

St. Andrew's Junior College



Economics Department JC 2 Preliminary Examinations (2014)

Suggested Answers

**H2 Economics Paper 1
(Syllabus 9732)**

Question 1

(a)	(i)	With reference to Table 1, compare the prices of Premium tickets to Fencing and Swimming events.	[2]
		<p>Similarity: The preliminary ticket prices were lower than the tickets for the finals.[1]</p> <p>Difference:</p> <ul style="list-style-type: none"> The ticket prices for Swimming event were higher than for Fencing [1] The <u>percentage</u> difference between preliminary round and final round is higher for swimming than fencing. [1] {do not award marks if students merely state that the difference is greater for swimming compared to fencing, because this shows absolute and not relative comparison of prices} 	
	(ii)	Explain two possible reasons to account for your observations in part (a)(i).	[4]
		<p><u>Justification for the similarity</u></p> <p>Similarity: Higher demand for tickets to finals as compared to the demand for the tickets to preliminary events.</p> <p>Reason: [<i>Taste and Preferences</i>] Spectators would prefer to attend and watch the final events as final events are usually more exciting and they would be able to witness their favourite idols winning the championship during the event.</p> <p>Or</p> <p>Similarity: Higher supply of tickets to preliminary events compared to the supply of tickets to Final events</p> <p>Reason: The number of preliminary events is greater than the final events of each sport.</p> <p><u>Justification for the difference</u></p> <p>Difference: Higher demand for tickets to Swimming events compared to the demand for tickets to Fencing events</p> <p>Evidence in Extract 1 → “demand was greatest foras well as the popular sports of ... swimming and artistic gymnastics”</p> <p>Reason: [<i>Taste and Preferences</i>] Due to the popularity of the swimming event, spectators would prefer to attend and watch swimming events.</p> <p>Or</p> <p>Difference: Lower supply of tickets to Swimming events compared to the supply of tickets to Fencing events</p> <p>Evidence in Extract 1 → “costs of maintaining of these pools were rather high.”</p> <p>Reason: Due to higher cost of holding the Swimming event, supply of swimming tickets would be lower than that of the Fencing event. This lower supply would in turn result in higher ticket prices for Swimming event. This shows that LOCOG had passed on the higher cost in terms of higher prices to the consumers.</p> <p><u>Mark Scheme</u></p> <p>2 marks – For any <u>one</u> well-explained factor for the similarity</p> <p>2 marks – For any <u>one</u> well-explained factor for the difference</p>	

(b)		With reference to Table 1, explain whether the differences in price charged for the same session of each sport event could be considered to be an example of price discrimination.	[4]
		<p>Yes [2 marks]</p> <ol style="list-style-type: none"> 1. The cost of hosting the event (e.g. ushers, ticket managers) does not vary for different spectators. 2. There might also be no perceived difference as all spectators are entitled to view the same sporting event. <p>Thus, it can be viewed as an act of third degree price discrimination.</p> <p>No [1 mark]</p> <p>There could be cost differences e.g. differences in quality of seats such as different materials, well-spaced out seats. Furthermore, consumers perceived the different categories of seats to be different example Premium seats offered better views of the games compared to Standard seats.</p> <p>Hence, in this case if there is a difference in cost and perceived differences, then the possible reason for the higher price could be the higher cost involved.</p> <p>Conclusion [1 mark]</p> <p>The price differential could be considered to be an example of price discrimination depends on whether there is indeed cost differences and perceived/real differences. In this case, there is insufficient evidence to conclude due to lacking evidence on the nature of the seats.</p> <p><u>Mark scheme</u></p> <p>1 mark: Stating of reasons for both sides 2 - 3 marks: Explanation of reason for both sides 1 mark: Conclusion No marks awarded for definition of price discrimination One-sided explanation: max. 2 marks</p>	
(c)	(i)	What can you conclude from the information contained in Figure 1 about the impact of the 2012 London Olympic Games on London's daily hotel occupancy rate?	[2]
		<p>During the Olympic period, there was a general increase in daily hotel occupancy rate compared to pre-Olympic period. [1]</p> <p>However, this increase was not sustained as the daily occupancy rate during the post-Olympic period was generally lower than pre-Olympic and Olympic period. [1]</p>	
	(ii)	Using the data where appropriate, discuss the short term and long term impact of the London Olympics on a dominant hotelier in the oligopolistic luxury hotel industry in London.	[8]
		<p><u>Impact on profits in the SR</u></p> <p><i>TR increased → Due to increase in demand for luxury hotels</i></p> <p>The increase in DD is due to the</p> <ol style="list-style-type: none"> 1. projected increase in visitors <ul style="list-style-type: none"> ○ <u>Evidence: Extract 2, Para1 "</u> <ul style="list-style-type: none"> ▪ <i>"international visitors are expected to spend a total of £709 million in the UK, an 18% increase on what would be expected if the Olympics Games were not taking place"</i> 2. ability of luxury hotels (e.g. The Hempel hotel) to secure deals for 	

	<p>exclusive bookings. Only bigger firms within the oligopolis industry would be able to enjoy such deals</p> <ul style="list-style-type: none"> ○ <u>Evidence: Extract 4, Para 2:</u> <ul style="list-style-type: none"> ▪ <i>"The Hempel Hotel, had secured a booking for exclusive use of the hotel during the Game"</i> <p>TR might not increase in the SR → DD for luxury hotel might not increase</p> <p>The demand for luxury hotels might not increase because</p> <ol style="list-style-type: none"> 1. the dominant luxury hotel (e.g. Intercontinental Hotel Group) might forgo potential demand and hence revenue due to sponsorship of the Games in exchange for certain privileges. <ul style="list-style-type: none"> ○ <u>Evidence: Extract 2, para 5</u> <p><i>"Intercontinental Hotel Group's Holiday Inn brand has been signed up as main hotel sponsor and the official hotel services provider to London 2012 ... the company will be able to use the 2012 logo in its advertising in exchange for help and accommodation for the athletes as well as for (LOCOG)"</i></p> 2. the fall in DD for hotel rooms for events and weddings dampened the increase in DD due to the increase in international visitors who came to London for the Olympics. <ul style="list-style-type: none"> ○ <u>Evidence: Extract 3, para 2</u> <p><i>"Business had been good in terms of occupancy and average room rate, as was to be expected with the proximity to the Olympic Park, but the events and weddings bookings have disappeared"</i></p> 3. there was lower travellers' interest during the Games because of travel warnings to avoid the Olympics-sized hassles. Some large luxury hotels were located further away from the Olympic venues and might not be popular with the Olympic international visitors. <ul style="list-style-type: none"> ○ <u>Evidence: Extract 3, para 2</u> <p><i>"other luxury hoteliers suffered from lower travellers' interest because of travel warnings to avoid the Olympics-sized hassles and not being so close to the capital"</i></p> <p>TC increased in the SR</p> <p>→ construction of new hotels and refurbishment of rooms</p> <ul style="list-style-type: none"> ○ <u>Evidence: Extract 2, para 3</u> <p><i>"Hoteliers have taken the view that if they have a good business case for building, operating or refurbishing in London"</i></p> <p>Assuming the increase in TR > than the increase in TC → <u>profits increased</u> in the SR.</p> <p>Overall increase in revenue might be small while potential revenue was forgone due to sponsorship of rooms and cost incurred for refurbishment. Hence, profits might not increase in the short run.</p> <p><u>Impact on profits in the LR</u></p> <p>TR increases in the LR → due to an increase in DD in the LR</p> <p>The demand for luxury hotels increased in the LR because</p> <ol style="list-style-type: none"> 1. Publicity generated via sponsorship → DD increases → TR continue to increase in LR. 	
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	<p>2. Backed by aggressive advertising, aided by availability of funds for dominant oligopolistic luxury hoteliers.</p> <ul style="list-style-type: none">○ <u>Evidence: Extract 2, para 5</u> “Intercontinental Hotel Group’s Holiday Inn brand has been signed up as main hotel sponsor and the official hotel services provider to London 2012 ... the company will be able to use the 2012 logo in its advertising in exchange for help and accommodation for the athletes as well as for (LOCOG)” <p>TR might not increase → due to possible fall in demand</p> <p>The demand for luxury hotels might fall in the LR because</p> <ol style="list-style-type: none">1. Entrance of new players (contestability in oligopoly market structure) → price war → Evidence of mutual interdependence <u>Evidence: Extract 3 , para 3</u> “When there is a drop in demand and an increase in supply, hoteliers start doing silly things with price. They either have to join the others or stand to their grounds and live with the consequences”2. occupancy rate fall (in the LR after the Olympic event <u>Evidence: Figure 1</u> <p>Assuming increase in TR > the increase in TC → profits increased in the LR.</p> <p><u>Synthesis/Judgement</u></p> <p>Impact on profits depends on</p> <ul style="list-style-type: none">• extent of increase in TR vs increase in TC which in turn depends on whether the dominant luxury hotel oligopolist could successfully make use of non-price strategies such as advertising and service differentiation to ensure and sustain high occupancy rates even after the Olympic. <table><tr><th>Level (Marks)</th><th>Level Descriptor</th></tr><tr><td>L3 (5-6)</td><td>Well-developed answer that examines both the SR and LR impact on profits of the dominant oligopolistic luxury hotelier with reference to the case material. Max 5 for a well-developed answer that examines both the SR and LR impact on profits of the dominant oligopolistic luxury hotelier without references case materials.</td></tr><tr><td>L2 (3-4)</td><td>Answer briefly explains the SR and LR impact without explicitly linking to profits. Some reference to the case material.</td></tr><tr><td>L1 (1-2)</td><td>Answer identifies the impact on either revenue or costs or without distinguish between SR and LR. Little or no reference to the case material.</td></tr><tr><td>E2 (2)</td><td>Evaluative assessment based on sound economic analysis.</td></tr><tr><td>E1 (1)</td><td>For an unexplained assessment or one that is not supported by economic analysis.</td></tr></table>	Level (Marks)	Level Descriptor	L3 (5-6)	Well-developed answer that examines both the SR and LR impact on profits of the dominant oligopolistic luxury hotelier with reference to the case material. Max 5 for a well-developed answer that examines both the SR and LR impact on profits of the dominant oligopolistic luxury hotelier without references case materials.	L2 (3-4)	Answer briefly explains the SR and LR impact without explicitly linking to profits. Some reference to the case material.	L1 (1-2)	Answer identifies the impact on either revenue or costs or without distinguish between SR and LR. Little or no reference to the case material.	E2 (2)	Evaluative assessment based on sound economic analysis.	E1 (1)	For an unexplained assessment or one that is not supported by economic analysis.	
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(d)	<p>Do you agree that the promotion of waste segregation is a sufficient measure to achieve an efficient allocation of resources in the market for plastic food packaging?</p>	[10]												

	<p><u>Explain that the promotion of waste segregation is an effective measure to achieve an efficient allocation of resources.</u></p> <ul style="list-style-type: none">Briefly explain how the over-usage of plastic food packaging will result in negative externality and hence over-allocation of resources<ul style="list-style-type: none">Example of MEC: Increase in non-compostable and degradable plastic waste may endanger wildlife and aquatic animals. Increase in plastic waste also takes up landfills, which are limited. If there's insufficient landfills, inappropriate disposal of plastic waste would harm human's healthExplain how waste segregation in promoting recycling will reduce MEC → show MSC shifting downwards <p><u>Explain that the promotion of waste segregation is insufficient even though it is effective. + suggested alternative policies</u></p> <ul style="list-style-type: none">Explain that MEC could only be reduced by a smaller extent due to the following factors<ul style="list-style-type: none">lack of assistance for spectators, potential confusion caused by items which were neither recyclable nor compostable → not enough campaign conducted before the Olympics on how to distinguish between the recyclable, compostable and residual productsThe bulk of packaging waste might not be recyclable in the first place resulting in a large amount of residual plastic which needs to be incinerated or buried in landfills, both of which are not environmental friendly. Better solution is to collaborate with suppliers such as coca cola to come up with food packaging that are mainly recyclable. → reduce DD for non-recyclable products and hence reduce negative externality									
	<p><u>Synthesis/Judgement</u></p> <ul style="list-style-type: none">Waste segregation is a necessary but not sufficient measure.Collaboration with suppliers to come up with totally recyclable food packaging is a more sustainable and long term solution. <p>To effectively deal with the problem, LOCOG needs to foster cooperation among the LOCOG, suppliers of food packaging and consumers. However, this may not be easy, because it might lead to higher cost of production for the suppliers.</p> <table><tr><th>Level (Marks)</th><th>Level Descriptor</th></tr><tr><td>L3 (6-8)</td><td>Well-developed answer that examines whether waste segregation is an effective and sufficient measure. At least one alternative policy is well-analysed. Analysis is based on economic framework (social costs & benefits vs private costs & benefits) and with reference to the case materials.</td></tr><tr><td>L2 (4-5)</td><td>Answer that attempt to address the sufficiency of waste segregation as a measure to achieve efficient allocation of resources in the market for plastic food packaging. Analysis must be based on economic framework of MSB-MSC analysis though there is reference to case materials.</td></tr><tr><td>L1</td><td>An answer that lacks both scope and depth. Did not address</td></tr></table>	Level (Marks)	Level Descriptor	L3 (6-8)	Well-developed answer that examines whether waste segregation is an effective and sufficient measure. At least one alternative policy is well-analysed. Analysis is based on economic framework (social costs & benefits vs private costs & benefits) and with reference to the case materials.	L2 (4-5)	Answer that attempt to address the sufficiency of waste segregation as a measure to achieve efficient allocation of resources in the market for plastic food packaging. Analysis must be based on economic framework of MSB-MSC analysis though there is reference to case materials.	L1	An answer that lacks both scope and depth. Did not address	
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		(1-3)	the issue of sufficiency of waste segregation as a measure to achieve efficient allocation of resources in the market for plastic food packaging. Brief mention of alternative if at all.	
		E2 (2)	Evaluative assessment of whether waste segregation is a sufficient measure based on sound economic analysis.	
		E1 (1)	For an unexplained assessment or one that is not supported by economic analysis.	

Question 2

(a)	<p>(i) Describe the trend in the current account balance of India between 2008 and 2013.</p> <p>India's current account as a proportion of GDP has been in deficit (1) and has worsened / deteriorated / increased / widened between 2008 and 2013. (1)</p> <p>Cannot accept: decreasing deficit</p> <p>Note: Because the GDP of India has been increasing (from Table 3), we can draw inferences on the <u>level</u> of current account balance, even though Figure 2 only shows the current account balance <u>as a proportion of GDP</u>.</p>	[2]
	<p>(ii) How might your observation in (a)(i) explain the change in the external value of Indian rupee against the US dollar between 2008 and 2013?</p> <p>From Figure 3, Indian rupee has <u>depreciated</u> against the USD between 2008 and 2013. (1)</p> <p>A worsening current account deficit may cause <u>relative increase in supply</u> of Indian rupee (increase in SS and/or decrease in DD) → external value of Indian rupee against USD is likely to fall as reflected in Figure 3. (1)</p>	[2]
(b)	<p>With reference to Table 2, what conclusion would you draw about the economic performance of the US between 2009 and 2012?</p> <p>From table 2, US economic performance showed an improvement: [2 marks]</p> <ul style="list-style-type: none"> - Inflation is low and stable and may imply an improvement in consumer and investor confidence since the sub-prime crisis in 2009 where there was deflation due to fall in AD. - Unemployment also fell since 2009 implying less wastage of resources. - Real growth rates were positive implying a rise in real income. Material standard of living improves. <p>However, despite the improvement in most of the key economic indicators, there are still concerns about the economic performance. [1 mark]</p> <ul style="list-style-type: none"> - Unemployment is still high at about 8% and growth rates are relatively low and may be slowing down further leading to stagnant growth. - Although the budget deficit is smaller, government spending is still higher than its revenue implying a greater tax burden on future generations. <p>In conclusion, while US economy showed signs of recovery, it still has not achieved a fundamentally sound economy. It is necessary for governments</p>	[4]

		to continue its reforms to ensure sustained economic growth./Lack of evidence on other performance indicators, such as BOP. [1 mark]	
(c)		<p>Using the concept of circular flow of income, explain how the expected fiscal cliff would affect the equilibrium level of national income in the US.</p> <p>Definition of circular flow of income: Illustrates the flow of money as well as goods and services between producers and consumers in an economy.</p> <p>Simple circular flow diagram to indicate the main components with reference to a 4 sector economy.</p> <p>Fiscal Cliff – Increase in tax, Fall in G (1) → Increase in withdrawals and fall in injection (1) → $W > J$ → firms reduce production → fall in firms making factor payments to factors of production → fall in national income → households will then save less, pay less tax and buy less imports until withdrawals fall to match injections. (1) → Equilibrium level national income is restored at a lower level. (1)</p>	[4]
(d)		<p>Assess whether the benefits of attracting foreign direct investments into India outweigh the costs.</p> <p><u>Introduction</u> Definition of FDI - defined as a company from one country making a physical investment into building a factory in another country which includes direct investment in buildings, machinery and equipment.</p> <p><u>Possible Benefits</u></p> <ul style="list-style-type: none"> ▪ Increase competition and efficiency → reduces unit cost of production → increase in SRAS → higher real GDP and lower cost push inflation. ▪ Increase in competition and efficiency → lower unit cost of production → lower prices for consumers → increase in consumer surplus → increase in consumer welfare. ▪ Transfer of technology → increase in productivity → lower unit cost of production and increase in productive capacity → increase in SRAS and LRAS ▪ Deregulation of power sector → increase foreign investment into energy sector → reduce power shortages → lower unit cost of production → increase in SRAS → higher real GDP and lower cost push inflation. ▪ Increase in FDI → higher investment → increase in AD → higher real GDP and employment → higher GDP per capita assuming increase in real GDP > increase in population → higher material SOL ▪ Inflow of FDI → c.p. improvement in KFA → c.p. improvement in India's BOP position ▪ Increase tax revenue → reduce fiscal deficit <p><u>Possible Costs</u></p>	[8]

	<ul style="list-style-type: none">▪ In SR, further burden on infrastructure → further demand pull inflation▪ May worsen income balance of current account in LR when profits are remitted back▪ May worsen income distribution as demand for skilled workers increase faster than the demand for unskilled workers <p><u>Evaluation</u></p> <ul style="list-style-type: none">▪ SR – less benefits as infrastructure may be unable to support the higher investments coming into the country▪ LR more benefits when productive capacity increases and is better able to support the FDI▪ Overall benefits outweigh cost <table><tr><th>Level (Marks)</th><th>Level Descriptor</th></tr><tr><td>L3 (5 – 6)</td><td>Well-developed answer that examines both benefits and costs of attracting FDI into India with reference to the case material and good application of economic framework.</td></tr><tr><td>L2 (3 – 4)</td><td>Answer examines either benefits or costs of attracting FDIs into India with good reference to the case material with some application of economic framework or Answer examines both benefits and costs but lacks application of economic framework (AD/AS) or reference to case material Max. 3 marks for an answer that excessively lifts evidence from the data with limited explanation</td></tr><tr><td>L1 (1 – 2)</td><td>Smattering of points with conceptual errors or Answer identifies either the benefits or costs of attracting FDI into India with limited application to economic framework</td></tr><tr><td>E2 (2)</td><td>Evaluative assessment based on sound economic analysis:</td></tr><tr><td>E1 (1)</td><td>For an unexplained assessment or one that is not supported by economic analysis:</td></tr></table>	Level (Marks)	Level Descriptor	L3 (5 – 6)	Well-developed answer that examines both benefits and costs of attracting FDI into India with reference to the case material and good application of economic framework.	L2 (3 – 4)	Answer examines either benefits or costs of attracting FDIs into India with good reference to the case material with some application of economic framework or Answer examines both benefits and costs but lacks application of economic framework (AD/AS) or reference to case material Max. 3 marks for an answer that excessively lifts evidence from the data with limited explanation	L1 (1 – 2)	Smattering of points with conceptual errors or Answer identifies either the benefits or costs of attracting FDI into India with limited application to economic framework	E2 (2)	Evaluative assessment based on sound economic analysis:	E1 (1)	For an unexplained assessment or one that is not supported by economic analysis:	
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(e)	<p>Using both the case study and your own relevant knowledge, discuss the relative importance of factors that might limit the effectiveness of the policies put in place by US or India to address the slowdown in economic growth.</p> <p><u>Introduction</u></p> <p>Briefly explain how the policies put in place by US works to improve economic growth</p> <p>US:</p> <ol style="list-style-type: none">1. Quantitative easing → increase money supply & lower interest rates→increase C and I→increase AD and AS <p><u>Factors that limit effectiveness (extract 1):</u></p> <ul style="list-style-type: none">- Austerity measures (policy conflict) →spending cuts and fall in transfer payments→Fall in G, C and I→ fall in AD- Lower private consumption (signs of low consumer confidence) → fall	[10]												

	<p>in AD</p> <ul style="list-style-type: none">- Weakening external demand→net exports fall→fall in AD- Cuts to education, science and infrastructure spending could reduce potential growth (Extract 2)▪ Students would need to explain how these factors may offset the effect of the expansionary monetary policy put in place to stimulate economic growth.▪ Students need to assess the relative importance of the factors discussed above in limiting the effectiveness of the policies. <p><u>Conclusion</u></p> <p>US will need to ensure austerity measures are implemented gradually to avoid hurting economic growth especially in view of weakening global demand.</p> <p>OR</p> <p><u>Introduction</u></p> <p>Briefly explain how the policies put in place by India works to improve economic growth</p> <p>India:</p> <ol style="list-style-type: none">1. Attract FDI→Increase I →increase AD and AS2. Privatisation →Increase efficiency and productivity→increase AS3. Expansionary FP <p><u>Factors that limit effectiveness:</u></p> <ul style="list-style-type: none">- Infrastructure deficit suggests that India is near full-employment. With an increase in FDI, output may not rise much and is accompanied by further demand-pull inflation. This will further slow down economic growth.- Weakening external demand- Competition from foreign firms may deter domestic investment (crowding out effect)- Fiscal deficit → competition for funds → higher interest rate → crowd out private investment- Increasing budget deficits → cut in diesel subsidies → increase COP > fall in SRAS <ul style="list-style-type: none">▪ Students would need to explain how these factors may offset the effect of the policies put in place to stimulate economic growth.▪ Students need to assess the relative importance of the factors discussed above in limiting the effectiveness of the policies. <p><u>Conclusion</u></p> <p>India may need to address its infrastructure bottlenecks if it hopes to have sustainable economic growth. Inflation is high and if the economy continues to increase AD without ensuring a rise in AS, it will face higher inflation that may stifle the economy.</p>					
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		(7 – 8)	limit the effectiveness of the policy(s) in place with reference to the case material and good application of economic framework. Answer also makes a considered attempt to rank the limitations from the most serious to the least.	
		L2 (4 – 6)	Answer accurately identifies the policy(s) in place but lacks depth in analysis of the factors that limit the effectiveness of the policy(s). There is some attempt to use economic framework in the analysis. Max. 6 marks for answers that make no attempt at ranking the factors.	
		L1 (1 – 3)	Smattering of points with conceptual errors and weak application of economic framework with regards to policy in place as well as the factors that limit effectiveness.	
		E2 (2)	Evaluative assessment based on sound economic analysis:	
		E1 (1)	For an unexplained assessment or one that is not supported by economic analysis:	