

**2014 J2 H2 Prelim Questions and Answers**  
**Yishun Junior College Economics Department**  
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**YISHUN JUNIOR COLLEGE**  
**JC2 PRELIMINARY EXAMINATIONS 2014**

**ECONOMICS**  
**Higher 2**

**9732/01**

**21 AUGUST 2014**  
1400h – 1615h

Additional materials:

Writing paper

Cover page



**TIME 2 hours 15 minutes**

**INSTRUCTIONS TO CANDIDATES**

Write your name, CTG and index number in the spaces provided on the cover page and on all sheets of writing paper handed in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use highlighters, glue or correction fluid.

Answer **all** questions.

At the end of the examination, tie a cover page to **two** separate questions:

1. Question 1, and
2. Question 2.

**INFORMATION FOR CANDIDATES**

Including this cover page, there are **eight** pages in this question booklet.

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

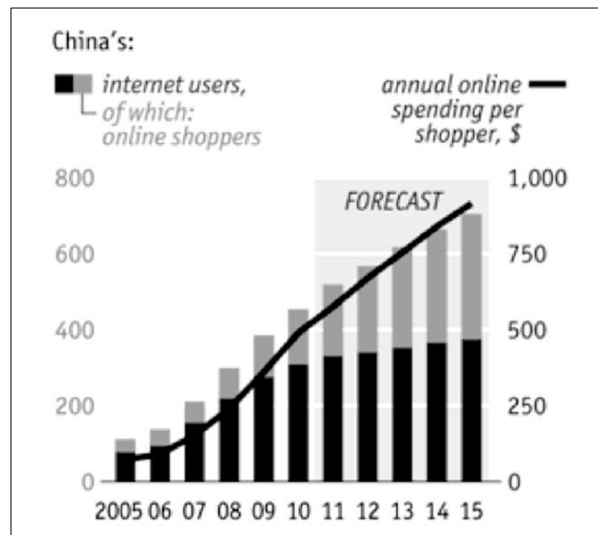
You are reminded of the need for good English and clear presentation in your answers.

Answer **all** questions.

### Question 1

#### Growth and Acquisitions

**Figure 1: Online shoppers in China as a proportion of total internet users (in millions) from 2005 to 2015**



Source: Boston Consulting Group

#### Extract 1: Acquisitions in the Southeast Asian market

Singapore and Southeast Asian tech start-ups are being eyed by foreign buyout firms in the wake of declining prospects in the struggling economies of Europe and the United States. The region's rapid adoption of the Internet, especially in social media and mobile usage, is generating a wealth of opportunities, according to industry experts.

Mr Bernard Leong, co-founder of tech blog SGEntrepreneurs, told The Straits Times: '(Investors) are looking at Southeast Asia as the next China before it gets big. Indonesia, for example, has a growing middle class, which is largely surfing the Web using mobile phones'. Mr Hugh Mason, co-founder of Joyful Frog Digital Incubator, said: 'Southeast Asia is attractive because it is where the next billion people are going to be. There are 600 million people now and the populations of the emerging markets in Indochina, Myanmar and Philippines are continuing to grow'.

Three local companies have been acquired this year. StubHub, a subsidiary of e-commerce giant eBay, snapped up Peekspy, which allows users to see the view they can expect before they buy an event ticket. Admax, a digital advertising network, was bought by Indian company Komli Media, while food review website HungryGoWhere was snapped up by telco SingTel.

Mr Michael Yap, deputy chief executive of the Media Development Authority, added 'We'll also be funding new firms started by experienced technopreneurs – entrepreneurs in the IT industry – with better international links to countries such as Russia and China, so as to help their start-ups venture overseas'.

Source: *The Straits Times*, 12 June 2012

### **Extract 2: The growth of online shopping**

The anti-monopoly bureau of the Ministry of Commerce (MOC) in China has approved plans by Wal-Mart Stores, allowing the U.S. retail giant to control China's largest online supermarket, Yihaodian. If successful, the acquisition will help Wal-Mart grab a bigger slice of China's booming online shopping market.

However, the MOC emphasised that the acquisition can only be completed under several restrictive conditions. Because of its comprehensive strength in both offline and online retailing, the acquired company will be able to gain a dominant position if it is allowed to enter China's value-added service market through Yihaodian. This 'may have an effect of restricting market competition in China's service market'.

According to a statement released by Yihaodian: 'Yihaodian fully respects and welcomes the MOC's decision. We have maintained high-speed growth since launching in 2008 and will create greater value for consumers as our partnership with Wal-Mart deepens'.

Founded in Shanghai in July 2008, Yihaodian sells a range of goods including food, cosmetics and consumer electronics. One of the key factors that help to give the companies an edge over others is the convenience of a one-stop shopping destination for a growing middle-class who is using their mobile phones for their online shopping needs. Other factors such as a high degree of consumer choice from budget to gourmet products from other countries play an important role in influencing customers' preference.

The website had more than 18 million registered users as of May 2011, and its sales exceeded 800 million yuan (126 million U.S. dollars) in 2010, according to company information. The online shopping market in China has been prospering despite an economic downshift, with the country's online population of shoppers reaching 210 million by the end of June.

Source: *Xinhua*, 14 August 2012

### **Extract 3: More investment = more jobs = more foreigners**

The Government's 'yes' to investments and inflows of foreign workers which led to today's infrastructure crunch is also why Singapore now enjoys low unemployment.

National Development Minister Khaw Boon Wan pointed out that from 2005 to 2006 following the 2003 SARS crisis and recession, Singapore was experiencing 'difficult times' when the future was uncertain and the country struggled for a stretch to secure investments. It was looking for investments to create jobs for Singaporeans, but companies also needed foreigners to fill positions that required a wide range of skill sets.

'Then suddenly, they came in a bunch. Do we take them or miss them? Sometimes we have to take a decision which has both negative as well as positive consequences. We have to weigh and make the trade-offs,' he said.

Source: *The Straits Times*, 4 June 2012

**Questions**

- (a) (i) Compare the changes in the number of online shoppers in China between 2005 and 2015 with the change in internet users over the same period. [2]
- (ii) Explain possible reasons for these changes observed. [5]
- (b) Explain why foreign firms are choosing to invest in South-East Asia. [5]
- (c) Discuss the impact of the Wal-Mart's acquisition on the online retailing market in **China**. [8]
- (d) Discuss the view that the Singapore government's 'yes' to 'investments and inflow of foreign workers...is also why Singapore now enjoys low unemployment'. [10]

[Total: 30]

## Answers

- (a) (i)** Compare the changes in the number of online shoppers in China between 2005 and 2015 with the change in internet users over the same period. [2]

Acceptable answers from Figure 1:

1. both were increasing over the time period (1m)
2. the rate of increase in the number of online shoppers is greater than the rate of increase for internet users (1m)

*Accept any other plausible answer based on the data.*

### Examiners' Comments:

- a) Some students did not phrase their answers using comparative statements. As a result, the comparisons were not highlighted in their answers and could not be given full credit.

- (ii)** Explain possible reasons for these changes observed. [5]

Acceptable answers mainly from Extract 2; students may use own knowledge as well:

*To explain why both number of online shoppers and internet users have increased:*

- (Extract 2) 'a growing middle-class who is using their mobile phones for their online shopping needs', 'other factors such as a high degree of consumer choice from budget to gourmet products from other countries play an important role in influencing customers' preference' and 'The online shopping market in China has been prospering despite an economic downshift' – leading to **increase in demand** for internet services and online shopping
- or (Extract 2) entry of new firms into the market, for example, Wal-Mart (i.e. **increase in supply**) providing internet services and opening of online shops

*To explain why the rate of increase in the number of online shoppers is greater than the rate of increase for internet users:*

1. as more and more people jump on the internet bandwagon, the market reaches saturation – there are fewer people with no internet access – however, a user with access to the internet may not necessarily use it as a tool to perform online shopping – this may suggest that there is still potential for the market to grow – additionally, as more companies leverage on the online medium to sell their products, this may entice users to switch to online shopping
2. or the network effect from the usage of the internet is greater – the online medium increases in value as more people use it – this leads to a rapid rise initially, followed by a plateau as more people have access to it; the network effect from online shopping may be arguably less – this means that there are likely other factors affecting the rate of increase such as consumers' convenience / firm's price and non-price competitive behaviour that may encourage the rapid uptake in online shopping

*Accept any other plausible answer which explains the data.*

*Max 3m for explaining only one of the changes observed in a(i).*

### Examiners' Comments:

- a) Many students only explained the reason for one of the changes cited previously. As a result, only a max of 3m was given, despite some students writing lengthy responses.

**(b)** Explain why foreign firms are choosing to invest in South-East Asia. [5]

Acceptable answers mainly from Extract 1:

- a) (Extract 1) 'Media Development Authority's funding for new firms' – government policies which help to build a conducive environment for the inflow of FDI – when funding is given out, the start-up cost is lower – this increases the profitability (costs can be reduced) of investing in SEA – encouraging foreign firms to invest in SEA
- b) (Extract 1) 'Southeast Asia is attractive because it is where the next billion people are going to be. There are 600 million people now and the populations of the emerging markets in Indochina, Myanmar and Philippines are continuing to grow' – rising income / rising population signals that there is likely to be rising consumer expenditure – rate of return from investment in SEA is expected to be higher as compared to other countries due to increasing profitability (revenue increasing) – encouraging foreign firms to invest in SEA

*Max of 5m for any 2 reasons from the data, well-explained.*

*Max of 3m for any 1 reason from the data, well-explained.*

*Answers can take a macroeconomic slant, but must centre back on reasons for **firms'** decision*

*Max of 3m if students only use own knowledge because Extract 1 clearly states both revenue and cost reasons.*

**Examiners' Comments:**

- a) Students were required to cite 2 possible reasons for firms' investment in SEA to get full credit.
- b) Majority of students were able to explain these reasons, however, their explanation lacked the concept of profitability in order to be given full marks.

**(c)** Discuss the impact of the Wal-Mart's acquisition on the online retailing market in China. [8]

Acceptable answers:

*Whether firms will restrict output due to market power, or to increase scale of production*

- a) acquisition leads to smaller number of firms, with the market share / power of each firm increasing – the level of competition in the online retailing market decreases – each firm has greater market power – better able to restrict output to raise price – likely leading to a rise in equilibrium price charged – leading to a reduction in consumer surplus
- b) HOWEVER, firms may not choose to restrict output as there are gains from expanding its scale of production in the form of internal EOS reaped e.g. in terms of marketing or storage EOS for retailing firms – this means that ceteris paribus, firms can earn greater profitability when they produce at a larger scale – thus if raising output (there is an expectation that the number of consumers will continue to expand rapidly) helps the firm increase profits, it will lead to a rise in equilibrium quantity transacted in the market
- c) with a lowering of average cost (AC) due to internal EOS (which also lowers LRMC), the firm may choose to pass on the cost-savings to consumers in the form of lower prices if it helps to increase profits – in this situation, equilibrium price in the online retailing market may fall
- d) the increase in profits could also allow firms to engage in R&D that could help to lower costs of production – similarly, equilibrium price in the online retailing market may fall

### Evaluation

- e) in China, in the SR after acquisition, the equilibrium price and quantity is likely to rise – this is because Wal-Mart is likely to take some time to further consolidate and strengthen its brand name / brand loyalty in the eyes of the consumers to ensure that certain key aspects such as affordability (i.e. Wal-Mart will still keep prices low) and quality of goods aren't being compromised despite the change in management, i.e. making sure the DD is less elastic so as to be able to raise prices, TR and profits later, *ceteris paribus*
- f) HOWEVER, in the LR, the bigger firm is likely to exercise its market power by restricting output to increase prices so as to achieve higher profitability, especially given its less price elastic demand after acquisition. The motive behind acquisition is to reduce the number of substitutes in the market – if it is also successful in making its DD less elastic (with instilling brand loyalty) – then it will also be reducing the closeness of substitutes in the market – this makes DD for its product less elastic – essentially, a less elastic DD reduces the ruinous effects of price competition and the degree of product differentiation also enables the good sold to command a premium over other similar goods (either due to perceived or real differences)
- g) to some extent, even in the LR, the bigger firm may not be able to flex its exploitative powers, if the MOC in China ensures that it creates a contestable market in the service industry – thus helping to equalise the competitive conditions between the incumbent and the potential entrants.

Level	Descriptors	Marks
L1	Major conceptual errors and/or merely stating / listing of points	1-2
L2	Well-developed but one-sided answer on: <ul style="list-style-type: none"> <li>- direction and extent of change in <u>only</u> equilibrium price or quantity</li> <li>- explaining an impact on equilibrium price and quantity without considering other alternatives</li> </ul> Answer may be balanced but under-developed	3-4
L3	Well-developed and balanced answer that explains the direction and extent of change in equilibrium price and quantity	5-6
E1	Unexplained judgement	1
E2	Judgement supported with analysis	2

### Examiners' Comments:

- a) Some students were unsure what an acquisition meant and instead explained the effect of an entry of a new firm. While in the main the analysis tended to be correct, the premise was flawed.
- b) Some answers took on a macroeconomic analysis, when a microeconomic one would have been more appropriate to analyse the impact on the online market.
- c) Some answers did not tailor their responses to the retailing market, and this led to relatively weaker analysis.

- (d) Discuss the view that the Singapore government's 'yes' to 'investments and inflow of foreign workers...is also why Singapore now enjoys low unemployment'. [10]

Acceptable answers:



- a) with greater FDI: as  $I$  is a component of  $AD$ , as  $I$  increases,  $AD$  increases as well – assuming the economy is currently operating below full capacity, when  $AD$  increases – firms face an unplanned reduction in physical stocks – they will step up production to meet the rising demand by hiring more resources, including labour – this will cause employment and real GDP to rise by multiple times through the multiplier effect – this causes economy to move towards full employment output level – in the LR, investment also increases productivity – the increase in LRAS leads to higher potential output and employment
- b) with the inflow of foreign workers: there is a greater quantity (and maybe, quality) of resources – AS increases – the increase in quantity of FOP / efficiency of FOP leads to an increase in productivity assuming that the combination of factor inputs leads to more output being produced per unit of resource – in the SR, this means that firms hire more resources, including labour, in order to produce more and thus, there is a rise in employment
- c) HOWEVER, as mentioned in Extract 3, there are pros and cons associated with an FDI-driven economy – the assumption here is that the investment can significantly raise the level of productivity and thus lead to an increase in output and employment – however, if the investment is spent on projects with little returns to the capital investment ploughed into the economy, then the rise in employment is more certain in the SR (due to the increase in total spending), but becomes more questionable in the LR.
- d) in Singapore, there are measures put in place to ensure that the quality of FDI attracted is high in terms of its positive returns to the economy, as well as in its ability to carve out a new niche / avant-garde market for Singapore to head towards.
- e) also, the inflow of foreign workers may lead to an increase in AS and thus, full employment national output – if this gap is large, it signals an increase in demand-deficient / cyclical unN, ceteris paribus – in addition, the inflow of foreign workers may lead to a changing CA and, thus there may be a need to restructure the economy – as the economy undergoes restructuring, structural unN is likely to be on the rise given that a segment of our labour force is still occupationally immobile.
- f) the reason why the low-skilled foreign worker can displace our local workers is because we have lost / don't have CA in low-skilled activities – this means that we are less cost-competitive in the production of lower value-added g/s as compared to foreign workers from countries with a CA in such activities – in which case, the argument that mobility of FOP, a change in the qty / quality of resources affecting our CA – thus causing unN, especially structural unN still holds
- g) HOWEVER, the inflow of foreign workers must be significant and prolonged enough for it to cause a change in our CA to the lower-skilled domestic and construction industries and thus cause a rise in structural unN – this is unlikely to be the case since foreign workers were brought in as a temporary measure to ease inflationary pressures in lieu of a tight domestic labour market

Level	Descriptors	Marks
L1	Major conceptual errors and/or merely stating / listing of points	1-2
L2	One-sided answer in terms of <ul style="list-style-type: none"> <li>- explaining <u>either</u> how <math>I</math> / foreign workers can lead + not lead to low unN</li> <li>- or explaining how <math>I</math> + foreign workers can lead to a low unN</li> </ul>	3-5

	<u>without antithesis</u> - <u>or antithesis without thesis</u> (Max 4m for one-sided answer)  Under-developed but balanced answer	
L3	Well-developed and balanced answer comprising: - How FDI and inflow of foreign workers can lead to low unN - How FDI and inflow of foreign workers <u>may not</u> lead to low unN and/or other factors could have explained for low unN	6-8
E1	Unexplained judgement  Generic / theoretical judgement not supported with relevant examples from the Singapore economy	1
E2	Judgement supported with analysis  Uses relevant examples from the Singapore economy to support the judgement	2

**Examiners' Comments:**

- Generally, most students were able to analyse how investments can lead to low unemployment.
- However, they were less clear as to how an inflow of foreign workers can result in low unemployment.
- The discussion on whether investments and foreign workers, as well as other relevant factors to lower unemployment, was not so well-developed. For example, students brought in supply-side policies to tackle low unemployment without linking back to the question and explaining why alternative measures had to be looked into.

## Question 2

### Retail, Gaming and Tourism in Singapore

**Table 1: Economic indicators of the Singapore economy, 2009 to 2013**

	2009	2010	2011	2012	2013
GDP (in current US\$ millions)	192 406	236 420	274 065	286 908	297 941
Portfolio equity, net inflows (in current US\$ millions)	962	5 290	- 5 730	3 561	- 90
Total reserves (in current US\$ millions)	192 046	231 259	243 798	265 910	277 797
Foreign direct investment, net inflows (in current US\$ millions)	23 821	55 075	50 367	61 159	63 772
Exports of Goods and Services (% of GDP)	192	199	200.2	195.1	190.5
Imports of Goods and Services (% of GDP)	168	173	174	173	168
Retail Sales Index*, excluding motor vehicle sales (2010 as base year)	94	100	108	111	112

\*Retail Sales Index is an estimate measurement of all goods sold by retailers. This is also often taken as a proxy indicator for the level of consumer confidence. The Retail Sales Index usually increases when consumer confidence is improving.

Source: World Bank and Singstat

#### Extract 4: Competition a game-changer for Orchard Road

Orchard Road, long synonymous with Singapore retail, has established itself globally as a prominent shopping belt due to its high concentration of retail stores offering mid to luxury brands. In recent years, Orchard Road has had to counter competition from an increasing number of sources. A property research analyst argues that competition is in fact good for Orchard Road and may hold the key to achieving a new level of success.

One of the key emerging sources of competition for Orchard Road is Changi Airport. While airport retail space around the world was largely leased for marketing purposes in the past, retailers are seeing strong sales growth at these stores. Changi Airport, for instance, registered 9 per cent annual growth in retail sales to a record of more than \$2 billion in 2013.

Changi Airport is one of the most highly connected airports to the rest of the world, and this translates to a high volume of passengers going through its doors daily. In 2013, the airport handled a record 53.7 million passengers; this is after three consecutive record-breaking years in 2012 (51.2 million), 2011 (46.5 million) and 2010 (42 million). The 37.1 million passengers handled in 2009 was a slight dip from 2008. This high volume thus provides retailers an excellent opportunity to market their brands to a wide catchment comprising a constant volume of potential customers from transit passengers, tourists and locals alike.

The 100% government-owned Changi Airport Group (CAG) is the sole landlord of the airport complex, and is able to manage the development in a more integrated and holistic fashion. In addition to ensuring that the retail tenant-mix and concepts across its three terminals are

differentiated, CAG has the capacity to introduce airport-wide programmes to promote its retail offerings and add tenants in customer retention and creation.

To continue growing its non-aviation business, the airport has plans for a mixed-use development codenamed Project Jewel, slated for completion by 2018. Retailers seeking a prime spot to build their profile among an international crowd may find Project Jewel an ideal location, with its likely iconic status and direct connectivity to the three existing terminals. The new development also has the potential to attract a higher volume of visitors as its retail area will be entirely accessible to all visitors – unlike most of the existing airport space, which is open to travellers only.

However, there are still some pull factors to Orchard Road. Retailers enjoy economies of agglomeration when located in Orchard Road, and Orchard Road landlords have been enhancing their developments and trying hard to differentiate developments from others – this has given shoppers a wider array of options. Orchard Road remains popular with international retailers looking to locate their first Singapore store.

The Urban Redevelopment Authority (URA) has been proactive in ensuring that Orchard stays attractive and relevant as a desired retail destination. It has led infrastructural and landscape changes to the area to improve the shopper's experience and encouraged landlords to enhance their assets through various schemes. The Singapore Tourism Board (STB) and the Orchard Road Business Association (ORBA) are also constantly working to promote Orchard Road as an attractive retail destination.

The competition that Orchard Road faces serves as a constant motivation for it to continue differentiating itself and sharpen its appeal to international shoppers. After all, the competition for new retailers is not just between Orchard and Changi Airport; the real challenge could be the one the Singapore retail market faces from other regional and global cities to attract and retain international brands.

Source: Adapted from *The Business Times*, 13 March 2014

### **Extract 5: Singapore's gaming industry defies odds**

Marina Bay Sands (MBS), the world's most expensive stand-alone casino resort at US\$6.9 billion, held its grand opening in 2010 in the teeth of a persistent global economic slump and in direct competition with the world's second-most expensive casino resort, the US\$5.7 billion Resorts World Sentosa (RWS). Many analysts doubted that these giants in the gaming industry would profit. They were wrong.

A year later, MBS and RWS Sentosa are the world's most profitable casinos. Singapore's economy grew a record 14.5% in 2010. Booming tourism has helped to fuel that growth, with visitor arrivals up 20% and expenditures up 49% in 2010. Forecasts for 2011 project Singapore's casino revenue at US\$6.4 billion, which would make it the world's number two gaming destination, just ahead of the Las Vegas Strip and trailing only Macau.

But seeing MBS just in terms of money misses much of the story. 'There is no doubt that the two integrated resorts (IRs) have added a new sense of vibrancy to Singapore,' University of Nevada-Las Vegas Singapore campus dean Andy Nazarechuk said. 'In the past you would hear comments about Singapore being conservative or boring - you don't hear those comments anymore.'

MBS has become an architectural icon, with three hotel towers linked by the SkyPark 57 stories above Singapore's financial district. The resort includes 2,560 hotel rooms, a

permanent production of Disney's *The Lion King* in one of its two theatres, the lotus-shaped ArtScience Museum, 121,000 square metres of convention space, a 74,300 square-metre mall with 300 stores, and more than 50 food and beverage outlets, including cuisine by six celebrity chefs representing four continents. MBS 'has incorporated everything Las Vegas Sands had learned in Las Vegas and Macau and created one of the most exciting IRs in the world,' Nazarechuk says.

Despite some teething problems, MBS attracted 19.6 million visitors in its first year. 'We are now top of the minds of many leisure and business travellers and have received overwhelming and positive responses,' a spokesperson for the resort said. 'With the various attractions lined up and future plans to keep our visitors engaged, we are confident that we will not only sustain but broaden the type of tourists who visit Singapore.'

MBS targets business travellers and the meetings, incentives, conventions and events (MICE) sector, while RWS, featuring a Universal Studios theme park, aims at the leisure and family markets. 'They appear to be perfectly complementary with regard to their products, facilities and experience offered,' said Robert Hecker, a managing director from a hospitality consultant firm. 'They are mostly attracting and accommodating distinctly different demand segments.'

As anyone who has visited Singapore recently knows, the addition of nearly 3,000 rooms at MBS hasn't caused hotel rates to plunge. 'There were initial concerns it might take a while to absorb the new rooms supply, but the scale of induced demand created extends beyond what the property itself can accommodate, so it's been beneficial to the entire market,' Hecker said.

'There's a race going on around the region about tourism being part of the future economy. Singapore has just blown past everyone,' former MBS chief executive Thomas Arasi said. Even better days may be ahead as the IRs come fully online. RWS still has a record-setting aquarium, a museum and a water park in the works.

So with all this good news, why is there so much discontent circling the IRs? Prime Minister Lee championed the IRs against unprecedented public opposition by Singapore's standards. His ruling People's Action Party (PAP) received the lowest vote total in history during the 2011 General Election, down nearly 10% from the previous election, with two cabinet ministers losing their seats.

The government imposes a S\$100 daily entry tax (or S\$2,000 annually) for residents to enter a casino, has banned casino shuttle buses in residential areas, and has issued fines for local promotions in its effort to discourage Singaporeans from gambling. Yet there's still a public perception that too many Singaporeans are spending too much money at the casinos.

'It depends on who you ask,' Workers' Party Member of Parliament Gerald Giam said in response to a question about whether the resorts are good for Singapore. 'Undoubtedly tourism receipts have increased and the IRs have contributed to GDP growth, and the owners and developers of the IRs have benefited. However, the IRs' overall impact on society as a whole is unclear.'

'The casinos bring with them moral and social costs,' opposition Singapore Democratic Party leader Chee said. 'The kinds of jobs they create will not help Singapore generate the kinds of talent that will be required for our economy's future. The priority of pursuing GDP growth at all cost by this government is ultimately unsustainable.'

Source: Adapted from *Asia Times*, 28 June 2011

## Questions

With reference to Table 1,

- (a) (i) explain **one** possible reason why Singapore's Balance of Payments may have worsened from 2009 to 2013. [2]
- (ii) use the concept of the circular flow of income to explain how the changes in Singapore's GDP from 2009 to 2013 could have arisen. [3]
- (iii) to what extent does the change in volume of passengers handled by Changi Airport (Extract 4) account for the change in Singapore's Retail Sales Index, a proxy indicator for the level of consumer confidence, from 2009 to 2013? [4]
- (b) The upcoming mixed-use development in Changi, Project Jewel, will have a retail area that is 'entirely accessible to all visitors' (Extract 4). Is Project Jewel a public good? Explain. [3]
- (c) With reference to Extract 5, discuss whether the launch of the IRs has increased the standard of living of Singaporeans. [8]
- (d) Extract 4 mentions the role that URA and STB, two government agencies, played to help make Orchard Road remain attractive to retailers; extract 5 mentions how the government had championed the development of the IRs.

Discuss the view that the government's interventions will be the most crucial determinant for success, for both Orchard Road and the IRs. [10]

[Total: 30]

## Answers

With reference to Table 1,

- (a) (i)** explain **one** possible reason why Singapore's Balance of Payments may have worsened from 2009 to 2013. [2]

Acceptable answers from Table 1:

1. Fall in net inflows of portfolio equity, leading to a worsening of capital & financial account from 2009 to 2013 – this could contribute to any possible worsening of Singapore's BoP. (2m)
2. or Rise in total reserves, leading to worsening of capital & financial account from 2009 to 2013 – similarly contribute to any possible worsening of Singapore's BoP. (2m)
3. or Rise in import expenditure (168% of US\$192 406 million in 2009 has increased to 168% of US\$297 941 million in 2013)

*Correct identification without any explanation can be credited with 1m.*

### Examiners' Comments:

a) There were three main types of answers:

- i. Group 1. Most of these answers tend to state the fall in exports as the possible cause for the worsening of Singapore's BoP. Upon closer reading of the data, it is the proportion of export (X) to GDP that has fallen slightly, not the inflow of export revenue. Since GDP has increased over time, a simple calculation would have shown that the export revenue has **clearly** increased over time.
- ii. Group 2 scored full credit. These answers were able to correctly identify a reason for the worsening of Singapore's BoP, and also correctly identify the BoP account in which it belongs to.
- iii. Group 3 scored one mark. These answers did not identify / identified incorrectly the BoP account in which the change occurred.

b) Some of the answers spent a disproportionate amount of time explaining why, for example, there was a fall in net inflows of portfolio equity, instead of / in addition to explaining why a fall in net inflows of portfolio equity may worsen Singapore's BoP. The former explanation is not required.

- (ii)** use the concept of the circular flow of income to explain how the changes in Singapore's GDP from 2009 to 2013 could have arisen. [3]

Students need to first recognise that Singapore's GDP has increased from 2009 to 2013.

Acceptable answers from Table 1:

1. X has increased
2. FDI (I) has increased

The process explanation should include (most of this):

- i. X and/or I increased
- ii. Injections more than withdrawals
- iii. Unplanned fall in stocks
- iv. Firms will raise production
- v. Hire more factors of production
- vi. National income will increase as a result

- vii. Leading to subsequent increase in induced consumption and further rise in national income by multiples
- viii. The end of the adjustment process occurs when change in injections equals change in withdrawals.

*1m for identifying an appropriate injection from the case (no sign of withdrawals decreasing in Table 1)*

*2m for explaining process for how an increase in injection leads to an increase in national income*

**Examiners' Comments:**

- a) Some answers surprisingly did not pick an injection and/or withdrawal from the Table, and instead came up with their own change.
- b) The answers, in the main, reflected a poor understanding of the circular flow model. The common mistakes were:
  - i. Being able to draw the circular flow model diagram, without any accompanying explanation.
  - ii. Constantly linking the changes in injection(s) back to changes in Aggregate Demand.
  - iii. Explained that general price levels change as part of the process.
  - iv. Neglected to explain the change in levels of withdrawal as part of the process.
  - v. Unable to state the end point of the explanation, as national income reaches a new equilibrium level, i.e. when the change in injection equals the change in withdrawal.
  - vi. Cited consumption as an injection.

- (iii) to what extent does the change in volume of passengers handled by Changi Airport (Extract 4) account for the change in Singapore's Retail Sales Index, a proxy indicator for the level of consumer confidence, from 2009 to 2013? [4]

Possible answers:

*Yes, the change in volume of passengers could account for the change in Retail Sales Index*

- 1. Volume of passengers has increased, as has Retail Sales Index from 2009 to 2013. This positive correlation could point to the possibility that the increase in volume of passengers has helped to contribute to the increase in retail sales. (this is also corroborated with how Changi Airport has experienced a 9% annual growth in retail sales – though this information is not required in the answer)

*However...*

- 2. There are other reasons that could contribute to an improving consumer confidence such as:
  - a. Increase in real GDP
  - b. Increase in X
  - c. Data that cannot be found in Table 1

*Mark allocation:*

- a) Up to 2m for a one-sided answer

**Examiners' Comments:**

- a) While most answers were able to cite the positive correlation between the volume in passengers handled by Changi Airport and Singapore's Retail Sales Index, very few answers could make an explicit link that a higher volume of passengers meant that there are more tourists, demand for retail goods and services would increase (population size



increase, as a non-price determinant of demand), expenditure on retail would increase, and hence the Retail Sales Index would increase.

- b) Some answers made no attempt to provide a judgement regarding the “extent to which” that the change in volume of passengers handled by Changi Airport account for the change in Singapore’s Retail Sales Index.
- c) Some answers rightly pointed out that Orchard Road would be a major contributor to Singapore’s Retail Sales Index as well, considering that it is a major shopping street. However, very few explicitly highlighted that locals who shopped at Orchard Road also contributed to Singapore’s retail sales; otherwise, it would seem to suggest that the increased volume of passengers (i.e. tourists) would then proceed to shop at Orchard Road as well. Without mentioning locals, it would turn what was originally intended as an alternative factor to Singapore’s retail sales, to another supporting statement for the thesis, i.e. the volume of passengers would strongly account for the Retail Sales Index.

- (b)** The upcoming mixed-use development in Changi, Project Jewel, will have a retail area that is ‘entirely accessible to all visitors’ (Extract 4). Is Project Jewel a public good? Explain. [3]

Explain that Project Jewel is rivalrous and/or excludable to justify why Project Jewel is not a public good.

*Mark allocation:*

- a) No marks awarded for just stating whether Project Jewel is a public good, or with very poor / erroneous explanation
- b) Up to 3m for well-developed explanation that Project Jewel is either rivalrous or excludable, and hence is not a public good
- c) Up to 1m for a well-developed but erroneous explanation that Project Jewel is non-rivalrous and non-excludable, and hence is a public good (credit for knowledge of content, but penalised for poor application)

**Examiners’ Comments:**

- a) The best (i.e. most efficient) answers cited that public goods needed to be non-rivalrous and non-excludable, and then went on to explain why Project Jewel was either rival or excludable. These answers gained full credit.
- b) Some other answers that gained full credit were able to explain why Project Jewel was rival and excludable.
- c) Many answers did not gain full credit because they either cited that Project Jewel was non-excludable, or they were able to identify the characteristic but could not complete the explanation.
- d) Answers that identified Project Jewel as a public good mostly scored no credit. The common mistakes are:
  - i. Project Jewel is non-excludable because it is accessible to all shoppers, travellers and non-travellers alike. Accessibility is not the main determinant for non-excludability. Recall that non-excludable means that it is impossible or very costly to exclude non-payers from the use of a good or service. Making a shopping mall accessible does not preclude the ability to restrict access one day. Claiming that Project Jewel is non-excludable is accessible to all is the same as claiming that a free unisex public toilet is non-excludable.
  - ii. Project Jewel is non-rivalrous because the presence of one shopper in Project Jewel does not reduce the satisfaction of another shopper. Answers that could point to the fact that Project Jewel is a very large shopping mall, and the sense of crowdedness may only set in at a very large volume of shoppers, and hence it is essentially non-rivalrous would receive one mark – there were, however, very few of such answers. Most answers did not explain; another small handful

erroneously stated that shoppers could enjoy the goods and services without reducing the satisfaction of other shoppers.

- (c)** With reference to Extract 5, discuss whether the launch of the IRs has increased the standard of living of Singaporeans. [8]

Possible answers:

*Standard of living has increased:*

1. IRs may have contributed to booming tourism – X rises – AD rises – real national income, employment rises – purchasing power rises – material SOL ↑
2. IRs have contributed to vibrancy in Singapore in terms of entertainment, retail, F&B etc. – more variety of goods and services available for consumption + more “fun” image – material and/or non-material SOL ↑
3. IRs have also contributed to the growth of hospitality and entertainment industries, attracting FDI into these and other related industries – I rises – AD and AS rises – real national income, employment rises while full employment rises as well with minimal increases in inflation rate – likely sustained increases in purchasing power – material SOL ↑

*Standard of living may not increase:*

4. Social problems arising due to IRs
5. Industry growth may not help long-term economic growth for Singapore, e.g. instead of focusing on industries that have a focus on technology

*Conclusion:*

6. It seems that the short-term economic benefits are clear – the issue would be whether these benefits are fairly distributed to Singaporeans in general, or will it just benefits the owners, shareholders of the IRs as well as the firms in related industries and employees of all these firms.
7. Even so, Chee’s comment does cast a doubt as to whether these economic benefits are even sustainable. The IRs will bring in an influx of technologies and talent related to the hospitality and entertainment industries, but these may not be where Singapore’s true Comparative Advantage lies. For more sustainable economic growth, we may be better off considering a more prudent approach.
8. Nonetheless, the IRs do bring with it a vibrancy to Singapore – and the benefits of attracting FDI, foreign talent to Singapore as a result, could be intangible.
9. The economic arguments aside, there are clear negative externalities that could arise due to the presence of the IRs. The issue is the size of these externalities, in comparison to the economic benefits, if any.

Level	Descriptors	Marks
L1	Major conceptual errors and/or merely stating / listing of points	1-2
L2	Well-developed but one-sided answer on: <ul style="list-style-type: none"> <li>- Whether standard of living has increased, with a focus on either material <u>or</u> non-material SOL</li> <li>- How standard of living (both material &amp; non-material) has increased <u>or</u> has not increased</li> </ul> Answer may be balanced but under-developed	3-4
L3	Well-developed and balanced (material & non-material) answer	5-6

	that explains whether standard of living has increased	
E1	Unexplained judgement	1
E2	Judgement supported with analysis	2

**Examiners' Comments:**

This question received a wide range of answers in terms of quality.

- a) Surprisingly, a significant minority could not explain the impact on material SOL well. This was the low-lying fruit in the question.
- b) Many answers stated that gambling would give rise to negative externalities, without explaining how external costs may arise.
- c) A significant minority also made the transition from real GDP to real GDP per capita in their analysis – there was no data shown to suggest that real GDP per capita had increased. The two are **not** the same. If an inference is to be made, there must at least be an assumption made about population growth.
- d) Some answers had erroneous analysis regarding the \$100 tax on Singaporean entry into the casinos. The main errors were:
  - i. The tax reduced disposable income. -- Since this is a consumption tax, you only incur the tax when you decide to consume, i.e. enter the casino. The same applies to Goods & Services Tax – the GST tax rate does not affect disposable income.
  - ii. The tax (and the ban on shuttle buses, fines on advertising) means Singaporeans are discouraged from using the casinos, and hence their SOL (material and/or non-material) falls. – Since the tax and other regulations have been in place since the launch of the IRs, Singaporeans never had an opportunity to use the casinos without paying the \$100 entry tax. At the very most, they would just choose not to patronise the casino. Their SOL should not fall, and should at the very least remain unchanged.
- e) A small minority quoted extensively without any attempt to use economic analysis.

- (d)** Extract 4 mentions the role that URA and STB, two government agencies, played to help make Orchard Road remain attractive to retailers; extract 5 mentions how the government had championed the development of the IRs.

Discuss the view that the government's interventions will be the most crucial determinant for success, for both Orchard Road and the IRs. [10]

**Possible answers:**

The intent of the question is to draw out a discussion on what can be considered determinants for success for Orchard Road and the IRs. A broad range of answer can be considered, though students should define what 'success' means, and whether they see Orchard Road and the IRs as two homogenous entities, or a cluster of firms that could offer very differentiated goods and services.

For the purpose of discussion, one possible approach to the question is to define success as level of profits earned, and to see Orchard Road and IRs as two homogenous entities.

***Government's intervention is a crucial determinant:***

1. In the case of Orchard Road- URA has worked hard to reduce the costs (infrastructural changes) of redevelopment and facilitate changes to allow Orchard to stay attractive (regulations), while STB has helped to attract more tourists, hence helping Orchard Road to increase demand. In the case of the IRs, the government was the crucial barrier to entry, and the granting of licenses to LVS and Genting was a key first step to allowing the IRs to be developed in Singapore.

*Government's intervention is not a crucial determinant / may be an impediment:*

2. Government's objective may not necessarily be the success of Orchard Road and the IRs alone. There are other objectives such as the building up of the tourism industry as a whole, or maintaining social order. As such:
  - a. Government (CAG) also has a part to play in building up Project Jewel, which may turn up to be a key competitor to Orchard Road (as well as the IRs for retail). If this helps to build up the tourism industry and revenues as a whole, government may not be too concerned whether the revenues flow to Orchard Road and the IRs specifically.
  - b. Government levies a tax on Singaporeans' entry into the casinos at the IRs, possibly reducing the revenue that the IRs will earn from Singaporeans.

*There could be other factors*

3. Orchard Road's and the IRs' ability to continuously differentiate themselves will be crucial as well, as they have to find ways to increase demand / make their demand more price inelastic
4. The strategies that regional and other international destinations use to attract tourists will also have an impact on the success of Orchard Road and the IRs

*Conclusion:*

5. Orchard Road and the IRs are currently still icons in Singapore's tourism scene – the government will not allow these to fail as it could tarnish Singapore's image and/or drag down the rest of the industry
6. Nonetheless, Orchard Road and the IRs cannot solely depend on the government's interventions, and have to find their own ways of safeguarding their interests / success sustainably, i.e. does not conflict with government's other objectives

Level	Descriptors	Marks
L1	Major conceptual errors and/or merely stating / listing of points	1-2
L2	Well-developed but one-sided answer on: <ul style="list-style-type: none"> <li>- Government's intervention is <u>or</u> is not a crucial determinant of success</li> </ul> Answer may be balanced but under-developed	3-5
L3	Well-developed and balanced answer that explains whether government's intervention is a crucial determinant to the success of Orchard Road and the IRs	6-8
E1	Unexplained judgement	1
E2	Judgement supported with analysis	2

#### **Examiners' Comments:**

This last question invited answers to use the data extensively, since many relevant arguments could be found within the data. However, the major flaw in a large majority of the answers was the inability to handle the part of the question, "...most crucial determinant for success, **for both Orchard Road and the IRs.**" The analysis should have been centred around the determinants for the success of the retailers in Orchard Road and the IRs, i.e. **firms.**

- a) A common error was to analyse how government intervention would / would not lead to success for the Singapore economy. Answers that only focused on this aspect would receive very little credit. Other answers were partially redeemed, when they went on to explain that a broadly healthy Singapore economy would mean increases in household income and purchasing power, and drive up retail sales, use of the IRs etc.

- b) A small minority of answers analysed Changi Airport's success as synonymous to the success of Orchard Road and the IRs.
- c) A small minority mistook STB and URA as non-government bodies. It was explicitly stated in the question that STB and URA are government agencies.
- d) Some answers contained discussions on whether or not the government should intervene. This was irrelevant to the question.
- e) A small minority of answers claimed that private firms would not bother with efforts to attract more consumers. This would not make sense for any profit-maximising firms, since more consumers = more revenue = possibly more profits. The only possible reason would be that it is too costly to do so and hence profits may even fall, though these answers did not include this analysis.
- f) The small minority of good answers showed good application of the data to the question, with very good arguments. The more basic arguments explained with economic analysis, that the government's efforts were essentially a form of subsidy and hence lower the cost of production (advertising costs) for firms. More advanced arguments went on to talk about how the government helped to pool resources because attracting tourists would potentially have a positive impact on all the retailers and tourist destinations in Singapore – it made sense for one organisation to do so, rather than several small private entities to advertise and possibly duplicate efforts. Some other answers were convincing in arguing that the IRs could be considered an infant industry that required some degree of government intervention / protection to be launched. All of these answers then made explicit links to the firms and how their profits could increase. These answers, in the main, were a pleasure to read.

**YISHUN JUNIOR COLLEGE**  
**JC2 PRELIMINARY EXAMINATIONS 2014**

**ECONOMICS**  
Higher 2

**9732/02**

**15 AUGUST 2014**  
0800h – 1015h

Additional materials:  
Writing paper  
Cover page



**TIME 2 hours 15 minutes**

**INSTRUCTIONS TO CANDIDATES**

Write your name, CTG and index number in the spaces provided on the cover page and on all sheets of writing paper handed in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use 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.

At the end of the examination, tie all your attempted questions to a **one** cover sheet. Indicate clearly on the cover sheet the **number** of your attempted questions.

**INFORMATION FOR CANDIDATES**

Including this cover page, there are **two** pages in this question booklet.

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

You are reminded of the need for good English and clear presentation in your answers.

Answer **three** questions in total.

### Section A

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

- 1 (a) Explain the causes of market failure that arise in the healthcare market. [10]  
 (b) Assess whether subsidies can address the market failure above. [15]
- 2 Advancement in technology, coupled with lower labour costs, and rising income levels have had major impacts on markets such as electronic and print books.  
 Discuss the likely effects on the expenditure by consumers in these markets. [25]
- 3 (a) Explain the key differences between oligopolistic competition and monopolistic competition. [10]  
 (b) Discuss the view that oligopolists will definitely exploit consumers given that they have market power. [15]

### Section B

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

- 4 In a country such as Singapore which has no natural resources and therefore depends much on its people, the assertion that is often made is it is important for Singapore to improve her labour productivity.  
 (a) Explain the macroeconomic goals of a government. [10]  
 (b) Discuss the extent to which an improvement in labour productivity can help Singapore achieve sustained economic growth. [15]
- 5 In the years after the Global Financial Crisis, large economies like the US and UK have faced slow recoveries, with the threat of re-entering recession always looming. Analysts suggested that these governments need to reverse their current contractionary fiscal policy, and implement further expansionary monetary policy to help boost growth.  
 Discuss the appropriateness of these suggested policies in helping governments prevent recession. [25]
- 6 (a) Explain the theory of Comparative Advantage. [8]  
 (b) Globalisation benefits small and open countries such as Singapore most; hence these governments should continue to embrace globalisation. Discuss. [17]

## Essay Q1 Review

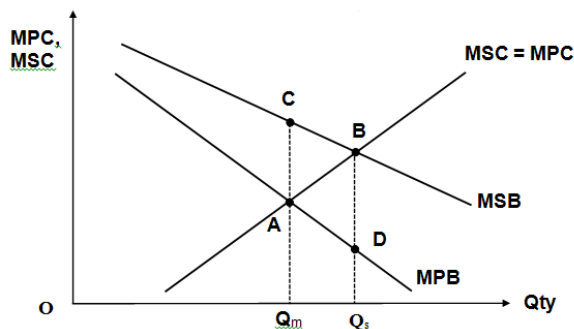
1	(a)	Explain the causes of market failure that arise in the healthcare market.	[10]
	(b)	Assess whether subsidies can address the market failure above.	[15]

### Q1a Suggested Answer

#### 1. *Introduction: Define market failure*

#### Body:

2. *Explain why healthcare is a market failure – the consumption of healthcare generates positive externalities*
3. *Explain the divergence between private benefits and social benefits and under-allocation of resources*
  - a. *An individual will only take into account his private marginal cost (e.g. financial cost of healthcare) and private marginal benefit (e.g. good health).*
  - b. *However, this individual does not consider the positive externalities that would be generated by the healthcare (i.e. the marginal external benefits, MEB, e.g. positive impact on economy, less spread of diseases) to the third parties. These are not taken into consideration by the individual. Hence, there is a divergence between the marginal social benefit, MSB and marginal private cost, MPB*
  - c. *Based on the price mechanism, the market equilibrium level of healthcare is where marginal private cost (MPC) equates to the marginal private benefit (MPB).*
  - d. *Due to the presence of positive externalities as explained above, the marginal social benefit (MSB) is greater than MPB at the market equilibrium level of healthcare (i.e.  $Q_m$ ). The socially efficient level of healthcare should be at  $Q_s$  where MSB equates to MSC i.e. the external benefits are taken into account. The price mechanism thus under-allocates resources to healthcare. This under-consumption of healthcare of  $Q_m$  to  $Q_s$  results in welfare to society not being maximised or further consumption beyond  $Q_m$  to  $Q_s$  will increase net societal welfare (i.e.  $MSB > MSC$ ).*



**Explain why market imperfections such as imperfect knowledge and market dominance lead market failure (choose one cause of market failure apart from positive externalities, and explain it well).**

4. *Imperfect information – Information failure occurs when people have inaccurate, incomplete, uncertain or misunderstood data and so make potentially inaccurate decision.*
  - a. *Imperfect information may arise when consumers lack the understanding of the possible positive effects of healthcare on themselves. Consumers do not have the perfect information of what is good for them (MPB is underestimated) and so their rational decision will be to under-consume. (merit good argument)*



- b. Also, when there is asymmetric information, for e.g. the doctor knows more than the patient. The doctors determine what a patient needs, however doctors may be incentivised to over-prescribe or to suggest more expensive treatments, as the cost of treatment has a direct link on the financial benefits they receive. In this case, there could be supply-induced demand, and lead to consumption beyond the socially desirable level. Therefore the market fails to allocate resources efficiently. (moral hazard argument)

OR

5. Market dominance

- a. There might be imperfect competition when the supply of healthcare services is restricted due to education and licensing requirements, causing supply curve to shift leftward as compared to a market with fewer restrictive licensing requirements, physicians are able to command higher fees. As such, the output may be restricted and higher price will be charged.

*\*note: Inequality in income distribution as well as its effects in terms of income inequity, should not be used as an explanation for a cause of market failure. Market failure is an inefficient allocation of resources – inequality in income distribution resulting in income inequity is the result of the free market operating efficiently!*

**MARK SCHEME 1(a)**

Level	Descriptor
<b>L3</b> 7-10	1. Well-developed explanation of how externalities and at least how one other form of market imperfections lead to market failure.
<b>L2</b> 5-6	2. Under-developed explanations of the causes of market failure. <u>OR</u> 3. Only one cause of market failure is explained.
<b>L1</b> 1-4	4. Answers contain statements without any clear attempts to explain the content. <u>OR</u> 5. Contains major conceptual errors.

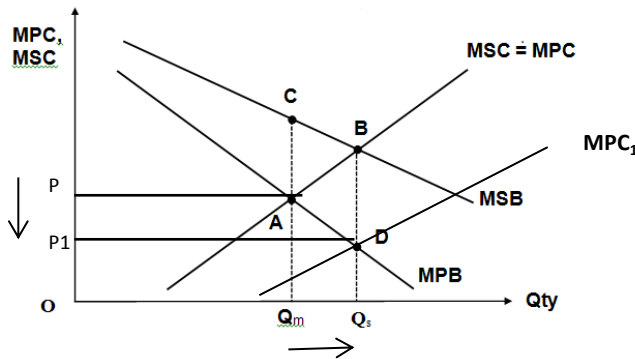
<b>1</b>	<b>(a)</b>	Explain the causes of market failure that arise in the healthcare market.	<b>[10]</b>
	<b>(b)</b>	<b>Assess whether subsidies can address the market failure above.</b>	<b>[15]</b>

**Q1b Suggested Answer**

1. **Introduction** – Briefly explain the corrective measures taken by government.

Body:

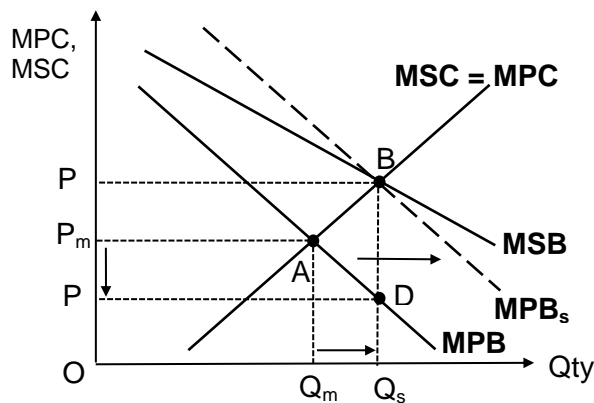
2. Explain how subsidies work (1) – increase the supply of healthcare
- The government estimates the socially optimal amount and provides subsidies to hospitals = MEB at Qs (BD)
  - As the subsidies lower cost of production, MPC of production will shift down, P reduces.
  - Subsidies lower the price and encouraged consumption of healthcare.



d. For e.g.: Singapore government gives subsidies to private healthcare institutions for training of healthcare professionals – this increases the supply of healthcare

3. Explain how subsidies work (2) – increase the demand of healthcare

- a. Subsidies that are received directly by consumers will act on the demand curve (MPB) as the subsidies increase their disposable income. Demand increases such that the market-optimal output now coincides with the social-optimal output.



b. For e.g.: Polyclinic and public hospital fees are generally subsidised, though the quantum varies by nationality.

4. Explain the advantages of subsidies

- a. Subsidies still allow market to operate. It encourages individuals and hospitals to internalise the external benefits. The size of the subsidy can also be adjusted (fairly easily) in accordance to the magnitude of the problem.
- b. Targeted subsidies (e.g. means-testing) also allow the lower income group to receive basic healthcare.

5. Explain the disadvantages of subsidies

- a. It will be administratively difficult and expensive to grant the amount of subsidy – might lead to under/over-subsidies.
- b. Even if the government decides on the amount of subsidy, the measurement of external benefits will be a problem as the third party benefits are not quantifiable.

Evaluation

6. Able to increase the output consumed/ produced (due to affordability) but not solving the root cause of the healthcare problem.

**Answer may contain a discussion on alternative policies. However, these should be used to illustrate why the subsidies may not necessarily be the most appropriate / effective to address all the causes of market failure in terms of positive externality / market dominance / imperfect information.**

7. *Explain alternative policy (1) – moral suasion*
  - a. *Government could reduce imperfect information through campaigns and advertisement – increase awareness of the beneficial effects of good health*
  - b. *Encourages consumption and reduces the gap between the perceived MPB and the true MPB of healthcare*
  - c. *For e.g.: Cervical Cancer campaign by HPB, IQuit campaign*
8. *Evaluate the effectiveness of moral persuasion*
  - a. *Providing necessary information of healthcare can correct the market due to imperfect information but sometimes individuals are reluctant to change their mindset towards healthcare. Individuals can interpret information given differently. As such, the result of moral suasion is not guaranteed and it might end up incurring a higher cost as compared to subsidy.*
  - b. *Even if the campaign takes effect, it requires time for the effects to show.*
9. *Explain alternative policy (2) – direct provision*
  - a. *Government takes over the role of provision of healthcare. This can increase the supply of healthcare. At the same time, it can help solve market failure arising from market dominance in the healthcare sector. (a variant of this is nationalisation)*
10. *Evaluate the effectiveness of direct provision*
  - a. *In the event that market-based solutions don't work well, this could be a more direct approach.*
  - b. *However, this might create over-reliance on government / crowd out private investment. Also, publicly-run healthcare institutions around the world are generally more inefficient (long waiting times, incompetent medical staff) compared to privately-run healthcare institutions. It may also take time for the government to build up the necessary infrastructure and personnel with expertise, if these are not already readily available.*
11. *Explain alternative policy (3) – legislation*

### **Conclusion**

12. *Evaluative comments can centre around a particular context, e.g. Singapore.*

### **MARK SCHEME 1(b)**

<b>Level</b>	<b>Descriptor</b>
<b>L3</b> 9-11	1. Full marks can be awarded for a well-developed (rigour of analysis, use of relevant diagrams) and balanced (yes, subsidies can address the causes of market failure vs. no, subsidies are unable to address the causes) answer on whether subsidies can address the causes of market failure explained in Part A. 2. Credit can also be awarded to a discussion of other policies to complement / used in place of subsidies. 3. Answer may contain a few minor conceptual errors.
<b>L2</b> 5-8	4. An under-developed, but balanced answer on whether subsidies can address the causes of market failure explained in Part A. <u>OR</u> 5. A well-developed but one-sided explanation of whether subsidies can address the causes of market failure explained in Part A. (max 6m) 6. Answer may contain some minor conceptual errors.
<b>L1</b> 1-4	7. Answer is descriptive, irrelevant and/or contains too many major conceptual errors.

<b>E2</b> <b>3-4</b>	A. Well-reasoned assessment on effectiveness (focusing on key word of “can” / “cannot” address causes of market failure) of subsidies and any other policy(ies) used as part of answer. Top credit may be awarded if answer contains a discussion based on a particular context, e.g. Singapore’s healthcare market.
<b>E1</b> <b>1-2</b>	B. For an unsubstantiated assessment.

## Essay Q2 Review

2	Advancement in technology, coupled with lower labour costs, and rising income levels have had major impacts on markets such as electronic and print books.	
	Discuss the likely effects on the expenditure by consumers in these markets.	[25]

### Q2 Suggested Answer

#### 1. Introduction

- a. The shift from print to electronic books (e-books) is gaining momentum, with major book publishers' sales increasingly coming from the e-book market. This means that consumer expenditure is shifting from print to e-books.
- b. In the coming decades, we could possibly observe how print books may become obsolete as e-books becoming cheaper and better.

#### Development (for 1<sup>st</sup> market, e.g. e-book market)

2. For the e-book market, the advancement in technology, lower labour costs and rising income levels will lead to increases in both supply and demand. The overall increase in demand is likely to be greater than the increase in supply, and coupled with both price elastic demand and supply, we will observe **a rise in consumer expenditure in the e-book market.**
3. Explain why demand for e-book increases, i.e. consumers are willing and able to purchase more quantities of e-books at all price levels, *ceteris paribus*:
  - a. **Improving tastes and preferences:** the advancement in technology has shifted tastes and preferences towards the use of e-books, as it is becoming an increasingly close substitute to print books.
  - b. **Lowering of price of complementary good:** the advancement in technology and lower labour costs has also led to the significant lowering of prices of a key complementary good to e-books, i.e. e-book readers and other electronic devices on which e-books can be read.
  - c. **Rising income levels:** assuming that an e-book is considered a normal good.
4. Explain why supply of e-books increases, i.e. producers are willing and able to produce more quantities of e-books at all price levels, *ceteris paribus*:
  - a. **Lower cost of production:** both the advancement in technology and lower labour costs will lower the cost of production for the production of e-books.
5. Justify why the increase in demand is greater than the increase in supply, through any reasonable analysis:
  - a. The supply change is likely to be small as the actual cost of production for e-books is low to begin with.
  - b. Because this is a growth industry, the potential for demand to increase is still significant.
6. Justify why both demand and supply are price elastic (note that this only affects the extent of increase in consumer expenditure, but does not change the analysis that consumer expenditure **will** increase as a result of increase in demand being greater than increase in supply).
7. Explain the price adjustment process and the eventual increase in consumer expenditure:

- a. As demand increases more than supply, a shortage ensues at the original equilibrium price, hence prices will be bid up in the e-book market.
- b. As price increases, consumers will reduce their quantity demanded (Law of Demand) while producers will raise their quantity supplied (Law of Supply).
- c. Eventually, the new market equilibrium where the market clears (i.e. quantity demanded equals quantity supplied) will lead to increases in both price and quantity.
- d. Therefore consumer expenditure (which is price multiplied by quantity in the market) increases.
- e. [This should be accompanied by a diagram that shows (1) concurrent shifts in demand and supply, (2) demand increases more than the increase in supply, (3) price elastic demand and supply, (4) clear labels for diagram, axes, graphs, original and new equilibrium, shortage at original equilibrium price.]

**Development (for 2<sup>nd</sup> market, e.g. print book market)**

8. For the print book market, the advancement in technology, lower labour costs and rising income levels will lead to an increase in supply but a fall in demand. The overall increase in supply is likely to be greater than the fall in demand, and coupled also with a price elastic demand and supply, we will observe **a fall in consumer expenditure in the print book market**.
9. Explain why demand for print book falls, i.e. consumers are willing and able to purchase less quantities of e-books at all price levels, *ceteris paribus*:
  - a. **(Demand falls) Falling tastes and preferences:** the advancement in technology has shifted tastes and preferences towards the use of e-books, as it is becoming an increasingly close substitute to print books.
  - b. **(Demand rises) Rising income levels:** assuming that a print book is considered a normal good.
  - c. A **judgement** is required on why the falling tastes and preferences will likely outweigh the rising income levels. A reasonable explanation will be that print books are considered necessity goods (i.e.  $0 < YED < 1$ ), and therefore the rising income levels only lead to a less than proportionate increase in demand, while the fall in demand due to changing consumer tastes and preferences has a larger negative impact on demand.
10. Explain why supply of print books increases, i.e. producers are willing and able to produce more quantities of print books at all price levels, *ceteris paribus*:
  - a. **Lower cost of production:** both the advancement in technology and lower labour costs will lower the cost of production for the production of print books.
11. Justify why the increase in supply is greater than the fall in demand, through any reasonable analysis:
  - a. The fall in demand is likely to be small, due to conflicting impact on demand.
  - b. The increase in supply may be significant, as labour could be a more significant part of the production process for print books, while advancement in technology has brought down fixed costs of printing significantly.
12. Justify why both demand and supply are price elastic (**because prices are likely to fall in the print book market, the price elasticity of demand and supply become crucial in analysing the direction and extent of change in the quantity transacted in the print book market**).
13. Explain the price adjustment process and the eventual fall in consumer expenditure:

- a. As supply increases and demand falls, a surplus ensues at the original equilibrium price, hence prices will be bid down in the print book market.
- b. As price decreases, consumers will increase their quantity demanded (Law of Demand) while producers will reduce their quantity supplied (Law of Supply).
- c. Eventually, the new market equilibrium where the market clears (i.e. quantity demanded equals quantity supplied) will lead to a fall in price.
- d. However, the new equilibrium quantity is indeterminate as it depends on (i) the relative shift in demand and supply as well as (ii) PED and PES.
- e. Use a clear diagram to support the analysis that consumer expenditure eventually falls.
- f. [This should be accompanied by a diagram that shows (1) concurrent shifts in demand and supply, (2) supply increases more than the fall in demand, (3) price elastic demand and supply, (4) clear labels for diagram, axes, graphs, original and new equilibrium, surplus at original equilibrium price.]

## MARK SCHEME 2

Level	Descriptor
<b>L3</b> 15-21	<ol style="list-style-type: none"> <li>1. Candidates should <b>analyse clearly</b>, with the <b>aid of diagrams</b>, the impact of <b>concurrent changes</b> in demand and supply on consumer expenditure <b>in at least two different markets</b>, e.g. electronic and print books.</li> <li>2. Candidates are also <b>expected to use relevant elasticity concepts</b> to aid analysis on consumer expenditure changes in these markets, to achieve top marks.</li> <li>3. There are few or no conceptual errors.</li> </ol>
<b>L2</b> 10-14	<ol style="list-style-type: none"> <li>4. Candidates were able to <b>analyse clearly</b>, with the <b>aid of diagrams</b>, the impact of <b>concurrent changes</b> in demand and supply on consumer expenditure <b>in only one market</b>. There may be few conceptual errors.</li> </ol> <p><u>OR</u></p> <ol style="list-style-type: none"> <li>5. Candidates attempted to analyse the impact of changes in demand and supply on consumer expenditure in one or two different markets, however, may have one or more of the following that did not warrant a L3 grade:               <ol style="list-style-type: none"> <li>a. Did not analyse the changes in demand and supply concurrently</li> <li>b. Lacked clear price adjustment process analysis</li> <li>c. Did not clearly extend impact analysis to changes in consumer expenditure, e.g. stopped at changes in market equilibrium price and quantity</li> <li>d. Made some conceptual errors</li> </ol> </li> </ol>
<b>L1</b> 1-9	<ol style="list-style-type: none"> <li>6. Candidates were only able to show a superficial understanding of the question requirement, for example:               <ol style="list-style-type: none"> <li>a. Explained changes in demand and/or supply factors with no explicit link to changes in equilibrium price and quantity</li> <li>b. Did not identify even one market for analysis</li> <li>c. Only stated, but did not / could not explain changes in demand and/or supply factors and its subsequent impact on the market equilibrium</li> </ol> </li> <li>7. Candidates who made a few major conceptual errors also could not score beyond the L1 grade.</li> </ol>
<b>E2</b> 3-4	A. A reasoned judgement on the likely impact on consumer expenditure (direction and extent), which depends on relative shifts in demand and supply, as well as the PED / PES of the market .
<b>E1</b> 1-2	B. Unsubstantiated judgement.

## Essay Q3 Review

3	(a)	<b>Explain the key differences between oligopolistic competition and monopolistic competition.</b>	<b>[10]</b>
	(b)	Discuss the view that oligopolists will definitely exploit consumers given that they have market power.	[15]

### Q3a Suggested Answer

1. *Introduction: Define oligopolistic competition and monopolistic competition.*

a. *Presence of BTEs, no of firms, nature of product, price setting abilities*

*Body:*

2. *Explain oligopolistic competition and MC differ in terms of the BTE and the no. of firms*

a. *In oligopolistic competition, there are few large firms due to high BTE while many small firms in MC market due to relative low BTE.*

b. *The difference of BTE can be both natural or artificial. E.g. due to high start-up cost for oligopolistic competition while low for MC.*

c. *For e.g.: telecommunication companies and restaurants market in Singapore*

3. *Explain oligopolistic competition and MC differ in terms of nature of the product sold by firms and hence price elasticity of demand.*

a. *In oligopolistic competition, the firms sell similar but differentiated product. Due to the nature of the product and the existence of a few dominant firms, the firms in the industry will be very conscious with the prices changes. If the firm increases its price, other firms do not follow so demand is price elastic but if the firm decreases the price, other firms will follow so demand is price inelastic. This explains the price rigidity in oligopolistic competition.*

b. *In contrast, in a MC market, there are many firms selling differentiated products that are close substitutes for one another. Therefore, the demand for the product produced by the firms in a MC market is more price elastic than the demand for the product produced by the firm in an oligopoly market.*

4. *Explain oligopolistic competition differ in terms of BTE and hence long-run profitability*

a. *In a oligopolistic market, the firm can make supernormal profit in the long run due to high BTE. Firms will collude with other firms to maximise profit. Firms in oligopolistic competition work together and act like monopoly where they fix a profit maximising price and output. This allows the industry firms earn supernormal profit in the long run.*

b. *In contrast, the firms in MC market can only make normal profit in the long run due to absence of BTE. If the firms in a MC market are making supernormal profit, potential firms will enter the market in the long run. Due to the increase in the number of firms in the market, each firm will have a smaller market share – lead to a fall in its profit. Potential will stop entering when the firms are making normal profit.*

5. *Answer **may** also include key differences in terms of behaviour.*

6. *Conclusion: relate back to the question.*

### MARK SCHEME 3(a)

Level	Descriptor
<b>L3</b> 7-10	1. Able to explain clearly how the key differences of oligopolistic competition and MC lead to different implications. 2. Top credit to be awarded to answers that include good use of examples and



	relevant diagrams where appropriate.
<b>L2</b> 5-6	3. Able to explain the key differences but undeveloped explanations.
<b>L1</b> 1-4	4. Merely listing of characteristics with little explanations.

3	(a)	Explain the key differences between oligopolistic competition and monopolistic competition.	[10]
	(b)	<b>Discuss the view that oligopolists will definitely exploit consumers given that they have market power.</b>	<b>[15]</b>

### **Q3b Suggested Answer**

1. *Introduction: Explain the meaning of market power*

- a. *Firms' ability to influence the price or output in the market as they are price setter. The degree of market power depends on factors such as the number of firms in the industry, the nature of product (homogeneous or differentiated), the level of barriers to entry.*

*Body:*

2. *Explain with the aid of diagrams showing oligopolists in long run equilibrium where  $P > MC$ ).*

- a. *Oligopoly market generally has greater market power and thus higher degree of consumer exploitation (i.e. greater mark-up in price above marginal cost) - few firms in the market, less level of competition and so large firms in oligopoly market generally are faced with more price inelastic demand curve and thus have greater market power.*

3. *Explain how market power leads to consumer exploitation*

- a. *oligopoly firms has the power to set price or quantity of sales of their goods - with downward sloping demand curve. To sell an additional unit, firms must reduce the price of all units. Thus, Marginal Revenue is less than Average Revenue / Demand curve.*
- b. *Profit maximising firms in the market structures will produce till the quantity where Marginal Cost equals Marginal Revenue. At the equilibrium output, price is greater than marginal cost for the last unit produced.*
- c. *Since oligopolists charge higher prices and under production of goods and consumers' welfare are not maximised and consumer exploitation (i.e. the mark-up in price above marginal cost).*

4. *Explain how LR profit can benefit consumers / exploit consumers*

- a. *Oligopolistic firms enjoy higher level of barriers and can retain supernormal profits in the long run. Thus, oligopolistic firms have the ability and the incentives (due to the greater degree of competition within industry) to innovate.*
- b. *This helps to improve consumer welfare through better quality products, new range of products etc.*
- c. *However, in a collusive / non-competitive oligopolistic industry, firms may behave more like monopolies such that any cost-savings from R&D in production will not be passed onto the consumers.*

5. *Explain how oligopolists can practice price discrimination to benefit the consumers / exploit consumers.*

- a. *Large firms in oligopolistic market structure can benefit consumers through price discrimination. Large firms in transportation and telecommunication industries provide essential services and they may price discriminate to benefit certain sectors in the economy such as students and senior citizens.*
- b. *Price discrimination may also allow firms to continue to produce goods despite low market demand. Eg. Public transport operators may continue to ply certain routes and thus benefits consumers despite low demand and less profit made.*
- c. *However, price discrimination will result in certain consumer segments being charged more, and a reduction of their consumer surplus.*

Conclusion:

6. *Generally firms may exploit consumers by charging higher prices and producing lower quantity of output compared to a perfectly competitive market. On the other hand, oligopolists provide better quality of goods and services which improve consumer welfare. In reality, government's checks and regulations in the market (e.g. anti-competition law) will ensure that despite having market power, especially for large firms, they do not have the incentive to exploit consumers. In fact, market power provides the incentives and the ability to improve the quality and price of the products in the long run through research and development.*

### MARK SCHEME 3(b)

Level	Descriptor
<b>L3</b> 9-11	1. Answer provided is thorough and well-balanced on how market power arising from the oligopolists market structure may lead to exploitation of consumers.
<b>L2</b> 5-8	2. Answer is able to provide a balanced view on how consumers in oligopoly market may or may not be exploited but lacking in depth analysis.
<b>L1</b> 1-4	3. Answer is mainly under- developed with some ideas of market power and consumer exploitation.
<b>E2</b> 3-4	A. Answer is able to arrive at a reasoned evaluation.
<b>E1</b> 1-2	B. Judgement on whether consumers are exploited when oligopolists have market power but without elaboration.

## Essay Q4 Review

4	In a country such as Singapore which has no natural resources and therefore depends much on its people, the assertion that is often made is it is important for Singapore to improve her labour productivity	
	(a)	Explain the macroeconomic goals of a government. [10]
	(b)	Discuss the extent to which an improvement in labour productivity can help Singapore achieve sustained economic growth. [15]

### Q4a Suggested Answer

1. **Introduction** – The main macroeconomic goals of a government are namely, low inflation, sustained economic growth, full employment and healthy BOP. These macroeconomic goals are important to a government as it helps to improve the standard of living for the citizens in a country.

### Development

2. Low inflation – Explain what inflation is
  - a. Explain the reasons why low inflation is a macroeconomic goal for the government
    - i. Real income would increase when output/income increases if inflation rate is low relative to growth rate → consumers will be able to purchase more goods and services → improves the SOL in material aspect
    - ii. Uncertainty reduced when inflation rate is kept low as the rate of returns from investment is stable. This promotes business confidence and hence long term investment increases.
    - iii. With low inflation rate relative to those in other countries, exports can remain price competitive, promoting economic growth in the country. BOP account will also improve since current account improves, assuming capital and financial account remaining unchanged.
3. Sustained economic growth – Explain what is meant by sustained economic growth → refers to the increase in real output in the economy over time and this increase can be maintained. This is only achieved with both actual and potential growth.
  - a. Explain the importance of sustained economic growth in a country
    - i. Can raise the SOL of the citizens in material aspects as there are more goods and services in the economy available for consumption
    - ii. With growth people are less concerned about being able to afford the material necessities of life and can foster qualitative attributes. Economy can now focus on the improving the environment and other aspects of life like sanitation, better amenities and ability to raise the quality of education in the country and as such improve the well-being of the people.
    - iii. With stable growth, it is likely to make the poor better off without having to make the rich worse off → helps to narrow income inequality gap
    - iv. This also results in more revenue for the government and as such countries can have more reserves kept, ready to meet any future crises
4. Full employment
  - a. Explain the importance of achieving full employment in a country
    - i. Country's resources are utilized efficiently → amount of resources left idle is reduced and hence little wastage of scarce resources; resources are channelled to produced goods and services that are desired and hence society's welfare is increased as output is raised; the objective of low unemployment is linked to economic growth as low employment promotes growth as more goods and services are produced in an economy

- ii. Less welfare payments or unemployment benefits to be paid by the government → funds can therefore be directed to develop the country further to bring about greater increase in output/income; and tax burden on those working can possibly be reduced
  - iii. Social problems are reduced. Lower crime rates and less social unrest--- time and resources can then be better directed to other more productive activities in the country
5. *Healthy Balance of Payment – Explain what BOP is → The BOP is a record of international transactions between a country's residents and the rest of the world.*
- a. *Explain the importance of a healthy BOP*
    - i. *It is important to maintain a healthy BOP because it has a direct impact on economic growth. With a healthy BOP, it may be caused by a rise in export earnings or a rise in FDIs, this will increase AD which will promote economic growth*
    - ii. *With a healthy BOP, the external value of currency will not depreciate and this will boost the confidence of the investors, leading to more investment in the country*
    - iii. *Also a healthy BOP means that the country is accumulating foreign exchange reserves. In times of need, these reserves can be used to finance purchase of imports as well as maintaining the strength of the Singapore dollar.*

### **Conclusion**

6. *Achieving the 4 macroeconomic goals is important as these aims bring about higher SOL for her citizens.*

### **MARK SCHEME 4(a)**

Level	Descriptor
<b>L3</b> 7-10	1. Clear explanation of the 4 macroeconomic goals on how they are important to the government and how achieving these goals can lead to a rise in SOL among the citizens. 2. A well-explained answer of 3 or more goals can be awarded full credit.
<b>L2</b> 5-6	3. Adequate explanation of the goals on how the goals are important to the government. <u>OR</u> 4. Too few goals are explained / well-explained.
<b>L1</b> 1-4	5. Brief explanation of the goals. Major conceptual errors made. 6. Answer does not address question, e.g. explaining the causes of macroeconomic problems, policies used to achieve macroeconomic goals.

4	In a country such as Singapore which has no natural resources and therefore depends much on its people, the assertion that is often made is it is important for Singapore to improve her labour productivity		
	(a)	Explain the macroeconomic goals of a government.	[10]
	(b)	Discuss the extent to which an improvement in labour productivity can help Singapore achieve sustained economic growth.	[15]

#### **Q4b Suggested Answer**

1. **Introduction** – Explain what is meant by labour productivity and reiterate sustained economic growth
  - a. Labour productivity measures the output per worker in a period of time. Labour productivity is an important factor in determining the productive potential of the economy. Countries with improvement in labour productivity growth tend to benefit from high and sustainable economic growth.
  - b. Reiterate sustainable economic growth (as mentioned in part a)
  - c. Factors that help to improve labour productivity include better skills and qualifications of workers, promoting innovation and technological progress.
  - d. In the case of Singapore, an improvement in labour productivity is one of the crucial factors in achieving sustained economic growth. However, there are also other policies that will also help sustain growth in the economy.

#### **Development**

2. Explain how an improvement in labour productivity can help Singapore achieve sustained economic growth (increase in AD and AS). As long as the increase in AD is matched by the increase in AS due to improvement in labour productivity, Singapore is able to achieve sustained economic growth. Students should draw and explain diagram to show how both increases in AD and AS can lead to a rise in non-inflationary sustainable growth.

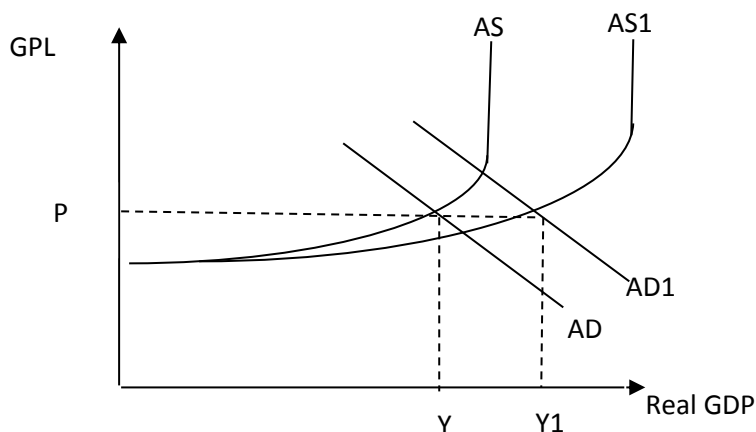
##### **Increase AD**

- a. With improvement in labour productivity, investors will be more willing to invest in our country as they are able to produce more output with a given amount of resources. This increases the expected rates of returns from investment → increase I.
- b. In addition, because of a more skilled workforce, it lowers the cost of production as the workers are able to increase production with a given amount of resources. This will reduce the price of exports, assuming producers pass on the cost savings. This increases the export competitiveness of the goods in Singapore → increase X
- c. The increase in AD due to I and X will lead to a rise in national income by multiples, promoting actual growth of the economy. The increase in AD is substantial in the case of Singapore as we rely heavily on I and X for growth.

##### **Increase AS**

- d. Singapore has focused on many supply-side measures to shift LRAS to the right so as to bring about sustained economic growth. For example, workers' training and retraining programmes like SPUR, improvement in education system to ensure that relevant skills are taught in schools.
- e. All these investments in human capital cause labour productivity to rise. As a result, the short-run AS curve shifts to the right, because a more skilled workforce lowers the cost of production. The long-run AS curve also shifts to the right because greater output is achieved on a permanent or sustainable basis, *ceteris paribus*.

- f. Furthermore, with the increase in investment due to improvement in labour productivity, it will also improve the AS in the long run as there are more spending on capital goods.
- g. This increase in AS will help to promote potential growth in the economy.



3. Explain how labour productivity may not be able to achieve sustained economic growth
  - a. If the improvement in labour productivity is focusing on low-skilled jobs, then the extent to which FDI inflow may not be substantial as Singapore mainly attracts high-value added FDIs.
  - b. Moreover, if the increase in labour productivity to increase AS is slower than the increase in AD, it will lead to inflationary pressures which will not be desirable for the economy. The slower increase in AS may be due to factors such as the difficulty to change the mind-set of the individuals to improve their skills and knowledge, the time taken to train the workers and the high costs involved in training the workers. With these limitations, economic growth may not be sustainable as inflationary pressures set in.
  - c. More importantly, if there are external factors, such as a global recession, causing our  $X$  to fall, then an improvement in labour productivity will not help to achieve sustained economic growth. As such, to achieve sustained growth, Singapore must look at the root of the problem before implementing the appropriate policy.
4. Explain that there are other factors which are needed to help Singapore achieve sustained economic growth, given the limitations of labour productivity
  - a. Besides improvement in labour productivity, other government policies must also be set in place to promote both actual and potential growth so as to ensure sustained growth in the economy.
  - b. For example, expansionary fiscal policy, with a supply-side intent, should be implemented. This includes building of infrastructure and spending on healthcare. This will not only increase AD through the rise in  $G$ , it will also be able to increase the AS in the long run due to the higher productivity of the resources.
  - c. Other supply-side policies can also be implemented, such as signing of free trade agreements with other countries so that we have larger export markets to increase  $X$  to promote actual growth and attracting more FDIs to enter to Singapore to promote potential growth.

### Conclusion

5. It is definitely very important for Singapore government to improve our labour productivity. As a small economy with no natural resources, there is a need to rely on human labour so as to achieve sustained economic growth.

6. In addition, such improvement in labour productivity will help Singapore to be better prepared with future demands of the economy and to cope with any short term problems of a recession. This will ensure continuous growth in Singapore.
7. However, raising labour productivity alone is not sufficient. It has to be complemented with other policies to manage both increases (and fluctuations) in AD and AS so that growth can be sustained in Singapore.

**MARK SCHEME 4(b)**

Level	Descriptor
<b>L3</b> 9-11	<ol style="list-style-type: none"> <li>1. Answer shows excellent knowledge of how sustained economic growth can be achieved by improvement in labour productivity in Singapore</li> <li>2. Candidates are able to explain clearly that improving labour productivity may not be effective in helping Singapore to achieve these aims due to certain limitations.</li> <li>3. Candidates are able to bring in other macroeconomic policies to complement policies to achieve sustainable growth in Singapore. (Optional. This is one alternative to answering the question). However, students should be able to draw links that there are limitations to labour productivity and thus there is a need to bring in other policies.</li> <li>4. Good use of examples.</li> </ol>
<b>L2</b> 5-8	<p><u>7-8m</u></p> <ol style="list-style-type: none"> <li>5. Answer shows some knowledge of how sustained economic growth can be achieved by increasing labour productivity in Singapore. (there is no need to mention both increases in AD and AS)</li> <li>6. Candidate did consider that improving labour productivity is may not effective in helping Singapore to achieve these aims.</li> <li>7. Briefly explained the use of other policies. (Optional. This is one alternative to answering the question)</li> </ol> <p><u>5-6m</u></p> <ol style="list-style-type: none"> <li>8. Answer shows some knowledge of how sustained economic growth can be achieved by increasing labour productivity in Singapore.</li> <li>9. Students are able to point out that sustained economic growth is due to increases in both AD and AS</li> <li>10. Underdeveloped explanation in some areas.</li> <li>11. Explanation has some reference to the AD-AS model and the Singapore economy.</li> <li>12. One-sided answer on how improvement in labour productivity can lead to sustained growth: max 6m</li> </ol>
<b>L1</b> 1-4	<p><u>3-4m</u></p> <ol style="list-style-type: none"> <li>13. Briefly explain how a rise in labour productivity affects economic growth</li> <li>14. Several errors and inconsistencies occur in the explanation.</li> <li>15. Little or no reference to the Singapore economy.</li> </ol> <p><u>1-2m</u></p> <ol style="list-style-type: none"> <li>16. Stating of a few valid points and briefly mentioned how a rise in labour productivity affects an economy, but did not explain how.</li> </ol>
<b>E2</b> 3-4	A. Explained judgement on the importance of improvement in labour productivity in Singapore to help achieve sustained growth in Singapore. This includes the state of our economy (recession or boom), the nature of our economy (which factor of production are we more dependent on) etc.
<b>E1</b> 1-2	B. Unexplained judgement on whether improvement in labour productivity will help to achieve sustained growth in Singapore



## Essay Q5 Review

5	In the years after the Global Financial Crisis, large economies like the US and UK have faced slow recoveries, with the threat of re-entering recession always looming. Analysts suggested that these governments need to reverse their current contractionary fiscal policy, and implement further expansionary monetary policy to help boost growth.
	Discuss the appropriateness of these suggested policies in helping governments prevent recession.
	[25]

### Background to question

Students should be able to show an appreciation of the macroeconomic conditions resulting from the Subprime mortgage crisis and European Sovereign Debt Crisis. A detailed understanding and analysis is not required.

- a) The U.S. **subprime mortgage crisis** was a major cause of the 2008 financial crisis, which spilt over to the real economy, leading many countries to enter into their worst recessions since the Great Depression.
- b) In late 2008, the Federal Reserve lowered its target policy rate effectively to zero. Given a deteriorating outlook for economic growth, the Fed began **quantitative easing**, an unconventional monetary policy in which the central bank purchases government securities or other securities from the market in order to **lower interest rates and increase the money supply** by flooding financial institutions with capital in an effort to promote increased lending and liquidity.
- c) On the fiscal front, **aggressive fiscal expansion** was pursued in the US. This includes lump sum payments made to US taxpayers, tax cuts for businesses and payments to veterans and pensioners (The Economic Stimulus Act of 2008), further tax cuts and subsidies, public investments for health, education and social security payments (The American Recovery and Reinvestment Act of 2009).
- d) In early 2009, the Bank of England, which had lowered its policy interest rate to its effective zero lower bound, also announced plans to purchase government bonds in order to increase nominal economic activity. In the same year, the UK government also pursued expansionary fiscal policy in response to the deep recession (GDP fell about 6%) that ensued, cutting the VAT in a bid to boost consumer spending. This caused a big rise in government borrowing. The increased government borrowing also arise because of the recession leading to lower tax revenue.
- e) From late 2009, concerns about rising government deficits and debt levels across the globe together with a wave of downgrading of European government debt created alarm in financial markets. Austerity cuts have been central to Europe's efforts to emerge from the **European sovereign-debt crisis**. In a number of countries, **austerity measures** were a condition of sovereign bailouts.
- f) In UK, when the new coalition government came into power in May 2010, they argued the deficit was too high and hence also announced plans to reduce government borrowing, and a series of sustained reductions in public spending, intended to reduce the budget deficit. The US, however, began to tighten fiscal policy only in 2010, after the economy showed some improvement, such as having a stronger banking and financial sector. The austerity measures were believed by many to be a factor in causing low economic growth in UK and US in 2011 and 2012.

**Q5 Suggested Answer****1. Introduction**

- a. The U.S. subprime mortgage crisis was a major cause of the 2008 financial crisis, which spilt over to affecting the real economy, leading many countries to enter into their worst recessions since the Great Depression.
- b. US and UK undertook aggressive expansionary fiscal and monetary policies to steer their economies out of recession. However recovery has been slow, and with added challenges due to the European sovereign-debt crisis, these economies may easily fall back into recession.
- c. On the backdrop of high budget deficits, both the UK and US governments have subsequently tightened fiscal spending. This, together with the tapering of Quantitative Easing in the US, has made many analysts worry that the two countries may slip back into recession due to the combined contractionary effects. Hence the call has been to reverse their current contractionary fiscal policy, and implement further expansionary monetary policy to help boost economic growth.

**Development**

2. Demand management policies refer to the use of monetary and fiscal policies to influence the aggregate demand for goods or services in an economy. During periods of recession and high unemployment, governments attempt to stimulate demand (and, hence, production and employment).
3. Explain expansionary fiscal policy → refers to an increase in government spending (G) and/or a lowering of direct taxes to boost AD.
  - a. Lower personal income taxes will increase consumer spending (C) because they have more disposable income. Lower corporate taxes will enable firms to retain more profits for investments (I)
4. Explain expansionary monetary policy → Lower interest rates stimulate I and C as cost of borrowing decreases.
  - a. With lower cost of borrowing, given an expected rate of return, I will be more profitable and thus the level of I will increase. Furthermore, lower interest rates also lower the opportunity cost of current consumption thus increasing consumption. As I and C are part of AD, this leads to an increase in AD.
  - b. Devaluation can also be considered as a theoretical possibility, though students will not score high L3 (max 16m, see mark scheme) as it is not a discussion centred around the context of the question, i.e. all large economies use interest rate as their main monetary tool.
5. Explain multiplier process → Higher AD will cause national income to rise through the multiplier process.
  - a. If the multiplier for public expenditure is 2, an increase in public expenditure of USD100b would increase GDP by USD200b in total. As the purpose of changes in the fiscal stance is to affect the real economy, it will therefore be preferable for the multiplier effect to be greater than 1. A change in fiscal policy will then contribute to GDP by more than the actual increase in public expenditure, and thus have a significant effect on the real economy.
6. Discussion on **appropriateness** of demand management policies in the aftermath of the financial crisis:
  - a. Higher government spending financed by borrowing from the private sector may result in crowding out effect. (1- Antithesis) **Crowding out effect** is the tendency of expansionary fiscal policy to cause a decrease in investments in the private sector which is normally resulted from the rise in interest rates. The government competes with the private firms for borrowing of funds. This leads to upward

pressure on interest rates as more parties are interested in the same pool of funds. Thus, due to higher cost of borrowing,  $C$  and  $I$  might fall. In the extreme case, the fall in consumption and investment may completely offset the rise in government expenditure and thus having no impact on  $AD$ . Thus the impact on national income and employment is significantly reduced.

Crowding out effect may happen as both the US and UK economies are at the recovery phase. However, when coupled with an accommodating monetary policy, i.e. the Fed and BOE keeps the key interest rate close to zero and flooding financial institutions with capital in an effort to promote increased lending, the effects of fiscal policy may be strengthened because the crowding-out effect is avoided.

In contrast to crowding out, as the government spends money, private industry must be prepared to provide the output demanded by the government. In order to do this, firms must invest in capital to increase their productivity. Hence government spending actually stimulates ("crowding-in") investment.

- b. Expansionary fiscal policy (cutting taxes and increasing  $G$ ) have caused an **(2- Antithesis) increase in budget deficit** in the US and UK that have led to both governments tightening fiscal spending. Higher budget deficits will require higher taxes in the future. High income taxes cause disincentives to work. If this occurs there will be a fall in productivity and  $AS$  could fall. High corporate tax rates will discourage investments.

When the government runs a budget deficit, it is spending more than it is taking in. In this way, national savings decreases. When national savings decreases, investment also decreases. Lower investment leads to lower long-term economic growth. A large national debt today will result in less physical capital, being passed on to future generations. In this way, future generations are burdened by a lower capacity for productivity as a result of decreased investment created by the national debt.

When US and UK already have high debt, additional government spending may even have a negative fiscal multiplier, because the financial markets do not accept additional government borrowing as they fear a sovereign default. In the longer term, rising interest rates will render the government insolvent.

With the real dangers to running high budget deficits, the UK and US governments should ensure spending increases are concentrated in areas where the expenditures are either reversible (such as workfare programs with a below-market wage offer will attract participants during downturns but will not be appealing once the economy recovers, i.e. spending will then fall), or likely to increase growth in the future (such as funding for training or R&D projects).

- c. Expansionary monetary responses **(3- Thesis) cause downward pressures on the exchange rates** of UK and US. Although a weakened currency causes import prices to become more expensive in the domestic currencies, the depreciation may come timely as export prices become lower in terms of foreign currencies. The added export price competitiveness is welcomed during the period of early recovery.
- d. Expansionary monetary policies carry the possibility of central banks losing anti-inflationary credibility, and the **(4- Antithesis) risk of accompanying high inflation** in US and UK. Although the Fed and BOE may eventually need to

tighten monetary policy to prevent a run-up on inflation in future, persistently low inflation may pose a more immediate threat than rising prices during the early recovery period, as both economies are still far from the full employment level.

- e. Being large and less open economies, the UK and US would have relatively **(5-Thesis) large multiplier size** compared to small, open economies like Singapore.

The size of the multiplier also varies according to economic conditions. For an economy operating at full capacity, the fiscal multiplier should be zero. Since there are no spare resources, any increase in government demand would just replace spending elsewhere. But when the UK and US economies were just coming out of a recession, when workers and factories lie idle, a fiscal boost can increase overall demand. Additionally, if the initial stimulus triggers a cascade of expenditure among consumers and businesses (barring crowding-out effect, which is less likely to occur as discussed), the multiplier can be well above one and demand management policies should be effective in stimulating higher income.

Multiplier size is also likely to vary according to the type of spending. Government spending on infrastructure development projects should have a bigger multiplier than a tax cut if consumers save a portion of their tax windfall, which may occur due to the increased uncertainty with the European sovereign debt crisis. A tax cut targeted at poorer people may have a bigger impact on spending than one for the affluent, since poorer folk tend to spend a higher share of their income (The Economic Stimulus Act of 2008 makes payments to veterans and pensioners).

### Conclusion

7. Fiscal interventions need to be timely in order to be effective, and that mistimed interventions can be counter-productive. This has been a challenge for many countries though less so for UK and US where data quality (to identify downturns and recoveries in real time) and fiscal institutions (to design and implement any proposed spending increases) were well established.
8. Policymakers need to consider the scope for coordinated monetary and fiscal interventions.
9. While the threats from the accumulation of high budget deficit and long term inflation may be real, expansionary fiscal and monetary policies may be necessary to ensure the continued recovery of UK and US. However, short-term policy orientation can have adverse effects in the long-term with huge price to pay. Deficit spending belongs to this category.

### MARK SCHEME 5

Level	Descriptor
<b>L3</b> 15-21	<ol style="list-style-type: none"> <li>1. For a <b>developed answer</b> that <b>thoroughly analyses</b> the limitations and advantages of the policies in the <b>context of UK and US</b> in the early recovery phase following the financial crisis.</li> <li>2. Up to 16 marks for a developed answer that analyses the pros and cons of expansionary fiscal and monetary policy in a slow growth / early recovery environment even though answer is strictly theoretical, not focused on the context of UK and US.</li> </ol>
<b>L2</b> 10-14	<ol style="list-style-type: none"> <li>3. For an answer that <b>adequately explains</b> with analysis how the <u>two policies</u> work to prevent recession and state some general limitations and advantages of the policies.</li> </ol>

	4. Up to 12marks only if answer contains a well-developed and balanced explanation of <u>either</u> expansionary fiscal or monetary policy.
<b>L1</b> 1-9	5. For an answer that shows some <u>superficial knowledge</u> of expansionary fiscal and monetary policy. Discussions on limitations are weak and some conceptual errors are evident. 6. Up to 5marks only if answer only <u>correctly explains</u> either expansionary fiscal or monetary policy.
<b>E2</b> 3-4	A. For a clear response to question requirements to discuss and with <b>reasoned conclusion</b> on the appropriateness of the policies for UK and US.
<b>E1</b> 1-2	B. Pros and cons were discussed but <b>conclusions on appropriateness despite each limitation were vague</b> or made <b>without justifications</b> .

## Essay Q6 Review

6	(a)	<b>Explain the theory of Comparative Advantage.</b>	<b>[8]</b>
	(b)	Globalisation benefits small and open economies such as Singapore most; hence these governments should continue to embrace globalisation. Discuss.	<b>[17]</b>

### Q6a Suggested Answer

#### 1. Introduction: **State the theory of Comparative Advantage:**

- a. Theory of Comparative Advantage asserts that trade at a mutually beneficial terms of trade can benefit economies if they specialise in producing and exporting goods in which they incur a lower opportunity cost in production relative to other economies, and importing goods in which they incur a higher opportunity cost in production relative to other economies.

#### Body:

2. **Stating the assumptions:** 2 countries, 2 commodities, each country uses the same amount of resources that is equally divided between the productions of 2 goods, there are constant returns to scale in production and transport cost is negligible.
3. Explain the theory either using a relevant table that shows the increase in output after specialising based on the theory of comparative advantage.
4. Explain that by specialising (based on theory of comparative advantage) and trading (using a mutually beneficially terms of trade), countries are better off with an increase in output for consumption that is beyond what both countries can initially produce.

#### Conclusion

5. Conclude that the theory of comparative advantage forms the basis of trade between countries.

### MARK SCHEME 6(a)

Level	Descriptor
<b>L3</b> 6-8	1. For an answer that thoroughly explains how the theory of comparative advantage forms the basis of trade and makes country better off in terms of the amount of goods and services available for consumption.
<b>L2</b> 4-5	2. For an under-developed explanation that has limited economic analysis, i.e. for answers that attempt to explain the following key terms: (1) Comparative Advantage, (2) specialisation and trade, (3) outcome such as increasing world output and/or individual economy consuming beyond production possibility curve.
<b>L1</b> 1-3	3. For a weak, superficial and descriptive answers which contain inaccuracies.

6	(a)	Explain the theory of Comparative Advantage.	<b>[8]</b>
	(b)	<b>Globalisation benefits small and open economies such as Singapore most; hence these governments should continue to embrace globalisation. Discuss.</b>	<b>[17]</b>

### Q6b Suggested Answer

1. Introduction – **Define globalisation as characterised by greater movement of goods, capital and labour.**

#### Body

2. **Explain that globalisation benefits small and open economies, such as Singapore, the most.**

- a. *Small economies have limited domestic demand. Since they are open economies, globalisation increases access to export markets and therefore allows small and open economies to experience economic growth.*
  - b. *Since they are open economies, globalisation allows for greater flow of FDI and therefore allows small and open economies to experience actual growth in the SR and potential growth in the LR.*
  - c. *Small economies often have a limited labour pool. Globalisation increases the flow of labour increasing the productive capacity thereby allowing the small and open economies to achieve potential growth.*
- 3. Explain that the globalisation harms these small and open economies.**
- a. *Increases the vulnerability of small and open economies to fluctuations in external demand; small economies like Singapore also face resource constraints, which make them vulnerable to imported inflation.*
  - b. *Large amount of financial capital in- or out-flow may lead to exchange rate / interest rate fluctuations, or asset price inflation*
  - c. *Globalisation may cause small and open economies to face brain drain and income inequality may worsen in these small and open economies.*
- 4. Explain that these above problems can be mitigated with the use of appropriate policies by small and open economies.**
- a. *Small and open economies should diversify their trade links to reduce over-reliance on any particular trading partners' economies.*
  - b. *Small and open economies like Singapore use mild and gradual appreciation to reduce imported inflation.*
  - c. *Small and open economies attract foreign talent by offering attractive scholarships.*
  - d. *Small and open economies like Singapore offer transfer payments to the lowest income group to reduce the income inequality. Furthermore, the government also provides training support to allow the low skills to improve their skill levels and be employed in higher skilled and better paying job. In this way, the income inequality is reduced as well.*

#### Conclusion

- **Explain that globalisation benefits small and open economies most as long as appropriate policies are undertaken by the government to mitigate the effects of globalisation.**
  - *With the appropriate policies in place, the small and open economies are more equipped to embrace globalisation.*
  - *Hence the small and open economies should continue to embrace globalisation.*

Level	Descriptor
<b>L3</b> 10-13	1. For an answer that discusses both the benefits and harms that globalisation can bring to small and open economies and thus if these economies should embrace globalisation.
<b>L2</b> 6-9	2. For an under-developed explanation that has limited economic analysis and justifications. 3. Answer is one-sided but well-explained.
<b>L1</b> 1-5	4. For weak, superficial and descriptive answers which contain inaccuracies.
<b>E2</b> 3-4	A. For an answer that takes a stand to say if these small and open economies should continue to embrace globalisation and the judgement supported by analysis.
<b>E1</b> 1-2	B. For an answer that takes a stand to say if these small and open economies should continue to embrace globalisation and makes a weak attempt to justify

	the stand.
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