

NATIONAL JUNIOR COLLEGE
SH2 Preliminary Examinations for General Certificate of Education Advanced Level
Higher 2

ECONOMICS

9732/01

Paper 1

14 September 2015

2 hour 15 minutes

Additional Materials: Answer Paper, Cover Pages

READ THESE INSTRUCTIONS FIRST

Write your name and subject class on all the work you hand in.
Write in dark blue or black pen.
You may use an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY OF THE MARGINS.

Answer **all** questions.

Start each question on a new piece of paper.
Start parts (e) and (f) for both case studies on a new piece of paper.
Fill in the necessary information on the cover pages.

At the end of the examination, fasten all your work securely with the cover pages given.
The number of marks is given in brackets [] at the end of each question or part question.

This document consists of **8** printed pages.

Answer **all** questions.

Question 1 The Aviation Industry

Extract 1: Liberalisation of the EU aviation market

The liberalisation of the European Union (EU) aviation market gave low-cost carriers the opportunity to fully penetrate the European market in the past decade. They took advantage of the opportunity to establish an ever increasing number of crew and aircraft bases all over Europe. Facilitated by the introduction of direct Internet booking platforms, low-cost carriers such as Whizzair, Jet2.com and Blueair started to gain market share quickly at the beginning of 2000. The low cost carrier business model is essentially different from that of traditional network carriers: using a low unit cost base to charge low fares, generate new market demand and serving routes at a lower frequency than the full service carriers. These carriers focused more on short haul flights which are typically defined as flights that take less than three hours to complete as compared to long haul flights which take 7 to 12 hours to complete.

On the other hand, the growth in the number of flights and routes served by the traditional carriers such as Lufthansa and Air France stagnated or became negative as of 2000, resulting in a substantially declining share in the number of European flights between 2000 and 2013. These airlines need to relook at their cost structure in order to survive.

Source: OECD Report, International Transport Discussion Paper 2014

Extract 2: American and US Airways officially merge to create world's biggest airline

The world's biggest airline was officially created on Monday with the merger of American Airways (AA) and US Airways, capping a round of consolidation that has worried the US government, rivals and consumer groups.

The merged airline will take the American Airlines name and will have a global network of nearly 6,700 daily flights to more than 330 destinations in more than 50 countries, and more than 100,000 employees worldwide. The company has a firm order for 600 new aircraft.

Last month, the Justice Department gave the \$11bn merger the go-ahead after initially raising anti-trust concerns. In order to address those concerns the two companies gave up gate slots and take-offs at major US airports including Washington DC's Reagan national, New York's LaGuardia, Boston's Logan and LAX in Los Angeles.

Earlier in the month the US Supreme Court rejected an attempt by consumer groups and travel agents to halt the merger. The objectors had argued that the merger would cause "irreparable injury" to the domestic airline industry, driving up prices and damaging service. AA and US Airways argued that the merger was vital as the two companies seek to cut their costs. AA went into bankruptcy in 2011, the seventh US carrier to go bust since 2000. The deal brings the company back out of bankruptcy.

The carriers' financial woes have fuelled a series of mergers that have reshaped the US airline industry, including Delta and Northwest, United and Continental and Southwest's merger with AirTran. Since 2005, mergers have reduced the US's major airlines from nine to four.

Challenges remain for the new airline. Previous mergers have been hampered by difficulties in merging staff and technology that have taken years to iron out.

Source: Adapted from Dominic Rushe, *The Guardian*, 9 December 2013

Extract 3: Airlines seek carbon market to curb post-2020 pollution

Airlines backed a call for an emissions market to offset growth in their greenhouse gases after 2020, a step that could spur international talks on tackling pollution from the industry, which is responsible for about 2 percent of greenhouse gases globally.

International Air Transport Association members adopted a resolution in favour of a market-based mechanism to help address airlines' emissions. However, they did not agree to a global limit on greenhouse gas emissions from air travel, or set out in detail how governments should implement a market-based mechanism to cover all airlines.

The IATA resolution comes as representatives of governments in the UN's International Civil Aviation Organization (ICAO) try to iron out a deal to reduce air industry pollution. Countries from Russia and China to the U.S. are seeking a global pact after protesting the inclusion of foreign flights in the European Union's emissions-trading system last year. The bloc deferred the carbon curbs to help the ICAO talks.

In addition to the current EU's carbon cap-and-trade system, airline companies can also top up their permit quota with carbon credits – awarded by the UN to projects that cut emissions in developing countries, such as solar panels or windfarms.

But green campaigners pointed out that Monday's IATA resolution could allow airlines simply to buy cheap carbon credits to offset their emissions, rather than make real reductions in the aviation sector itself, and this system could be less effective than alternatives.

Carbon credits are currently at rock bottom prices because of a glut on the market, and because companies covered by the EU's emissions trading system were awarded far more free permits than they needed.

The resolution was backed by an “overwhelming” majority of airline executives voting at the meeting, according to IATA Chairman and Qantas Airways Ltd. CEO Alan Joyce. However, Air India Ltd. and Air China Ltd. both voiced concerns.

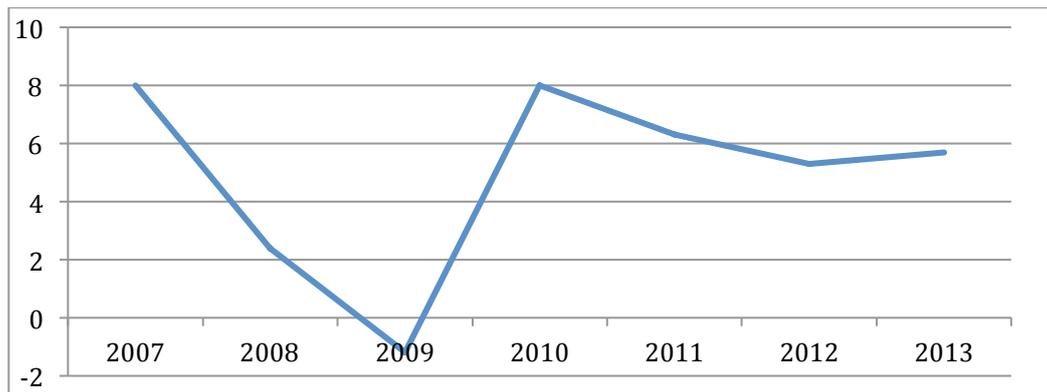
Market-based measures for airlines should be considered only as a secondary tool and as a part of a broader package of measures to cut greenhouse gases, Air India Chairman Nandan Rohit said.

They shouldn't be implemented unilaterally and “should only be applied within the national boundaries of a state and limited to the national carriers,” he said at the meeting today. “If a state decides to implement market-based measures on air carriers of third states there should be a bilateral agreement in place.”

Some economists however have argued that such a policy alone may not be effective to bring down pollution. Instead, they recommend another policy based on the polluter-pays-principle by placing a price on carbon dioxide and other greenhouse gases.

Will these measures work to curb post-2020 pollution?

Source: Adapted from *Bloomberg*, 4 June 2013 and *The Guardian*, 31 January and 4 June 2013

Figure 1: Revenue Passenger Kilometers Growth (%)

*Revenue Passenger Kilometers (RPK) is a measure of sales volume of passenger traffic

Source: International Air Transport Association Report (IATA)

Table 1: US Airline Shares (September 2012-August 2013)

Carrier	Passengers ('000)	Share (%)
JetBlue	7,245	28.97
United	3,227	12.90
US Airways	3,209	12.83
American	3,025	12.10
Delta	2,709	10.83
Others	5,592	22.36
Total	25,007	100

*Figures based on passenger arrival and departure

Source: CAPA- Centre for Aviation, 2013

Questions

- (a) (i) Describe the trend in Revenue Passenger Kilometers from 2008 to 2013. [2]
- (ii) Suggest 2 reasons to account for the trend in Revenue Passenger Kilometers in (ai). [2]
- (b) Compare the likely price elasticity of demand values for short haul and long haul flights. Explain your answer. [2]
- (c) Explain how liberalisation of the EU aviation market has affected the survival of traditional carriers. [4]
- (d) Given the information in Table 1, identify the market structure of the US Airline industry. Justify your answer. [2]
- (e) Discuss the view that the merger between US Airways and American Airways is undesirable. [8]
- (f) Discuss the extent to which the market based mechanisms in Extract 3 are appropriate in addressing problem of pollution in the airlines industry. [10]

[Total: 30]

Question 2 Balancing growth and long term economic health

Extract 4: Resilient Dynamism

The theme *Resilient Dynamism* perfectly captured the tenor of the global economy at the time of the 43rd Annual Meeting of the World Economic Forum. In the post-crisis world, resilience must be a goal for all countries if they are to endure another significant downturn. Achieving dynamism also has to be a priority now that crisis response has given way to the implementation of restructuring programmes.

Resilient dynamism means tackling immediate problems and long-term challenges at the same time. In a session on Europe, Young Global Leader alumnus Valdis Dombrovskis, Prime Minister of Latvia, described how, confronted by the crisis, his government had to implement an austerity programme while also taking steps that would improve the economy's competitiveness over time. Aiming for resilient dynamism goes hand in hand with the never-ending missions to achieve sustainability and competitiveness. Countries must restructure at home so they can compete in the world.

Source: Adapted from *World Economic Forum Annual Meeting 2013 Report*

Extract 5: China's reform plan to deliver 7.5 percent growth

China put its fast-growing consumer class at centre-stage as outgoing Premier Wen Jiabao set out a reform plan on Tuesday to spread the fruits of economic growth more evenly in the country of 1.3 billion.

Mr Wen said unleashing the power of China's consumers was vital to the future of the world's second biggest economy. "We should unswervingly take expanding domestic demand as our long-term strategy for economic development," Wen told delegates at the once-a-year meeting of China's National People's Congress (NPC).

Mr Wen made consumers the cornerstone of an economic strategy designed to deliver an overall growth target of 7.5 percent in 2013. Rebalancing growth away from the investment-driven, export-oriented model that has delivered three decades of double digit growth, lifted hundreds of millions of people from rural poverty and turned China into the world's biggest trading economy, has been a policy priority for much of Mr Wen's decade in office.

There are growing concerns that more fixed-asset investment - already worth about 50 percent of GDP - would simply add to the inefficiency of China's state sector.

Inefficiency in industry exacerbates China's horrific pollution problem, which has its origins in its factory-fuelled expansion. "The state of the ecological environment affects the level of people's well-being and also posterity and the future of our nation," Mr Wen acknowledged.

There has been widespread public anger and rare media criticism over pollution in China after choking smog enveloped large swathes of the north of the country recently, grounding flights, forcing people indoors and forcing emergency measures such as factory closures.

In addition, China needs about 40 trillion yuan (\$6.4 trillion) to pay for a 10-year urbanisation plan the Government hopes will close the chasm between the country's urban rich and rural poor. Beijing aims to bring 400 million people to cities as the Government seeks to turn China into a wealthy world power with economic growth generated by affluent consumers.

Despite its ranking as the second-largest economy globally after three decades of stellar growth, China remains an aspiring middle-income country with high income inequality and dependent on state-backed investment. About 13 percent of China's population still live on

less than \$1.25 per day, and average urban disposable income is just 21,810 yuan (US\$3,500) a year. Yet at the same time, the Hurun Report says China has 317 billionaires - a fifth of the total number in the world.

Urbanisation could cure China's economic imbalances, putting it on a path to domestic consumption-led growth to replace three decades of investment and export-driven development that stoked global trade tensions. The Government hopes 60 percent of China's population will be urban residents by 2020, from about half now, and will build homes, roads, hospitals and schools for them.

Source: *The Telegraph*, 5 Mar 2013

Extract 6: We've got growth - but it's the wrong sort

In Britain, Treasury officials can allow themselves a small sigh of relief. Barring any accidents, UK growth this year should be close to 2 per cent, with survey evidence pointing to a 3 per cent plus surge in output next year.

Low interest rates and improved credit conditions are finally working their magic on demand. Even the squeeze on living standards should, with a fast-improving jobs market, be over by late next year.

All good then, at least from the Government's perspective? Unfortunately not. It's still far too early to make that sort of judgment, for what we are seeing is very much the wrong sort of growth. "Low interest rates and rising house prices are the opposite to the UK's long-term needs," says Simon Wells, chief UK economist at HSBC. Much the same point is made by Michael Saunders at Citi: "The rebound is led by demand rather than supply-side improvements, and is not rebalancing the economy towards investment and exports."

Regrettably, the Government has not addressed the deep structural faults at the heart of the economy - the results of a decades-long failure to live within our means. It comes to something when splashing the cash takes priority over investment in the country's infrastructure and energy needs.

For evidence of what's gone wrong, there are two key statistics. One is the "current account deficit", which measures the shortfall between what the nation earns abroad and what it spends. Britain has not been in current account surplus for 30 years, and shows few signs of changing. Last year, the deficit was 3.8 per cent of GDP, and in the first quarter of this year, it was an astonishing 5.5 per cent. Despite a massive 20 per cent plus devaluation in the pound since the start of the financial crisis, which theoretically makes exports more competitive and imports less so, we cannot get over our addiction to all things foreign.

The other measure of economic ill-health is "gross fixed capital formation", which tells us how much of our economic output is being invested rather than consumed. At just 14 per cent of GDP, it's by far the lowest among the advanced countries, and has been for years. On both exporting and investment, Britain is failing on a monumental scale.

Policy-makers pay lip service to the idea of more balanced, sustainable growth, but act differently, with measures to boost demand in what remains in many sectors a profoundly supply-constrained economy.

Source: Adapted from Jeremy Warner, *The Daily Telegraph*, 18 Oct 2013

Table 2: Key Economic Indicators of the United Kingdom

	2009	2010	2011	2012	2013
Growth in GDP, constant prices (% change)	-4.3	1.9	1.6	0.7	1.7
Unemployment rate (%)	7.6	7.9	8.1	8.0	7.6
Current Account Balance (US\$ billion)	-64.8	-62.7	-43.4	-98.2	-119.9

Table 3: Key Economic Indicators of China

	2009	2010	2011	2012	2013
Growth in GDP, constant prices (% change)	9.2	10.4	9.3	7.8	7.8
Unemployment rate (%)	4.3	4.1	4.1	4.1	4.1
Current Account Balance (US\$ billion)	243.3	237.8	136.1	215.4	182.8

Source of Tables 1 and 2: World Economic Outlook database, International Monetary Fund

Questions

- (a) Compare the change in China's current account balance with that of the United Kingdom between 2009 and 2013. [2]
- (b) Explain **one** example of how a government's tackling of an immediate economic problem could lead to a challenge in the longer term. [2]
- (c) With reference to Extract 6, explain a possible reason why despite a massive devaluation of the pound, UK's current account deficit rose further. [2]
- (d) With reference to the data, explain how urbanisation would affect China's economic well-being. [6]
- (e) Discuss why the economic growth in the UK might be "the wrong sort of growth". [8]
- (f) According to Extract 4, "resilient dynamism means tackling immediate problems and long-term challenges at the same time." With reference to the data and your own knowledge, discuss the appropriate policy measures you would recommend for China to achieve "resilient dynamism". [10]

[Total: 30]