Mark Scheme & Suggested Answers

(a) (i)	**Use the concept of opportunity cost to explain the theoretical relationship between interest rates and level of savings**	**[2]**
	State the theoretical relationship: Direct/positive Explain using O.C. concept O.C. is cost measured in terms of the next best alternative forgone. Interest rates affect choices made by households between saving and consumption. When interest rates fall, O.C. measured in terms of interest forgone falls thus making saving less attractive or consumption more attractive (1m). Therefore, rational households spend more and save less (1m).	
	Marking policy: Wrong relationship but correct explanation - Can award 2 marks Correct relationship but wrong explanation - Can award 1 mark Accept alternative approaches touching on the key elements: - Interest rate linked to choice between S and C - OC of S is higher the lower the i/r - OC of C is lower the lower the i/r - Rational decision is C more and save less, if i/r falls.	
(ii)	**Comment on whether the relationship is shown in Figure 1 from 2009.**	**[2]**
	- No: Graph shows a clear divergence of saving and interest rate. Interest rate was very low (close to zero and remain flat) yet saving rate rose sharply and remain relatively high (1m) - Financial crisis: households are pessimistic about the economic outlook and they will tend to save more (paradox of thrift). (1m) [FYI: Test is on the psychological impact on S and C or so-called pessimism or loss of confidence to spend in bad times]	
**Marking policy:** Not required to state explicitly the concept paradox of thrift. Correct explanation with indirect reference e.g. psychological impact on consumption and saving in bad-times is sufficient.	
(b)	**Using the data provided in Extract 1, explain whether the call by IMF for a reassessment of the UK austerity policy is justified.**	**[4]**
	Yes (1m for evidence and 2m for explanation) – Extract 1, para 2: - Case Evidence: Austerity measures are believed to '*derail growth due to larger multiplier (k>2) during recession and the strong 'knock-on effects'*. (1m) Analysis: - Larger k: Higher than expected negative or downward K effect generated by a cut in G spending as a result of fiscal austerity. The size of the K is determined by the marginal propensity to consume (mpc) or withdraw	

(mpw). Since, interest rate is close to zero (using case evidence) this elevates k by increasing the propensity to consume (bigger MPC) rather than save (smaller MPS). (1m)

[FYI: The value for UK multiplier =1.28,   Source: Colin Bamford 26 August 2015]

- Knock-on effects *:
Knock on effects further reinforced the negative K effects due to the austerity measures. Government cutting back on spending and higher taxes further DISCOURAGES autonomous consumption and investment by the private sector (1m)

[FYI: *The knock on effects refer to the positive impact on PRIVATE sector consumption and Investment "sparked off" by public sector pump-priming measures initiated by the government to brighten up economic outlook and restore confidence in the economy. Unlike pump-priming, the knock on effects in this context have a negative impact on private C +I because of fiscal austerity. In other words, fiscal austerity dampens or causes "loss of confidence" in private sector spending]

No (1m)
Case evidence: Extract 1, para 3

Analysis:
Fiscal multipliers are weaker in open economies such as Britain due to higher MPM. Accept other reasonable contextualised arguments such as tax cuts will lead to an even larger debt which the UK will have more problems clearing in the future.

(c)	**Explain the statement in extract 1 'austerity is still having a dampening effect on the economy, and is making it harder for the Finance Minister to hit his deficit reduction targets'.**	**[2]**
	- A reduction in government spending and higher taxes reduce AD and causes national income to contract that leads to cyclical unemployment. (1m) - When income falls, lesser income taxes are collected due to progressive taxation system and higher unemployment benefits pay-outs due to cyclical unemployment. (1m) [FYI : This question test on automatic stabilisers]	
(d)	**Based on Extract 2, explain how austerity measures have adversely impacted the standard of living in some countries.**	**[2]**
	- Evidence: Countries that practice austerity measures: cut in health-care e.g. Greece, USA: Suicide, depression, HIV + rising crime issues (1m) - Theory: Intangible dimension of living standards or quality of life worsens. (1m)	
(e)	**Discuss how inflation has affected different types of households in post-crisis UK.**	**[8]**

Introduction
- Define inflation as a sustained or persistent rise in general price level
- The data provides information on the impact of inflation on rich and poor households in UK.
- Inflation caused a redistribution of income amongst different types of households resulting in 'losers' and 'gainers'.

Body
    A. Losers (Thesis)

Explain why the poorer households are worse off with inflation.
    a. Incomes

Case evidence:
'Stagnating wages, cuts to benefits and tax credits' due to austerity measures have reduced purchasing power of households.

    b. Household expenditure pattern ie consumer basket

Case evidence:
From Figure 2, rising food, rented apartments and energy prices, formed a bigger proportion of the spending of poorer households than the rich.

    Explain why pensioners are hit hardest.
- *Pensioners had been hit hardest with 4.2% increases in their costs compared with the 2.4% rise as indicated by the CPI.*
- Pensioners have fixed income; spend more on food and energy.
- Benefits delinked to inflation.

Evaluative comments:
The impact on poor were mitigated by government policies.
Case evidence:
'increasing the tax-free personal allowance to £10,000; freezing council tax for five years; and freezing fuel duty.'

    B. Gainers (Anti-Thesis)

Explain why rich households benefit.

    a. Incomes
        Asset prices and investment income rising e.g. property income. Such assets appreciate in value in times of inflation.

    b. Expenditure pattern

The rich has benefited from *cheaper mortgage rates (dropped by 40% since 2008)*

Case evidence:
According to Figure 2, rich households spend a much larger proportion on MIP.
Debtors (borrowers) gain because a fall in the value of money (due to inflation) means that the payments of their debts will be less in real terms: real interest rate = nominal interest rate – inflation + Figure 1 shows interest rates have fallen.
Large part of their consumption is on non-essentials (e.g. luxury cars, fine dining, expensive

overseas holidays) of which prices were not the culprits of rising COL in the UK.

   c. Shoe-leather costs
   'the rich having bank account for direct payments, or access to buy online or compare prices across a wide range of suppliers. The rich have access to resources which allowed them to shop for the 'best deal' ie Stretch their Consumer dollar or spending power.

Conclusion
Whilst all households suffered a fall in real disposable incomes in post-crisis UK, the poor were hit hardest. It can be said that the poor households were the 'losers' and the rich households were the gainers. Stagnating wages of the poor and rising COL affecting key items such as food and energy, which accounted for a substantial proportion of the expenditure pattern of poor households, led to widening "poverty gap" or income disparity between the rich and poor.

Mark Scheme

Band	Band Descriptors	Marks
L3	Answer will provide in-depth and accurate analysis that links consumption pattern of rich and poor households in UK to the impact on their respective purchasing power as well as differences in sources and change in the level of incomes. There will be due reference to the data provided in both extracts and figure 2. Evaluative comments & judgement –reaches a conclusion based on the analysis offered.	6-8
L2	Answer will provide basic analysis that links consumption pattern of either poor or rich households, but not both, to the impact on their purchasing power. Not much reference to income levels e.g. stagnating wages. Limited reference made to the data.	4-5
L1	Superficial explanation with little or no reference to the data.	1-3

(f)	Singapore was ranked the most expensive city in the world in 2014 according to the Economist Intelligence Unit's Cost of Living Survey. Discuss the validity of this ranking and consider whether high cost of living is a threat to long term economic growth for Singapore.	**[10]**
	Key issue : Ranking (Statistical discrepancy issues) Sub-issue : Implication for growth prospects (Growth issues) **Introduction** Clarify Singapore being the 'most expensive' city to live in the world' means it has the highest cost of living in the world. This ranking has negative implication for growth. Thus, if the ranking is valid, it might suggest in the LR the country will experience difficulties in maintaining healthy growth rates. **Body** 	

Thesis: Ranking is valid	Anti-thesis: Ranking is invalid

(a) Issues with using CPI indicator as a measure of COL (1) COL based on local consumption pattern • High cost of living in Singapore is mainly due to **rising food, transport and housing costs**. • High COE prices have added on to cost of production to businesses and higher transport costs due to higher fuel price, caused cost-push inflation. • Strong demand in the property market has resulted in demand-pull inflation in Singapore. Case evidence: • *Singapore property prices surged 50 percent between 2007 and 2011, by strong foreign demand; rising costs and a growing population, has also led to discontent among locals who feel the influx of foreign workers has contributed to the overall rise in living costs.* • In fact, there is a fear of a wage-price spiral. [Didn't happen] (2) Currency Factor The strong$ favour the purchasing power of locals in SG. The purchasing power of their incomes increases as the currency appreciates. The same amount of income can now be used to purchase more imported goods such as cars, consumer durables and even imported foodstuff and fresh produced. Therefore, the strong Sing$ will have a dampening effect on rising COL in SG. This is alluded to in Tharman's remarks.	(a) Issues with using CPI indicator (1) COL based on expat consumption pattern. • This ranking applies to expatriates living in Singapore only and mainly due to the strengthening of SGD over the years. • It is not representative of an average Singaporean because the basket of goods taken into calculation for the cost of living is not of a typical Singaporean. • Cost of living of a country is the average cost of the basic necessities of life, including food, shelter, and clothing. That is the price of goods and services required for maintaining an average level standard of living. It is measured by the consumer price index. Case evidence: • But the EIU consumption *basket includes imported cheese, four best seats in a theatre, and three-course dinners in high-end restaurants for four people* *.* (2) Currency Factor Moreover, given the strength of the Sing$ vis-à-vis other major currencies, the COL for expats would be " inflated" by a strong sing$. Expats would need more of their own home currency to convert to the same amount of Sing$ in order to spend in Singapore. Case evidence: *A 2012 Asia Competitiveness Institute report had separate rankings of living costs for expatriates and a typical local household. Singapore was the fifth most expensive city out of 109 for expatriates but only 61st for locals, comparable to Hong Kong at 58 and Seoul at 60* *.*
(b) Threat to growth prospects. (1) Actual growth High COL retards growth: Reduces real incomes or purchasing power => falling AD High COL disadvantage exporters. It raises their cost of production (e.g.	However….. Not a major threat/concern at least for the foreseeable future (1) Mitigating Policies to curb rising COL SG government swift to implement policies to curb rising domestic sources of inflation e.g. cooling measures to slow down rise in property prices. Measures

wages raise/Office rentals/fuel cost) making export price uncompetitive vis-à-vis our rivals/competitors. These rising business costs are domestically generated (not imported cost push), therefore cannot be mitigated by our GRAMA policy.

Evaluative comment:
The COL based on typical local consumption pattern or consumer basket suggests that the COL isn't as high as that suggested by EIU. SG ranked only 61/109 countries.

    (2) Potential Growth

High COL for expats might hinder the inflow of foreign manpower which is important to augment our local workforce e.g. foreign talent. As a result, growth might be adversely affected by the lack of skilled manpower & entrepreneurs to boost productive capacity.

Case evidence:
- *Foreigners make up about 38 percent of Singapore's population, up from about 25 percent in 2000. More than 7,000 multinational companies operate in the city and expat workers are seen as key to developing Singapore, not just as a regional hub in finance but also in other sectors such as oil and gas.*
- As seen from *Table 1, there are other comparable cities to Singapore yet relatively cheaper to live in, namely, Hong Kong and Shanghai.*
- Thus, it is important for the government to ensure Singapore stays competitive and attractive to foreign talents and FDIs.

to moderate increases in transportation costs (e.g. MRT and bus fares); improve public transport infrastructure to encourage more people to give up driving, ease road congestion and moderate rise in COE prices; measures to contain wages-prices from spiraling out of control.

Evaluative comment:
Such policies are best complemented by raising productivity to enable wage growth to rise faster than prices, so that real income rises

(2) Better quality of Life

The threat to expats rising COL is mitigated by the fact that our quality of life remains very high and attractive to foreign expats e.g. clean safe and green environment compared to HK polluted environment. Politically more stable than HK. In recent years, HK rocked by 'yellow umbrella' protests. All things considered, SG remains an attractive destination for FDI inflows as well as a place for foreign talent to live and work.

Conclusion
- While the ranking may be misrepresentative of an average Singaporean, it is still a concern as it is still relatively high by world standard for expatriates (1st according to EIU and 5th according to ACI).
- Being the most expensive city to live in for expatriates deters the influx of foreign talent and even FDI which may threaten potential growth. Whether rising COL pose a serious threat to future growth prospects will depend on the effectiveness of government policies to rein in inflationary pressures as well as sharpen our international competitiveness. All things considered, at least for the present moment and foreseeable future, rising COL is unlikely to pose a major threat to future growth prospects for SG.

Mark Scheme

Band	Band Descriptors	Marks
L3	Answers will provide sound analysis based on differing basket of goods for expats and locals to assess the validity of the ranking. There will be due reference to the data provided, and coherent links to the implication of the ranking for LT economic growth for SG.	6-8
L2	Answers will provide some understanding of the link between differing consumption pattern of expats and locals and its implication on the ranking. But, the explanation is not well-developed. The focus is either slanted towards ranking or growth-related issues (lop-sided)	4-5
L1	Superficial explanation or descriptive answers	1-3
E2	Substantiated Judgment / well–reasoned conclusion based upon consideration of the analysis. For example, high COL is a deterrence but not yet a threat to the influx of expats and FDI as the returns from investment is still attractive + quality of life is better compared to other Asian cities like HK. Or Some evaluative judgement on the validity of the ranking. It is high based on expats COL (1 or 5) not locals (61/109). Should be a concern to SG because we depend on FDIs and foreign talent to drive economic growth.	2
E1	Unsubstantiated judgement on validity of ranking. No judgement is required for growth-related issues since the command word is "consider whether".	1

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