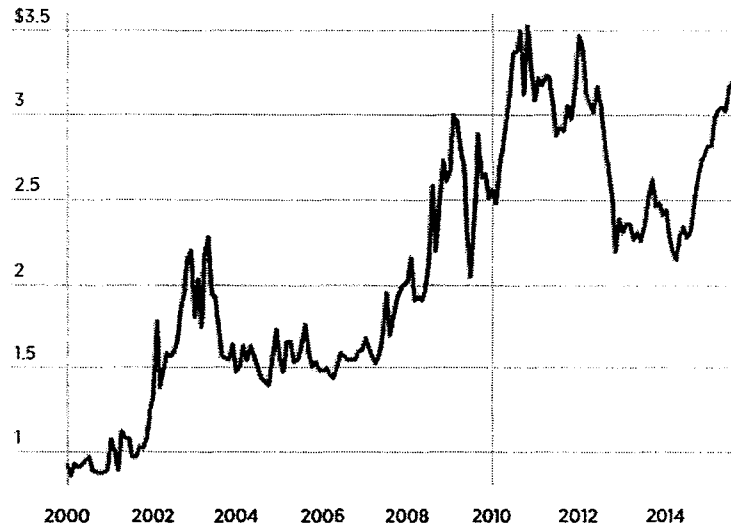
On paper, a sale to Mondelez could benefit Hershey. Hershey's U.S. market share was at about 44% as of last year, and Mondelez, which generates about 30% of its global sales from chocolate, owns major chocolate brands such as Cadbury. While Hershey has a strong U.S. presence, Mondelez has a global network. A marriage of the two would create the world's largest confectionery company with an estimated 18 percent of the market share, said market research firm Euromonitor International Ltd. In addition, because almost 75% of Mondelez's business is concentrated outside of North America, a potential Hershey takeover may not raise many antitrust concerns within the U.S.

However, while Mondelez has vowed to keep Hershey's name and preserve jobs, some said such promises would ring empty. U.S. food giant Kraft drew controversy in 2010 after it shut a factory in southwest England following its takeover of Cadbury, now owned by Mondelez, going back on an earlier promise to keep the factory open.

Mondelez's bid for Hershey to create the world's largest cocoa buyer, could also hand the bargaining chips in the volatile niche market back to the candy makers. With more buying power, candy makers could demand lower prices from traders already operating on thin margins. The consolidation among chocolate makers create larger buyers of commodities including cocoa and sugar, worrying middlemen who have already seen their margins squeezed. Mondelez is already the world's largest cocoa consumer, and after a tie-up with Hershey it would consume 650,000 tonnes per year, 50 percent more than the No. 2 consumer, Nestle.

Adapted from: *Reuters and Fortune*

Figure 1: Cocoa Prices from 2000-2014



Source: World Bank

CNBC

Source: CNBC, 13 Feb 2015

Questions

- (a) (i) With reference to Figure 1, describe the trend in cocoa prices. [2]
- (ii) With reference to Extract 1, use a diagram to explain how an increase in demand for chocolate affects the market for cocoa. [2]
- (b) (i) Identify and justify the type of market structure operating in the confectionery sector. [2]
- (ii) Explain how the firms in this market structure compete against one another. [2]
- (c) Explain why food retail chains are concerned with price fixing by the three confectionery giants. [4]
- (d) With reference to Extract 3 and 4, discuss the impacts of Mondelez and Hershey "joining forces". [8]
- (e) Assess the options open to the government to reduce the possible detrimental effects that will result if Mondelez successfully takes over Hershey. [10]

(a)	(i)	With reference to Figure 1, describe the trend in cocoa prices.	[2]
		Overall, Cocoa prices increased however there was with a sharp drop in 2013.	
	(ii)	With reference to Extract 1, use a diagram to explain how an increase in demand for chocolate affects the market for cocoa.	[3]
		Draw a DD/SS diagram An increase in demand of chocolate will cause demand for cocoa to increase since the demand for cocoa is derived from demand. The equilibrium price and quantity for cocoa increased. Given that supply of cocoa beans are price elastic due to its long gestation period of 5 years, the increase in price brings about a less than proportionate increase in quantity supplied.	
(b)	(i)	Identify and justify the type of market structure operating in the confectionery sector.	[2]
		Oligopoly. The market is dominated with firms with large market share and its 3-firm concentration ratio is larger than 50%.	
	(ii)	Explain how the firms in this market structure compete against one another.	[2]
		In an oligopolistic market, firms are mutually interdependent as there are a few firms with huge market share. They could compete where they engage in non-price competition such as repackaging or advertising to differentiate their range of chocolates sold from their rival firms.	
(c)		Explain why food retails chains are concerned with price fixing by the three confectionery giants.	[3]
		From Extract 2, it is said that the companies are 'conspiring to raise prices', hence they are colluding to behave like a monopoly where they restrict output and increase prices. The food retail chains are concerned as more costly chocolates sold by the confectionary giants reduce food retail chains' consumer surplus and raise their unit cost of production. [1m] If the food retails chains are unable to pass on the higher cost to the consumers in the form of higher prices, their total revenue and hence profits will fall.	
(d)		With reference to Extract 3 and 4, discuss the impacts of Mondelez and Hershey "joining forces".	[8]
		[Impacts on producers]: Examples <ul style="list-style-type: none"> The merged firm has more substantial market share (Table 1) and will be able to produce at higher output. It is more able to reap internal EOS e.g. marketing economies as the "combined company can save [money] by pooling resources and ingredient purchasing" (Ext 3), managerial economies from better division of labour. As a result, the firm enjoys lower average cost of production This is especially beneficial to the firm since "the bulk of the costs of making chocolate are in transportation and marketing costs" (Ext 1) and therefore the merger will allow for costs of production to be lower to a large extent. 	

[EV] However, other confectionary companies might engage in more non-price competition if they view the takeover as a threat. The merged firm may respond by also spending more money engaging in non-price competition (e.g. advertisements) to compete with the other confectionery companies, reducing their profits.

[Impact on consumers]: Examples

- When the merged firm is able to enjoy lower costs, they might be able to pass down cost savings to consumers via lower prices hence increases consumer surplus
- The merged firm's ability to sustain supernormal profits in the LR implies that they will have greater ability to channel supernormal profits into R&D which results in greater ability to innovate, generate new products and greater variety for consumers. It is also more able to generate new processes to lower cost of production too and consumers may benefit in the long term

[Overall impact on economy/society]

- The takeover might lead to more jobs being created as the combined company expands internationally. This increases employment in factories not just in the U.S. but other areas in which both the companies have factories
- However, in its costs savings drive, it might streamline its production process and lay off workers
- This seems plausible as mentioned in Ext 4 that "while Mondelez has vowed to keep Hershey's name and preserve jobs, some said such promises might ring empty" as similar issue happened when Kraft shut down its factory in southwest England following its takeover of Cadbury, now owned by Mondelez (Ext 4) when Mondelez had earlier agreed to keep the factory open

[Potential impact on cocoa farmers]

- The buying power of the merged firm leads to lower prices which may lead to lower profit margins for cocoa traders, hence reducing their material standard of living as the lowered profits reduces their income and hence access to goods and services

[Synthesis/Conclusion]

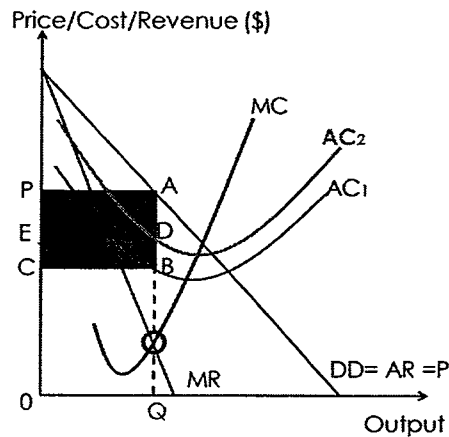
Cost of merger is likely to outweigh benefits

- [Potential entry/ Theory of contestable markets] The combined market share of Hershey's and Mondelez in U.S. will be significantly higher than the next highest firm, Mars. Together with the fact that cocoa prices are rising (Ext 1), and that consumers are increasingly switching away from consuming chocolates for healthier options (Ext 3), it is unlikely that there will be potential new suppliers entering the market → suggests that there will be little threat of potential competition → merged firm is less incentivized to pass down cost savings to consumers and innovate further for the benefit of consumers.

Level	Level Marking Scheme	Marks
L3	Candidate demonstrates their ability to analyse and evaluate the pros and cons of merger for consumers and producers with reference to case materials.	7-8

	<table border="1" data-bbox="327 192 1283 401"> <tr> <td data-bbox="327 192 432 327">L2</td> <td data-bbox="432 192 1158 327">Candidates accurately analyse the effects of merger with the use of economic tools. However, no evaluative comments are demonstrated. Little use of case materials</td> <td data-bbox="1158 192 1283 327">4-6</td> </tr> <tr> <td data-bbox="327 327 432 401">L1</td> <td data-bbox="432 327 1158 401">Candidates makes some relevant comments but without any appropriate analysis.</td> <td data-bbox="1158 327 1283 401">1-3</td> </tr> </table> <p data-bbox="312 437 1295 567"><i>Adv/disadv without evaluative conclusion- max 6m</i> <i>Cite evidence for both sides of analysis. If evidence only cited for 1 side- max 6m</i> <i>No evidence provided- max 4m</i></p>	L2	Candidates accurately analyse the effects of merger with the use of economic tools. However, no evaluative comments are demonstrated. Little use of case materials	4-6	L1	Candidates makes some relevant comments but without any appropriate analysis.	1-3	
L2	Candidates accurately analyse the effects of merger with the use of economic tools. However, no evaluative comments are demonstrated. Little use of case materials	4-6						
L1	Candidates makes some relevant comments but without any appropriate analysis.	1-3						
(e)	Assess the options open to the government to reduce the possible detrimental effects that might result if Mondelez successfully takes over Hershey.	[10]						
	<p data-bbox="312 741 1295 810"><i>Students are expected to address the detrimental effects identified in part(d)(i)</i></p> <p data-bbox="312 841 879 874"><i>(Identify the detrimental effects to address)</i></p> <p data-bbox="312 878 1295 975">Detrimental effects to address: possible exploitation of consumers by merged firm, possible loss of jobs (structural unemployment), impact on cocoa traders who might face lower prices</p> <p data-bbox="312 1011 1295 1073"><i>(Identify & analyse the different policies to detrimental effects of a takeover)</i></p> <p data-bbox="312 1079 576 1112"><u>Anti-trust policies:</u></p> <ul data-bbox="312 1116 1295 1721" style="list-style-type: none"> • Detrimental effects: Exploitation of market power leading to higher prices, inefficient allocation of resources and/or anti-competitive behaviours (such as collusion, predatory pricing). The result is a loss in consumer welfare • Anti-trust policies are programmes designed to prevent the deliberate creation of monopolies, and to prevent dominant firms from engaging in anti-competitive practices (such as the price-fixing behaviour by Nestle, Hershey and Mars in Ext 2). Government agencies can take firms accused of such behaviours to court, forced it to be split up and/or impose penalties such as fines • [EV] However, whether a firm has breached an anti-trust policy is rarely a clear cut case. Also, in this particular instance, as Ext 4 mentions, it seems like the potential takeover may not raise many antitrust concerns within the U.S. simply because almost 75% of Mondelez's business is concentrated outside of North America. • Moreover, sometimes companies merge or take over another company not to reduce competition but to lower costs through more efficient joint production. The lower cost can benefit the consumers. <p data-bbox="312 1790 820 1823"><u>Regulation through lump-sum taxes</u></p> <ul data-bbox="312 1827 1295 2020" style="list-style-type: none"> • Detrimental effect: greater inequity if the merged firm reaps excessive profits at the expense of consumers and other firms • A lump-sum tax can be used to reduce this excessive profit earned as a result of market dominance. A lump-sum tax is a tax fixed in amount and levied without any regard to the output or revenue of the firm. It can be regarded as a fixed cost to the firm and therefore shifts the AC 							

curve upwards. If the government uses the tax revenue earned to subsidise the lower-income families, inequity issues can be further reduced.



[EV] Firms have incentive to avoid excessive profits by charging lower prices which will help to reduce inequity

Supply-side policies (to deal with loss of jobs)

Conclusion: Offer evaluative judgement as to which policy options are better.

Level	Knowledge, Application, Understanding & Analysis	Marks
L3	A well-developed answer on at least 2 detrimental effects of Mondelez's takeover (demerits of monopoly, unemployment due to shutdown of companies, low prices of cocoa) and at least 2 policy available(well explained) to tackle it, considered in the context of that is well supported with usage of analytical tools and evidences. Reasoned judgment on which option should be undertaken based on the problems faced.	7-8
L2	One-sided answer that analyses the effectiveness of 1 relevant policy and 1 detrimental effect OR underdeveloped analysis of two policies and effects of the takeover, with little reference to case materials.	5-6
L1	A descriptive answer that only explains the detrimental effect and policy in brief with many inaccuracies. No evidence capped at level 1	1-4
	Up to 2 marks for evaluation	
E1	Application of relevant economic concepts to make judgment about the appropriateness of measures in the Singapore's healthcare market.	1-2

Question 2 Rebalancing to generate growth

Extract 5: China's economic growth misses target

China's economy grew 7.4 percent in 2014, at its slowest pace in 24 years as property prices cooled and companies and local governments struggled under heavy debt burdens, keeping pressure on Beijing to take aggressive steps to avoid a sharper downturn.

A further slowdown in China could hinder the chances of a revival in global growth in 2015, given the major role it plays, in particular for commodities and high-tech. China's property market - a major driver of demand across a range of industries - has proven stubbornly unresponsive to policy support, and lending data from the banking system shows enduring weakness. At the same time, there may be a looming fiscal crisis among debt-sodden local governments, which depend on land sales for most of their revenue. And more companies, especially small property developers, could flirt with default.

Policymakers also are concerned about the potential onset of a deflation aggravated by plummeting energy prices, industrial overcapacity and sluggish demand. Systemic deflation is an economically toxic cycle in which investors and consumers hold off on fresh spending on the assumption prices will drop further in the future. This is cited as a major reason why Beijing will need to put more money into the system.

Nevertheless, the International Monetary Fund's chief economist Olivier Blanchard said slower growth seen for 2015 reflects a welcome decision by the Chinese government to rebalance the economy away from a heavy reliance on investment and exports to a more consumption-based growth model.

Source: Kevin Yao and Pete Sweeney, *Reuters*, 20 Jan 2015

Extract 6: Why China's economy is slowing

Structurally, China's economy faces headwinds. In the long run, growth is a function of changes in labour, capital and productivity. When all three increase, as they did in China for many years, growth rates are superlative. But they are all slowing now. China's working-age population peaked in 2012. Investment also looks to have topped out. Finally, China's technological gap with rich countries is narrower than in the past, implying that productivity growth will be lower, too.

Another important development has been its credit binge. Total debt, including government, household and corporate, has climbed to about 250% of GDP, up 100 percentage points since 2008. This debt allowed China to power its economy through the global financial crisis but also saddled it with a heavy repayment burden. Most worrying, much of the credit flowed to property developers. China's inventory of unsold homes sits at a record high. The real-estate sector, which

previously accounted for some 15% of economic growth, could face outright contraction. From this vantage point, the abruptness of China's current slowdown looks more cyclical than structural.

Whereas previous leaders propped up growth whenever it slowed, Xi Jinping, China's president since 2013, has instead spread the gospel of the "new normal", by which he means less emphasis on growth and faster structural reform. As a result, the central bank has been hesitant to ease monetary policy. Changes to fiscal rules have also made it harder for local governments to spend money.

Source: *The Economist*, 11 Mar 2015

Extract 7: Fears mount that UK's plan to rebalance the economy is failing

Britain's recovery remained on track in the third quarter but fresh figures revealed growth was heavily reliant on the consumer, leaving the government's much hoped-for rebalancing of the economy elusive. Companies have become increasingly concerned about the economic outlook and falling business investment once again leaves the economic upturn in the hands of the consumer.

Exports fell by 0.4%, while imports increased by 1.4%, worsening Britain's trade position. The UK's trade deficit with the rest of the world widened to £11.2bn in the third quarter from £8.9bn in the second. Business investment, which the government is banking on to drive a sustainable recovery, actually fell by 0.7% or £300m compared with the second quarter. On the other hand, household spending, increased by 0.8% over the third quarter, extending the run of growth to 13 consecutive quarters. Services sector output was revised up to 0.8% from an initial estimate of 0.7%, reinforcing the picture of a UK recovery reliant on the consumer.

A spokesman for the Treasury repeated its persistent line that growth in the third quarter was a sign the government's long-term economic plan is working, and that the UK economy was under threat from factors abroad. "The UK is not immune to weakness in the euro area and instability in global markets, so we face a critical moment for our economy. We need to carry on working through our economic plan that is securing a resilient economy and a better future."

Source: Angela Monaghan, *The Guardian*, 26 November 2014

Extract 8: Deflation in the Euro zone is all too close

The euro area is on the verge of tipping into its third recession in six years. The zone's overall inflation rate has slipped to 0.3% and may well go into outright decline next year. A region that makes up almost a fifth of world output is marching towards stagnation and deflation.

Some price falls are welcome. Tumbling oil prices, in particular, have given consumers' incomes a boost. But slowing prices and stagnant wages owe more to

weak demand in the economy and roughly 45 million workers are jobless in the rich OECD countries. Worse, short-term interest rates are close to zero in many economies, so central banks cannot cut them to boost spending.

If Europe is to stop its economy getting worse, it will have to stop its self-destructive behaviour. France and Italy should be allowed to slow the pace of their fiscal cuts; in return, those countries should accelerate structural reforms. Reducing the fiscal deficits has been difficult to achieve because reductions in government spending and increases in taxes depress economic activity. Lower economic activity causes increased transfer payments and reduced tax revenue, offsetting the original fiscal contraction. A cheapening euro would be an important boost for eurozone countries such as Spain, Italy and France that have very large fiscal deficits. Although the lower euro would not change the relative prices among the eurozone countries, it would have a powerful effect because nearly half the trade of the eurozone countries is with countries outside the eurozone.

Source: *The Economist*, 25th October 2014

Table 2: GDP growth rates (Annual % change at constant prices in local currency)

	2010	2011	2012	2013	2014
China	10.6	9.5	7.8	7.7	7.4
UK	1.5	2.0	1.2	2.2	2.9
Euro Area	2.1	1.6	-0.9	-0.3	0.9

Table 3: Inflation rates (Annual % change in consumer price index)

	2010	2011	2012	2013	2014
China	3.3	5.4	2.6	2.6	2.0
UK	3.3	4.5	2.8	2.6	1.5
Euro Area	1.5	3.3	2.5	1.4	0.2

Source of Tables 2 & 3: *World Bank*

Table 4: Government Budget Balance (% of GDP)

	2010	2011	2012	2013	2014
China	-2.5	-1.1	-1.5	-2.1	-2.1
UK	-9.7	-7.7	-8.3	-5.6	-5.6
Euro Area	-6.2	-4.2	-3.7	-3.0	-2.6

Source: www.tradingeconomics.com

Questions

- (a) Which economy in Table 2 shows the least variation in its growth rate? [1]
- (b) (i) Besides the balance of trade in goods and services, state one other component of the current account on the balance of payments. [1]
- (ii) With reference to Extract 5, explain how a trading partner's current account on the balance of payments is affected by China's slowdown. [2]
- (c) How might UK's multiplier size change with the rebalance of the UK's economy? [4]
- (d) Comment on the usefulness of GDP growth rates in measuring UK's standard of living. [4]
- (e) Discuss whether policymakers should be concerned about the onset of deflation. [8]
- (f) Both UK and China are experiencing slow growth and have plans to rebalance their economies. In light of the data, assess the most appropriate policy approaches their governments can adopt to achieve high and sustained growth. [10]

[Total: 30]

(a) Which economy in Table 2 shows the least variation in its growth rate? [1]

China. It shows a decreasing trend that is consistent throughout, with the least fluctuations.

(b) (i) Besides the balance of trade in goods and services, state one other component of the current account on the balance of payments. [1]

Income flows or current transfers of gifts

(ii) With reference to Extract 5, explain how a trading partner's current account on the balance of payments is affected by China's slowdown. [2]

China's real output is falling, demand for high-tech and primary commodities from trading partners which are used to produce manufactured goods falls leading to a fall in export revenue for the trading partner. Assuming current account was initially in equilibrium, c.p. trading partner's current account will be in deficit.

(c) How might UK's multiplier size change with the rebalance of the UK's economy? [4]

Re-balancing economy → reduce reliance on consumer demand & increase reliance investment & external demand to drive economic growth.

The plan to reduce reliance on consumption expenditure to boost growth (Extract 3), implies that government will aim to reduce the MPCd of UK where an additional increase in national income will lead to a smaller increase in Cd. achieved via encouraging a higher MPS value which in turn enables higher accumulation of funds for loans, leading to higher investment levels, fulfilling the rebalancing objectives to drive a sustainable recovery. Assuming MPM and MRT remains constant, a higher MPS will lead to a smaller K size, given that $K = 1 / MPW$

Address "might"

However, the K size may also remain the same (or increase) UK government may decide to reduce corporate tax rates as another policy option to lower business cost & boost export competitiveness. Hence, this negates the rise in MPS, resulting in negligible change in MPW causing K size to remain the same or even increase

(d) Comment on the usefulness of GDP growth rates in measuring UK's standard of living. [4]

Usefulness in measuring material well-being

UK's GDP growth rates have been positive which suggests annual increase in GDP. If growth rates are higher than the rate of change in population, GDP per capita will increase. An average citizen enjoys higher purchasing power, thus having greater access to goods and services. Material well-being increases, SoL improves.

Limitations

However, GDP growth rates do not reflect the improvement in non-material well-being. The increase in GDP could have come at the expense of longer working hours and greater stress faced at work, resulting in lower quality of life. Hence, more information is required to give a more holistic assessment of SoL in UK.

Comment on the usefulness

To have a more accurate measurement of material well-being, GDP growth rates is insufficient. Information on population growth is needed for a more accurate

measurement and hence growth in GDP per capita rather than GDP growth rates is a better indicator. Its usefulness is also largely limited as the non-material aspect of SoL cannot be accurately reflected.

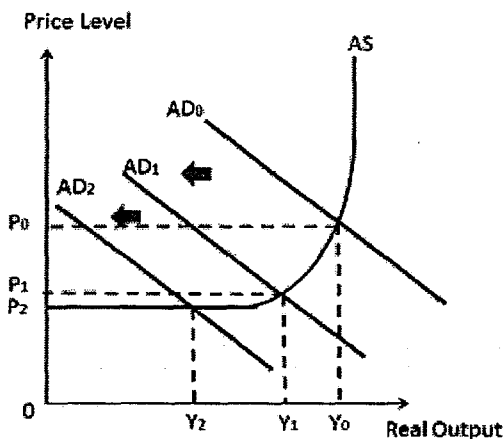
(e) Discuss whether policymakers should be concerned about the onset of deflation.
[8]

Introduction: Define deflation – a period of sustained and inordinate fall in GPL. Policy makers would have to examine the underlying causes and consequences of deflation to decide whether it is a cause for concern.

Thesis: Policymakers should be concerned

Analysis: Underlying cause of falling GPL – “sluggish demand” implies that other macroeconomic goals are not achieved.

Extract 5 suggests that the underlying cause of a deflation can be due to sluggish demand. This implies that total expenditure in the economy i.e. falling AD could be the cause of falling GPL.



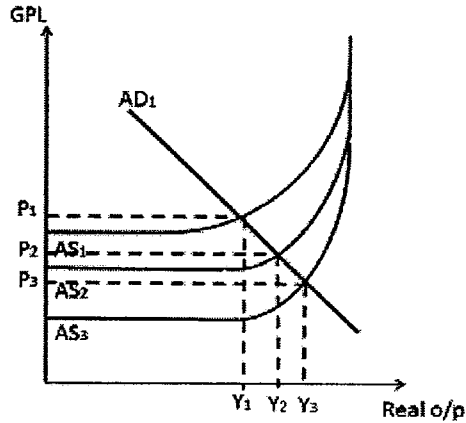
Draw diagram to explain how deflation suggests other macro goals are not achieved → this results in a fall in real output in the economy, and rising demand deficient unemployment. Hence, it signifies that other internal macroeconomic goals are not achieved. This is reinforced by evidence in Extract 8 where weak demand has resulted in '45 million workers jobless'.

Evaluation: Evidence support that policymakers should be concerned to a large extent. Extract 5 explains how falling GPL in one time period will cause 'investors and consumers' to hold off spending on the assumption that prices will fall further in the future. Such a spending pattern reinforces the negative impact on economic growth and employment making deflation a greater cause for concern for policymakers.

Anti-thesis: Policymakers need not be concerned by deflation

Analysis 1: Underlying cause of deflation – “tumbling oil prices”

As suggested in Extract 8, 'some price falls are welcomed'. In the case of falling oil prices, this can have positive impact on the economy and the consumers of oil related products such as petrol.



Explain with diagram the impact of falling oil prices → fall in price of raw materials for economies → shift SRAS to the right as P_m falls → falling GPL and increase in Real output instead.

Evaluation: However such positive impact tend to be short term in nature as oil producing economies/firms have the incentive to strategize to raise prices of oil again. Given that oil has $PED < 1$, a fall in price of oil will lead to less than proportionate increase in qty dd for oil, causing a fall in export revenue for oil producing economies. Thus, in the long term, they may choose to restrict oil output in order to cause the price to rise again, eroding any benefits from falling prices.

Synthesis:

Whether a policymaker should be concerned about the onset of deflation depends on the cause and extent of fall in prices. The overall global environment of slowing economic growth as suggested in the case study reinforces the idea that sluggish demand is causing deflation. Hence the onset of deflation is likely to bring about more costs than benefits. Eurozone, China and UK are all experiencing slow growth and inflation rates are also falling, with Eurozone's persistently lowest amongst the three and showing the sharpest decline in 2014 (Table 3). Hence the likelihood of deflation is much higher for Eurozone and hence policymakers in the Eurozone should be most concerned about the onset of deflation.

- (f) **Both UK and China are experiencing slow growth and have plans to rebalance their economies. In light of the data, assess the most appropriate policy approaches their governments can adopt to achieve high and sustained growth. (10m)**

Introduction

Interpret signpost: Both UK and China are experiencing slow growth. However, China is rebalancing towards greater reliance on Cd for future growth, away from I and X. but UK plans to rebalance away from Cd reliance towards more of I and X for future growth. Governments can consider demand management policies and SS side policies in attaining

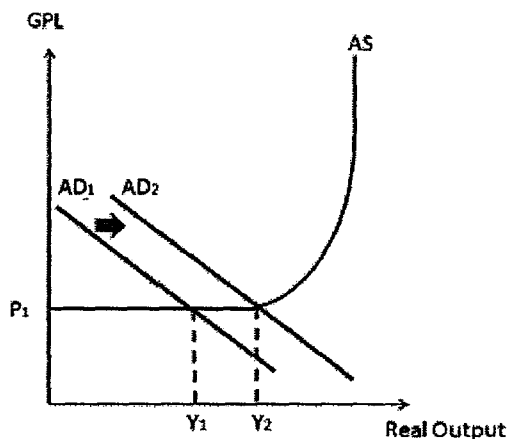
high and sustained economic growth.

Policy 1: Fiscal Policy

1. Analyze how Exp FP works to achieve high and sustained economic growth

(students only need to explain increase in G or cut in T, not both due to exam time constraints)

- A cut in personal income taxes → increased Y_d → increase purchasing power → increase in C_d and hence AD → Increase in Real output and NI by a K amount, given that the economy is operating with spare capacity.



2. Evaluation: Compare UK and China's approaches

E.g. Both UK and China have budget deficits as seen in Table 3. The budget deficits have been sustained over the last 5 years showing that it is a long term problem for them. Large budget deficits accumulated may result in lower credit ratings and poor investors' confidence. Hence despite the need to expand the economy, the use of expansionary FP may not be appropriate for UK and China.

Difference: Size of K

The effectiveness of an exp FP policy will differ due to the difference in size of K . Assuming ceteris paribus, Extract 3 suggested that UK has not been very successful in rebalancing the economy implying that the economy is still relatively reliant on C_d as a key driver for growth. Hence, the value of MPS is relatively low also implying a higher K size for UK. Thus in terms of effectiveness of expansionary FP, it would be more appropriate for UK to employ FP than that of China in attaining high growth.

Policy 2: Monetary Policy

Analyze how devaluation works to stimulate growth

Both UK and China may turn to weakening of their currency to boost economic growth in the short term in light that exp FP may not be a viable tool to use.

E.g. a weakening of the pound against other foreign currencies will lead to exports of UK becoming cheaper in foreign currency while imports to UK become more expensive in pounds. Demand for UK exports increase while quantity demanded for imports by UK

households fall. Assuming Marshall-Lerner condition holds, where $PED_x + PED_m > 1$, a devaluation of the pound will lead to an increase in $(X-M)$. AD increases and leads to increase in real output.

Evaluation:

E.g. A weakening of the currency may be ineffective for both countries. Given that the slow growth environment is a global one since major economies like UK, China and Euro are impacted; a fall in relative price of the good may not be able to offset a fall in demand for goods & services around the world due to falling purchasing power rendering a weakened currency ineffective (Extract 3: UK is not immune to the weakness in Euro). Therefore effectiveness of policies to increase growth will also be dependent on the economic growth recovery of other trading partners.

Compare Exchange Rate policy & Fiscal Policy

Underlying cause of slow growth is rising total debt in China's economy as seen in Extract 2. Whereas, there is only evidence to show that UK's debt is largely that of a fiscal debt. This implies that for China, any fiscal policy stimulant for the economy may not be effective, as increase in Y_d or post-tax profits will not be channelled to spending, but rather the repayment of debt. Hence, similarly a devaluation policy might be more appropriate than fiscal policy in the case of China.

Other Policies : E.g. SS Side policy to target sustained long term growth.

Synthesis:

Both UK and China will require SS-side policies in order to achieve sustained growth. However, increases in AS without sufficiently high AD will result in potential growth that is not actualised. Hence, both UK and China should complement SS-side policies with demand-management policies. Given UK's intention to drive growth through X and I, devaluation may help to boost its export competitiveness in the short-term and boost investors' confidence. As for China, its rebalancing may have to take a backseat as it continues to rely on X for growth as its consumers and the government struggle to repay the large loans accumulated. As the loans are reduced, the government may then consider using alternative monetary policy tools such as interest rates to help in achieving growth.

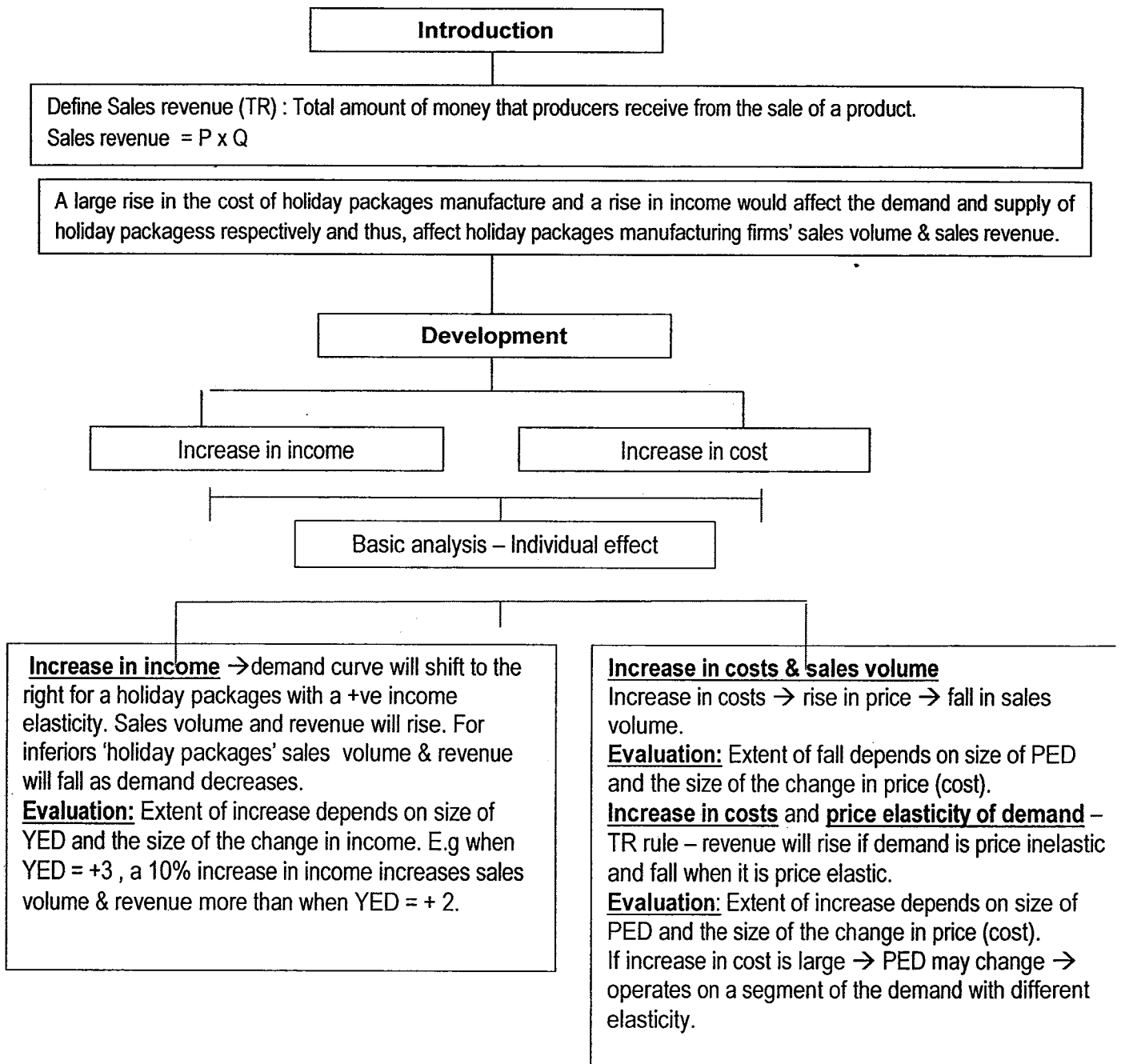
Question 1

Many different types of holiday packages ranging from budget to high-end luxury packages are available in Singapore. A large fall in the cost of producing holiday packages in the midst of a global slowdown are likely to affect the sales of different categories of holiday packages in Singapore

Critically examine the likely impact of a large fall in cost of production of holiday packages in Singapore and a global slowdown on the sales volume and revenue earned from the sales of different categories of holiday packages. [25]

Suggested Answer Model a

Explain how elasticities of demand can assist in understanding the effect of each of these changes on the sales volume of different categories of holidays.



Extended analysis – Combined effect

4 possible combinations

Case 1

Volume:

Rise in Y: +ve YED → Q rises

Rise in cost: PED < 1 → Q fall

The impact on Q of a rise in income and that of a rise in cost contradict each other.

Total impact on total Q depends on extent of shift of DD compared to that of SS

→ Rise in DD > Fall in SS → Increase in Q

Total revenue:

Rise in Y : +ve YED → TR rises,

Rise in costs : PED < 1 → TR rises

Total revenue rises since the impact on TR of a rise in income and that of a rise in cost reinforce each other.

Case 2

Volume:

Rise in Y: +ve YED → Q rises

Rise in cost: PED > 1 → Q fall

The impact on Q of a rise in income and that of a rise in cost contradict each other.

Total impact on total Q depends on extent of shift of DD compared to that of SS

Rise in DD > Fall in SS → Increase in Q

Total revenue:

Rise in Y : +ve YED → TR rises

Rise in costs : PED > 1 → TR falls:

Total impact on total revenue is indeterminate since the impact on TR of a rise in income and that of a rise in cost contradict each other.

Case 3

Volume:

Rise in Y: -ve YED → Q fall

Rise in cost: PED < 1 → Q fall

Total Q falls since the impact on Q of a rise in income and that of a rise in cost reinforce each other.

Total revenue

Rise in Y : -ve YED – TR falls

Rise in costs : PED < 1 - TR rises:

Total effect on total revenue is indeterminate since the impact on TR of a rise in income and that of a rise in cost contradict each other.

Case 4

Volume:

Rise in Y: -ve YED → Q fall

Rise in cost: PED > 1 → Q fall

Total Q falls since the impact on Q of a rise in income and that of a rise in cost reinforce each other.

Total revenue

Rise in Y: -ve YED - TR falls

Rise in costs: PED > 1 - TR falls:

Total revenue falls since the impact on TR of a rise in income and that of a rise in cost reinforce each other.

Evaluation

A comment comparing either different income or price

E.g. Impact also depends on the size of the change in income, size of the change in price, magnitude of the YED and PED

- E.g. In case 3 ($YED = -ve$, $PED < 1$), if the change in income is very large while the increase in price (due to increase in cost) is very small then the fall in the total revenue due to the rise in income is likely to be greater than rise in total revenue of a rise in price (due to the rise in cost). Hence overall, total revenue falls.
- If the YED value is very positive while the PED is close to one, the effect on the total revenue of the rise in income is likely to be greater than that of a rise in price (due to the rise in cost). Hence, overall total revenue falls.
- If the increase in price is very large, the PED of a good may change. If the increase in income, is very great the YED of a good may change.

Synthesis / Conclusion

Finally, as a country becomes more affluent, even the more luxurious holiday packages may be perceived increasingly as necessities.

- The above analysis suggests that overall sales revenue from (i) luxury holiday packages with $PED > 1$ is indeterminate, (ii) budget holiday packages (normal goods) with $PED < 1$ will increase and (iii) budget holiday packages (inferior goods) with $PED < 1$ will indeterminate.
- However, the ceteris paribus assumption is unlikely to hold as factors other than cost of holiday packages manufacture and income may change in reality. Changes in other factors such as prices of related goods, competitive strategies undertaken by firms, government policies and taste and preferences may also impact sales volume and revenue. Hence, the impact on sales volume and revenue for different holiday packages models may be different from the above analysis.

Leve I	Knowledge, Application, Understanding and Analysis	Marks
L3	<p>For an answer using analysis to support the conclusion on whether expenditure rises or falls. Expect 3-4 possible combined effect cases analysed to gain L3 marks (7-9)</p> <p><u>4 possible cases:</u></p> <p>(1) rise in Y : +ve Y ed – Q rise ; TR rises / rise in costs : Ped <1 – Q falls; Q indeterminate; TR rises : they reinforce each other.</p> <p>(2) rise in Y : +ve Yed - Q rises; TR rises / rise in costs : Ped >1 – Q falls; TR falls: Q indeterminate ; TR indeterminate impact.</p> <p>(3) rise in Y : -ve Y ed – Q falls; TR falls / rise in costs : Ped <1 – Q falls; TR rises: – indeterminate effect.</p> <p>(4) rise in Y : -ve Yed - Q falls; TR falls / rise in costs: Ped >1 - Q falls; TR falls: reinforce each other.</p>	15 – 21 (18)
L2	For an answer that gives <u>descriptive</u> explanation of the impact of an income and cost	9 – 14

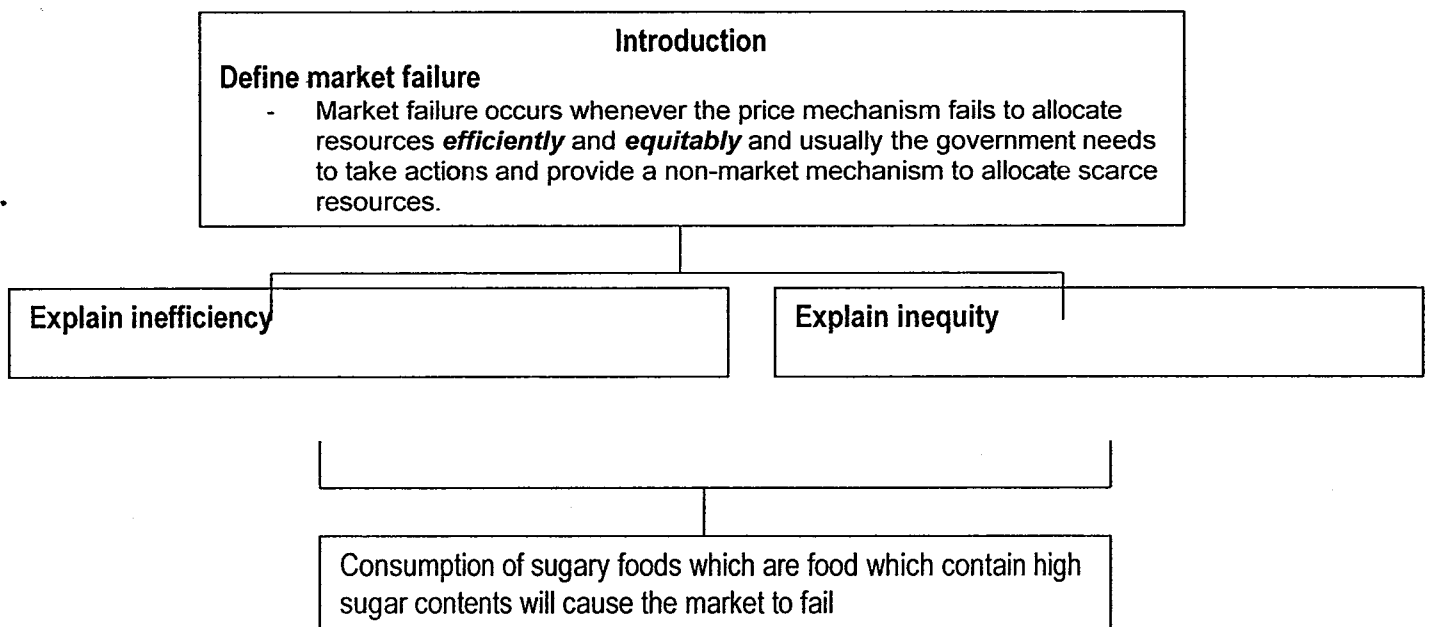
	<p>change on total revenue for two of the four possible combined effect cases or an <u>analytic</u> answer for one of the four possible combined effect cases. [[Max 6 marks if only one combined effect analysed]. Expect 2-3 combinations to gain L2 marks</p> <p><u>4 possible cases:</u></p> <p>(1) rise in Y : +ve Y ed – Q rise ; TR rises / rise in costs : Ped <1 – Q falls; Q indeterminate; TR rises : they reinforce each other.</p> <p>(2) rise in Y : +ve Yed - Q rises; TR rises / rise in costs : Ped >1 – Q falls; TR falls: Q indeterminate ; TR indeterminate impact.</p> <p>(3) rise in Y : -ve Y ed – Q falls; TR falls / rise in costs : Ped <1 – Q falls; TR rises: indeterminate effect.</p> <p>(4) rise in Y : -ve Yed - Q falls; TR falls / rise in costs: Ped >1 - Q falls; TR falls: reinforce each other.</p>	(11.5)
L1	For an answer that shows descriptive knowledge of effect of an income and cost change on volume and total revenue. For an answer that shows some basic but largely unexplained knowledge of S + D curves plus the factors that might causes them to shift.	1 – 8 (4.5)
	Allow up to 4 additional marks for Evaluation	
E2	For an evaluative assessment based on economic analysis e.g. one that uses elasticities or relative shifts in curves to come to a well-argued conclusion. A brief <u>comment</u> comparing either different income or price effects.	3-4
E1	For unexplained assessment e.g. a basic statement that the effect depends on the relative shifts in both the supply and demand. Or an unexplained evaluation statement - revenue from low end model cars will fall whilst that for other models will rise.	1-2

2 Sugar consumption contributes to increasing obesity rates in Singapore, where around 1.7 million Singaporeans are at risk of obesity-related diseases such as diabetes. There are calls for a tax on sugared drinks and soda to reduce sugar consumption, following in the footsteps of countries like Mexico, the UK and the city of Berkeley in California.

(a) Explain how the consumption of sugary drinks is likely to cause market failure. [10m]

(b) Discuss the view that a sugar tax represents the best option by a government to tackle obesity-related diseases such as diabetes. [15]

Suggested Answer (a)

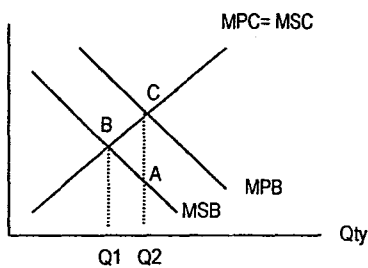


Inefficiency

Externalities

- Consumers' choice is based on private benefit and private cost. In the case of Sugary foods, the benefit of consumption is the utility that one derives from consuming sugary foods while the private cost is the monetary cost of buying them and the healthcare cost as a result of increased risk of obesity related diseases
- However, consumption of sugary foods imposes an external cost on the society i.e. cost borne by 3rd party for which no compensation is made
- E.g. healthcare expenditure by the government on obesity related diseases, lower productivity in the economy as a result of absenteeism from work with rising obesity
- Divergence between private cost and social cost curve ($MSB > MPB$)
- Individuals do not bear the full cost of their consumption decisions → over consumption of sugary food by Q_1 to Q_2 if left to the market → market failure and resource misallocation → society welfare loss ABC (see diagram)

Cost/Benefit



Market Imperfections

Imperfect Information

- In deciding to consume sugary foods, consumers may not be fully aware of the calorie content of the sugary food,; they also not understand fully or perceive accurately the risks and consequences of their choices. While the consumers are able to calculate the price of Sugary foods (short term private cost) they underestimate the private costs of health deteriorations (long-term private cost) e.g. risk of heart disease
- underestimation the private cost of consuming sugary foods (high in sugar, salt and sugar) → demand for Sugary Food is higher than what it would have been had they have the full knowledge of the negative private effects of obesity
- overconsumption of sugary foods → market failure and resource misallocation → society welfare loss

Inequity

- Sugary foods such as unhealthy fast foods are typically the cheap food option for the poor.
- As income is unequally distributed, the poor may end up with an unusually higher consumption of sugary foods as compared to the rich and therefore leading to market failure

Conclusion

Price mechanism fails to achieve optimal resource allocation due to the nature of sugary food. This necessitates government intervention.

Suggested Answer (b)

Introduction

- Obesity is a chronic medical condition which occurs over time when a person continues to consume more calories than needed. These excess calories are converted to fat and stored in the body and this leads to obesity and the higher risk of obesity related diseases.

Use of tax is best

1. Use of Tax is considered as best as it brings about improved society's welfare

Taxation leads to improved efficiency

- This corrects the over-production and over-consumption which explains why it should be used.

EV:

- In addition, the revenue generated could be used for educational projects on food nutrition and raise awareness on the higher risks associated with obesity → mitigating the problem of imperfect information of the consumers

Use of tax may not be best

Use of Tax may not be best because there are limitations

1. A Tax may worsen equity

- Consumption tax is regressive. The poor pays a bigger portion of their income as taxes
- EV: However, the consequences of risking obesity and diabetes are potentially worse than the effects of a slight fall in real purchasing power.

2. Difficult to ascertain the right amount of tax → A tax may not improve efficiency

Conclusion

- Obesity in Singapore may be higher than most of her counterparts, and there is an upward pressure on this trend and it is unlikely that the market is able to correct itself. Rising obesity not only raise healthcare expenditure but may lower the quality of the national defence. Over the longer term, the benefits of preventing higher obesity rates will be higher than the short term costs of policies and so government intervention is justified.
- The best approach is probably a combination of measures.

2. Better alternatives such as legislation and education available.

Education helps consumers make informed choices and increases welfare

- The policy option of raising tax should be considered against other options.
 - Greater awareness of the health risk of obesity will reduce demand for sugary foods and lead to optimal consumption of sugary foods
 - Government may fund campaigns to educate the public on obesity related diseases and put in more healthcare professionals in the schools and at the public outpatient clinics to educate the public and raise awareness → lower demand for sugary foods
- EV: However, outcome is hence less predictable

3. Govt should not do anything if the benefits of intervention doesn't outweigh the cost

Cost of enforcing the regulations (substantial political will and manpower) may be greater than the gains from the reduction in consumption of sugary foods and thus obesity

Marking Scheme

Part a

L3	A well structured response demonstrating economic rigour in analysis with a clear theoretical framework.	7-10
L2	Some attempt to respond to the question but quality of response is inconsistent and lack rigour or an answer that lacks scopes.	5 - 6
L1	Mere regurgitation of the various sources of market failure. Students are unable to relate the consumption of sugary foods to market failure	1- 4

Part b

L3	A balanced discussion that is well structured with a clear theoretical framework.	9-11
L2	Some attempt to respond to the question but is largely one-sided and arguments may sometimes lack rigour.	6 - 8
L1	Students did not understand the demands of the question and merely explained, with inaccuracies the various policies that government can use to intervene with rising obesity.	1- 5
Evaluation		
E2	Judgement based on analysis	3-4
E1	Mainly unexplained judgement	1-2

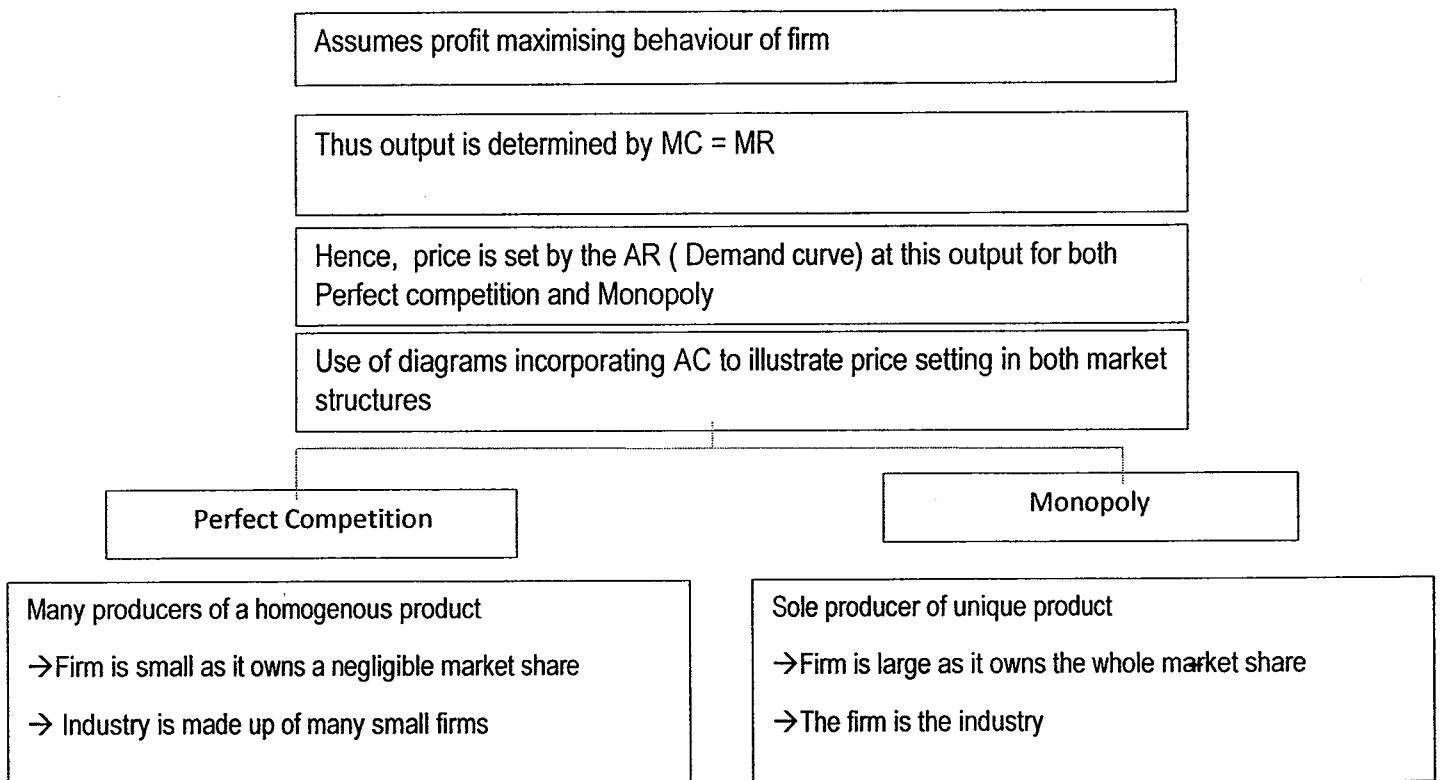
Question 2

- a. Differentiate between the key features of the economic models of perfect competition and monopoly, illustrating your answer with examples. [10]
- b. Discuss whether the determination of a firm's price and output is more dependent on the competition that it faces or the firm's objectives. [15]

Define and explain each market structure concept. The key differences that should be explained include those regarding the market structure including barriers to entry, number of producers, market dominance and market outcomes e.g. the ability or otherwise to set price and to make normal or abnormal profits in both the short and long run.

Knowledge, Application, Understanding and Analysis		
L3	Clear differentiation between monopoly and perfect competition with examples. The analysis should refer to the market structure (e.g. barriers to entry etc) and the market outcomes (abnormal v normal profits etc).	7-10
L2	Undeveloped differentiation, e.g. of either market structure or of market outcomes but not both, and without underlying analysis.	5-6
L1	For an answer that has some basic correct facts such as an unexplained list of key features.	1-4

Suggested Answer Model (a)



Horizontal AR curve

- Firm is a price taker
- Firm has no market power.
- Goods produced by firm has many perfect substitutes in the market

Ease of entry & exit

- Existence of supernormal profits → entry of new firms
- Industry supply increases → SS curve shifts right
- market price falls
- Abnormal profits of firm competed away
- Firms have no market power.

Downward sloping price inelastic AR curve

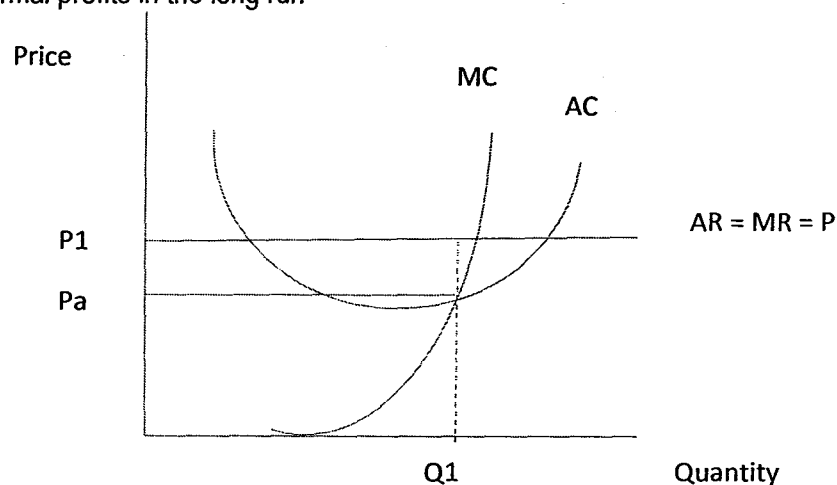
- Firm is a price maker
- Firm has significant market power → able to restrict output to raise price
- Existing firm may respond by non-price competition to make it's AR even more inelastic
- Goods produced by firm has no substitutes in the market

Formidable barriers to entry

- abnormal profits can be preserved

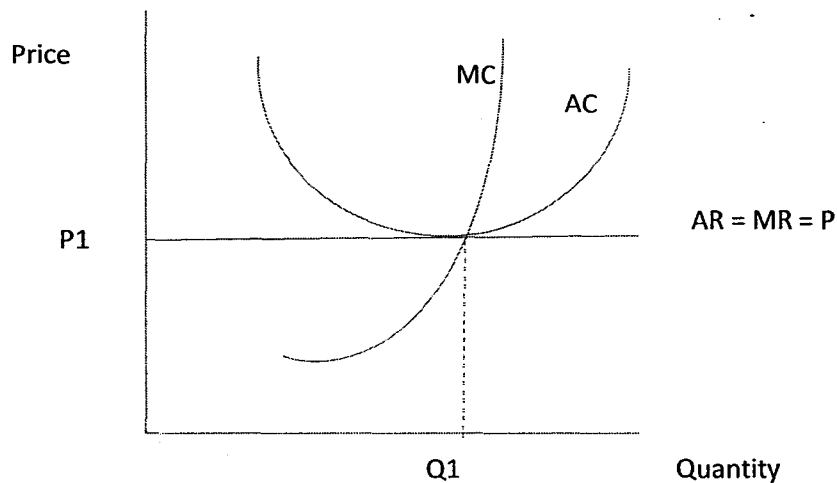
Impact on price and output determination:

- No market power and many perfect substitutes available → perfectly price elastic demand curve
- Earn only normal profits in the long run



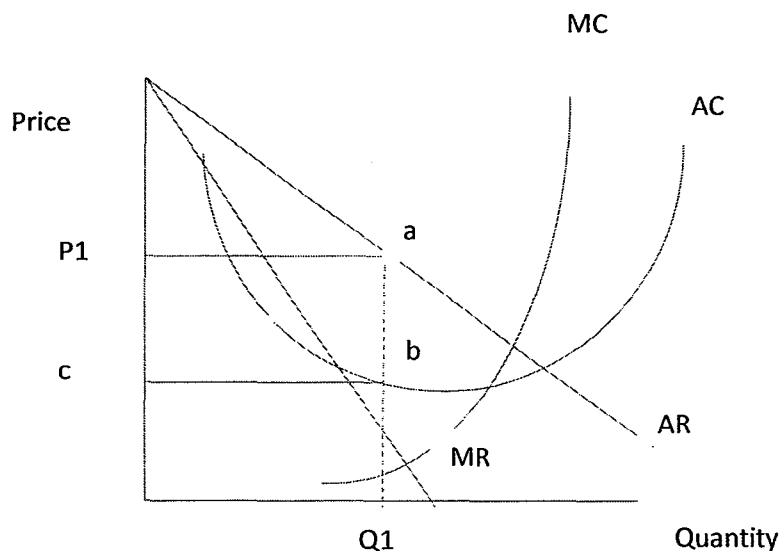
If existing firms are earning supernormal profit in the short run (figure above), new firms will be attracted into the industry → The supply curve of the industry will shift rightward. The market price, the AR and the MR faced by the firm will be reduced.

Supernormal profit is thus reduced. The rightward shift of the supply curve of the industry continues until the market price, the AR and the MR faced by the firm is tangent to the LRAC curve and normal profit is made. When the firms in perfect competition make only normal profit, there is no incentive for new firms to enter the market. Long run equilibrium is attained. In the long run, the firm will be producing at output OQ and charging a price of OP , as illustrated by figure below. At OQ , the price charged is just enough to cover AC. Hence the firm is earning normal profit.



Impact on price and output determination:

- Significant market power and absent of substitutes, low PED
- The monopolist can make supernormal, normal or subnormal profits in the **short run**.
- The monopolist can persevere supernormal profit even in the **long run** because of formidable barriers to entry. Figure below shows a monopoly in long run equilibrium and making long run supernormal profit of $P1abc$.



CONCLUSION

Several differences in the characteristics of perfect competition and monopoly separate the two market structures. This would have important implications on threat of competition that a firm faces or the firm's objectives.

- (b) Discuss whether the determination of a firm's price and output is more dependent on the competition that it faces or the firm's objectives. [15]

Introduction

Summarise comparison of PC against oligopoly/monopoly/ monopolistic competitive

- Differences in characteristics
- Imperfect information
- Barriers to entry → size of market power
- number of firms
- PC firms are price takers ; imperfectly competitive firms are price maker

Development

Determinants of a firm's price and output

Perfect competition

Imperfect competition e.g. Monopoly

Dev 1 : Determination of firm's price and output in PC and monopoly can be similar and is dependent on firm's profit-maximising objective.

Economic Theory suggests that PC firms and imperfectly competitive firms can make their output decision based on same objective of profit maximizing → implies that they can have similar objectives.

Maximize profits → Profits = TR – TC → Produce output where MC = MR

Dev 2: Determination of firm's price and output in PC and monopoly are likely to be different .

While PC firms are likely to practise profit maximization, firms in imperfect market structures e.g. monopoly are likely to practise other objectives

Explain why PC firms are likely to practice profit maximization :

Able to max profit : Perfect Competition → Maximize profits $\text{Profits} = \text{TR} - \text{TC}$ → Take price as dictated by the industry and set output where $\text{MC} = \text{MR}$

In theory → able to max profit In theory, able to get perfect info → can get MR and MC info → profit max

Want/Need to max profit : In theory → Want / Need to max profit In theory → LR can only make normal profits. Use cost and revenue diagram to show → If PC firm does not max profit → must leave industry → competed out.

Explain why imperfect competitive firms e.g. monopolists are not likely to practice profit maximization :

Imperfect competition → In theory, imperfect competitive firms may have other objectives than to max profits

Not able to max profit : May not be able to max profit → Not able to get info on MC and MR → estimate the average cost of output → adds a profit margin → Cost plus pricing

Not want to : Need not necessarily want to max profit → Other objectives → Managerial and behaviour aims

- 1) Aim to maximize sales revenue – market share dominance
- 2) Subjected to government control – practise AC/MC pricing

Not want to : Need not necessarily want to max profit → objective is to deter entry . Hence the threat of competition determines the firm's price and output.

- 3) Keep out potential rivals through predatory pricing
- 4) Reduce potential competition in highly contestable markets – practise limit pricing
- 5) Not invite unwanted attention from potential rivals and govt – do not want to make excessive profits → choose a output and price that do not max profits

Synthesis/ Conclusion:

Address the qn → In theory, both may aim to maximize profits. However, economic theory suggests that imperfect competitive firms may have other managerial and behavioural objectives

PC firm has the ability to maximise profit due to perfect information. It also has to maximise profit if it wants to remain in production. State-owned monopoly may be required by regulation to practise MC pricing. For these firms, their P and Q are more dependent on the firms' objective.

In reality, objectives likely to differ for firms in imperfect markets because firms in imperfect markets are not likely to have enough information to be able to maximize profits. Hence, imperfectly competitive firm's price and output is more dependent on the threat of competition

Mark Scheme

Level	Knowledge, Application, Understanding, Analysis	Marks
L3	For an answer that uses appropriate analysis to explain how market structure and a firm's objectives determine a firm's price and output.	7-11
L2	For an answer that gives a descriptive explanation of how market structure and a firm's objectives determine a firm's price and output.	5-6
L1	For an answer that shows knowledge of price and output determination in different market structure, and under alternative objectives of the firms	1-4 (3)
E2	For an answer that arrives at an analytically well-reasoned judgement about whether the determination of price and output is more dependent on the competition or the firm's objectives	2-4
E1	For an answer that makes some attempt at a judgement about whether the determination of price and output is more dependent on the competition or the firm's objectives.	1-2

- 4 Governments in economies worldwide solve unemployment problems through the use of loose monetary policy and investment in human capital.
- (a) Explain why reducing unemployment is a key macroeconomic objective in many countries. [10]
- (b) Discuss the view that Singapore would be better off reducing unemployment through the use of exchange rate policy. [15]

Suggested Answer Model:

INTRODUCTION

State the 4 macroeconomic objectives

Explain meaning of unemployment

The four macroeconomic objectives of the government are high and sustained economic growth, low and stable inflation, low unemployment, and healthy balance of payments.

There are two main types of unemployment: cyclical unemployment and equilibrium unemployment (structural unemployment & search unemployment)

Elaborate

Interpret the question

Low unemployment is a key objective of many governments because of the many benefits of low employment, and the pursue of low unemployment allows the countries to achieve other objectives.

DEVELOPMENT 1

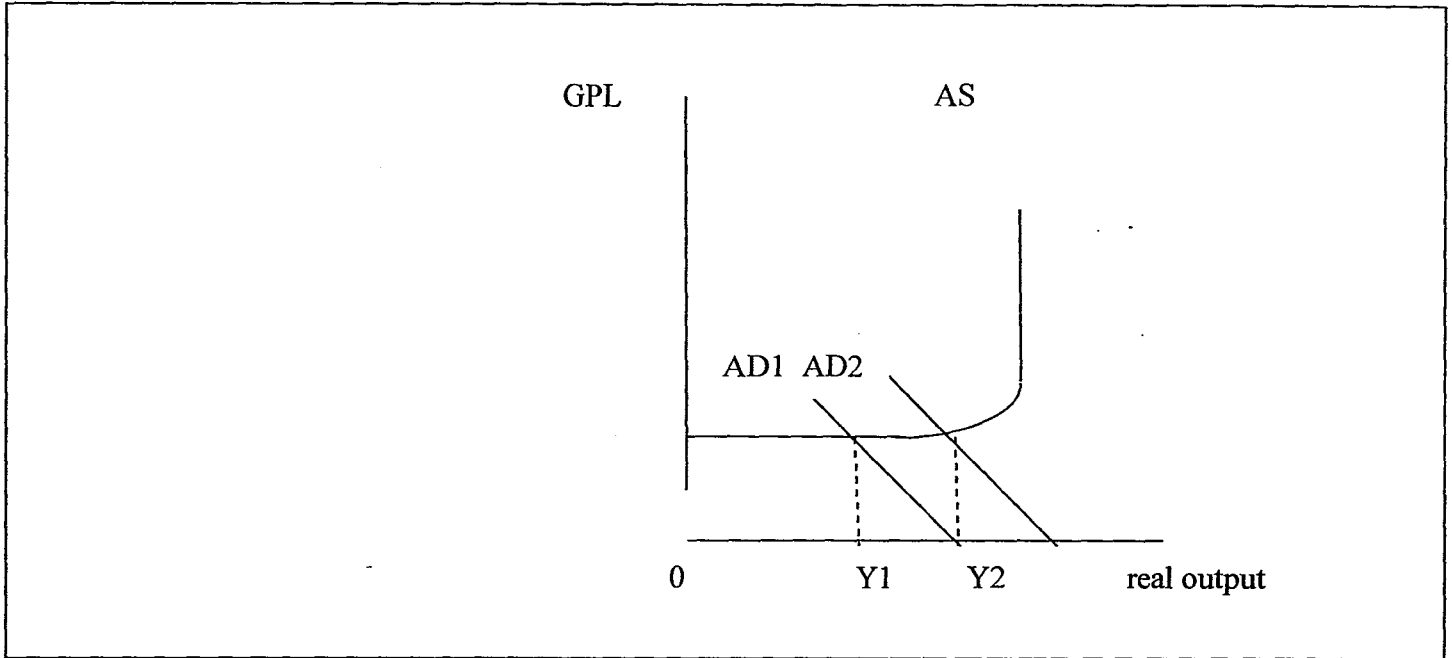
Benefit of low unemployment

Increase in Material Well Being

Both demand and supply side caused growth can lead to lower unemployment and hence improvement in SOL

(1) Increase in AD → increase the rate of economic growth when the economy is not operating at capacity → rightward shift in the AD curve from AD1 to AD2 in Figure 1. As total demand for goods and services in the economy increases, this stimulates producers to increase production and hence real output of the economy increases → raises the demand for labour → increases income of households, raise purchasing power and increases their ability to access goods and services and hence their material SOL.

Assuming income growth is faster than the growth in population, the real income per capita increases & increases the material well-being of the citizens.



Individuals :

→ Higher income & standard of living

EV: However, they have less leisure

Firms:

→ Lower unemployment leads to higher income & high demand for firms' goods and services

→ Higher workers' morale which in turn may raise labour productivity

EV:

→ More difficult to recruit staff and people applying for jobs may possess lower skills. The existence of lower unemployment may make workers less fearful of losing their jobs. As a result, they are less willing to adopt good working practices

Economy::

→ Most significant gain - higher output (operating nearer the PPC) → Rise in GDP growth

→ Higher standard of living

→ Less govt resources required to restructure the economy to solve unemployment problem

→ Higher revenue from direct and indirect taxes

EV:

→ If unemployment falls below the equilibrium level of unemployment (NAIRU/NRU) → 'overheating' of the economy and inflationary pressure.

→ Explain why rising inflation may be undesirable.

Development 2

The pursue of low unemployment allows the countries to realise other macroeconomics objectives such as economic growth and less strain on government budget. Increasing employment is often accompanied by higher economic growth and higher real GDP, increase in productive activities.

CONCLUSION

Conclusion: Address the keywords 'many countries' & 'key' and Link to part b)

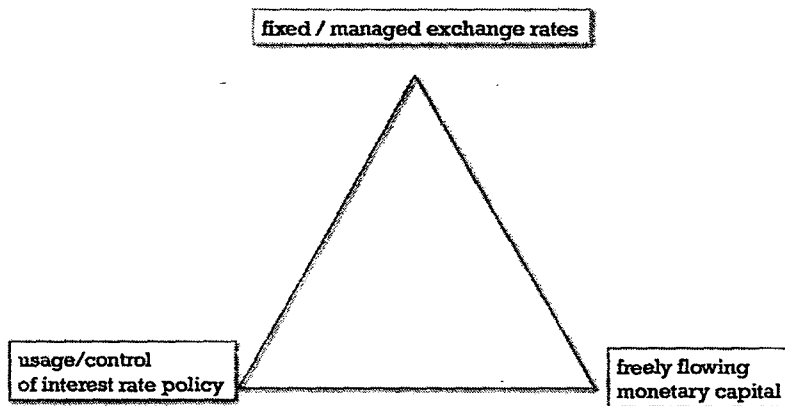
Low employment is often a key objective of many countries. However, there are times when unemployment may not be the main macroeconomic objective of the economy, for instance, severity of other problems. When a country faced hyperinflation, functions of money will be severely impaired. People will no longer be willing to accept money as a form of payment and store of value. The great uncertainty will result in capital flight and reduce the volume of savings, investment and economic growth. In such situation, government should address the problem of inflation and restore confidence in the economy before achieving macroeconomic aims.

(b) Discuss the view that a small and open economy such as Singapore would be better off solving unemployment problems through the use of exchange rate policy. [15]

Introduction

- The policy choices that economies can employ to solve their unemployment problems will depend on
 - The nature and state of their economy restricting their usage of certain economic policies
 - The type of unemployment that they are experiencing

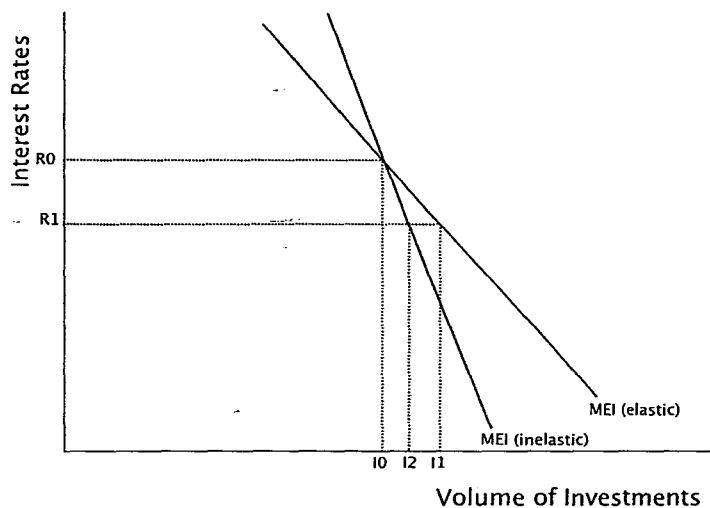
Development 1 – Problems trying to use expansionary i/r policy to solve DD-deficient unemployment in SG



- Open economy trilemma restricts policy choice
 - Open economies like Singapore are heavily engaged in trade. SG's trade volume ($X+M$) is about ~400% of GDP. Due to the large amounts of trading done daily, SG requires freely flowing capital flows in and out of the economy
 - If Singapore were to decrease i/r → financial investors will face a fall in monetary returns → due to freely flowing capital, they will withdraw their investments to seek for better returns in other countries → hot money outflow → sell SGD to buy foreign currency → pressure on SGD to depreciate
 - In SG → as we are a small and open economy without natural resources → heavily dependent on imports of raw materials and intermediate products as inputs into production, as well as imports of final goods and services → as a result of the need for high amounts of imports, SG is extremely vulnerable to imported inflation
 - If SGD depreciates → price of imports become more expensive → worsens imported inflation → increases firms' costs of production and competitiveness, and at the same time decreases consumers' purchasing power and therefore decreasing consumers' material SOL
 - Open economies also tend to want to manage their exchange rates so as to control

the price of their exports (and therefore, their export competitiveness), and as such any changes in interest rates causing pressures on the exchange rates to appreciate or depreciate would mean that the government needs to further utilize their foreign reserves to manage the exchange rates, on top of what they are already doing → this is a wastage of time and resources for the government

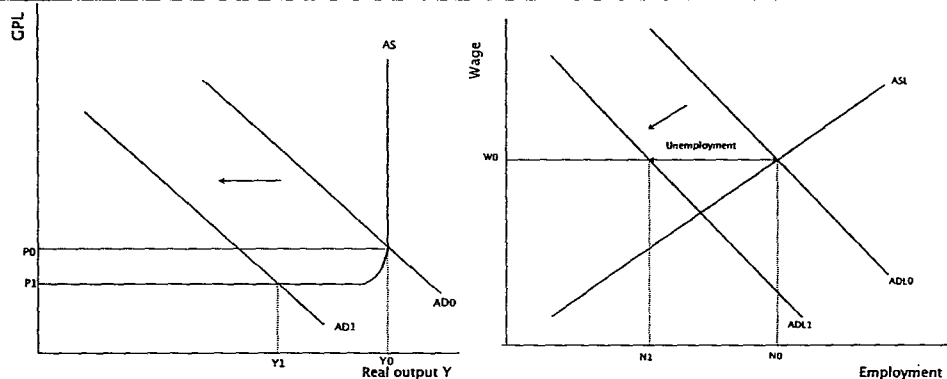
- Therefore, open economies like SG are unlikely to utilize interest rates as a policy tool



- Interest rates policy tends to primarily affect domestic producers and consumers, and work most effectively in economies that have a large domestic demand
 - Small economies like Singapore tend to have a small domestic demand, and are likely to be very open to foreign direct capital investments
 - Since most of the foreign capital investors are likely to have their own source of funding and will not be borrowing from the local banks, it is likely that they are very unresponsive to changes in interest rates
 - The MEI function is thus likely to be very interest inelastic, so for a given fall in interest rates from R_0 to R_1 , volume of investment is likely to increase less than proportionately to I_2 , instead of to I_1 when the MEI is relatively more interest elastic
 - Therefore, small economies like SG with a small domestic market tend to not utilize interest rates policy

Development 2 – Utilization of exchange rates policy would be better for open economies like SG

- Since open economies are highly dependent on trade, exchange rates policy, which affects prices of exports and imports, are more likely to have a direct impact on export revenue and import expenditure
- Furthermore, open economies are likely to be affected by external events and economic shocks. This increase in volatility would mean any factor affecting demand for their exports (such as a recession in their trading partners' economies, or fall in export competitiveness) will likely decrease export revenue (X) by a significant amount, causing AD to fall



- The fall in AD will cause surpluses of output in the economy, and exporting firms will start to face an unplanned increase in inventories → they thus decrease their demand for labour → since wages are sticky downwards (at W_0) due to contractual obligations → demand-deficient unemployment results
- Utilization of a depreciation of the currency will lead to a fall in the price of exports in foreign currency, increasing the demand for exports in domestic currency, and therefore causing X to rise → this directly solves the root cause of the problem, and exports can be more competitive, thus helping to resolve the fall in export competitiveness (albeit temporarily)
- For small and open economies that do not have a lack of natural resources → the increase in the price of imports due to a depreciation may not impact the standard of living of the households, and thus the depreciation of the exchange rates may not come with negative effects (like it does on SG)

Development 3 – Which policy is best will still have to depend on the type of unemployment

- The situations described in Developments 1 and 2 related to demand-deficient unemployment, thus the discussion circled around demand-management policies
- If faced with structural unemployment, it is better to use supply-side policies
- Open, trading economies such as Singapore are likely to be very vulnerable to structural changes due to changing demand patterns worldwide
- As the economy changes its structure to develop new comparative advantages in trade, workers' skills may become obsolete. In this case, supply-side policies like retraining and skills upgrading may thus be necessary (as discussed in part (a)) rather than the demand-management policies such as exchange rates and interest rates
- In Singapore, the labour market is at full employment and much of the unemployment is equilibrium unemployment – structural and frictional unemployment
- Frictional unemployment in SG (in the form of search unemployment) is mostly caused by the open door policy to foreign labour that is adopted by many open economies → the influx of foreign labour into the economy → wages are lower → more people are voluntarily unemployed as they would prefer to search for a higher paying job → larger search unemployment
- Open economies that are reliant on foreign workers may thus need to explore policies that instead reduce the reliance on foreign workers to solve frictional unemployment, than to use demand-management policies
- Therefore, the utilization of policies to solve equilibrium unemployment will likely have to be

supply-side policies than demand-side policies

Synthesis and conclusion

- The decision to utilize policies should ultimately depend on whether the country is restricted with policy usage, and if the policies solve the problem
- All things being equal, small and open economies will find it useful to utilize exchange rates policy, especially if trying to solve demand-deficient unemployment and if the expansionary exchange rates policy does not impact its households' standard of living (through higher import prices) severely
- But if the unemployment type is equilibrium unemployment, such as structural unemployment or frictional unemployment → better to solve the problems through supply-side policies

Knowledge, Application, Understanding and Analysis

L 3	<i>For an answer <u>using analysis</u> to <u>support the conclusions</u> about the use of exchange rate policy as opposed to other policies to correct unemployment in small, open economies</i>	9-11
L 2	<i>For an answer that gives a <u>descriptive explanation</u> of exchange rate policy and other policies to correct unemployment</i>	6-8
L 1	<i>For an answer that shows some basic but largely <u>unexplained knowledge</u> of exchange rate policy, policies to correct unemployment <u>and/or</u> small, open economies</i>	1-5

Allow up to 4 additional marks for Evaluation

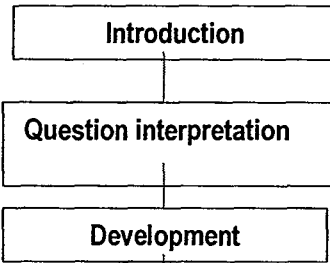
E 2	<i>For an evaluative discussion supported by relevant economic analysis that either exchange rate policy or any other policy is justified</i>	3 – 4
E 1	<i>For an unexplained evaluative e.g. a largely unexplained statement that exchange rate policy is justified</i>	1 – 2

.....

Question 5

During 2009 the Bank of England engaged in what is known as 'quantitative easing' by pumping more than £200 billion into the economy. Record low levels of interest rates have also been maintained within the UK economy. Quantitative easing and low interest rates were also adopted by the US.

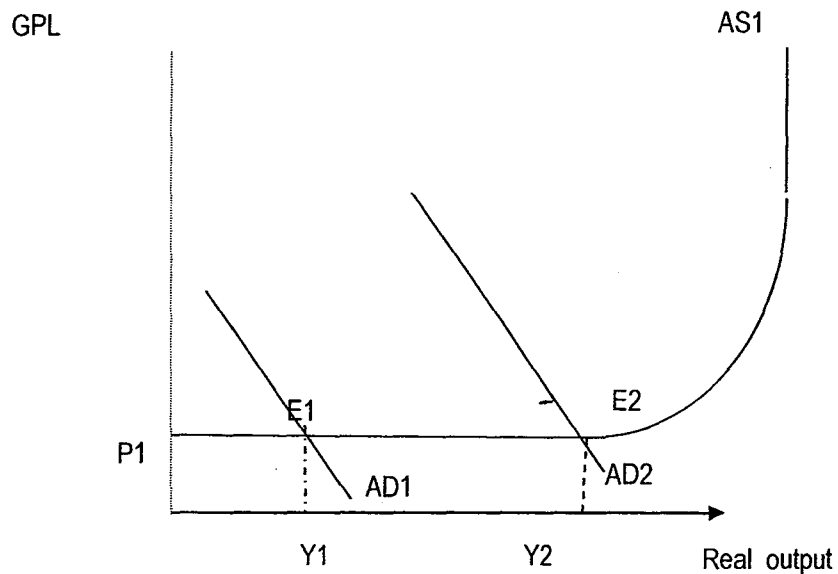
Discuss the potential impact of quantitative easing and low interest rates on an economy and its trading partners. [25]



Development 1 : Explain how quantitative easing and low interest rates in USA and UK might lead to economic growth in USA and UK.

Using AD/AS analysis, explain how a quantitative easing and decrease in interest rates brings about actual growth in the USA/UK economy

- Explain QE
- Assume excess capacity in economy
- Analyse the links between quantitative easing and low interest rates and the components of AD in USA/UK
- Illustrate using AD-AS diagram how AD shifts outwards.
- Explain the adjustment process towards the new equilibrium
- Summarise: $\downarrow i/r \rightarrow AD \uparrow \rightarrow \uparrow NI$, output by a MULTIPLIED amount



EV: While an economy with high unemployment may see increased borrowing due to QE & low interest rate, and a move out of recession, the potential drawback is that QE & lower interest rate may lead to inflation if US and UK are operating close to full employment. (Analyse)

Explain impacts the balance of trade.

Explain impact on the balance of trade

Decrease in export revenue (X): When inflation in US is relatively high, US produced goods will become more expensive and less competitive internationally. Exports will be relatively more expensive, thus foreigners will reduce the quantity demanded of exports. If $PED_x > 1$, the rise in price of exports will lead to a more than proportionate fall in quantity demanded → Total export revenue (X) will fall because the rise in total revenue due to the increase in price is smaller than the fall in total revenue due to more than proportionate fall in quantity demanded.

Increase in import revenue (M): When US goods become more expensive, US residents will buy more imports assuming imports and US produced goods are substitutes. Demand for imports increases and import expenditure increases.

Assuming that initially there is a balance in the current account position, as receipts from exports falls while payments for imports increases, the trade balance and hence the current account worsens for USA.

Low interest rate may also cause capital flight and hence a depreciation of pound and USD.

Development 2: Explain how quantitative easing and low interest rates in USA and UK impact their trading partners such as Singapore.

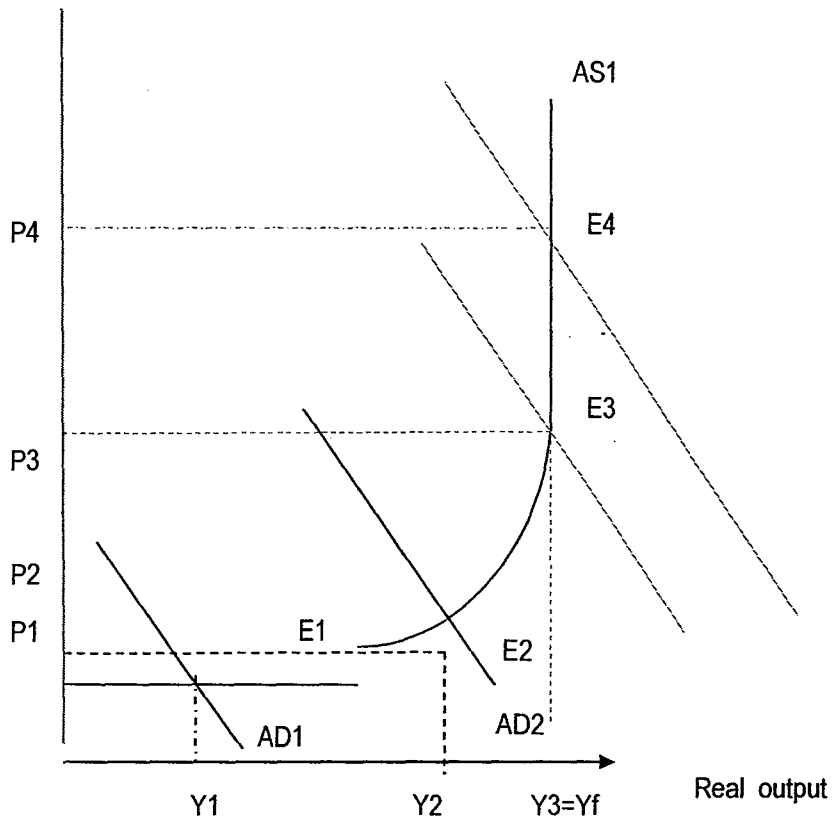
Quantitative easing and fall in interest rates in USA and UK might lead to economic growth in USA and UK, hence increased imports by USA/UK which will benefit Singapore as some of this increase will be for exported goods from Singapore.

Economic growth, higher disposable income in USA/UK will cause Americans/British to increase their demand for Singapore's exports, leading to an increase in Singapore's export revenue. The increase in exports increases AD. The impact on the SG economy depends on the state of the economy. Assuming that the SG economy is operating very near to capacity i.e. on the upward sloping part of the AS curve. The increase in AD promotes AG in Singapore increasing real output from Y_1 to Y_2 but GPL to increase for P_1 to P_2 . Persistent increases in AD due to continued QE and lower interest rates in USA/UK may create demand pull inflation in SG.

Assuming ceteris paribus condition, AD increases beyond the level of AD (AD_3) that brings about full employment then further increases in AD (to AD_4) will cause no change in real output but will instead raise GPL and creates demand pull inflation. E.g. increase in AD from AD_2 to AD_3 and to AD_4 , real output in SG economy remains at Y_f but GPL rises from P_2 to P_3 and to P_4 .

GPL

Singapore economy



Development 3: Consider the impact of a fall in interest rate on hot money flows or exchange rates and explain the impact of these 'indirect' changes on Singapore.

Conclusion :
Make judgement on extent of the impact and compare the effect caused by US's and UK's policy

Knowledge, Application, Understanding and Analysis		
Suggested Mark Scheme 5 :		
L3	For an answer using analysis to explain the impact on both an economy and its trading partners	15-21
L2	For an answer that gives a descriptive explanation of the impact on an economy and/or its trading partners	9-14
L1	For an answer that shows some basic but largely unexplained knowledge of the impact on an economy and/or its trading partners	1-8

Allow up to 4 additional marks for Evaluation		
E2	For an evaluative assessment based on economic analysis.	3-4
E1	For an unexplained assessment, or one that is not supported by analysis.	1-2

Question 6

6 Economists warn of the rising waves of protectionism around the world although some governments are opening markets and improving competitiveness.

(a) Explain why protectionism exists. [10]

(b) A country wishes to improve its export competitiveness in producing manufactured goods. What does this mean and how might this be achieved? [15]

Suggested Answer Model (a)

- Definition of protectionism: Restriction of imports. Protectionism is a deliberate government policy to erect trade barriers in order to shield domestic industries from foreign competition.
- Aim of protection: The aim of protectionism is to switch expenditure, both domestic and foreign to the output of goods and services of the domestic economy.

Barriers on the movement of goods and services between countries.

Types of barriers
 → Overt measures
 → Covert measures

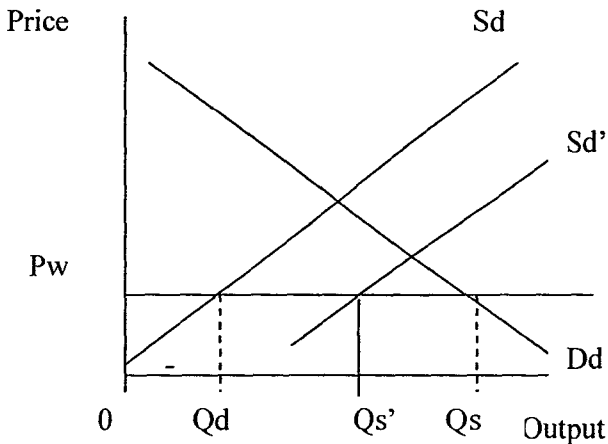
In real world, countries impose trade restrictions e.g. subsidies, tariffs & quotas on goods and services.

Define subsidies

Explain how subsidies work

Explain & comments on reasons for restrictions of free trade

- protect infant industry
- enable sunset industry to decline gradually/protect employment
- prevent dumping



Conclusion
 Governments may want to restrict imports to reduce some of the costs brought about by free trade. However, such protection measures result in a loss of welfare for consumers. Domestic consumers are forced to buy from high-cost domestic industries, rather than from low-cost foreign industries. They end up with fewer consumer choices and pay higher prices.

Suggested Answer Model 6(b)

Introduction

Meaning of improvement of Export Competitiveness

Export competitiveness has 2 aspects and refers to price competitiveness as well as quality competitiveness. Govts can promote policies that help to increase export competitiveness in specific industries. Improvement in export competitiveness results from a **reduction in relative price of the goods exported or improvement in the quality of these exports**. Export competitiveness is a dynamic concept as it can and does change over time.

Manufactured goods : goods processed from raw materials

Reason for wanting to improve its export competitiveness

Reap **more gains** from trade
→ Increase in Economic growth
& therefore a higher Standard of living

Development

How govts can increase export competitiveness

Increase in the quantity and quality of factors of production available (i.e. the size and efficiency of the available labour force, the productivity of the existing stock of capital and the rate of investment).

Use of supply side measures: Govts can invest in education, increasing stock of human capital and thus raising labour productivity in their manufacturing industries and lowering average costs of producing manufactured goods hence maintain export competitiveness.

Evaluation: A measure that is considered to be good as it addresses the root cause of problems in many countries. However, financing such measures can be costly, outcomes seen only in long-term and these outcomes uncertain. Supply-side measures which increased competition may compromise other issues such as safety e.g. airline industry

Reduce domestic inflation

E.g . The use of **contractionary monetary policy** will lower inflation and raise competitiveness of a country's manufactured goods.

Evaluation: May conflict with other macroeconomic goals .
E.g. May have negative impact of economic growth

Export subsidies can be used to create an artificial competitive advantage for a country's products: US cotton producers are a good example.

Evaluation:
Creates tensions with trading partners and invites retaliations as this is considered to be unfair trade practices. Is against the guidelines of WTO recommendations
Is costly and imposed a burden on tax payers.

Devaluation of domestic currency

E.g. a devaluation of the exchange rate of a country's currency make the domestic exports cheaper in the foreign currency and make them more competitive in the international markets.

Evaluation:

For a small open economy like SG that is highly dependent on imports and hence vulnerable to imported inflation, a devaluation may not necessary improve export competitiveness since the price advantage gained from a devaluation can be negated by an increase in cost of production due to dearer imported raw materials and intermediate goods.

Non-price factors can lead improvement in export competitiveness. e.g product design, reliability, quality of after sales support.

Evaluation: A measure that is considered to be good as it addresses the root cause of problems in many countries. However, financing such measures can be costly, outcomes seen only in long-term and these outcomes uncertain.

Conclusion

Suggested Mark Scheme (a) :

Description of the classic case for free trade between nations, using the Ricardo Comparative Advantage Approach.

Knowledge, Application, Understanding and Analysis

L3	For an analytical explanation of protectionism and the reasons for restricting imports. Includes some mention of the evaluative aspects.	7-10
L2	For an answer that shows knowledge of protectionism and provides a descriptive explanation of various reasons for restricting imports. OR For an answer that shows knowledge of protectionism and provides an analytical explanation of one reason for restricting imports.	5-6
L1	For an answer that shows some knowledge of protectionism and lists the reasons for restricting imports.	1-4

Knowledge, Application, Understanding and Analysis

Suggested Mark Scheme (b) :

L3	For good analytic discussion on 3-4 factors which can improve XC	7-11
L2	For undeveloped explanation that has not fully addressed both stems e.g. a focus on knowledge and comprehension of 2-3 factors bringing about improvement in XC	5-6
L1	An answer which shows some knowledge & comprehension , e.g. Meaning of improvement of CA & reasons for wanting to improve export competitiveness of manufactured goods (XC)	1-4

Allow up to 4 additional marks for Evaluation

E2	For an evaluative assessment based on economic analysis.	3-4
E1	For an unexplained assessment, or one that is not supported by analysis.	1-2

