



HWA CHONG INSTITUTION
JC2 Preliminary Examinations
Higher 2

CANDIDATE NAME

CT GROUP

CENTRE NUMBER

INDEX NUMBER

ECONOMICS
Paper 2

9732/02
19 September 2011
2 hours 15 minutes

Additional Materials: Answer Paper

INSTRUCTIONS TO CANDIDATES

Write your **name** and **CT class** clearly in the spaces at the top of this page and on every page 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, graphs or rough working.

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

Answer **three** questions in total, of which **one** must be from Section A, **one** from Section B and **one** from either Section A or Section B.

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

You are to fasten the answer sheets to essay questions separately together with the cover pages provided.

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

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

You are reminded of the need for good English and clear presentation in your answers.

Start each question on a fresh sheet of writing paper.

This document consists of 2 printed pages.

[Turn over

Answer **three** questions in total.

Section A

One or two of your three chosen questions must be from this section.

- 1** In recent years, many countries have seen a stronger surge in trade, foreign direct investment, technology transfer and labour mobility.

Assess the impact of these recent developments on expenditure by consumers on luxury and non-luxury goods and services. [25]

- 2** With growing environmental awareness, large cosmetic companies advertise they have invested in research to ensure their products are environmentally friendly. The aim is to increase demand and profits.

(a) Explain what might happen to the fixed and variable costs in the above companies and how any changes might affect their profit maximising prices and output. [10]

(b) Discuss whether the profits of such companies will increase, and whether in the real world they will set prices and output at profit maximising levels. [15]

- 3** Discuss the effectiveness of government intervention in resource allocation in the provision of merit goods and when market dominance exists. [25]

Section B

One or two of your three chosen questions must be from this section.

- 4** In 2009, Singapore experienced a negative growth of 1.3% and a current account surplus of US\$32 billion while the United States had a negative growth of 2.6% and a current account deficit of US\$378 billion.

Discuss to what extent such economic data indicate that the standard of living for the average person in both countries had declined. [25]

- 5** (a) Using examples, explain why the size of the national income multiplier for different countries may differ. [10]

(b) Assess the role of the multiplier in influencing the policies used by the Singapore government in managing unemployment in recent years. [15]

- 6** (a) Explain how globalisation has affected Singapore's pattern of trade with the rest of the world. [12]

(b) Singapore should not continue to rely on an export-led growth strategy as it causes much volatility to economic growth.

To what extent do you agree with the above statement. [13]

Suggested Essay outline

1 In recent years, many countries have seen a stronger surge in trade, foreign direct investment, technology transfer and labour mobility.

Assess the impact of these recent developments on expenditure by consumers on luxury and non-luxury goods and services. [25]

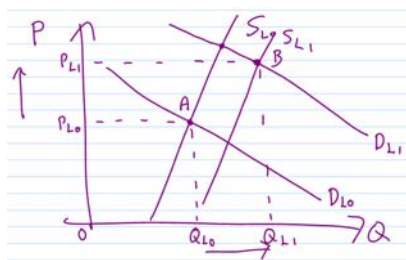
Concepts to be tested: **demand, supply, PED, PES and YED**

Surge in trade and FDI – increase in **national income and thus affect demand**

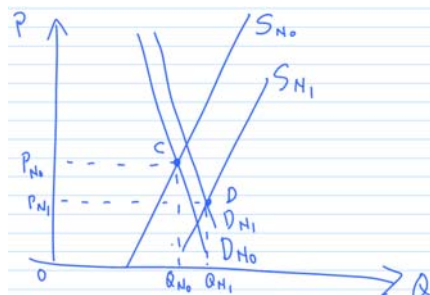
Outsourcing, offshoring, technological transfer and labour mobility – increase productivity, **reduce cost of production and increase supply.**

Types of goods	Δ in Demand when $Y \uparrow$ Consider YED & PES	Δ in Supply Consider PED	Final impact on expenditure (Evaluation in the form of judgment – what outcome is likely)
Luxury goods Give examples and justify why $YED > 1$ As income rises, people usually prefer to spend a bigger percentage of their extra incomes on luxury goods to improve their quality of life once these basic necessities are more or less satisfied.	Demand \uparrow more than proportionate PES < 1 assuming luxury goods are of top quality and take longer production period + relatively smaller number of producers When demand increases, both price and output increase but price increases more significantly than output – TE \uparrow	PED > 1 due to the nature of the good + higher proportion to income A rise in supply means fall in price with a more than proportionate increase in Qd and thus TE \uparrow .	TE \uparrow Illustrate with diagram to show simultaneous shifts and TE \uparrow
Necessities Give examples and justify why $0 < YED < 1$ YED is relatively low because the desire for increased consumption usually does not grow in direct proportion to increased incomes for such basic goods which are meant to provide for a minimum decent living standard.	Demand \uparrow less than proportionate PES < 1 assuming necessities such as agricultural produce have specific planting and harvesting time and also lack of spare capacity and difficult to accumulate stocks. When demand increases, both price and output increase but price increases more than output – TE \uparrow <i>Evaluation: BUT TE \uparrow will not be as significant as in luxury goods where demand increases more than proportionate.</i>	PED < 1 as they are basic goods + smaller proportion to income A rise in supply means fall in price with a less than proportionate increase in Qd and thus TE \downarrow .	TE is indeterminate. It will increase if the impact on TE by the rise in demand outweighs the increase in supply and vice versa Illustrate with diagram.
Inferior goods Give examples and justify why $YED < 0$ As income increases, people usually turn away from products that are of relatively poorer quality.	Demand \downarrow with a rise in income. PES > 1 assuming they are low-end manufacturing goods with many suppliers and stocks are easily accumulated. TE \downarrow since both price and output fall but output falls more significantly than price.	PED > 1 assuming many substitutes A rise in supply means fall in price with a more than proportionate increase in Qd and thus TE \uparrow .	Though TE is indeterminate, there is a high possibility that TE \downarrow esp. if the demand for inferior goods is income elastic. Illustrate with diagram

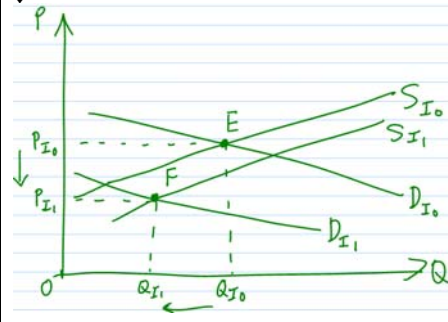
A simultaneous rise in demand and supply for luxury goods leading to $\uparrow TE$



A simultaneous rise in demand and supply for necessities and TE is indeterminate



A fall in demand and rise supply for inferior goods leading to a fall in $\downarrow TE$



Note:

- Markers to be ready to accept answers that defer from the suggested outline. Students are free to justify the PED/PES of the goods concerned as long as they are conceptually sound and reasonable. And that will have impact on the final outcome of TE.
- Strictly speaking, PES is not really needed to analyse the outcome on TE – demand increases, regardless the steepness of supply, $TE \uparrow$ and vice versa.
- But nonetheless, it is still good to include the concept to have a complete analysis to see whether P or Q has the greater impact on TE and also to illustrate accordingly.

2 With growing environmental awareness, large cosmetic companies advertise they have invested in research to ensure their products are environmentally friendly. The aim is to increase demand and profits.

(a) Explain what might happen to the fixed and variable costs in the above companies and how any changes might affect their profit maximising prices and output. [10]

1.	Briefly explain fixed and variable costs
2.	Justify why advertising and R&D costs affect only fixed costs – so only AC not MC will increase. Illustrate with rev-cost diagram to show no change in pricing and output decision since only AC has increased.
3.	However, one can argue that advertising can be a variable cost – ‘advertise frequently’ - more advertisement if the sales increase after the publicity – so in that sense cost increases with output. This may be true especially if it is persuasive advertising and also when the cost is relatively low – examples – advertisement on internet and also printing of flyers as compared to TV commercials. Illustrate with rev-cost diagram to show higher price and lower output when VC increases that causes both AC and MC to rise.

Note: Students will be awarded a max of 7m, L3 (lower) even if they did not include advertising cost to be variable.

- (b) Discuss whether the profits of such companies will increase, and whether in the real world they will set prices and output at profit maximising levels. [15]

Yes	No
<p><u>Advertising is effective:</u></p> <ul style="list-style-type: none"> Briefly explain effective advertising, be it informative or/and persuasive, increases demand Explain and illustrate with diagram to show increase in AR/MR and price, output and profits increase at profit maximizing output. Firms will set price at profit maximizing level. <p><u>Evaluation:</u> <i>To maximize profits, producers need to know where exactly $MR=MC$ where MC is rising. In real life, implicit costs are difficult to estimate and usually not taken into consideration. So firms do not maximize economic profits. They at best can maximize accounting profits since MC (explicit costs) are more readily available.</i></p> <p><i>Also, one has to realize even though the skin products' companies are able to maximize profits at $MR=MC$ where MC is rising, it does not necessary mean a rise in profits immediately. Profits will only increase if the rise in revenue outweighs the rise in costs.</i></p>	<p><u>Advertising is ineffective – unable to increase and maximize profits:</u> Producers 'predicted' the change in demand wrongly due to inaccurate info.</p> <p>What if demand does not increase? It really depends on taste and preferences of consumers – consumers are kings as they are the ones who decide whether they will buy the new products. They might not be as 'green' as the producers anticipated.</p> <p>This may be due to inaccurate info that the producers have.</p> <p><u>Alternate goal in the short-run:</u> Sales/growth maximization These are new products and companies may not want to set price at maximize profits initially. Lower price to gain market share – create awareness.</p> <p>It is not uncommon that companies give out free samples, have promotion such as buy 2 get 1 free, etc so as to attract consumers to their new products.</p> <p><u>Evaluation:</u> <i>However, once publicity is over, companies will resort back to profit maximizing pricing.</i></p>

- 3 Discuss the effectiveness of government intervention in resource allocation in the provision of merit goods and when market dominance exists. [25]

NEW QUESTION

- 4 In 2009, Singapore experienced a negative growth of 1.3% and a current account surplus of US\$32 billion while the United States had a negative growth of 2.6% and a current account deficit of US\$378 billion.

Discuss to what extent such economic data indicate that the standard of living for the average person in both countries had declined. [25]

Define standard of living (SOL).

- Material well-being:** main indicators will be high growth rate, low unemployment, low inflation, healthy BOP and low Gini Coefficient.
- Non-material well-being:** indicators regarding quality of life

Clarify some key concepts:

Growth rate is derived from a change in GDP over time. Define GDP.

Briefly explain what current account is made of and it is part of the balance of payment.

Thesis: ↓SOL	Anti-thesis: Not necessary
Negative growth rate	
<p>Negative growth rate will mean a fall in value of goods and services - less goods and services for consumption - ↓SOL.</p> <p>Consider the source of the negative growth is important: The negative growth in US was a result of a fall in C & I. Explain with exemplification. This had direct impact on both actual and potential growth and the former is SOL.</p> <p>One can also infer from the negative growth rate that there is less job opportunity and a rise in cyclical unemployment in both countries which is undesirable - ↓SOL</p>	<p>The negative growth in Singapore was mainly due to a fall in NX by our top trading partners such as US and EU (27), not a direct fall in C so not a ↓SOL.</p> <p>Evaluation: <i>But ultimately, this would lead to a fall in NI by k and increased cyclical unemployment and thus ↓SOL.</i></p> <p>Negative growth means a possible falling of inflation rate or even drop in GPL – lower cost of living.</p>
<p>Synthesis: <i>It is a more serious problem in US as compared to Singapore as the negative growth rate was worse (-2.6% as compared to -1.3%) and also the source came from ↓C & I.</i></p> <p><i>Need to have other economic indicators such as unemployment rate and inflation rate to better assess the SOL. 3% unemployment rate in Singapore vs 9% in US + both had low inflation – students do not need to know.</i></p> <p><i>To assess the SOL of 'an average person' – crucial to have population growth. Theoretically, if population growth rate falls more than the growth rate, SOL can improve. Nonetheless, justify this is unlikely to happen, unless there is a large scale natural disaster or war.</i></p>	
Current Account Surplus (Singapore)	
	<p>If the bulk of the current account of surplus is due to high X, it does not really contribute to SOL in terms of more consumption of goods and services.</p> <p>In the case of Singapore, a surplus might not mean the economy has performed better as we have surpluses for most of the years.</p> <p>Evaluation <i>But need more info regarding the change – In 2009, this probably was a shrink from previous years since there was a fall in global income.</i> <i>Singapore is an export-driven economy with $X=2.5GDP$ and a fall in trade will mean a fall in SOL when NI shrank.</i> <i>This indicator should be used together with GDP growth and unemployment rate figures.</i></p>
<p>Synthesis: <i>On the other hand, assuming this surplus is due to a BOT surplus leading to higher AD and thus an increase in NI by k – SOL has improved. But the fact is there is a negative growth rate, SOL more likely to deteriorate.</i></p>	
Current Account Deficit (US)	
	<p>This suggests that US was not doing well in her export market or/and she was importing too much. If imports were mainly consumer goods - ↑SOL and not deteriorated.</p>

	<p>Evaluation</p> <p><i>A prolonged current account deficit indicates a loss in export competitiveness and will decrease NI and rising structural unemployment and thus ↓SOL. SOL when NI shrunk.</i></p> <p><i>This indicator should be used together with GDP growth and unemployment rate figures.</i></p>
<p>Synthesis:</p> <p><i>US main engine of growth is its domestic market rather than its external demand. Nonetheless, it is crucial for US to restructure the economy to reap the benefit of their CA, rather than clinging on to those in which they have lost to low-cost economies. A healthy balance of payment is crucial to a country's SOL.</i></p>	

Need more information on the non-material well-being: indicators regarding quality of life.
Generally, negative growth/recession will mean ↓SOL since it is stressful without a job involuntarily.

Conclusion

- 5 (a)** Using examples, explain why the size of the national income multiplier for different countries may differ. [10]

Define k and give the formula for k.

	MPM	MPS	MPT
Singapore	High MPM High due to lack of natural resources – import almost everything from daily necessities to import content for exports	High MPS Thrifty country – Asian values + CPF	Low MPT Government has lowered income taxes over the years to attract foreign talents and ensure a pool of skilled labour to attract FDIs.
US	Relatively lower MPM More self-sufficient with more factor endowment	Low MPS Generally Americans have the habit of spending in debt – less thrifty	High MPT Generally higher tax rates in advanced countries due to the welfare system

Overall, k in Singapore is relatively smaller than that of US.

- (b)** Assess the role of the multiplier in influencing the policies used by the Singapore government in managing unemployment in recent years. [15]

Explain briefly the 2 main types of unemployment in Singapore in recent years – cyclical and structural unemployment.

	Cyclical Unemployment	Structural Unemployment
<p>Demand management tools</p> <p>Illustrate with AD-AS to show a rise in AD from the Keynesian range.</p>	<p>Expansionary Fiscal Stimulus Briefly explain how expansionary fiscal policy works and state it may be ineffective due to the small k as explained in part (a).</p> <p>But need to elaborate on the (+) of FP in terms of $\Delta NI = \Delta G \cdot k$ so it is better to have some form of spending by the government than none – also the possibility of crowding-in.</p> <p>Singapore has high reserves so little</p>	<p>Expansionary Fiscal Stimulus Relevant if it is of supply-side slant.</p> <p>Slight Depreciation Not relevant.</p>

	<p>crowding-out and also with one incumbent ruling party, it is easier to implement.</p> <p>Slight Depreciation Explain how this can increase NX with detailed analysis $PED_x > 1$ during bad times and $PED_m < 1$ with Marshall Lerner condition satisfied.</p> <p>Warning: Possible inflation especially if there is still threat of import-price-push inflation.</p>	
Supply-side policies – Short-run vs Long-run	<p>SR SSP Cut in business cost such as reduction of employer's CPF contribution rate and wage control.</p> <p>Illustrate with a rightward shift in SRAS that increases NI.</p>	<p>LR SSP Singapore has lost quite a number of mid-range manufacturing to low-cost economies over the years. Urgent need to speed up restructuring – moving up the value chain (tourism) and also to prepare people for the correct skills. Relevant – in fact is the best policy for structural unemployment E.g. SPUR.</p>
Trade policies	<p>Diversification to mitigate the direct impact of one top 'troubled' trading partner on our NX & FDO.</p> <p>Decouple from the source of recession – US.</p>	<p>Attract more FDI to create jobs.</p> <p>But must have ready pool of labour with correct skills – if not, worsen structural unemployment.</p>

Most appropriate policies? No one-size-fits-all

Cyclical unemployment which is due to demand-deficiency – use demand management tools + SR SSP

All these policies are limited as recession is externally induced.

Structural unemployment: Use SSP and trade policies.

6 (a) Explain how globalisation has affected Singapore's pattern of trade with the rest of the world. [12]

- Explain how globalisation has changed factors of endowment and link it to how CA might change – explain inter-industry trade in details.
- Explain how globalisation has increased competition that will also impact on intra-industry trade.

(b) Singapore should not continue to rely on an export-led growth strategy as it causes much volatility to economic growth.

To what extent do you agree with the above statement. [13]

Thesis 1: Should not continue the export-led growth strategy because of externally induced recession

- External shocks – recession (cyclical unemployment) – volatility in growth rates

Thesis 2: Should not continue the export-led growth strategy as the alternative is to turn inward

- Should turn inward – increase C+I+G (evaluation – constraint by 'smallness')

Note: There are other points but the huge fluctuation in the business cycle in recent years is the major concern for the government to reconsider this export-oriented growth model.

Anti-thesis: Should continue the export-oriented growth strategy due to its benefits

- Given our small and open nature ($X+M=4$ times of GDP), this model has brought about high growth rates.
- Besides increase in trade, to support this model, Singapore government signed numerous FTAs which led to increase in FDIs + more migration of labour
- AD-AS diagram to illustrate non-inflationary growth.

Synthesis:

With globalization, this model is the way to go?

Are there any other alternatives for Singapore besides export-oriented model?

- *No obvious better alternative, given our small and open nature ($X+M=4$ times of GDP)*
- *Not beneficial if Singapore chooses to move away from trade because of the possible threats.*
- *Instead of changing the strategy, need policies to **mitigate** the negative impact of external shocks.*
- *With growing protectionism in the midst of a worldwide recession, besides export-oriented growth model, signing numerous FTAs is a way to ease our exports to other markets. The main purpose is to diversify the risk of external shocks especially if over-reliant on a few top trading partners; a means to 'decouple' from only a few top trading partners.*