

NATIONAL JUNIOR COLLEGE
SH2 Preliminary Examinations for General Certificate of Education Advanced Level
Higher 1

ECONOMICS

8819/01

Paper 1:

2 September 2014

3 hours

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your student registration number and name on all the work 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 paper clips, highlighters, glue or correction fluid.

Section A: Case Study Questions

Answer **ALL** questions. You are advised to spend some time reading through the data before you begin writing your answers.

Section B: Essay Questions

Answer **ONE** question.

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

Start each question on a new piece of paper.

Start the last part of both case studies on a new piece of paper.

At the end of the examination, fasten all your work securely with the cover pages given.

Fill in the necessary information on the cover pages.

This document consists of **13** printed pages; including 3 cover pages.

Answer **all** questions.

The influence of the Fashion Industry

A giant photo of a model in tiny underwear is in danger of causing car-crashes on a busy intersection in Mexico City. The billboard announces the arrival of H&M, a Swedish fashion retailer, which opened its first Latin American store in Mexico City on November 1st. A fortnight earlier Forever 21, an American chain, celebrated its debut in the country. That followed the first opening of a Mexican store by Gap, another American clothing giant, in September. The new entrants promise high fashion at low prices.

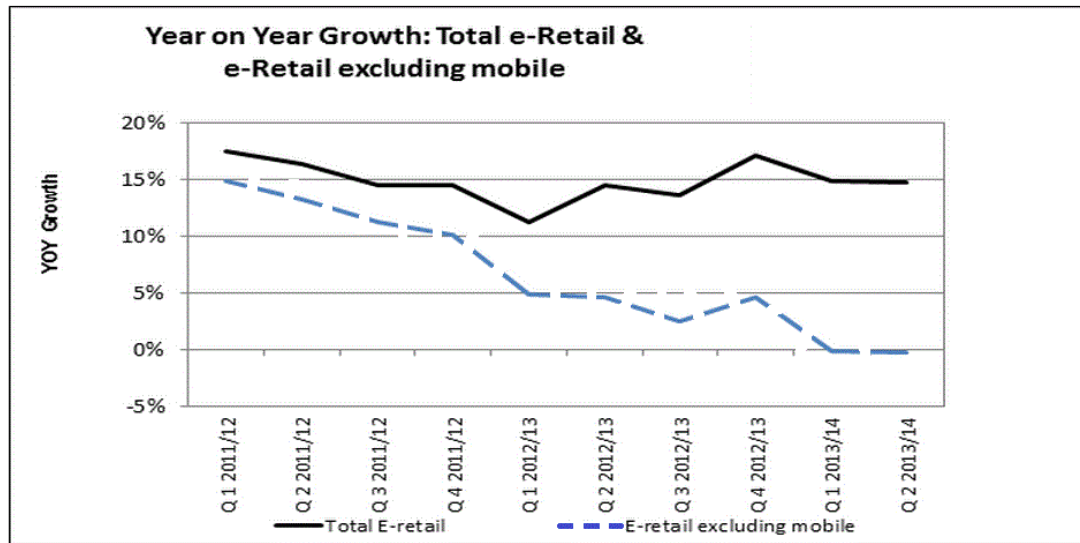
Now tariffs are coming down, and the market is opening up. Having fallen slowly in recent years, they were slashed in December 2011, to around 20%. The lower tariffs have opened the door to retailers such as H&M, the suppliers of which are 80% Asian. H&M's three-storey Mexican megastore stocks boots, dresses, sweaters and handbags made in China.

Mexican firms are fighting back by focusing on quality, where Mr López believes they can still beat China. The cheap but dowdy basics sold at street markets (often imported illegally from China) still account for 60% of Mexico's clothes business, according to Euromonitor, a research firm. But now that more and more Mexicans sport the label "middle class", fashionistas are vying to clothe them.

Extract 2: Chinese manufacturers aim to increase direct sales to Western online shoppers

Source: <http://www.internetretailer.com/>, accessed on Aug 2014

Figure 1: Online Retail Sales



Source: IMRG and Capgemini

Extract 3: Fashioning Success

The online fashion retailing industry is burgeoning. Numerous sites have cropped up in the past few years to claim their share of a very satisfying retail pie. This competition has also resulted in small and big ventures innovating to try and stay ahead of a ferocious pack. Consumers on the other hand, are most likely to gain from the increasingly competitive prices and qualitative services.

Selling is increasingly about service. The average consumer who shops online chooses to because of increasing time-poverty, changing lifestyle, convenience and flexibility of shopping and option of free home delivery. There is also a significant change in consumer behaviour, as online shoppers migrate from desktops and laptop computers to mobile devices such as smartphones and tablet devices. Possible contributing factors to the emerging trend include accessibility, convenience and confidence.

Source: Adapted from *Business Today*, May, 2013

Extract 4: Online Marketplaces Adopting Models to Ensure Discounted Prices

With price being the most potent weapon in their arsenal, online retailers looking to snare more customers are cajoling sellers to offer steep discounts and reimbursing those who do so. India's largest online marketplaces like Amazon, Flipkart and Snapdeal are adopting several models to ensure that merchants on their portal offer discounted prices. Their unbridled aggression is drawing the ire of smaller peers as well as traditional brick-and-mortar retailers who are struggling to keep pace.

Officially most portals maintain that they only offer a technology platform where merchants sell to customers, that they have little role to play in pricing.

However, several merchants that *Economics Times* spoke to said they are constantly badgered to drop prices. Sayak Sahu, founder of IE Ventures that runs design-led gift products and gadgets firm Smiledrive, sells products on Amazon, Snapdeal, Flipkart and eBay, and is urged by each to compare prices for similar products and offer the lowest price.

Source: Adapted from *The Economic Times*, 20 May, 2014

Extract 5: Global recovery could depend on China's taste for luxury

China's looming coronation as the world's largest economy, years ahead of schedule, is probably not particularly surprising in one sleepy corner of Oxfordshire. Around half of the international visitors who flock to Bicester retail village are Chinese nationals, making the one-hour train trip from London, or using the fleet of special coaches that head there each day – to stock up on luxury goods.

A World Bank-backed report has declared that the country's national currency, the yuan, will go further than previously thought in the hands of the Chinese consumer and that this supercharged purchasing power will push the world's second-largest economy ahead of the US this year.

Gareth Leather, Asia economist at Capital Economics, says the UK stands to benefit substantially from the spending power of the Chinese. "China is a huge market for luxury goods, and there are high taxes on luxury goods in China, so there is a tendency to travel abroad."

Chinese buyers are brand junkies, and the Bicester outlets of their favourite labels are heaving. A sprawling two-floor Burberry store is packed with Chinese visitors poring over the brand's trademark trench coats and accessories, while the Prada branch nearby is thronged too. And this is not just window shopping. To judge by the masses of shopping bags bearing luxury names such as Ralph Lauren and Gucci, as well as Burberry and Prada, some serious cash is being spent. An economist estimates that around two-thirds of luxury shopping by Chinese consumers is done outside China. He says the reason Chinese nationals prefer to buy luxury goods abroad is because of a lack of trust in branding – and genuine safety issues with domestic products, from foodstuffs to cars, clothing and electrical goods. If Western economies such as the UK's are to tilt back towards export-driven growth, China's status as the world's factory floor has to change. The West needs China to open up as a market that consumes goods rather than just making them.

Source: Adapted from *The Guardian*, 11 May, 2014

Questions

- (a) (i) Compare the year-on- year growth of online sales of total e-retail with that of e-retail excluding mobile from Q1 2012 to Q2 2014. [2]
- (ii) Account for the difference that you have observed. [1]
- (b) With the aid of a diagram and reference to the data in Extract 3, explain what has happened to prices of online retail products. [6]
- (c) (i) What is meant by price elasticity of demand? [2]
- (ii) Explain how the concept of price elasticity of demand can explain the pricing strategy of the online retailers mentioned in Extract 4. [3]
- (d) Explain the case for the protectionist measures imposed by the Mexican government on clothes and shoes. [4]
- (e) Explain two ways in which the decrease in the tariffs on imported clothes from China could benefit a country such as Mexico. [4]
- (f) Discuss the view that “The West needs China to open up as a market that consumes goods rather than just making them.” [8]

[Total: 30]

Question 2

Challenges in economic policymaking

Extract 6: Policymakers fiddle while the economy burns

The Roman emperor Augustus is supposed to have come up with the phrase “festina lente”, which means make haste slowly. It is apt for what has been happening to the global economy these past four years: policymakers have been hyperactive but progress has been painfully slow.

The weakening in activity this year has set off warning bells. The International Monetary Fund (IMF) says the risk of a serious global slowdown is "alarmingly high", due in part to governments imposing austerity programmes. Changes to tax and spending affect the economy through a multiplier effect, which the IMF believes to be larger than expected. The implication is that raising taxes and cutting spending cause a much bigger loss of output, helping to explain why growth has been so weak.

This deserves to be taken seriously. Why? Because a larger multiplier effect could well jeopardise any economic recovery when governments implement austerity programmes, and if interest rates are already extremely low there may be a limit to what a further easing of monetary policy can do to stimulate activity.

What is to be done? The obvious answer would be to relax fiscal policy. Today's policymakers should, in other words, take a leaf out of Franklin Roosevelt's New Deal for America in the 1930s and embark on a major programme of spending on public works. This has its attractions for Britain, where the infrastructure is so poor and the cost of borrowing so cheap.

But the economic historian Nick Crafts has warned against drawing parallels with the 1930s, mainly because US public finances were much healthier at that time than the UK's are now. That's not to say that a different approach to fiscal policy would be impossible - but there is a balance of risks. Tightening or tightening too fast could send the economy on a downward spiral of spending cuts and weak growth. On the other hand, fiscal expansion would result in a burgeoning public debt that would drive interest rates up. Other risks would be a loss of confidence and the possibility that individuals and companies would save more in anticipation of higher taxes or higher inflation in future resulting from the expansionary fiscal policy today.

As a result, we have to assume that monetary policy will continue to take most of the strain in the UK, as it will in the US and the eurozone. At the very least, the UK Central Bank's interest rate will stay at 0.5% for the foreseeable future.

Source: Adapted from Larry Elliot, *The Guardian*, 2 Oct 2012

Extract 7: Fiscal cliff threatens US recovery

The US economy will be facing a sharp plunge in spending or fiscal cliff, when tax cuts introduced during the Bush Administration expire at the end of the year, causing taxes to increase. At the same time, government spending cuts mandated under the Budget Control Act of 2011 will kick in at the start of 2013. With the US government debt reaching the limit that is permitted by law, the spending cuts are necessary in order to reduce the government's budget deficit, but can have an adverse impact on the economy.

The Federal Reserve chairman, Ben Bernanke, has warned that the fiscal cliff would threaten the recovery of the US economy. According to Bernanke, the expiry of Bush-era tax

cuts at the end of the year and imposition of deep spending cuts would send the US “toppling back into recession”: He further warned that a row in Washington over increasing the US debt ceiling would also have dire consequences. Protracted disagreement over raising the debt limit in 2011 triggered panic in financial markets around the world, as concerns rose over the possibility of the US government defaulting on its debt payments.

Source: Adapted from Dominic Rushe, *The Guardian*, 21 Nov 2012

Extract 8: Japan slump adds to woes over global economy

A shock slump for Japan rang new alarm bells over global growth prospects yesterday as the world's third-biggest economy was braced to plunge back into recession. The dire figures - which showed Japan's economy shrinking at an annual pace of 3.5 percent between July and September - come days before the eurozone's slide back into a double-dip recession is set to be confirmed.

The nation has been battling deflation and weak growth for more than 20 years since the burst of an asset bubble in the early 1990s, with last year's tsunami and earthquake adding to its headaches. Japan has also been hit by a rising yen as woes elsewhere encourage investors to park their cash in the yen, deterring investment and hitting its competitiveness. Uncertainty in Europe is also affecting Japan. Exports to the EU plunged 23 per cent in the third quarter, the biggest decline since 2009.

Source: Adapted from Russell Lynch, *The Independent*, 13 Nov 2012

Extract 9: Spain is a black hole that could pull in all around it

Where is the world economy heading? The IMF, at its spring conference in Washington, says the prospect is for stronger growth as long as the Europeans, Americans and Chinese do not mess up their domestic recoveries.

However, the interconnected nature of modern economies makes them especially vulnerable to upheavals in other nations, making it even more challenging for governments to manage their economy. Like a black hole, Spain, in particular has the capacity to suck in and destroy all around it.

A member of the eurozone which adopts the euro as a common currency, Spain declared this week that bad bank loans, much of it on empty or abandoned property, had risen to more than 8%. There is some concern that poorly performing bank loans will need to be indemnified by the government or be allowed to fail. Bailing out the affected banks would require additional funds from the EU and aggravate the government's debt problem, raising concerns over the government's ability to service its debt. Allowing the banks to fail could also trigger a financial and confidence crisis that could affect the whole region. Either way, it would cause havoc for the eurozone - and it is the fear of this that keeps investors away.

Source: Adapted from Phillip Inman, *The Guardian*, 20 Apr 2012

Table 1: Japan: selected economic indicators

	2009	2010	2011	2012
GDP Growth (annual %)	-5.5	4.7	-0.5	1.4
Exports of goods and services (% of GDP)	13	15	15	15
Imports of goods and services (% of GDP)	12	14	16	17
Current account balance (US\$ millions)	147,017	203,916	119,064	60,859
Government budget balance (% of GDP)	-7.6	-6.7	-8.2	-8.0
Central government debt (% of GDP)	166.8	174.8	189.5	196.5

Table 2: Spain: selected economic indicators

	2009	2010	2011	2012
GDP Growth (annual %)	-3.8	-0.2	0.1	-1.6
Exports of goods and services (% of GDP)	24	27	31	33
Imports of goods and services (% of GDP)	26	30	32	32
Current account balance (US\$ millions)	-69,775	-62,498	-55,066	-15,142
Government budget balance (% of GDP)	-8.5	-5.2	-3.6	-9.0
Central government debt (% of GDP)	47.0	48.7	56.1	67.6

Table 3: US: selected economic indicators

	2009	2010	2011	2012
GDP Growth (annual %)	-2.8	2.5	1.8	2.8
Exports of goods and services (% of GDP)	11	12	14	14
Imports of goods and services (% of GDP)	14	16	17	17
Current account balance (US\$ millions)	-381,638	-449,477	-457,729	-440,423
Government budget balance (% of GDP)	-10.3	-10.1	-9.1	-7.5
Central government debt (% of GDP)	76.3	85.6	90.1	93.8

Source of Tables 1 to 3: World Bank

Questions

- (a) (i) Define the balance of trade of a country. [1]
- (ii) Compare the change in Japan's balance of trade with that of Spain between 2009 and 2012. [2]
- (iii) With reference to the information in Extract 8, explain one factor that could cause Japan's exports to fall. [2]
- (b) With reference to the data, explain how GDP growth might affect the government's budget balance. [3]
- (c) Explain one reason why the size of a country's multiplier could become larger. [2]
- (d) Using data from Table 2, account for the trend in Spain's central government debt. [2]
- (e) It is mentioned in Extract 9 that Spain has the capacity to suck in and destroy all around it. Discuss how the economic conditions in Spain could impact other countries in the eurozone. [8]
- (f) With reference to the countries mentioned in the data, discuss whether domestic factors or external factors have the greater impact on a government's choice of macroeconomic policies. [10]

[Total: 30]

Section B

Answer **one** question from this section.

3. The Singapore government plays an active role in managing road congestion and promoting education for Singapore citizens.
- (a) Using the concept of externalities, explain why the Singapore government intervenes in these two areas. [10]
 - (b) Discuss the view that the best way for the Singapore government to respond to the market failure in education is to provide it for free at all levels. [15]
4. Globalisation has increased the flow of goods and services, financial capital and labour across countries, making the world economy more integrated.
- (a) Explain the possible macroeconomic problems that globalisation may bring about for the Singapore economy. [10]
 - (b) Discuss the measures that the Singapore government can use to curb these possible problems. [15]

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