



SERANGOON JUNIOR COLLEGE

JC2 Preliminary Examination

ECONOMICS Higher 2

9732/01

PAPER 1

19 August 2014

2 hours 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your name and civics group 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 staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.

Start your answers to each case study question on a new sheet of writing paper. Fasten your answers to questions 1 and 2 separately.

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

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

This document consists of **7** printed pages and **1** blank page.

Answer **all** questions.

Question 1 Soaring Commodity Prices: A Cause for Nutritional ‘Inequity’?

Extract 1: Sugar prices defy rising supply surplus

Sugar prices are defying mounting surpluses on the back of large crops in Brazil, Thailand and China, keeping the commodity stuck at a historically elevated range of 19–22 cents a pound.

The mood in the industry has remained cautious as it gathered in London for its biennial Sugar Week, due to the uncertainty over the effects of the Brazilian weather as well as the country’s biofuel policy, which in effect puts a floor under the market.

Apart from the weather, the so-called “ethanol parity” – the price level at which it becomes more profitable for Brazilian processors to turn their sugarcane into ethanol – is providing support.

The short term uncertainty comes amid a bullish long term backdrop, with demand for sugar in developing countries forecast to rise as their economies grow. McGraw-Hill’s price reporting agency Platts forecast world sugar consumption to grow by 32m tonnes by 2020, an increase of 2.2% a year.

Source: The Financial Times, <http://www.ft.com>, accessed 18 October 2012

Table 1: Sugar production, kilo tonnes (for biofuels)

	2008	2009	2010	2011	2012
Brazil	34318	40878	38127	35195	40300
China	13585	11650	11365	12520	14600
Thailand	7478	7131	10061	10670	9500

Source: OECD-FAO Agricultural Outlook 2013-2022

Extract 2: Is this the end of the soft-drink era?

Coca-Cola Co., PepsiCo Inc. and Dr Pepper Snapple Group Inc., the three biggest soda companies in the US, have struggled to reverse the decline in soda consumption in the US, where shoppers increasingly reach for water, coffee, and other drinks.

Now they have a bigger worry: soda revenue.

As US consumption steadily slipped over the past eight years, the beverage giants typically were able to raise prices enough to keep soda revenues from America’s favourite drink growing. But soda sales at US stores declined in the second half of last year – including during the holidays, when partygoers normally pay up to gulp more.

Now industry analysts wonder if the downturn in sales is here to stay.

“The question from here is if that is the new norm,” Steve Powers, a beverage analyst at Sanford C. Bernstein, said of the latest store sales numbers.

Soda companies raised prices aggressively in 2011 after commodity costs surged. Prices were increased a bit in late 2012, but volumes fell even more sharply.

Sugary bubbles have become a lightning rod in the US for consumer health concerns, such as diabetes and obesity.

Meanwhile, baby boomers are aging, and soda's traditional target market – youth – is often turning to water, energy drinks and coffee instead.

Coke, Pepsi, and Dr Pepper Snapple have all aggressively expanded their portfolios to include faster growing products like sports drinks and fruit juices. PepsiCo is also investing hundreds of millions of dollars in marketing to turn around its US soda business after losing market share to Coke. In 2010, Diet Coke unseated Pepsi as the No. 2 domestic soda by volume, behind Coca-Cola.

The soda companies also are working to develop zero- or low-calorie natural sweeteners that better mimic the taste of full-calorie sodas. But the going has been slow, keeping diet soda's share of the overall soda market at around 30%. One candidate, based on the stevia plant, can leave a bitter aftertaste in some sodas, particularly cola.

But such efforts have yet to turn soda's fortunes. Pepsi Next and Dr Pepper 10 each have less than a 1% market share and Coke's last big diet cola launch, Coke Zero, was in 2005. Some industry observers think soda companies haven't done enough on other fronts to win back drinkers.

"They're so focused on a sweetener event that they've neglected more traditional innovation like flavours and functions," said Mark Swartzberg, a beverage analyst at Stifel Nicolaus.

Source: The Wall Street Journal, <http://online.wsj.com>, accessed 13 January 2013

Extract 3: UK's food poverty revealed – nutrition falls as fruit and vegetable prices rise

The UK's poorest households are being disproportionately hit by the impact of soaring food prices, according to new government figures that also show the consumption of every major nutrient has fallen in the last four years.

In order to cut costs since 2007, UK households have spent less on fresh produce but more on bacon.

The government's annual Family Food survey, which provides the most detailed annual snapshot of food and drink spending and consumption, found that weekly spending per person on all household food in 2011 was £27.99, an increase of 1.5% on the previous year. But because of price rises, that bought less food – 4.2% less in 2011 than in 2007.

The survey also showed how households saved 6.8% by "trading down" to cheaper – and in many cases, less healthy – products, hitting consumption of fresh fruit and vegetables.

The poorest have been hit hardest by price rises. One pound in every six of household expenditure for the poorest 20% went on food, compared with one in nine for all UK households. Among the poorest members of society, consumption of every major nutrient has fallen between 2007 and 2011. By contrast, among the richest tenth of the population, the intake of nine of the 20 nutrients has risen or stayed roughly the same.

The report finds further evidence for a "nutritional recession", with rising food prices and shrinking incomes driving up consumption of fatty foods and reducing the amount of fruit and vegetables we buy.

A Defra spokesperson said: "We take rising food prices very seriously and understand the pressure it puts on families' budgets. The government is helping the most vulnerable in society afford and have access to nutritious food."

"We give school pupils free fruit and vegetables, and help pregnant women and new mums on the lowest incomes buy essential foods. We are working to keep the global food market stable, helping families get their food at the best price."

But consumer groups said the government should be doing much more to help the most hard-pressed social groups eat more healthily. Malcolm Clark, coordinator of the Children's Food Campaign, said: "With nutrition trends continuing to go the wrong way, especially amongst lower income households, how much longer will the government rely on half-measures and a failing leave-it-to-industry approach?"

"We have little confidence that the latest pledges on increasing fruit and vegetable consumption will have much impact, especially whilst retailers and manufacturers continue to heavily promote junk food and sugary drinks."

Source: The Guardian, <http://www.theguardian.com>, accessed 13 December 2012

Questions

- (a) Compare the change in production levels of sugar for the three countries in Table 1. [2]
- (b) Explain why 'sugar prices defy rising supply surplus' (Extract 1). [3]
- (c) In view of the market structure that the US soda companies are operating in, explain why there is a need for them to raise price in 2011. [4]
- (d) Using Extract 2, comment on one strategy that the soda companies use to increase market share. [3]
- (e) Using relevant elasticity of demand concepts, discuss the impact of rising food prices and shrinking incomes on expenditure on food items such as fresh produce and bacon. [8]
- (f) 'The government should be doing much more to help the most hard-pressed social groups eat more healthily.' As a consultant economist, discuss the various ways the government can adopt to achieve the microeconomic goals. [10]

[Total: 30]

Question 2 Taking the Pulse of Eurozone

Extract 4: What Germany offers the world

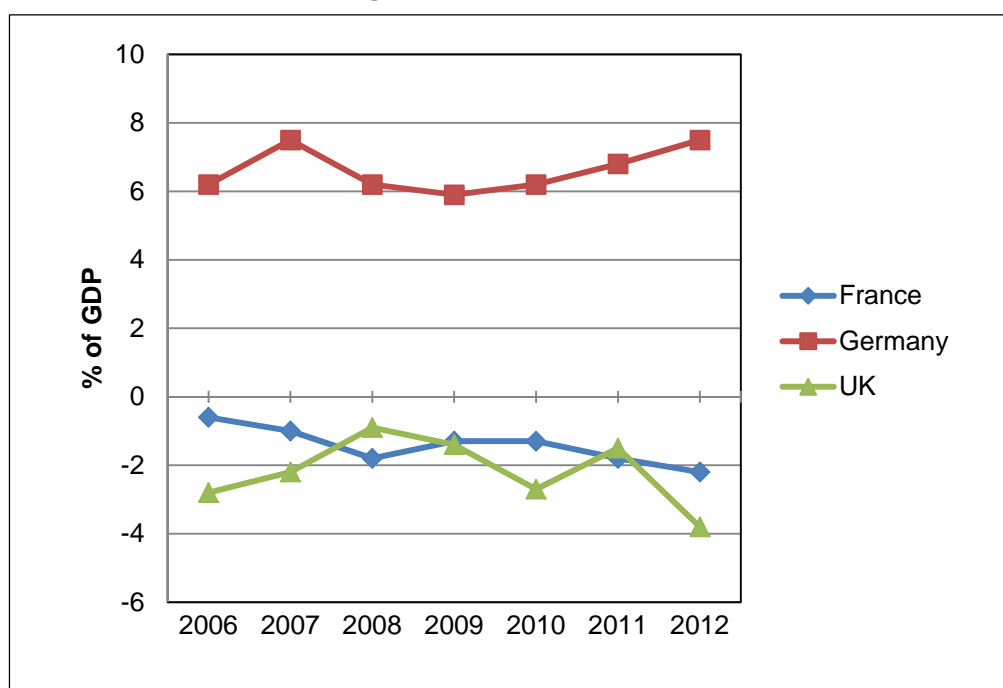
Beckhoff Automation, one of Germany's family owned businesses, is among thousands of "hidden champions" that account for much of Germany's prowess as a manufacturer and exporter. Its sales leapt 34% to €465m last year. It is aiming for €2 billion by 2020. Largely thanks to its Beckhoffs, Germany looks like a bright exception to the dispiriting rule among developed economies. True, its economy contracted more than those of most rich countries during the 2008-09 world recession, but the jobless rate rose by less than in all the others, peaking at 7.9%. And nobody talks about downgrading Germany's AAA credit rating; it can borrow money for practically nothing.

Not all the news is good. The economy shrank in the final quarter of 2011; and even if first quarter figures do not reveal Germany itself to be in recession, its economy will continue to suffer the drag of recession elsewhere in the euro area and a slowdown in developing countries. But just 1% growth is enough to create jobs, according to Bert Rürup, a former chairman of the government's council of economic "wise men". In a book written with a journalist, Dirk Heilmann, "Fat Years: Why Germany has a Brilliant Future", he giddily predicts that by 2030 Germany will become the world's richest large country in terms of income per head.

Such success brings a great deal of admiration. Spain's education minister is looking into Germany's "dual system" of vocational training, which combines classroom instruction with work experience. John Cridland, director of the Confederation of British Industry, wants Britain to have its own version of firms like Beckhoff. Nicolas Sarkozy began his campaign for re-election as France's president sounding as if he would gladly swallow the model whole. Germany prioritised "jobs, jobs, jobs," he said. "If it worked for them, why wouldn't it work for us?"

Source: *The Economist*, 14 April 2012

Figure 1: Current account



Source: OECD

Table 2: Selected economic indicators of Germany

	2009	2010	2011	2012
Annual % growth rate (at constant prices)	-5.1	4	3.3	0.7
Consumer prices inflation (annual %)	0.3	1.1	2.1	2.0
Unemployment (% labour force)	7.7	7.1	5.9	5.4
Government debt (% GDP)	47.6	55.5	55.1	56.9
Gross capital formation (% GDP)	16	17	18	17

Source: World Bank

Extract 5: The eurozone crisis: growth problem

Europe's politicians are often berated for an excessive focus on austerity. And it seems likely that there is a huge problem with several countries pursuing austerity simultaneously. One cannot switch the economy from domestic consumption to exports, if all your neighbours are trying to do the same. Canada's success in the 1990s occurred during the great boom of its biggest trading partner, the US.

This is what makes the debt crisis so difficult. The best way to eliminate a debt problem is to grow the economy rapidly but Europe seems to have lost the knack. And the demography is not encouraging because the workforce is likely to stagnate or shrink. Indeed, there was something perverse about taking on so much debt in the first place; debt requires confidence, on the part of the lender or the borrower and ideally both, that the borrower's income is going to grow. But Europeans piled up the debt even as the growth rate slowed, rather like a 64-year old going on a spending spree before retirement.

It may well be that European economies would perform better collectively if austerity programmes were relaxed. But it is a stretch to believe that Europe can return to the growth rates seen in the 1960s or even the 1970s. And those rates might be needed to make the debt problem go painlessly away.

Source: *The Economist*, 17 December 2012**Extract 6: Eurozone needs a growth strategy, not more austerity**

The recession on the eurozone's periphery is deepening and moving to the core, namely France and Germany. Indeed, the recession will worsen throughout this year, for many reasons. First, fiscal austerity is accelerating the contraction, as higher taxes and lower government spending and transfer payments reduce disposable income and aggregate demand. Moreover, as the recession deepens, resulting in even wider fiscal deficits, another round of austerity will be needed. And now, thanks to the fiscal compact, even the eurozone's core will be forced into recessionary austerity.

Moreover, while über-competitive Germany can withstand a strong euro, for the rest of the eurozone's periphery, where unit labour costs rose 30-40% during the last decade, the value of the exchange rate would have to fall to parity with the US dollar to restore competitiveness and external balance. After all, spending less and saving more to reduce debts depress domestic private and public demand and the only hope of restoring growth is an improvement in the trade balance, which requires a much weaker euro. Meanwhile, the credit crunch in the eurozone periphery is intensifying: thanks to the European Central Bank

(ECB) long-term cheap loans, banks there don't have a liquidity problem now, but they do have a massive capital shortage.

There are also signs of austerity and reform fatigue both in Spain and Italy, where demonstrations, strikes, and popular resentment against painful austerity are mounting with the rise in unemployment rates and a severe lack of jobs. The trouble is that the eurozone has an austerity strategy but no growth strategy. And, without that, all it has is a recession strategy that makes austerity and reform self-defeating, because, if output continues to contract, deficit and debt ratios will continue to rise to unsustainable levels. Moreover, the social and political backlash eventually will become overwhelming.

Structural reforms in areas such as education, innovation, competition and green growth is also essential but that which will eventually increase productivity growth can be recessionary in the short run. Increasing labour market flexibility by reducing the costs of shedding workers will lead to more layoffs in the public and private sector in the short run, exacerbating the fall in incomes and demand.

Without a much easier monetary policy and a less front-loaded mode of fiscal austerity, the euro will not weaken, external competitiveness will not be restored, and the recession will deepen. And, without resumption of growth – not years down the line, but in 2012 – the stock and flow imbalances will become even more unsustainable. More eurozone countries will be forced to restructure their debts, and eventually some will decide to exit the monetary union.

Source: *The Guardian*, 13 April 2012

Questions

- (a) (i) Compare Germany's balance on current account with that of France's and Britain's over the period 2006 to 2012. [2]
- (ii) From Extract 4, explain one reason for the difference you observed. [2]
- (b) How far can Figure 1 be used to infer about Germany's current account contribution to its economic growth between 2009 and 2012? [4]
- (c) In view of rising labour cost, explain whether allowing the exchange rate 'to fall to parity with the US dollar will restore competitiveness and external balance'. [4]
- (d) The data elaborates on the effects of fiscal austerity (Extract 6) on the eurozone. Discuss how such a measure will affect its standard of living. [8]
- (e) Nicholas Sarkozy claimed that Germany prioritised 'jobs, jobs, jobs'. To what extent do you agree that 'jobs, jobs, jobs' should continue to be Germany's top priority in 2012? [10]

[Total: 30]

End of Paper