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## 2014 Preliminary Examination II Pre-university 3

**ECONOMICS**

**9732/01**

Paper 1

**17 September 2014**

Additional Materials: Answer Paper

**2 hours 15 minutes**

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### READ THESE INSTRUCTIONS FIRST

Write your name and class 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 or graphs.  
Do not use paper clips, highlighters, glue or correction fluid.

Answer **all** the questions.

Begin answer for Question 2 on a fresh sheet of writing paper.  
At the end of the examination, hand in your answers to the 2 questions separately.  
The number of marks is given in brackets [ ] at the end of each question or part question.

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**This question paper consists of 8 printed pages.**

**[Turn over**

Answer **all** questions.

### Question 1

#### The World Beer Industry

**Table 1: Beer Consumption by Country (All Volumes in 000's kiloliters)**

	2008	2009	2010	2011	2012
China	39,130	42,194	44,683	44,738	44,201
United States	25,004	24,483	24,138	23,861	24,186

Source: Kirin Holdings News Release, 2009 – 2012

#### Extract 1: The spirit level

Awareness of the effects of alcohol is extremely low in China. For centuries people enjoyed booze at celebrations, but few drank regularly. As incomes have shot up over the past 35 years, alcohol consumption has accelerated. Average annual consumption rose from 2.5 litres of pure alcohol in 1978 to 6.7 litres in 2010. Nearly 70% of that is spirits.

More than half the Chinese population do not drink. Those who do drink often do so to great excess. Male Chinese drinkers drink far more than Japanese ones, and almost as much as notoriously sozzled British, Australian or Irish boozers. Binge-drinking is prevalent and high-risk drinking has reached “epidemic proportions” in China, reckons Hao Wei of Central South University in Changsha, the capital of Hunan province. In China drinking with clients and colleagues is now seen as vital to career advancement; some job adverts even call for “good drinking capacity”.

The state has taken some action in response. Drink-driving cases fell by nearly 40% in the two years after May 2011, when the government started to clamp down and increase penalties. President Xi Jinping's anti-corruption drive has quashed lavish banquets (although this has made high-end liquor much cheaper).

But the government has done little to promote public education. Other countries have curbed drinking by increasing tax on booze. In 2006 China lowered its already paltry liquor tax. Its health services and professionals are poorly equipped to deal with alcohol-related problems, says Yilang Tang of Emory University in Atlanta, Georgia. There are no national guidelines on responsible drinking and the minimum drinking age is ambiguous. Rules relating to the sale, consumption and advertising of alcohol are weak or ill-enforced. As Central South University's Mr Hao puts it: “Alcohol can be bought anywhere, at any time, by any person.”

Source: The Economist, 9 August 2014

#### Extract 2: Why are American drinkers turning against beer?

Light beer sales fell for three years after the recession in 2008. Just 20 years ago, it was America's most popular alcoholic beverage by far. Since then, per capita consumption of beer down 20 percent and despite population growth, annual domestic production has fallen down, too.

One explanation has been that American drinkers are more health-conscious today because there are so many studies and media reports of studies that make it impossible to be less health-conscious. This has hurt high-sugar and empty-calorie drinks that face relentless press criticism. "You're seeing that the consumer is taking a healthier look and having more alternatives [than soda], such as tea, and coconut water," Thomas Mullarkey, an analyst from Morningstar.

Wine is delicious and affordable and many Americans only just recently realised that. It's not just Americans who are ordering bottles of wine in record numbers. Wine exports are growing every year, too. In this light, it's not that Americans are turning against beer so much as our preferences are turning somewhat more European as our capacity to produce good affordable wine has caught up to the old continent.

Source: The Atlantic, 5 August 2013

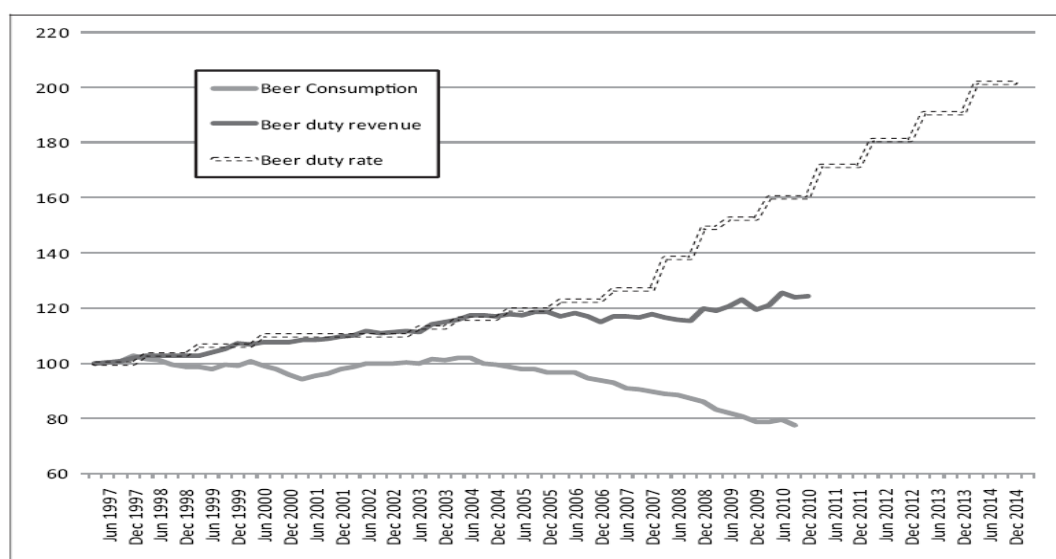
### Extract 3: Britain's binge drinking reaches crisis level

Binge drinking – defined as consuming more than six drinks a session has reached crisis levels in Britain, health experts say, costing the cash-strapped National Health Service 2.7 billion pounds (US\$4.4 billion) a year, including the cost of hospital admissions related to booze-fueled violence and longer-term health problems.

Under the mechanism known as the beer duty escalator, beer duty has risen by 2% above inflation each year since 2008. The level of tax rises with the strength of the beer and is paid directly by the brewer. The industry says beer duty has risen by 42% in the last 47 months. The Treasury generates around £3.7bn a year from duty on beer and cider. British beer in a pub is heavily hit with the duty and value-added tax leading to an average of 6 pubs closing per day.

Source: The Daily Mail, 21 March 2012

**Figure 1: Index no. of beer consumption, beer duty revenue, beer duty rate**



Source: UK Parliament Website, 2011

#### **Extract 4: S'porean brewery bubbling over with big plans**

With the takeover by Dutch beer giant Heineken completed, brewer Asia Pacific Breweries (APB) is now eyeing bubbling opportunities in regional markets, said the new head of APB's Singapore operations. The brewery makes beers like Heineken and Tiger, and APB is hoping to increase its exports to regional markets like Japan, South Korea, Taiwan and the Philippines.

To meet expansion plans, the brewery in Jalan Ahmad Ibrahim will boost its capacity by 10 per cent over the next two months, and by 50 per cent within the next 18 months, said APB Singapore general manager Samson Wong, who took on the role four months ago. Wong says the leaner corporate structure after the takeover is opening the door for APB to expand its wings. A big hope is that the Singapore brewery will be able to export more beer to the region.

In June, Heineken announced that it will integrate its existing Singapore operations with APB's group headquarters here. The result is a new regional hub in Singapore for Heineken. "Now it's all under one roof, we can look at the development and supply chain arrangements," said Wong. "That helps us to be more aggressive in expanding our business."

Among the target markets is Japan, which has traditionally imported its Heineken beer from the brewery in Amsterdam. Apart from being able to cut shipping time to Japan from Singapore compared with Europe, the Singapore brewery is also smaller and "more flexible" than its Amsterdam counterpart.

Another aspect of growth is in expanding the reach of its brands, and APB plans to take Tiger Beer, a Singapore icon, to greater heights. "Now, about 47 countries carry Tiger and we hope to grow further in Western Europe," said Wong. He plays down the chances of cannibalisation between Heineken and Tiger, noting that both brands have existed beside each other for decades and that each beer will attract different consumers. "In fact, in one night, the same consumer can drink two different brands."

Source: asianewsnet.net, 26 August 2013

#### **Questions**

- (a) (i) With reference to Table 1, compare the trends in beer consumption in the United States of America with that of China from 2008 to 2012. [2]
- (ii) Account for the trends observed. [4]
- (b) (i) Explain the term 'market failure'. [2]
- (ii) With the aid of a diagram, explain how market failure could arise from consumption of beer. [4]
- (c) With reference to the data, discuss the effectiveness of taxation in discouraging beer consumption. [8]
- (d) Discuss the impact of the takeover of APB on Heineken and on consumers. [10]

[Total: 30]

**Question 2****Crisis in United Kingdom and Spain****Table 2: Spain Key Economic Indicators**

	2009	2010	2011	2012	2013*
Gross domestic product, constant prices (% change)	-3.8	-0.2	0.1	-1.6	-1.3
Inflation (% change)	-0.2	2.0	3.1	2.4	1.8
Unemployment rate (%)	18.0	20.1	21.7	25.0	26.9
Current account balance (US billion \$)	-70.4	-62.3	-55.4	-14.8	19.4
Government Net Debt (% of GDP)	42.5	50.1	58.6	73.5	80.8
Government budget balance (% of GDP)	-9.3	-8.1	-8.1	-6.3	-4.9

\*Estimated figures.

**Table 3: UK Key Economic Indicators**

	2009	2010	2011	2012	2013*
Gross domestic product, constant prices (% change)	-5.2	1.7	1.1	0.2	1.4
Inflation (% change)	2.1	3.3	4.5	2.8	2.7
Unemployment rate (%)	7.5	7.9	8.0	8.0	7.7
Current account balance (US billion \$)	-31.4	-61.9	-36.0	-93.9	-69.2
Government Net Debt (% of GDP)	62.4	72.2	76.8	81.6	84.8
Government budget balance (% of GDP)	-10.3	-8.4	-6.0	-5.8	-4.0

\*Estimated figures.

Source: International Monetary Fund, 2013

**Extract 5: Spain set to reveal its pain in its books**

Spain, a Eurozone behemoth, is in the crosshairs of Europe's financial crisis. The country is suffering from soaring borrowing cost (for the sovereign bond), a banking system leaking cash and unemployment rates at devastating levels. The Spanish economy is the eurozone's fourth-largest -- after Germany, France and Italy -- making up around 11% of the bloc's GDP.

After Bankia, the country's fourth largest bank, asked for a €19 billion state intervention to prevent bankruptcy, the situation in Spain has developed like a perfect storm, with money being pulled out of the country. This leaves Spain in a precarious financial state, driving investors away and making it more likely to need a bailout by seeking financial support from International Monetary Fund (IMF) or European Union (EU).

The mood of the markets may, ultimately, dictate Spain's ability to pull itself from its financial hole. Investors already twitchy about the prospect of a "Grexit" -- a Greek exit from the euro -- will react badly to further bad news out of Spain. Greece has been swallowing austerity medicine to cut government spending and raise taxes as part of the bailout deal with IMF and EU since 2010. But its economy has slid further into recession, and initial hopes it could detach itself from external life-lines within two years now look wildly optimistic.

As with other fragile countries within the euro bloc, Spain cannot benefit from an independent monetary policy. Spain has focused on cost cutting and labour reforms in November 2011. Spain has also been under pressure to implement austerity measures to try and combat its debt crisis.

If governments implement austerity measures too soon they risk snuffing out demand and recovery, but delays could provoke a catastrophe with inflation and high interest burdens to service countries' debt.

Source: Cable News Network, September 2012

#### **Extract 6: U.K. budget deficit unexpectedly swells on spending gain**

Britain's budget deficit unexpectedly widened in November as spending surged and a drop in income-tax receipts depressed government revenue, prompting warnings that Britain could lose its top credit rating.

"There has to be a very real danger that at least one of the credit rating agencies will strip the U.K. of its AAA rating (a measure of credit rating) over the coming months," said Howard Archer, an economist at IHS Global Insight in London. Fitch Ratings said letting the debt goal slip weakened the credibility of the fiscal regime and Standard and Poor's lowered its outlook to negative from stable, citing weak prospects.

The pound remained lower against the dollar, down 0.2 percent on the day.

Source: Cable News Network, 21 December 2012

#### **Extract 7: Bank of England steps up stimulus**

The Bank of England stepped up its economic stimulus, announcing an increased bond-buying program designed to jolt the struggling British economy out of a double-dip recession. The £50 billion, or \$78 billion, in additional stimulus comes on top of £325 billion already pumped into the economy by the Bank of England over the past several years.

Noting that the British economy was already in recession, with corporate earnings down and consumers and companies reluctant to spend, stimulus measures had "to work harder and harder," Graeme Leach, chief economist at the Institute of Directors said. "The end result is that we could see another £50 billion on top of this, within a few months."

Britain's banking crisis wrecked government finances, prompting London to embark on its biggest austerity program since World War II. Meanwhile, the economic outlook has been worsened by the crisis in the euro zone economy, which has sapped global confidence and decreased demand in key trading partners.

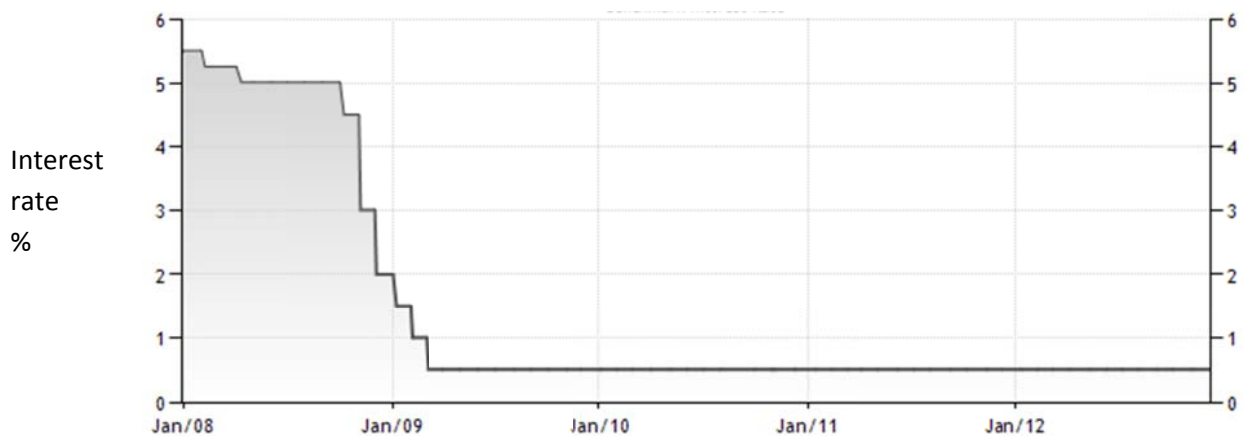
The program of spending cuts and tax increases appears to have persuaded the financial markets that the government intends to tackle its huge budget deficit and permitting the government to borrow cheaply. But the austerity measures have also reduced consumer confidence and household spending, compounding the downturn. Government departments, with the exception of health and education, would be subject to further spending cuts, and public-sector pay caps would be extended.

Finance Minister George Osborne said the government's policy of fiscal discipline and active monetary policy would eventually bear fruit.

The U.K. economy risks falling into a triple-dip recession in the first quarter of 2013 as domestic demand remains depressed by austerity measures and falling real incomes and exporters feel the impact of the Eurozone crisis, despite a weaker currency.

Sources: New York Times, 5 July 2012 and Cable News Network, 20 March 2013

**Figure 2: Bank of England interest rates**



Source: Bank of England

**Questions**

- (a) (i) What is the difference between real GDP growth and nominal GDP growth? [1]
- (ii) Identify the economy which is projected to have a higher growth in nominal GDP in 2013. [1]
- (b) (i) Describe the trend in the UK's government net debt from 2009 to 2012 shown in Table 3. [1]
- (ii) With reference to the data, account for the above trend in the UK's government net debt. [4]
- (c) (i) Explain how the credit downgrade affects the external value of pounds. [2]
- (ii) Explain how this change in external value of pounds might affect the prices of goods and services in the UK. [3]
- (d) Discuss the impact of Eurozone crisis on the UK's balance of payment. [8]
- (e) To what extent can Spain adopt the policies used by the UK to achieve her macroeconomic aims of sustained economic growth and low unemployment? [10]

[Total: 30]