



MERIDIAN
JUNIOR COLLEGE

JC 2 PRELIMINARY EXAM 2008

9732/01

**ECONOMICS HIGHER 2
Paper 1**

**12 September 2008
2 hours 15 minutes**

Additional materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

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

Write your name, class and register number on all the work you hand in.

Write in dark blue or black pen.

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

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

Answer **all** questions.

At the end of the examination, fasten all your work securely together.

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

[Turn Over]

Answer **all** questions.

Question 1

The Airline Industry

Extract 1: UK takes to the air

Air travel in and around the United Kingdom (UK) has grown by over 60% since 1995. This is largely due to the ways in which low-cost airlines such as Ryanair and EasyJet have introduced new affordable services within the UK. In the main, they use airports that are not widely favoured by more established airlines, such as British Airways (BA).

The overall demand for air travel is highly price elastic. The low-cost airlines are not only cheaper than their more established competitors, but also cheaper than the monopoly operator of rail services for the route between London and Edinburgh.

Source: Economic Review, Feb 2005

Extract 2: Difficult Times for Industry - But Travel Set to Pick Up

The last few years have been difficult for the aviation industry. September 11 was the most severe crisis the industry has faced. Nearly all airlines were unable to cope with the increased cost of added security and higher insurance premiums. Last year, East Asia was hard hit by the SARS outbreak. The airline industry in East Asia lost money for six months because people were afraid of SARS and stopped travel to SARS-affected countries. Singapore Airlines (SIA) had to drastically cut back its flights, especially those to SARS-affected areas. To stop the bleeding, management cut their own and staff salaries, got pilots and cabin crew to take compulsory unpaid leave and so was able to reduce retrenchment to 2%. Nevertheless it suffered its first-ever quarterly loss in April/Jun 2003. For the whole of 2003, passenger traffic fell 14.9 per cent from the previous year.

Governments in Asia are beginning to liberalise their air transport regimes. They have seen the potential spin-offs in trade, tourism and investment flows. As has happened in the US and Europe, the winners will be those countries in Asia whose governments liberally exchange traffic rights and expose their national airlines to market competition. Air travellers will have a wide choice of options to choose from, ranging from premium services offered by the full service carriers like SIA and Qantas, to low cost, no frills services offered by low cost carriers like Lion Air and Thai Air Asia. Competition will be in quality of service, pricing, adequacy of networks in terms of frequencies and destinations ie the overall quality of the product. Competitive pressures will force airlines to innovate and reinvent their businesses to become more competitive.

Low-cost carriers have eaten into the lower end market share of full service carriers, but has made air travel affordable to a larger group. In the region, low-cost carriers include Indonesia's Lion Air, Malaysia's Air Asia and Singapore's proposed Valuair and Tiger Airways. Low-cost carriers depend on short, point-to-point routes and keeping their costs low so that they can price their air tickets cheaply. They do not require aerobridges and ground handling. They need minimalist check-in counters.

Adapted from Address by Senior Minister Lee Kuan Yew, Sunday, 22 February 2004

Extract 3 Case to airlines and agents: Show full fares on ads

Singapore's consumer watchdog, faced with a growing tide of complaints from frustrated travellers, wants airlines and travel agents to reveal full air fares in their advertisements. It is wrong to mislead people with low fares when the real cost of travel - with taxes and other fees thrown in - is much more, said the Consumers Association of Singapore (Case). The practice by airlines and travel agents of not being totally upfront with the real cost of air fares has become more blatant since budget airlines made their debut and increased competition for the air traveller's dollar. The final cost of an air ticket today includes not only the base fare - which is really just the cost of the seat on the plane - but a whole host of charges lumped under 'taxes and fees', which include security and airport taxes, insurance and administrative charges and fuel surcharges. These extras can make up more than 75 per cent of the final cost, particularly for budget airlines which have lower base fares. Case president Yeo Guat Kwang, wants the Government to introduce legislation to protect the consumer. Other countries like Australia, New Zealand and Britain already require airlines to disclose full fares in their ads. The need for regulation has also become more pressing in recent years because low-cost carriers operate on multi-tier fare structures that reward early birds with bargain fares. The catch is that consumers do not know how many of such bargain-priced tickets are actually available. And the big airlines are doing the same thing.

Karamjit Kaur, Aviation Correspondent, 26th Aug 2006

Table 1: Singapore Airline Operating Results

	2002	2003	2004	2005	2006
Operating Revenue (\$m)	8,047	7,187.6	9,260.1	10,302.8	11,343.9
Operating expenditure (\$m)	7,838	7,037.4	8,562.3	9,651.8	10,316.9
Passengers carried ('000)	15,326	13,278	15,944	16,995	18,346

Questions:

- (a) (i) Explain what is meant by the term 'cross elasticity of demand'. [1]
 - (ii) The cross elasticity of demand for low-cost air travel from London to Edinburgh with respect to the price of rail travel is +1.8. Explain what this means. [2]
 - (iii) Explain why 'overall demand for air travel is highly price elastic' and account for its significance to an airline pricing & output decision. [5]
- (b) (i) Describe the trend in Singapore Airline's profitability from 2002 to 2006. [2]
 - (ii) Suggest reasons for the trend observed. [4]
- (c) Using the data provided, discuss the extent to which Singapore Airlines might be adversely affected by the entry of low-cost airlines. [6]
- (d) In the light of the information provided, assess whether it is necessary for the Singapore government to regulate airfares in the airline industry. [10]

Question 2

The Tale of Two Deficits

Extract 1

The trade deficit in UK is giving cause for concern again. Official figures show that Britain's trade in goods balance was in deficit by £3.6bn in October 2002. In the 305 years of data, stretching back to 1697, it was the worst month on record. So far in 2002, the deficit has been £27bn and, according to the statisticians, there is worse to come.

Do the figures, in conjunction with Europe's trade surpluses tell us that the pound is uncompetitive with the euro? A little, but the main reason Britain's trade position with the EU has worsened is the weakness of demand in Europe. Unlike other European consumers, the UK consumer has continued to spend, sucking in imports from elsewhere. You might even argue that, as long as we can finance the trade deficit with ease, Britain's consumers are doing themselves a favour by spending, and doing the rest of Europe some good by being a source of demand. So why worry? The reason is that the deficit tells us that Britain's economy is dangerously reliant on the consumer, as it has been for the last six years. Not since the 1870s has there been a period in which strongly rising domestic demand has run ahead of overall economic growth for so long.

Source: Adapted from The Sunday Times 15 December 2002

Extract 2

The Yuan isn't the cause of the U.S. trade deficit and a "large" appreciation would hurt China's economy, Vice Premier Wu Yi said, signaling the nation won't cave in to demands for faster gains.

"China will continue to reform its exchange rate on its own initiative, gradually," Wu said at a dinner in Washington after two days of talks with U.S. Treasury Secretary Henry Paulson that yielded no agreements on the currency and failed to quell calls in Congress for sanctions against China.

About 85 percent of China's trade surplus with the U.S. is generated by foreign companies such as Wal-Mart Stores Inc. exporting products from China that are no longer made in the U.S., Wu said, citing textiles, shoes and furniture. Imposing protectionist measures to cut last year's record \$232.5 billion U.S. deficit with China would harm both nations, she said.

"The U.S. government also doesn't want a trade war with China," Chen Xingdong, chief China economist at BNP Paribas SA in Beijing. "If that really happens, the losses for the Americans might not be lower than those for the Chinese."

The Yuan closed little changed at 7.6527 against the dollar in Shanghai from 7.6519 late yesterday, completing its second - biggest weekly gain since February. China has allowed the currency to rise 8.2 percent since abandoning a fixed link to the dollar in July 2005.

Source: Adapted from Bloomberg News 25 May 2007

Table 1: Selected economic indicators, UK Economy

	2000	2001	2002	2003	2004	2005
Real GDP growth (%)	3.8	2.4	2.1	2.8	3.3	1.8
Unemployment rates (%)	3.56	3.15	3.06	2.98	2.7	2.71
Current Account Balance (% GDP)	-2.6	-2.2	-1.6	-1.3	-1.6	-2.5
Government Budget (% GDP)	4	0.9	-1.7	-3.3	-3.3	-3.5

Table 2: Selected economic indicators, US Economy

	2000	2001	2002	2003	2004	2005
Real GDP growth (%)	3.7	0.8	1.6	2.5	3.6	3.1
Unemployment rates (%)	4.0	4.7	5.8	6.0	5.5	5.1
Current Account Balance (% GDP)	-4.3	-3.8	-4.4	-4.8	-5.5	-6.1
Government Budget (% GDP)	1.6	-0.4	-3.8	-4.8	-4.4	-3.6

Source: Organization for Economic Co-operation and Development

Figure 1 Labour Productivity in UK

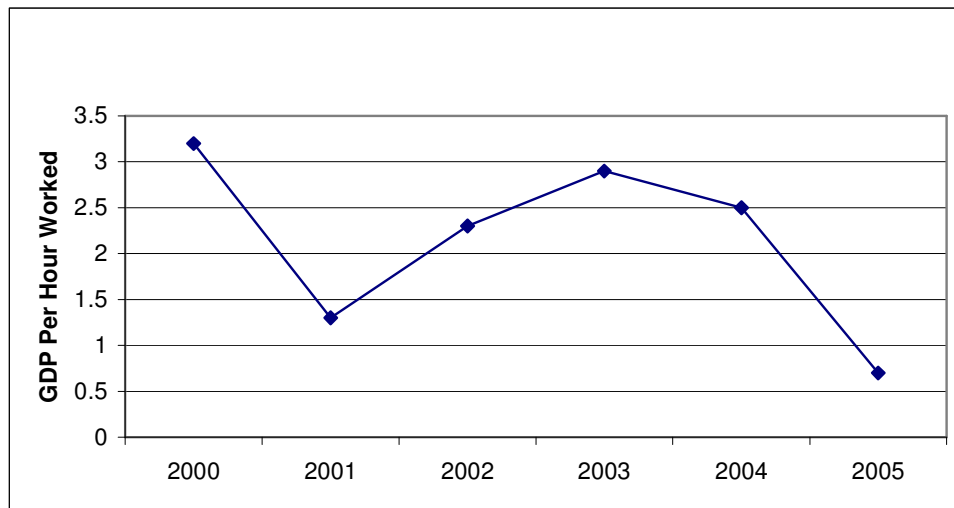
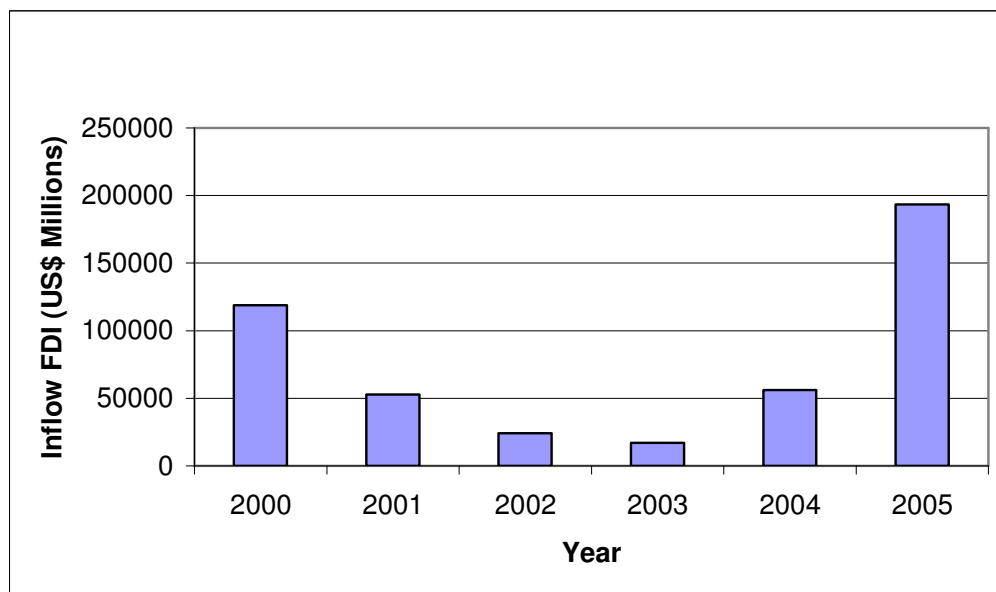


Figure 2 Inflow of Foreign direct Investment in UK



Questions:

- (a) (i) Summarize the relationship between labour productivity and growth in UK. [2]
- (ii) Account for the relationship above. [4]
- (b) To what extent do US protectionist measures solve her unemployment problem? [6]
- (c) “The trade deficit in UK is giving cause for concern again”. Discuss whether UK’s government budget was the main cause of her trade deficit with EU. [8]
- (d) In light of the data provided, assess the relative abilities of UK and US economies in solving their respective trade deficits. [10]

END OF PAPER