

# **St. Andrew's Junior College**



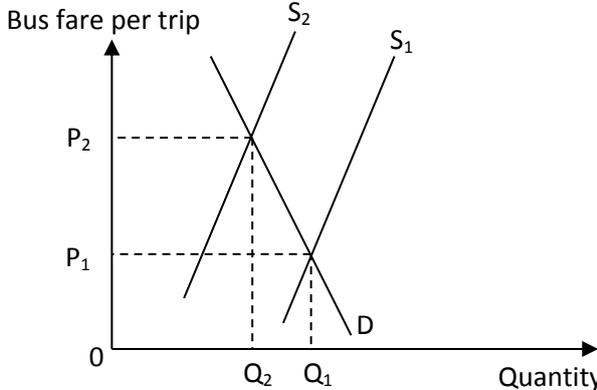
## **Economics Department JC 2 Preliminary Examinations (2015)**

### **Suggested Answers**

### **H2 Economics Paper 1 (Syllabus 9732)**

**Question 1 Bilateral transportation between Singapore and Malaysia**

**Suggested Answers:**

(a)	<p><b>Compare the trend of the price of crude oil and diesel between 2008 and 2013.</b></p> <p>Similarity [1m]</p> <ul style="list-style-type: none"> <li>- Prices of both fuel generally increased throughout the period.</li> <li>- Prices of both fuel moved in tandem throughout the period.</li> </ul> <p>Difference [1m]</p> <ul style="list-style-type: none"> <li>- Diesel prices were consistently higher than those of crude oil throughout the period.</li> </ul>	[2]
(b) (i)	<p><b>With the aid of diagram, explain how the changes in price of diesel will affect the market for express bus services.</b></p> <p>Price of diesel rose          → COP of Express Bus Services would rise          → Supply of Express Bus Services would fall [1m]          → Market <math>P_e</math> ↑ and <math>Q_e</math> ↓ [1m]</p> <p>Optional: TR ↑ (assuming PED &lt; 1)</p> <p>Correct Diagram [1m]</p> 	[3]
(ii)	<p><b>Explain how the completion of the High Speed Rail is likely to affect the demand curve for Express Bus Services between Singapore and Kuala Lumpur.</b></p> <p><i>Relationship between the two services – substitute</i></p> <ul style="list-style-type: none"> <li>- Completion of HSR              → consumers who previously demand for Express Bus Services may switch to HSR [1m]</li> <li>→ Demand for EBS would fall [1m]</li> </ul> <p><i>Increase in the availability of closed substitutes.</i></p> <ul style="list-style-type: none"> <li>- PED for EBS trips that end in KL becomes more price elastic,</li> </ul>	[3]

		larger in value [1m]  Max 2 marks for Demand without Price elasticity of demand.	
(c)	(i)	<p><b>Explain how the formation of cartels results in the worsening of the market failure.</b></p> <p>Key word: 'worsening'</p> <ul style="list-style-type: none"> <li>- Establish existence of market failure <i>prior to</i> formation of cartel, <math>P &gt; MC</math> [1m]</li> <li>- Formation of cartel <ul style="list-style-type: none"> <li>⇒ greater MCR (market concentration ratio) of cartel members, cartels would act and behavior more like a monopoly [1m]</li> <li>⇒ demand for cartel members' goods and services become more price inelastic due to reduced competition among firms [1m]</li> <li>⇒ price charged would become even more than or even higher than MC</li> <li>⇒ Greater DWL, hence worsening of market failure [1m]</li> </ul> </li> </ul> <p>Max at 3m if answers explained clearly how imperfect information resulted in a market failure but did not mentioning on the 'worsening' or increase in deadweight loss.</p>	[4]
	(ii)	<p><b>Discuss whether the disadvantages to consumers from 'higher fixed prices' (Extract 2) outweigh any benefits they may gain from the existence of the Express Bus Services cartel.</b></p> <p>Disadvantages of 'higher fixed prices'</p> <ul style="list-style-type: none"> <li>- 'Higher prices' <ul style="list-style-type: none"> <li>→ lower consumer surplus for consumers who continue to take the bus service</li> <li>→ market quantity decreased, total loss of utility for some consumers who are now priced out of the market.</li> </ul> </li> <li>- 'Fixed prices' <ul style="list-style-type: none"> <li>→ not being able to enjoy lower price even if there is to be cost savings (e.g. lower fuel prices or improvement in technology etc)</li> </ul> </li> <li>- Complacency of Cartel members <ul style="list-style-type: none"> <li>→ due to fixed price and reduce in competition, Cartel members might become complacent and not produce at the lowest cost or invest in R&amp;D.</li> </ul> </li> </ul> <p>Benefits of 'higher fixed prices'</p> <ul style="list-style-type: none"> <li>- 'Higher prices' <ul style="list-style-type: none"> <li>→ Cartel is more likely to earn supernormal profits or increase in the amount of supernormal profits → firms in cartel will be more able to upgrade of equipment, more comfortable ride, and promotion of dynamic efficiency in the market.</li> </ul> </li> <li>- 'Fixed prices' <ul style="list-style-type: none"> <li>→ as Cartel members do not have the ability for price</li> </ul> </li> </ul>	[8]

		<p>competition, they might embark on non price competition by improving quality of services.  → Ensured continued provision of service at fixed prices. Excessive competition may drive out weaker firms in the long run, leaving the remaining stronger ones with even more market power and may charge <b>even</b> higher prices.</p> <p>Conclusion &amp; Evaluation:</p> <ul style="list-style-type: none"> <li>• Students must choose a stand whether pros outweigh cons or vice versa. (1m)</li> <li>• Students justifying their choice of stand based on the context of the Express bus service. (1m)</li> </ul> <p>Setter's comments:  Likely to have more Cons than Pros, if not the government would not need to step in and restrict the formation of cartels in the EBS.</p>									
	<table border="1"> <thead> <tr> <th data-bbox="349 813 528 880">Level and Marks</th> <th data-bbox="528 813 1315 880">Knowledge, Understanding, Application, Analysis</th> </tr> </thead> <tbody> <tr> <td data-bbox="349 880 528 1048">Level 3 6-8m</td> <td data-bbox="528 880 1315 1048">Two sided analysis with clear use of relevant economic theories. Judgment based on sound evaluation in the context of the case. Max 6 for two sided answers without a judgment.</td> </tr> <tr> <td data-bbox="349 1048 528 1115">Level 2 4-5m</td> <td data-bbox="528 1048 1315 1115">Two sided analysis with some use of relevant economic theories.</td> </tr> <tr> <td data-bbox="349 1115 528 1305">Level 1 1-3m</td> <td data-bbox="528 1115 1315 1305">One sided, Max 3 Unfocused answer or simply listed a large number of points Smattering of points. No use of economic theories.</td> </tr> </tbody> </table>	Level and Marks	Knowledge, Understanding, Application, Analysis	Level 3 6-8m	Two sided analysis with clear use of relevant economic theories. Judgment based on sound evaluation in the context of the case. Max 6 for two sided answers without a judgment.	Level 2 4-5m	Two sided analysis with some use of relevant economic theories.	Level 1 1-3m	One sided, Max 3 Unfocused answer or simply listed a large number of points Smattering of points. No use of economic theories.		
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(d)		<p><b>Discuss how the High Speed Rail as a 'game changer' will affect the performance of firms in Singapore that provide transport to Malaysia.</b></p> <p><i>Question analysis:</i></p> <ul style="list-style-type: none"> <li>- Performance of transport firms in Singapore that provide transport services to Malaysia – Express Bus Services (eg Grassland), normal airlines (eg SIA and MAS), budget airlines (eg Airasia and Tigerair) etc.</li> <li>- Performance indicators include AE, PE, DE, Choice and Equity.</li> <li>- Evaluation: Degree of impact also depends on the different destinations in Malaysia</li> </ul> <p><i>Game changer:</i></p> <ul style="list-style-type: none"> <li>- Certain firms may face a shake-up</li> </ul> <p><b>Substitutes of HSR:</b>  Performance of transport firms in Singapore that provide transport services to Malaysia which are substitutes to HSR:</p> <ul style="list-style-type: none"> <li>• Express Bus Services (eg Grassland)</li> </ul>	[10]								

- *Normal airlines (eg SIA and MAS)*
- *Budget airlines (eg Airasia and Tigerair)*

**Allocative Efficiency:**

Decrease in demand and Demand becoming more price elastic will reduce deadweight loss as the degree of  $P > MC$  will be reduced.

**Productive Efficiency:**

Assuming Profit motivated, firms will continue to minimise cost, with more competition, firms will be even more eager to minimise cost making them more productive.

**Dynamic Efficiency:**

With more competition, firms will be even willing to innovate. Firms might be less able to innovate due to a decrease in demand and profits.

**Choices:**

More choices for transport to Malaysia.

**Equity:**

Prices are likely to decrease, making a more fair distribution of consumer and producer surpluses.

**Transport services unrelated to HSR**

- HSR are only substitutes to some routes and areas. For those routes from Singapore that are unrelated or unaffected by HSR, there should be no changes in performance of those firms.

**Evaluation:**

- Depend on degree of substitutability or closeness.
- HSR will take a few years to complete, there might be changes to the different transport markets from now till the completion of HSR.
- Prices of HSR would also determine the impact on performance.

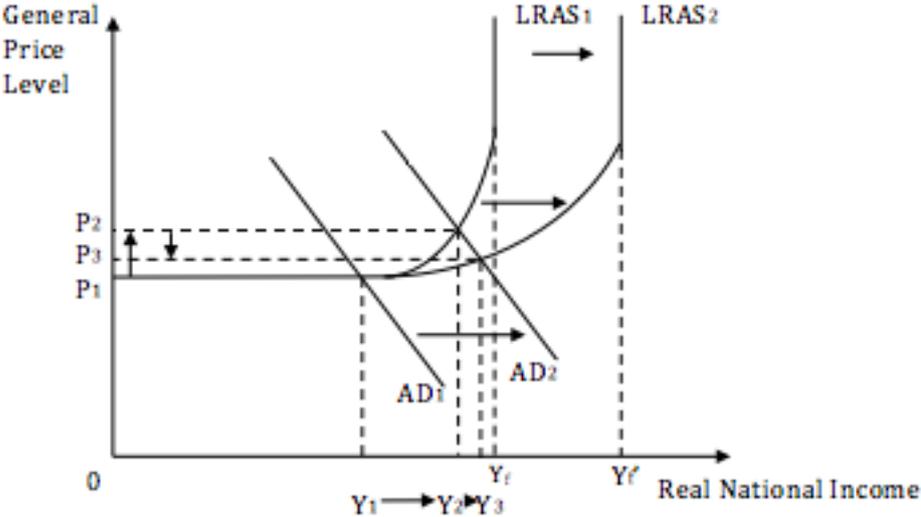
Note: Choices and Equity are not compulsory, they are bonus points that students can write.

<b>Level and Marks</b>	<b>Knowledge, Understanding, Application, Analysis</b>
Level 3 6-8m	All three efficiencies are required, analysis with clear use of relevant economic theories.
Level 2 4-5m	At least two out of three efficiencies analysis with some use of relevant economic theories.
Level 1 1-3m	One sided, Max 3 Unfocused answer or simply listed a large number of points Smattering of points. No use of economic theories.
Evaluation 1-2m	Judgment based on sound evaluation in the context of the case with justification.
<b>[Total: 30 marks]</b>	

## Question 2 Tale of Two Economies

### Suggested Answers:

(a)	i)	With reference to Table1, describe the trend in the government budget balance as a percentage of GDP of Indonesia between 2009 and 2013.	[2]
		<ul style="list-style-type: none"> <li>Indonesia's government budget balance is in deficit throughout 2009 and 2013. <b>[1]</b></li> <li>However, Indonesia's government budget balance as a percentage of GDP has been improving (Or deficit has become smaller). <b>[1]</b></li> </ul>	
	ii)	Explain how the government budget could have affected GDP growth rate in Indonesia.	[2]
		<ul style="list-style-type: none"> <li>Indonesia's budget deficit means that its government is pursuing an expansionary policy, i.e Government spending is greater than its revenue. This would lead to an increase in Aggregate Demand with an increase in Govt spending, consumers expenditure and investment expenditure. National income will rise as there would be an increase in production to meet the increase in the aggregate demand. <b>[1]</b></li> <li>Hence GDP growth rate would be positive. <b>[1]</b></li> </ul>	
(b)	i)	How far does the data support the changes in the capital and financial account in Indonesia from 2009 to 2013?	[4]
		<ul style="list-style-type: none"> <li>From Table 1: <ul style="list-style-type: none"> <li>Capital and financial account shows a falling positive net inflow from 2009 to 2010 to an increasing negative net inflow for the rest of the period. Thus the statistics shows that there is more outflow than inflow from 2011 till 2013. <b>[1]</b></li> </ul> </li> <li>Evidence from Extract (4) seems to indicate that there is a greater net inflow of FDI from 2012 to 2013. <p>Evidence :</p> <ul style="list-style-type: none"> <li>"increase foreign direct investment by 23 percent in 2013, after record inflows in 2012"</li> <li>"Indonesia remained attractive to foreign investors" <b>[1]</b></li> </ul> </li> <li>However because inflows &lt; outflow, this may indicate that while FDI into Indonesia is rising, there could be relatively more long term investment flowing out of Indonesia. Moreover, data of other components of capital and financial accounts, eg ST capital flow, has not been provided. <b>[1]</b></li> <li>Conclusion: Therefore the data given does not fully explain the position of the Indonesia's capital and financial account. <b>[1]</b></li> </ul>	

ii)	<p>Explain the rationale for Indonesia's aim "to increase foreign direct investment by 23 percent this year".</p>	[4]
	<p>Indonesia aims to increase foreign direct investment as it helps it in achieving its macroeconomic objectives of sustained economic growth as well as lowering unemployment in the face of falling exports. [1]</p> <p><b>Note:</b> To get the mark, students must use evidence from the Table 1 or Extract 4 to support why Indonesia would want to increase FDI.</p>  <p>In the short run, an increase in foreign direct investment greater than the fall in exports would bring about an increase in AD. When AD increases from AD<sub>1</sub> to AD<sub>2</sub>, at the original equilibrium price of OP<sub>1</sub>, there would be an excess demand for goods and services and this causes a rundown in inventories stocks. In response, producers would have to increase production of goods and services. To meet the increase in production of goods and services, producers would have to increase their demand for both labour and capital goods to increase output, resulting in lower unemployment. [1]</p> <p>As such, this would bring about an increase in real national income from Y<sub>1</sub> to Y<sub>2</sub>. [1]</p> <p>In the long run, due to the increase in foreign direct investment, the quantity of factors of production would have increased and this brings about an increase in the productive capacity of the economy leading to an increase in LRAS. This is represented by the rightward shift of LRAS<sub>1</sub> to LRAS<sub>2</sub> in the diagram above. This would bring about an increase in national income from Y<sub>2</sub> to Y<sub>3</sub> and reduce GPL from OP<sub>2</sub> to OP<sub>3</sub>. [1]</p> <p><b>Note:</b> Students may also relate this to improving BOP position of Indonesia given that it is facing deficits in both the current as well as capital and financial accounts.</p>	
(c)	<p>Comment on the view that residents in Japan enjoyed a higher standard of living compared to those in Indonesia in 2013.</p>	[8]
	<ul style="list-style-type: none"> <li>• Define SOL and explain how it is measured; and make comparison <ul style="list-style-type: none"> <li>○ Refers to the well-being of average person residing in the country. It includes both the quantitative and the qualitative aspects of living</li> <li>○ Measurement <ul style="list-style-type: none"> <li>▪ Quantitative measure – real GDP per capita</li> <li>▪ Qualitative measure –</li> </ul> </li> </ul> </li> </ul>	

	<ul style="list-style-type: none"> <li>• Quality of life – hours worked, pollution access to education, health care and housing</li> <li>• Equity - fairness, ease of access to goods and services, (Supplementary data HDI ( includes life expectancy data)</li> </ul> <ul style="list-style-type: none"> <li>• Quantitatively, from the data <ul style="list-style-type: none"> <li>○ Japan real GDP in 2013 is 10 times higher than that of Japan. But one cannot deduce that Japan's residents SOL is 10 times better than those living in Indonesia. Residents in Japan are able to consume more goods and services compared to those in Indonesia.</li> <li>○ However, there could be an over estimation of the difference in the SOL as there is insufficient data to make accurate assessment as some key information were missing: <ul style="list-style-type: none"> <li>▪ Population figure to calculate GDP per capita.</li> <li>▪ Gini coefficient – measure on income distribution – link to equity issue</li> <li>▪ Indonesia – developing economy – existence of non-marketed transaction not included in the national income calculation, inaccurate data</li> <li>▪ Use of common currencies – exchange rate – ppp value?</li> </ul> </li> </ul> </li> <li>• Qualitatively from the data– <ul style="list-style-type: none"> <li>○ Life expectancy is given and it shows that Japan is experiencing a higher SOL. Higher life expectancy indicates that the Japanese are enjoying better standards in healthcare, sanitation, etc.</li> <li>○ However, more information is needed to assess the non-material SOL – e.g. leisure hours, pollution index, literacy rates, etc.</li> </ul> </li> <li>• It is therefore reasonable to agree with the view that Japan has a higher SOL than Indonesia as HDI, a composite index which considers income, literacy rates and life expectancy is higher.</li> <li>• But the difference in the level of SOL cannot be ascertained or accurately assessed as more information is needed.</li> </ul>	
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Level	Knowledge, Application, Understanding and Analysis
L3 (7-8)	<ul style="list-style-type: none"> <li>• A thorough assessment of the criteria to compare SOL accurately and the <b>difference</b> in SOL between Japan and Indonesia based on given information</li> <li>• Explain why information provided is insufficient</li> <li>• To get full marks, the importance of using PPP exchange rates must be considered.</li> </ul>
L2 (4-6)	<ul style="list-style-type: none"> <li>• Able to identify and explain specifically the quantitative measures and the lack of information to make accurate assessment of SOL OR</li> <li>• Incomplete/undeveloped in analysis of both the material and non-material aspect of SOL.</li> </ul>
L1 (1-3)	<ul style="list-style-type: none"> <li>• Have some knowledge of how SOL is measured.</li> <li>• 1-sided answer</li> <li>• Able to identify but not explain differences in SOL</li> </ul>

(d)	Discuss the view expressed in Extract 6 which suggests that “Japanese Prime Minister Shinzo Abe must rethink his Abenomics program in its entirety.”	[10]
	<p>Introduction :</p> <ul style="list-style-type: none"> <li>• Identify the objective of Abenomics program <ul style="list-style-type: none"> <li>○ ‘Abenomics’ as explained in Extract 5, “refers to an aggressive set of monetary and fiscal policies, combined with structural reforms, geared toward pulling Japan out of its decades-long deflationary slump.”</li> </ul> </li> </ul> <p>Body</p> <ul style="list-style-type: none"> <li>• <b>Policies</b> adopted – Fiscal Policy, Monetary Policy and structural reform</li> <li>• <b>Explain</b> how the program works (Use AD/AS analysis – demand side management for FP &amp; MP and AS-structural reform) to solve the problems and its ineffectiveness, and its positive effects on the economy. <ul style="list-style-type: none"> <li>○ <b>Monetary policy</b> Japan undertook “quantitative easing” and increased money supply, resulting in a fall in interest rates. This also has the added effect of causing the Japanese yen to weaken. (Extract 5)</li> </ul> <p>The aim of the policy is to stimulate C &amp; I so as to boost AD and real national income by the multiplier effect thereby achieving positive growth and higher GPL.</p> <p>The weakening of the Japanese yen could help spur Japan into a recovery, as it would make its exports relatively cheaper in terms of foreign currency. When this happens, assuming Marshall-Lerner condition holds, this would increase net exports revenue (X-M). Assuming ceteris paribus, this increase in (X-M)</p> </li> </ul>	

would increase AD and real national income by the multiplier effect.

**Need to rethink:**

While the aim of this policy is to increase domestic consumption (C) and investment (I), Japan's domestic demand is weak given the fact that it has been facing deflationary pressures in the past.

The increase in money supply could also run into a situation known as the liquidity trap, whereby any further increase in money supply by the Bank of Japan (BoJ) would not cause any fall in the interest rates. This would then render the effectiveness of this policy to be limited as C & I may not increase as desired.

Moreover, as mentioned in Extract 6, the weakening currency did not increase export competitiveness as "growth in Japanese exports has failed to keep pace with the rising cost of imports". The weakening of the Japanese yen would cause price of imports to be relatively more expensive in Japanese yen and could lead to imported inflation reducing competitiveness of domestic goods which are highly dependent on imported raw materials. This, according to Extract 6, "is an unsustainable source for growth in the long-run." Thus Japan would need to adjust in response to the challenges faced for monetary policy.

- **Fiscal policy**

Japan undertook an expansionary fiscal policy and spent a large amount on capital spending to improve its infrastructure. Tax cuts were also introduced to encourage both consumption (C) as well as investment (I).

According to Extract 6, it seems that the focus of fiscal policy seems to be more on government spending. The increase in AD due to higher G would result in higher real national income by the multiplier effect.

**Need to rethink:**

*"To stimulate productive investment, Japan must revamp the second arrow of Abenomics and focus on tax incentives rather than government spending."* (Extract 5)

Also focus on government spending would prove to be problematic for an economy like Japan as based on Table 2 as well as Extract 6, we know that Japan is facing a public debt amount of more than twice its GDP. Further increasing the public debt amount would have dire consequences to the Japanese economy as it may erode confidence in the Japanese economy and raise questions of the government's ability to repay the debt.

While the intent of the government spending is to encourage households and businesses to increase C and I, it may not be sustainable for the government to spend in the long term to boost its AD. Thus, Japan would need to adjust in response to the challenges faced for fiscal policy.

- **Structural reforms**

Japan embarked on "structural reforms—including slashing business regulations, liberalizing the labor market, cutting corporate taxes, and increasing workforce diversity—aims to revive Japan's long-term competitiveness." (Extract 6). These policies aim to reduce cost of production to improve competitiveness of domestic goods and services. While these

reforms help in making Japan more attractive to businesses, with the slashing of business regulations which is more business-friendly, as well as the reduction in corporate taxes which contribute to higher post-tax profits for businesses, stimulating I.

**Need to rethink:**

However, these policies fail to address the issues that are plaguing them, namely, aging and shrinking population as well as improving the rigidity in the labour market in Japan.

To tackle the aging and shrinking population, Japan may wish to relook its policy on allowing foreign labour in to help plug the gap caused by the aging and shrinking population. The aging and shrinking population could cause labour cost and wages to increase and this would add on to businesses' cost of production. This may lead to firms looking elsewhere where cost of production is much lower. Allowing foreign labour in would help to reduce the pressure of the rising wages.

In addition to the above problem, there is also mention of rigidity in the labour market which leads to a 'dual' labour market. To improve this condition, the government may wish to embark on retraining and upgrading programmes to help the development of skills in the workforce. It could focus on retraining and upgrading for those who are stucked in "temporary" jobs so that with the completion of the training programme, they could go out and look for a job which would ensure that his/her skills are put to good use and contributing to the Japanese economy.

Thus Japan would need to adjust in response to the challenges faced for structural reforms.

**Evaluation and synthesis**

Based on Table 2, Japan seems to be on the rebound as they returned to positive economic growth in 2012 and 2013. In addition, Japan is also starting to move from a state of deflation to inflation again. Unemployment rate also fell during the period of 2009 to 2013. All these are positive signals and could imply that the Japanese economy is seeing an increase in economic activity. Typically, these policies undertaken would require time for the effects to slip in and thus it may be too premature to suggest rethinking of Abenomics in its entirety to solve the problems faced by Japan. There are still some areas of concern. That is when the FP is seen ineffective and may lead to the possibility of over-reliant on the loose MP, there is the need to counter the undesirable effect of a weakening Yen. Moreover, given the ageing population, demand-side management to stimulate the economy is to be supplemented by structural reform which would affect the long term capacity to produce. The policies have to be reviewed, performance to be monitored so that they are adjusted, if necessary, in a timely fashion to help Japan and its economy to achieve its macroeconomic objectives and recover from their predicament.

<b>Level</b>	<b>Knowledge, Application, Understanding and Analysis</b>
<b>L3</b> (7-8)	<ul style="list-style-type: none"> <li>• Clear 2-sided answers</li> <li>• Answers show clear understanding of the working and the ineffectiveness of the 3 arrows of the Abenomics program outlined in the extracts</li> <li>• Able to analyse the changes suggested to increase the effectiveness of the policies in the context of the problems.</li> <li>• Appropriate data to support the view that Abenomics prog need not be adjusted/rethought.</li> </ul>
<b>L2</b> (4-6)	<p>Undeveloped answer</p> <ul style="list-style-type: none"> <li>• Able to explain at least 2 policies but lack the analysis to explain why the need to rethink the Abenomics program</li> </ul>
<b>L1</b> (1-3)	<ul style="list-style-type: none"> <li>• Able to identify the policies used in Abenomics</li> <li>• Unable to link to the problems pertaining to Japan</li> <li>• 1-sided answer</li> </ul>
<b>E2</b> (2)	Evaluative comments with justification.
<b>E1</b> (1)	Evaluative comments without explanation.