

	PRELIMINARY EXAM 2017
	Economics JC2 H2 (9757/02)

PAPER 1

Tuesday
12 September 2017
08:00 – 10:15

TIME : 2 hours 15 mins

INSTRUCTIONS TO CANDIDATES

Do not open this paper until you are told to do so.

Write your name, class and name of economics tutor in the space provided on the writing paper.

Do not use staples, paper clips, glue or correction fluid/tape.

Answer **all** questions. The number of marks is given in the brackets at the end of each question. Write your answers on the writing papers provided. If you use more than one sheet of paper, fasten the sheets together. Submit the answers for both case study questions **separately**.

You are advised to spend several minutes per question reading through the data and questions before you begin writing your answers.

There are 8 printed pages including this cover page

Answer **all** questions.

Question 1

Milk Market on the Milky Way

Extract 1: Rising formula milk price

Formula milk manufacturers have been spending more on research and development as well as marketing, pushing the wholesale prices of their products up, and in turn resulting in the higher prices seen at retail stores, the Competition Commission of Singapore (CCS) has found. A standard can of 900 grams of infant formula purchased from a regular supermarket costs about S\$56 on average, compared to \$25 in 2007

The CCS report found that manufacturers spend heavily on research and development as well as marketing campaigns that contain “premiumisation” messages in order to build consumer loyalty and make their products appear to be higher quality. Manufacturers introduce new ingredients that contribute to attributes desired by parents and make promises like improving overall mental function, promoting a healthy intestinal tract and aiding brain and eye development. A premium image is important to these brands because they compete against other brands and their products based on brand name, nutrition and safety. Such strategies appear to have worked, with premium and specialty formula milk making up an estimated 95 per cent of total sales in 2015.

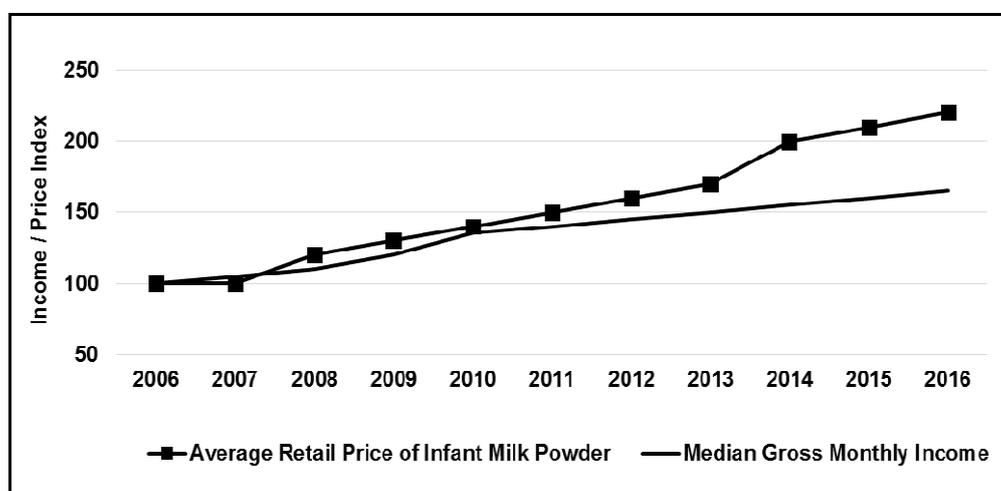
Source: Adapted from Channel NewsAsia, accessed 12 May 2017

Table 1: Price of staples over 10 years

Goods	2007	2017
Fresh Milk (1 litre pack)	\$2.63	\$2.81
Infant Formula Milk Powder (900gram tin)	\$25.42	\$56.06
Cheese (pack of 12 slices)	3.89	\$4.56
Hen eggs (10)	1.69	\$2.17
Ordinary white bread (400gram)	\$1.21	\$1.62
Thai Fragrant Rice (5 kg)	\$7.87	\$13.13

Source: Singapore Department of Statistics, accessed 27 May 2017

Figure 1: Changes in median income and price of infant milk powder in Singapore



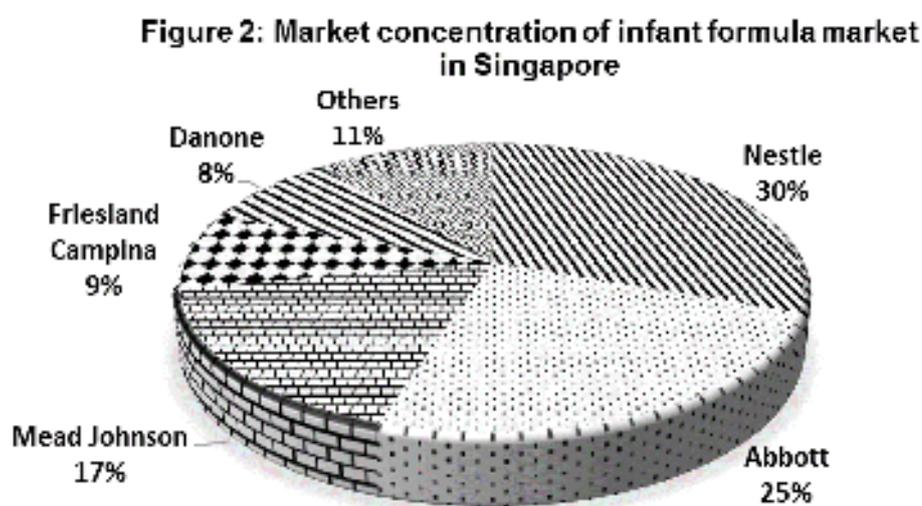
Source: Various

Extract 2: Children over one do not need formula milk

While parents may rely on health claims to choose a formula milk brand for their children, experts say such claims meant for children above one are a “marketing ploy” because the same nutrients can be found in everyday food.

Referring to nutrients like docosahexaenoic acid (DHA), taurine and choline which are prominently promoted on milk tins, paediatric dietitian Meave Graham from Child Nutrition Singapore said: “These nutrients are found in breast milk and in normal balanced diets. Children do not need special supplements of these nutrients.” These nutrients have been promoted by milk manufacturers as giving health benefits like brain and eye development, healthy immune system and helping fat digestion.

Source: Channel NewsAsia, accessed 30 May 2017



Source: Channel NewsAsia, accessed 27 May 2017

Extract 3: Government shares concerns about rising prices of formula milk

The Singapore government shares the concerns of parents about the rising prices of infant formula milk and will take steps to ensure that options are available for their children, said Senior Minister of State for Trade and Industry (MTI) Koh Poh Koon.

A concentrated market, coupled with aggressive marketing and existing consumer preferences, have raised barriers for new players in the infant formula milk market in Singapore. Retailers such as supermarkets and pharmacies are keen to stock more of what consumers demand which may further reinforce consumer brand loyalty. They also prefer to obtain formula milk supply only from local authorised distributors and do not consider parallel importing a viable alternative.

“The government will simplify and streamline import requirements as well as remove unnecessary barriers to bring in more options for parents” Koh said. He added that there are a number of formula milk products in Singapore across different brands that range from \$20 to over \$60 per 900g and regardless of brand and price, all milk products sold here must meet the safety and nutrient requirements set by the Agri-Food & Veterinary Authority.

“The Agri-food and Veterinary Authority (AVA) will also tighten its restrictions on labelling and advertising further, including prohibiting the use of nutritional and health claims, and idealised images for infant formula milk,” Koh said. On their part, parents should be careful about unsubstantiated claims from sellers of such products, he added.

Source: Adapted from Yahoo News Singapore, accessed 13 May 2017

Extract 4: United States’ WIC Programme

In the United States, the Special Supplemental Nutrition Programme for Women, Infants, and Children programme (WIC) provides subsidies for infant formula milk. The programme believes that by providing needed assistance to low income mothers, it can help the development of their children and avoid future health issues.

The programme provides a benefit card for beneficiaries to use at authorised retailers. With the card, beneficiaries can purchase selected types and brands of infant formula milk at a discounted cost. Since the 1990’s, only three manufactures have been chosen as the manufacturer of choice for the WIC programme. Though this programme does not provide great profit margins for the manufacturers, it is most likely part of the reason that the three WIC manufacturers maintain almost all market share in the United States.

Source: United States Department of Agriculture, accessed 28 May 2017

Questions

- (a) (i) Compare the change in price of infant formula milk powder (900 grams) with that of Thai fragrant rice (5 kg) between 2007 and 2017. [2]
- (ii) With the use of a diagram, account for the change in the price of infant formula milk powder as mentioned in (i). [4]
- (b) Explain how “premiumisation” affects the price elasticity of demand of infant formula milk. [2]
- (c) Explain how the high price for infant formula milk in Singapore can represent a form of market failure. [4]
- (d) Assess the factors that formula milk manufacturers would consider in deciding to supply a new formula milk product in Singapore. [8]
- (e) Discuss whether provision of subsidies such as the WIC programme in the US would be the most appropriate way of responding to the rising formula milk prices in Singapore. [10]

[Total: 30 marks]

Question 2

Trade Slump and Deflation

Extract 5: UK slips into deflation as prices fall 0.1%

The UK has officially slipped into deflation for the first time in more than half a century, but economists and policy makers are not concerned, saying that a brief period of gently falling prices is more likely to help growth than harm it.

The UK has been teetering on the brink of deflation for several months because of the slide in global oil prices, falling household incomes and the strength of sterling, which has reduced UK's export competitiveness.

Suneil Mahindru, chief investment officer international equity at Goldman Sachs Asset Management, reacted by saying: "We are not concerned about the UK". Falling prices are "freeing disposable income and many industries, such as retail, are benefiting", he added. UK households have suffered from falling real wages over the past few years. Now that prices of consumer essentials like food and energy are stagnant or falling, many households are finally getting a boost in living standards.

Chancellor George Osborne said the data were good news for family budgets and should not be mistaken for "damaging deflation" — a vicious cycle of falling prices and wages which shrinks an economy. He added that once deflation sets in consumers would expect prices to fall and they would delay spending for as long as possible in order to save money. This would perpetuate the problem and is known as a deflation trap. The deflation trap would lead to falling economic growth.

Source: Adopted from The Financial Times, 19 May 2015

Extract 6: Deflation risk and trade slump cast chill over global economy

The world economy is at risk of slipping into a deflation trap and faces a historic slump in global trade that should serve as a wake-up call for governments around the world. The International Monetary Fund warned on Tuesday that a "broad-based phenomenon" of low inflation, fed by a collapse in commodity prices and faltering demand, risked deteriorating into a full-blown deflation trap, particularly in advanced economies.

The fund's warning, came as the World Trade Organisation forecast global trade volumes would rise only 1.7 per cent this year. This would be the slowest increase since the 2008 financial crisis, and a big reduction from the 2.8 per cent growth it forecast in April. "The dramatic slowing of trade growth is serious and should serve as a wake-up call," said Roberto Azevêdo, the WTO's director-general.

The trend was particularly worrying in the context of an increase in protectionism and anti-globalisation rhetoric seen in the US and around the world, he said, adding: "This is a moment to heed the lessons of history and recommit to openness in trade, which can help to spur economic growth."

The twin warnings highlight mounting concerns over the world economy's slow recovery from the 2008 crisis and the tepid response by policymakers. They also point to two key areas of concern. International institutions are increasingly worried about the potential impact on a fragile global economy of the rise of populist politicians, such as US presidential candidate Donald Trump, and the protectionist policies they put forward.

They are equally frustrated by what they see as the failure of many governments to take tough decisions and their continuing overreliance on central banks and monetary policy to respond to slow growth. The IMF has for years urged governments to adopt more growth-friendly fiscal policies and to push structural reforms to stimulate consumption and investment. Alongside the warning of a deflation trap, the IMF called for governments to target stagnant wages and adopt policies such as raising the minimum wage to boost incomes. Such a response, IMF economists wrote, was particularly necessary in advanced economies, where “the scope of monetary policy to further stimulate demand is perceived to be increasingly constrained” and “policy rates are not far from their effective lower bounds”.

Source: Adopted from The Financial Times, 28 September 2015

Extract 7: MAS 'must remain alert' to signs of slow growth

Singapore's central bank should "remain vigilant" to signs of slow growth in the country and make policy adjustments if needed, the International Monetary Fund (IMF) said. In a statement released yesterday, after a visit here, fund representatives noted that Singapore's growth prospects remain subdued, given a lacklustre global outlook.

The IMF also said the Monetary Authority of Singapore's (MAS) latest move to stop the local currency from rising further against a basket of key currencies was "appropriate", given slowing growth, a weakening labour market as well as low oil prices worldwide. The fund noted that Singapore's economic growth has slowed markedly in recent years owing to both domestic and external factors.

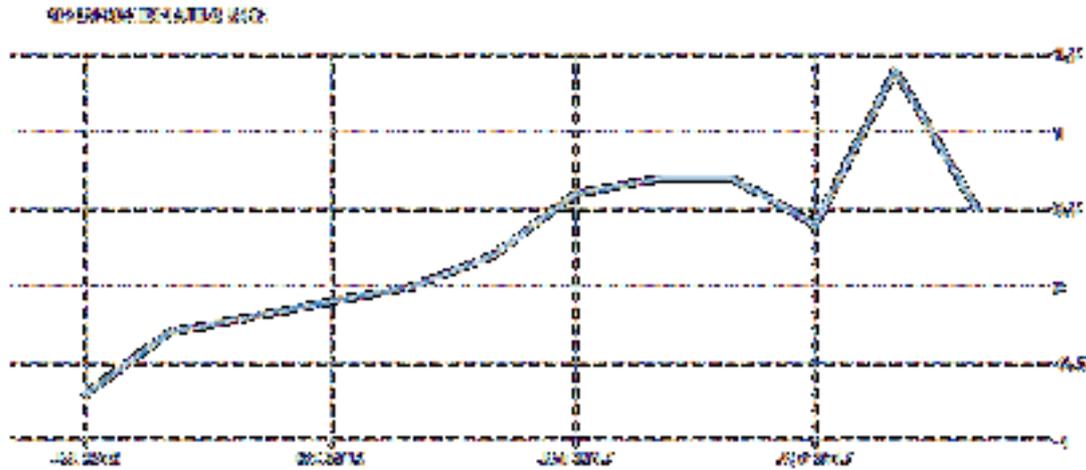
At home, growth is constrained by an ageing labour force, tighter limits on foreign workers and the transition costs of the shift to an innovation-based growth model. On the external front, the outlook for global growth and trade remains subdued, the IMF said. The fund also said Singapore's growth is likely to slow further this year, as the full impact of the slowdown in global trade and capital outflows is felt and companies continue to hold back on hiring and investment. The most important short-term external risk is a sharper-than-expected global slowdown, which could result from weak growth in China, other emerging economies as well as key advanced economies.

Still, the Singapore Government has enough in its coffers to ramp up spending and provide a short-term lift if the economic outlook worsens further, said the IMF. "The authorities are prepared to implement fiscal stimulus through targeted measures, for example providing more income transfers to poor families and seniors and accelerating infrastructure spending," added the fund in its statement.

In the longer run, raising productivity will be essential to Singapore's growth, given slower labour force expansion, the IMF said.

Source: The Straits Times on 11 May 2016

Figure 3: Inflation Rate in Singapore



Source: SingStats

Questions

- (a) Describe the trend in the consumer prices in Singapore between July 2016 and April 2017. [2]
- (b) Using extract 5, comment on whether economies should fear deflation. [4]
- (c) Using aggregate demand and supply analysis, explain the causes of deflation in the UK in 2015 as identified in extract 5. [6]
- (d) Using both the case study and your own relevant knowledge, discuss whether “an increase in protectionism and anti-globalisation rhetoric” seen in the US and around the world can be justified in terms of economic theory. [8]
- (e) Discuss whether depreciation of the Singapore dollar would be most appropriate way of responding to slow growth in Singapore. [10]

[Total: 30 marks]

***** The End *****