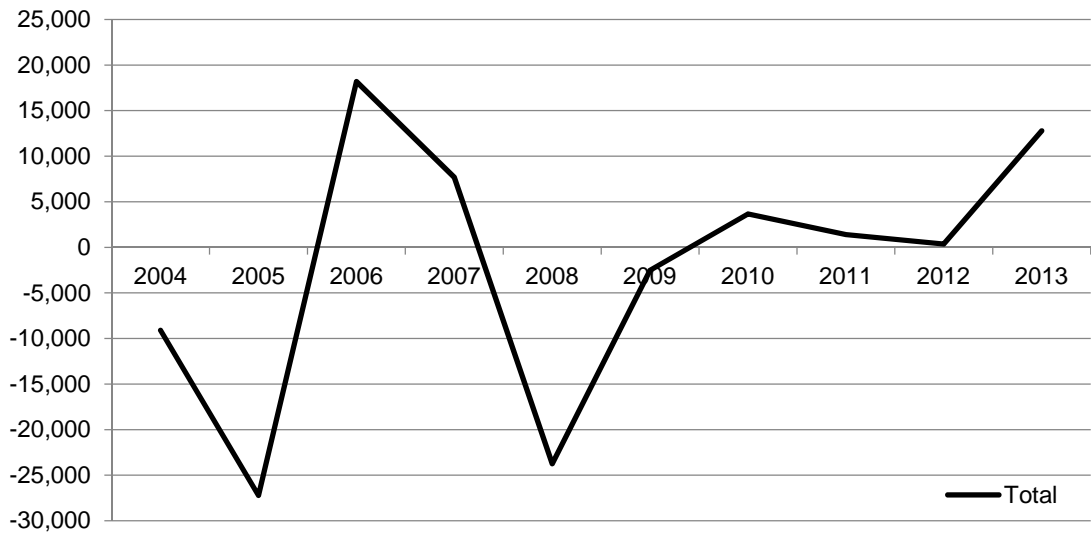


**Question 1 — The evolution of the US domestic airline industry****Suggested answers**

(a)	(i)	State the theoretical relationship between market power and prices in an industry.	[1]																						
		The greater the market power, the stronger the monopoly power, the higher the prices.																							
	(ii)	Do the data reflect this relationship? Explain why or why not.	[5]																						
		<p>No, the data does not reflect this relationship stated in a(i) because despite the number of carriers shrinking “from eight or nine big carriers in 2000 to just four” (Extract 2), fare prices generally fell from 2000. [1]</p> <p>Demand factor [2m]</p> <ul style="list-style-type: none"><li>• The fall in fare prices (especially between 2008 and 2010) could be due to the subprime mortgage crisis that led to a recession. This resulted in a fall in demand for air travel, which is a luxury good, and hence a fall in fare prices.</li></ul> <p>Cost factors [2m]</p> <ul style="list-style-type: none"><li>• Market dominance: as firms consolidate and grow bigger, they are at a better position to reap internal economies of scale (e.g., bulk buy, managerial economies, etc.), and this would result in their AC and MC falling, and hence translating to cheaper prices</li><li>• Price wars: as the domestic carriers are generally oligopolistic in nature and are therefore mutually interdependent, there is a tendency for them to engage in price wars. This is evidenced in the “fire-sale airfares” (Extract 2) charged by airlines. This might possibly motivate the airlines to continually lower prices to undercut one another, resulting in a price war and hence a fall in fare prices.</li><li>• Bundling (indirect price discrimination): the fall in fare prices could also be due to the existence of low cost carriers that charge low base fares but high ancillary fees. The low base fares could have lowered the average fare prices.</li></ul>																							
	(iii)	Describe the trend of the net income of US carriers over the period of 2004 to 2013.	[2]																						
		 <table><tr><th>Year</th><th>Net Income (Millions of Dollars)</th></tr><tr><td>2004</td><td>-10,000</td></tr><tr><td>2005</td><td>-27,000</td></tr><tr><td>2006</td><td>18,000</td></tr><tr><td>2007</td><td>8,000</td></tr><tr><td>2008</td><td>-24,000</td></tr><tr><td>2009</td><td>-2,000</td></tr><tr><td>2010</td><td>4,000</td></tr><tr><td>2011</td><td>2,000</td></tr><tr><td>2012</td><td>1,000</td></tr><tr><td>2013</td><td>13,000</td></tr></table>	Year	Net Income (Millions of Dollars)	2004	-10,000	2005	-27,000	2006	18,000	2007	8,000	2008	-24,000	2009	-2,000	2010	4,000	2011	2,000	2012	1,000	2013	13,000	
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		<ul style="list-style-type: none"> <li>Net income level of the US carriers generally increased over the period of 2004 to 2009 [1]</li> <li>The net income level of US carriers experienced great fluctuations between 2004 and 2009, but these fluctuations moderated after 2009. [1]</li> </ul>	
(b)	(i)	<b>Identify how the market structure for domestic US airlines has evolved since the early 1970s.</b>	<b>[2]</b>
		<p>The deregulation of US domestic airlines in 1978 has caused the industry to evolve from a <u>more</u> oligopolistic market structure to a <u>more</u> monopolistic competitive market structure. [1m]</p> <p>However, consolidation in the 2000s has caused the <u>more</u> monopolistic competitive market structure to revert to a <u>more</u> oligopolistic market structure. [1m]</p>	
	(ii)	<b>Explain the reasons for the evolution identified in b(i).</b>	<b>[4]</b>
		<p>Deregulation [2]:</p> <ul style="list-style-type: none"> <li>The deregulation of the US domestic airline industry was a government intervention to open the industry to higher levels of competition. This could force carriers to increase efficiency and hence mitigate the rising costs arising from:             <ul style="list-style-type: none"> <li>Arab oil embargo → rising cost of fuel (Extract 1)</li> <li>Inefficient routes (i.e. insufficient passengers per flight to cover the cost of flying)</li> <li>Bureaucracy</li> </ul> </li> <li>The rising cost of production were passed onto consumers as rising fares, resulting in mounting congressional pressure to review the regulated industry in the interest of consumers.</li> </ul> <p>Consolidation [2]:</p> <ul style="list-style-type: none"> <li>The airline industry was making losses, causing many firms to face bankruptcy. This led to the merger of firms in order to survive.             <ul style="list-style-type: none"> <li>Labour costs were high due to the unionisation of workers that allowed for a greater bargaining power for higher wages. Airlines were earning supernormal profits then and hence, were not as stringent with wage increases.</li> <li>However, they were unable to cope with the high costs of production when their revenue fell and hence some resulted in bankruptcy.</li> <li>Merger of firms occurred, allowing the newly merged firm to reap internal economies of scale (e.g., bulk buy, managerial economies, etc.). This may help firms to lower their costs of production and become profitable.</li> </ul> </li> <li>Mergers and acquisitions occurred as firms seek to reduce competition and increase their market share.             <ul style="list-style-type: none"> <li>The larger market share may increase the firm's market power and enable the firm to set higher prices, hence earning higher revenue and profits.</li> <li>The larger firm may also compete away market share from smaller firms, resulting in a rise in demand. This may lead to an increase in total revenue and profits.</li> </ul> </li> <li>Consolidation may have occurred because larger firms tend to have greater ability to deal with demand shocks than smaller firms.</li> </ul>	

		<ul style="list-style-type: none"><li>○ The 2008 subprime crisis resulted in the global recession and a fall in demand (both internal and external) for flights. Smaller firms tend to have less ability to deal with sudden shocks relative to the larger firms. Hence, the smaller firms may have fallen out of the industry (shut down) or may have been acquired by the larger firms, resulting in the consolidation.</li></ul>																
	(iii)	Discuss the costs and benefits of the consolidation.	[8]															
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	(c)	Assume you are the economic advisor to the CEO of Jetblue. Justify your recommended strategies for Jetblue to remain competitive in the airline industry.	[8]															
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**Question 2 Singapore and the Dynamic Environment of Global Trade**

Question 2 – Singapore and the Dynamic Environment of Global Trade																			
(a)	(i)	<b>Explain how the current account of an economy is calculated and suggest an explanation for the 62% growth in the current account of Singapore from 2009 to 2010.</b>		<b>[3]</b>															
		<ul style="list-style-type: none"><li>• The current account contains: the balance of trade in goods and services, net property income from abroad and net unilateral transfers. [1]</li><li>• The addition of all positive and negative payments reveals the current account balance [1]</li><li>• The 62% growth can be explained by the recovery of other countries from the 2008/9 recession [1]</li></ul>																	
	(ii)	<b>Using Tables 3 and 4, explain the change in relative importance of the USA and China as Singapore’s trading partners, from 2007 to 2012.</b>		<b>[2]</b>															
		<ul style="list-style-type: none"><li>• The data reveal the relative increase in total trade with China and the relative decline in total trade with the USA [1]</li><li>• This could be due to the decoupling of the US and Chinese economies [1]</li></ul>																	
(b)		<b>Explain one reason why the Chinese government is promoting structural change.</b>		<b>[3]</b>															
		<ul style="list-style-type: none"><li>• Achieve sustainable growth [1]</li><li>• Current pattern of growth makes China vulnerable to external shocks [1]</li><li>• This has caused an imbalance with a relatively low level of consumption expenditure [1]</li></ul>																	
(c)		<b>Extract 5 reports that the Indian middle class is expected to double by 2016. Explain how this might affect trade between India and Singapore.</b>		<b>[4]</b>															
		<ul style="list-style-type: none"><li>• The rise of a significant middle class in India may boost demand for Singaporean export goods [1]</li><li>• Singaporean firms are eager to develop markets beyond the borders of the city-state [1]</li><li>• A reputation for high quality medical service may encourage Indians to seek treatment in Singapore [1]</li><li>• Invisible exports may also rise with more Indians visiting Singapore or travelling on Singapore Airlines [1]</li></ul>																	
(d)		<b>Analyse potential impacts of the “punitive tariffs” on American producers and consumers.</b>		<b>[8]</b>															
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(e)		Discuss the threats and opportunities facing the economy of Singapore in light of recent developments.	[10]															
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