RIVER VALLEY HIGH SCHOOL
YEAR 6 Preliminary Examination II
in preparation for General Certificate of Education Advanced Level
Higher 2

ECONOMICS 9732/01

Paper 1 Case Study **15 September 2015**

2 hours 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your index 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 staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.
Start each case study on a new sheet of paper.

At the end of the examination, fasten your work securely together.
Your answers for each case study are to be handed in **separately.**

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

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

[Turn over

Answer **all** questions.

Question 1

Developments in the supermarket industry

Extract 1: Aldi becomes the fastest-growing supermarket in Britain

Aldi has been best known, until recently, for its ultra-low prices. But in the past few years, the chain has been winning over an increasing number of upmarket customers. Verdict, a retail research company, has calculated that 18.6% of Aldi's regular customers were from the "middle class" socioeconomic group, up from last year's 12.9%.

This is a remarkable achievement, proof of how far Aldi has come since arriving in a Britain that was in the midst of the recession in the early 1990s. This demonstrates how this recession has caused a huge shift in shopping patterns, with people more willing to shop around in search of a bargain, and also for a treat.

Verdict reported that people shop at Aldi for different reasons. We can't forget that a lot of people are still feeling the squeeze. Unemployment is high and so is inflation, and those affected have no choice but to make shopping at a discounter a way of life. But people are also proud about being able to pick up high quality staples for not a lot of money. This has helped Aldi win customers trading down not just from Asda and Tesco but also from Sainsbury's and Waitrose.

Questions have been asked about how the company can sell relatively high-quality goods at very low prices. One answer is that it sells a surprisingly small range of goods, making it easier to rely on a small number of suppliers that can use their scale to cut costs on the few things they make.

Source: *The Telegraph*, 29 October 2013

Extract 2: Online shopping for food set to increase

Shoppers are turning their backs on large 'big barn' supermarkets – fed up with spending their precious time off trudging the long aisles. When families get relatively little time to spend together, many have come to resent the chore of battling the crowds and queues associated with the weekend shop.

A new industry study predicts a huge shift towards shopping for food and groceries online with a 126% increase in sales over the next five years to £14.6 billion. Tesco, Asda, Sainsbury's and Ocado already offer web groceries and they will soon be joined by Morrisons, despite the fact that running a home delivery service is very expensive. According to the Institute for Grocery Distribution (IGD), online retailing is reaping the rewards of people's changing lifestyles. IGD chief executive, Joanne Denney-Finch, said: 'With more of us owning smartphones and tablets, online grocery shopping is becoming more popular. Retailers are also introducing more convenient and flexible services, such as temperature controlled 'click & collect' lockers for shoppers to pick up their groceries at a time and place that suits them.'

Source: *Daily Mail*, 12 September 2013

Extract 3: Aldi and Lidl deny plans for online shopping

Fast-growing supermarkets Aldi and Lidl have no plans to launch online home delivery despite the online grocery market set to surge by 50% in the next two years. “E-commerce is not an immediate focus for Aldi, as we currently have the best performing business model in the grocery sector”, said Giles Hurley, managing director of corporate buying at Aldi.

Aldi’s business model focuses on the key principles of standardisation, simplicity and continuous improvement. This approach has been vital in driving out complexity – often the key ingredient to spiralling operating costs. Aldi has structurally lower costs due to the simple fact that there is significantly less activity than in comparable operations.

Although a significant proportion of consumers are in favour of a home delivery service being rolled out at Aldi, some consumers expressed concern that discounters’ low prices could rise if online shopping is launched as significant investment is required in maintaining websites, servicing vans and employing packers in-store.

Source: *Retail Gazette*, 20 June 2014

Extract 4: Supermarkets sense that size may no longer be key to conquering universe

There is trouble afoot in supermarket land. The UK’s £160 billion a year grocery business has run on a fairly simple model since the early 1990s, with one of the key routes to success being the ability to open more and bigger shops. It was dubbed the space race and at times the mission threatened to carpet the country with superstores, extending the shops that were already open and shoving in floors of endless racks of goods.

But, quite suddenly, it has dawned on the major players that size is not necessarily what matters, because shoppers are changing their habits fast. They are shopping in smaller outlets, more often, and moving online at a dramatic rate. They are also less loyal with shoppers now using four to six different shops a month.

Official data shows online retail sales reached more than £50 billion last year, out of total UK retail sales of £350 billion. According to retail analyst Philip Dorgan at Panmure, more than 30% of retail sales will eventually be transacted online. Sales through mobile devices were up more than 300% last year, but the value of each online “basket” declined, suggesting consumers are going online for smaller, more regular purchases.

Tesco is the biggest online grocer, but it has too many big stores. Tesco is also battling to prevent its market share from being further eroded. In February, market share slipped to 29.7%, its lowest in seven years. Chief executive Phil Clark is fighting back with price promotions, which always provoke a reaction from rivals. But shoppers are still defecting to upmarket Waitrose and hard discounters like Aldi and Lidl. What do they have in common? Smaller stores which require less time to do the weekly shop and a clear price position.

Source: *The Observer*, 17 March 2013

Table 1: Market Share of UK grocers (%)

Type		2011	2012	2013
'Big Four' supermarkets	Tesco	31.0	30.7	29.8
	Asda	17.4	17.3	17.2
	Sainsbury's	16.7	16.9	16.8
	Morrisons	12.3	11.7	11.5
Discounters	Aldi	2.5	3.0	3.9
	Lidl	2.6	2.8	3.0
	Iceland	1.9	2.0	2.0
Others		15.6	15.6	15.8

Source: GN Grocery News

Questions

(a) With reference to Table 1,

(i) Compare the changes in market share of the 'Big Four' supermarkets with that of the discounters between 2011 and 2013. [2]

(ii) Describe the market structure operating in the UK grocery sector in 2013. [2]

(b) Explain one reason for the changes observed in (a)(i). [2]

(c) Extract 4 notes that since the early 1990s, one of the key routes to success for supermarkets is the ability to open more and bigger shops. Explain why this may be the case. [6]

(d) Extract 2 notes that online grocery retail is set to rise in the near future. Discuss whether all grocery retailers in the UK should venture into this aspect and how this might affect consumer welfare. [8]

(e) In the light of the market structure of the UK grocery retail sector, discuss the extent to which price competition is the only way for firms to survive. [10]

[Total: 30]

Question 2

Europe's economic problems

Extract 1: Germany is crushed by its export obsession

If Germany's economic model is the future of Europe, we should all be quite troubled. But that is where we seem to be going. The policy response to the eurozone crisis is to induce member states to follow Germany's path to competitiveness: cutting the cost of labour. This has been the basis of the nation's export success; and exports have been its sole consistent source of growth in that period. But low wages are not the basis on which a rich nation should compete.

Ideally, a wealthy country should stay competitive through research and development, and capital investment. Instead, total gross fixed investment has fallen steadily in Germany to less than 18 per cent of gross domestic product. The other way for a rich country to stay at the top of the value-added chain is to invest in human capital. In Canada, France, Japan, Poland, Spain, the UK and the US, the share of young workers with advanced education is at least 10 per cent higher than in Germany. The result is that Germany's productivity growth has been low compared with its peers. It is no wonder German business is competing only by reducing relative wages and moving production east. In addition, manufacturing's share in total employment has fallen by the same amount in the past 40 years, about 15 per cent, in almost all the advanced economies – including Germany.

Dependence on external demand has deprived Germany's workers of what they could have earned. This leaves them dependent on exports for growth, in a self-reinforcing cycle. Most importantly, this means they move down the value chain in relative terms, not up. The pursuit of the same policy by its European trading partners will reinforce those pressures. Wage compression will not be a successful growth strategy for the future of Germany and Europe.

Source: Adam Posen, *The Financial Times*, 3 September 2013

Extract 2: Germany's trade surplus is detrimental for the eurozone

In late October, the US singled out Germany as a threat to the global economy. The Treasury issued a report saying that Germany's current account surplus – now around 7 per cent of GDP – imposes "a deflationary bias for the eurozone as well as for the world economy." Many German politicians and business people quickly dismissed these allegations, claiming that the surplus is mostly with the rest of the world, not the eurozone, and so does not affect the periphery eurozone countries; that the surplus reflects the country's competitiveness; and that deflation in the eurozone periphery is positive as it indicates that these economies are becoming more competitive.

There are two routes through which Germany's external surplus compounds deflationary pressures in the eurozone, making it harder for the periphery to recover. Before the crisis, Eurozone's healthy trade balance was a result of Germany's trade surplus being offset by the deficits of the other member-states. But as these deficits have narrowed, the eurozone has moved into a large external surplus and the euro has appreciated. The other channel through which Germany's surplus spreads deflationary pressure is through the weakness of Germany's domestic demand. Furthermore, the deflationary pressure is worsened by the austerity measures in the eurozone periphery.

The Germans are not powerless to address the imbalances in their economy. If the periphery can take steps to prevent excessively strong growth in domestic demand, then Germany can do the opposite. More expansionary fiscal policy would help. But fiscal policy alone cannot solve Germany's feeble domestic demand, because the obstacles are to an extent structural. One thing is clear, wage dumping is not the answer to Europe's economic woes.

Source: Centre for European Reform Bulletin, Issue 93, December 2013

Extract 3: Germany needs a service sector to match its makers

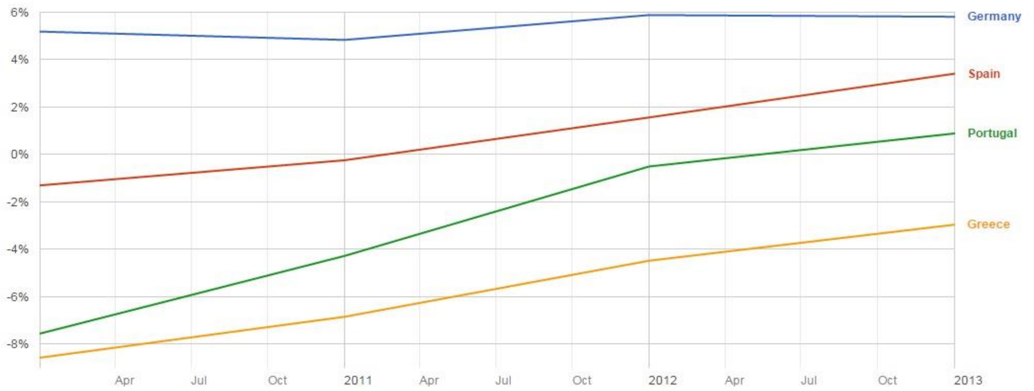
Only 10 years ago, Germany was considered the sick man of Europe, but the German economy is now admired for its strength. However, important domestic sectors are still held back by regulation. For businesses in general, the licensing and permit system is burdensome. It acts as an obstacle to entrepreneurship, including in the services sector. The consequence is an economic model in which the services sector has hardly increased in importance.

This failure has held back German economic performance. Empirical evidence suggests that reforms to remove entry barriers and foster competition would not only improve productivity but also raise investment. A reduction in regulations in the German service sector could therefore increase output substantially.

New business opportunities would trigger investment in the sector and also offer new employment opportunities. This would make the German domestic sector more attractive and probably lead to higher wages underpinned by higher productivity. These reforms could also improve the quality of German exports. The manufacturing sector depends on the provision of cost-efficient and innovative solutions from the service sector. In addition to that, such reforms could also help Europe, including the ailing southern countries by increasing labour demand in this part of Germany's economy.

Source: Guntram Wolff, *The Financial Times*, October 7, 2013

Figure 1: Trade Balances as a percentage of GDP, 2010-2013



Source: World Bank

Questions

(a) (i) Compare the trade balances as a percentage of GDP of Germany with that of Spain, Portugal and Greece from 2010 to 2013. [2]

(ii) With reference to the data, explain how the above trend might be a concern to the economy of Germany in the future. [2]

(b) Explain how 'cutting the cost of labour' has been the basis of Germany's 'export success'. [2]

(c) With reference to Extract 2, explain how Germany's external surplus has made it harder for 'the periphery' to recover from deflation. [6]

(d) Discuss the extent to which Germany is 'crushed by its export obsession'. [8]

(e) Discuss the economic policies available to the German government that could be an 'answer to Europe's economic woes'. [10]

[Total: 30]

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