

---

## 2016 Preliminary Examination 2

### Pre-University 3

**ECONOMICS**

**9732/01**

Paper 1: Case Study

**14 Sep 2016**

**2 hours 15 minutes**

Additional Materials: Answer Paper

---

### **READ THESE INSTRUCTIONS FIRST**

Write your name and class on all the work you hand in.  
Write in dark blue or black pen on both sides of the paper.  
You may use a soft pencil for any diagrams or graphs.  
Do not use staples, paper clips, highlighters, glue or correction fluid.

### **Answer all questions.**

Begin your answer to Question 2 on a fresh sheet of writing paper.

At the end of the examination, hand in your answers to the 2 questions **separately**.

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

Answer **all** questions.

### Question 1 Technological Advancement and Income Inequity

#### Extract 1: Technology and Inequality

The homeless are the most visible signs of poverty. Median income in Silicon Valley reached \$94,000 in 2013, far above the national median of around \$53,000. Yet an estimated 31 percent of jobs pay \$16 per hour or less, below what is needed to support a family in an area with notoriously expensive housing.

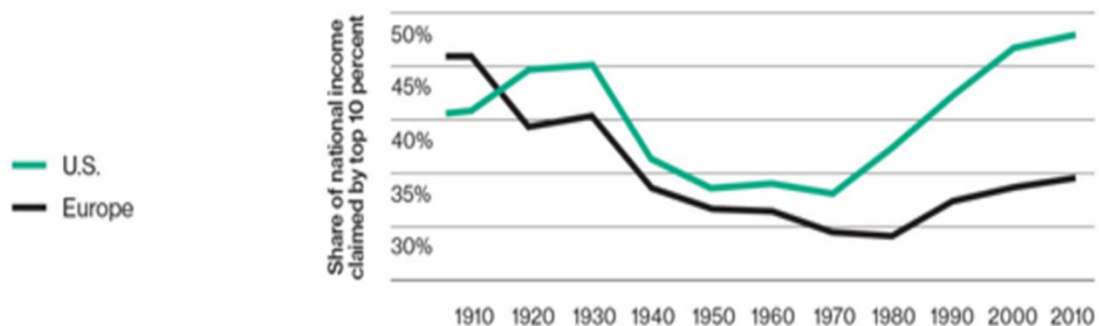
The anger in Northern California and elsewhere in the United States springs from an increasingly obvious reality: the rich are getting richer while many other people are struggling. It's hard not to wonder whether Silicon Valley, rather than just exemplifying this growing inequality, is actually contributing to it, by producing digital technologies that eliminate the need for many middle-class jobs.

Piketty attributes it in part to unjustifiably large salaries for people he calls "supermanagers." About 70 percent of the top 0.1 percent of earners is corporate executives, by his calculations. The standard explanation for rising inequality is the race between the demand and the supply for high skills. This is an important part of the overall explanation.

Though California's economy—the world's eighth-largest—is strong in many sectors, the state has the highest poverty rate in the country, if cost of living is factored in. The situation in Silicon Valley helps explain why. About 20 to 25 percent of the population works in the high-tech sector, and the wealth is concentrated among them. This relatively small but prosperous group is driving up the cost of housing, transportation, and other living expenses.

Source: David Rotman, *MIT Technology Review*, 21 October 2014

**Figure 1: Income Inequality in Europe and the United States**



Source: David Rotman, *MIT Technology Review*, 21 October 2014

#### Extract 2: Is Amazon a Monopolist?

Much attention has been given to the dispute centering around Amazon and its actions in the market for e-books, where it holds close to two thirds of the market share. Critics of Amazon suggest that this is just one example of Amazon using its monopoly power to exploit consumers and suppliers, including the publishers and their authors.

But rather than criticizing the actions of a monopolist like Amazon, should we instead be praising the company and its ability to compete other firms out of the market. One of the main reasons why consumers use Amazon to buy goods is that prices are cheap. So, in this respect, perhaps

Amazon is not acting against consumers' interests, as under a monopoly we typically expect low output and high prices, relative to a model of perfect competition.

Amazon relentlessly drives down prices for goods and services and delivers them fast and cheap. It ploughs its profits into price cuts and innovation rather than putting them in the hands of its investors. That benefits millions of families.

Source: *The Sloman Economics News Site*, 21 October 2014

### **Extract 3: Europe creates 30 \$1bn-plus tech firms since 2000**

Europe has produced 30 technology companies worth more than \$1bn since the millennium, according to research that explodes the myth that the region's internet entrepreneurs lack vision and sell up too early.

Clothing retailer Asos, games studio King Digital, property portal Zoopla and music service Spotify are among the select group of Europe's most valuable technology companies, most of which remain independent.

The UK, with its big domestic market, love of online shopping and high level of internet and smartphone adoption, has been most successful in creating technology millionaires – since January 2000, the country has produced 11 unicorns. Among these are recently listed appliances retailer AO World and takeaway service Just Eat.

GP Bullhound co-founder Manish Madhvani said that Europe is much more adept at creating billion-dollar tech companies than most experts expected because the ambition levels and ecosystem have progressed to allow entrepreneurs to scale global businesses.

Source: Juliette Garside, *The Guardian*, 15 June 2014

### **Extract 4: Tougher times for Amazon as rivals get smart**

As Amazon marks its 20th anniversary this year, sales growth has been slowing. Analysts said it has been feeling the squeeze in Britain for a number of reasons.

First, traditional players such as John Lewis and Dixons raised their game – particularly with “click and collect” services. John Lewis uses its sister food chain, Waitrose, as a “physical” collection point for web purchases as an example of how established chains are finally starting to act smarter. Amazon lacks its own network of physical stores, although it has begun offering a click-and-collect service by opening “lockers” in selected sites.

A second problem is that competition is heating up in electricals – an important market for the maker of the Kindle e-reader. Dixons' decision to match Amazon on price shows the US giant is no longer finding it so easy to undercut rivals, says independent retail analyst Nick Bub.

Amazon intends to launch Sunday deliveries. Mr Bezos claims that Amazon is planning to use remote-controlled drones for same day delivery.

Meanwhile, Tesco's successful launch of its own-brand, low-cost Hudl tablet and the expansion of its TV-and-film streaming service Blinkbox are aimed at Amazon's Kindle Fire tablet and LoveFilm movie service.

Source: *The Straits Times*, 23 October 2013

### **Extract 5: Should digital monopolies be broken up?**

There are good reasons why governments should regulate internet monopolies less energetically than offline ones. First, barriers to entry are lower in the digital realm. It has never been easier to launch a new online product or service: consider the rapid rise of Instagram, WhatsApp or Slack. Building a rival infrastructure to a physical incumbent is far more expensive, and as a result there is much less competition in the real world. True, big firms can always buy up rivals (as Facebook did with Instagram and WhatsApp, and Google did with Waze, Apture and many more). But such acquisitions then encourage the formation of even more start-ups, creating even more competition for incumbents.

Second, although switching from Google and other online giants is not costless, their products do not lock customers in as Windows, Microsoft's operating system, did. And although network effects may persist for a while, they do not confer a lasting advantage: consider the decline of MySpace, or more recently of Orkut, Google's once-dominant social network in Brazil, both eclipsed by Facebook—itself threatened by a wave of messaging apps.

Finally, the lesson of recent decades is that technology monopolists may be dominant for a while, but they are eventually toppled when they fail to move with the times, or when new technologies expand the market in unexpected ways, exposing them to new rivals.

Source: *The Economist*, 29 Nov 2014

### Questions

- (a) (i) Compare the changes in income inequality in Europe and the US from 1990 to 2010. [2]
- (ii) With reference to the data, account for the income disparity between the rich and the poor in the US. [4]
- (b) Using demand and supply analysis, explain reasons for a fall in the price of online goods and services. [4]
- (c) With reference to the concept of price elasticity of demand, explain the expected impact of a price fall on Amazon's total revenue from the sale of electronics. [2]
- (d) To what extent is Amazon a monopoly in the online retail industry. [8]
- (e) With reference to the extracts, discuss the impact on producers and consumers with increasing competition in the online retail industry. [10]

**[Total: 30]**

## Question 2 Exports and Economic Stagnation

**Table 1: Annual percentage change in selected export-oriented countries**

	Exports of total merchandise trade									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
China	27.2%	26.0%	17.2%	-16.0%	31.3%	20.3%	7.9%	7.8%	6.0%	-2.9%
Germany	14.1%	19.2%	9.5%	-22.6%	12.4%	17.1%	-4.9%	3.1%	3.4%	-11.0%
Singapore	18.4%	10.1%	13.0%	-20.2%	30.4%	16.4%	-0.3%	0.5%	-0.1%	-14.5%
United States	13.9%	11.9%	12.1%	-18.0%	21.1%	16.0%	4.3%	2.2%	2.6%	-7.1%
World	15.4%	15.6%	15.2%	-22.3%	21.9%	19.8%	0.9%	2.4%	0.2%	-13.2%

Source: WTO, Statistics Database

### Extract 6: Legacies, Clouds, Uncertainties

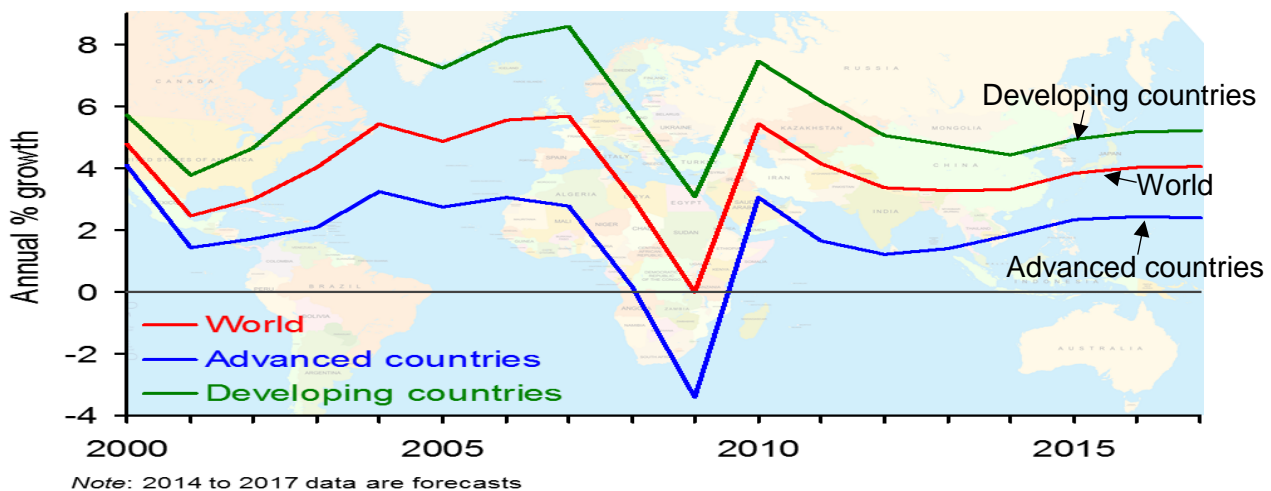
Despite setbacks, an uneven global recovery continues. Largely due to weaker-than-expected global activity in the first half of 2014, the growth forecast for the world economy has been revised downward to 3.3 percent for this year, 0.4 percentage point lower than in the April 2014 World Economic Outlook (WEO). The global growth projection for 2015 was lowered to 3.8 percent.

Downside risks have increased since the spring. Short term risks include a worsening of geopolitical tensions. Medium-term risks include stagnation and low potential growth in advanced economies and a decline in potential growth in emerging markets.

Given these increased risks, raising actual and potential growth must remain a priority. In advanced economies, this will require continued support from monetary policy and fiscal adjustment modified in pace and composition to supporting both the recovery and long term growth. In a number of economies, an increase in public infrastructure investment can also provide support to demand in the short term and help boost potential output in the medium term. In emerging markets, the scope for macroeconomic policies to support growth if needed varies across countries and regions, but limited in countries with external vulnerabilities. And in advanced economies as well as emerging market and developing economies, there is a general, urgent need for structural reforms to strengthen growth potential or make growth more sustainable.

Adapted from: *World Economic Outlook*, IMF, October 2014

**Figure 2: World economic growth rates (%)**



Source: World Economic Outlook, IMF, October 2014

### **Extract 7: The end of growth in the West**

Investors are prepared to lend to governments at a loss, that implies they don't see anywhere else they can confidently lend at a risk-adjusted profit. It is important to note that investors are equally prepared to lose money when lending to the US and to most of the eurozone. This shows investors are becoming more pessimistic about the long term. Conventional theory says this is a manifestation of a conviction among investors that the rich developed economies will stagnate; that they will, for decades, enjoy no growth or low growth that is below expected target growth rates.

In making these supposedly safe bets with their cash, investors are not putting enough of their money where it might help make us more prosperous - namely in the productive, wealth-generating private sector. So their preference for supposedly safe government debt might not be a statement that they anticipate long-term economic stagnation. But it might end up causing such economic stagnation, by starving those who create our prosperity - small businesses in particular - of risk capital.

Which suggests that the brilliant thing for the British government to do, for example, would be to take advantage of its ability to borrow for 25 years at less than zero cost to throw money at investment in infrastructure - to generate both short-term growth and enhance long-term productive potential. That would mean UK government's ambition to balance the current budget, but still borrow for investment, might be more sensible than the suggested plan to create a surplus on the overall budget.

Except for one thing. None of us can know for sure if fickle investors would continue to give the government free money if the government were to elongate the timetable for deficit reduction by doing something economically useful with the money it borrows.

Adapted from: Robert Peston, *BBC News*, 26 September 2014

### **Extract 8: Eurozone area may be in 'persistent stagnation trap' says OECD**

Insufficient policy stimulus could be undermining potential growth, and risks deflation in the euro area. The Organisation for Economic Cooperation and Development's (OECD) report said that the euro area may be falling into a "stagnation trap". "The euro area as a whole, and in particular the vulnerable countries, seems to be most likely to be affected by persistent stagnation tendencies," OECD said.

Its inflation forecasts of 0.6% for the euro area next year and 1.0% for 2016 are slightly more pessimistic than the EU's own forecasts, and far from the European Central Bank's target of just below 2%. The GDP of the euro area is still below its pre-crisis peak, compared with the US and UK, which have surpassed theirs, the OECD said.

Growth in the euro area will remain weak because of still-high public and private debt, tight credit conditions and high unemployment. In addition, "the crisis-related hit to potential output has been significant" in the euro area, with investor confidence knocked by "geopolitical risks" in Eastern Europe, it said.

Source: *BBC News*, 25 November 2014

### Questions

- (a) (i) Describe the trend in the merchandise exports of the selected countries inferred from Table 1. [2]
- (ii) Explain how the changes in merchandise exports affect the selected countries' balance of trade and exchange rate in 2015. [2]
- (b) (i) With reference to Figure 2, compare the economic growth rates of the developing countries with the advanced countries from 2000 to 2015. [2]
- (ii) Explain two possible reasons for the observations made in b(i). [4]
- (c) (i) Explain what is meant by the term 'stagnation'. [2]
- (ii) Discuss whether the investors' pessimism is more likely a cause or consequence of stagnation. [8]
- (d) Assess the economic policies a government could adopt to address stagnation. [10]

**[Total: 30]**

**End of paper**

**BLANK PAGE**