2015 Preliminary Examination 2
Pre-University 3

ECONOMICS **9732/01**

Paper 1: Case Study **15 September 2015**

2 hours 15 minutes

Additional Materials: Answer Paper

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 staples, paper clips, highlighters, glue or correction fluid.

Answer all questions.

Begin your answer to 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.

Answer **all** questions.

Question 1

Australian Agriculture Sector

Extract 1: Challenges faced by Australian farmers

A near-perfect growing season for small farmers in two of Australia's biggest food belt regions - south-east Queensland and Victoria - has produced a bumper crop. But despite a bountiful yield, oversupply has driven down prices. It should be a time for celebration for growers, who have become hardened to a relentless cycle of droughts and floods in recent years. Instead many are complaining that they are being paid less at wholesale markets than the cost of harvesting their crops.

The number of farmers in Australia is shrinking, and it's not just the current domestic oversupply that is hurting the bottom line. The amount of imported fresh produce has reached record levels, and growers are facing unfair competition from overseas imports. Local farmers want prices to be set by the federal government to guarantee a decent return. If not, the sector will continue to contract.

In contrast, Tasmania produced large crops of apples and many other crops. Artisan farming has blossomed on the island state in recent years, where small enterprises labour away making high-value, niche specialities, including hand-ground spelt and rye flour along with boutique jams and relishes. Tasmanian farmers are also leading the way on exporting extensively. But Tasmania's optimism gives way to a sense of gloom in other parts of Australia.

In Queensland's sugar capital, Bundaberg, Mark Presser, a fourth generation cane farmer, enjoyed a record crop last year, and is on course to harvest another reasonable yield this time around. Yet he too feels besieged by falling prices and growing competition from overseas, most notably Brazil and India, where production costs are far less.

Source: *BBC News*, 31 October 2013

Extract 2: Australian dairy industry

The Australian dairy industry starts with some 6,686 registered dairy farms. Most of the dairy farms in Australia are family owned and operated small businesses that produce fresh milk on a daily basis. Only about 2% of dairy farms are corporates. As a community of small businesses the bargaining power of the dairy farmers is generally low. Key factors that impact on their farm’s profitability are the domestic price of milk at the farm gate, the demand for milk, and the price of key inputs such as electricity and animal feeds. The impact of drought can also play a significant role. Over the years, small-scale farmers are exposed to competitive market pressures. This has forced them to invest more in technology designed to enhance on-farm productivity. A modest growth in milk production over the next five years is forecast due to improved herd management and greater economies of scale. However, the total number of farms is expected to fall. Farm management and the application of greater science and technology to herd health, pasture production, feeding and milking systems will be critical to success.

Downstream from the farmers are the milk processors and dairy product manufacturers who control both the farm gate price and the export and domestic market distribution channels. Dairy product manufacturing is capital intensive and requires large scale and scope in operations to be economically viable. Today the Australian milk processing and manufacturing sector is dominated by a handful of large firms.

Traditionally farmer-owned co-operatives dominated Australian dairy processing sector. However, today it is dominated by foreign companies. Foreign ownership of Australian dairy manufacturing and export is not inherently bad. However, for the thousands of small, family-owned dairy farms, the lack of bargaining power in the market may be a cause of concern. Dairy co-operatives serve the interests of the small family farm businesses, for instance co-operatives such as Dairy Australia engage in investment projects to achieve internationally competitive farming systems that cannot be done efficiently by individual member farmers. Unlike foreign ownership that needs to pay substantial returns to shareholders, a co-operative serves to improve the relative competitiveness of their members by taking all the milk its members wish to supply in order to help them grow their own farm businesses. The existence of large co-operative in a dairy market generally helps to keep prices stable at the farm gate. Yet no co-operative farmers are forced to be price takers.

Source: *The Conversation*, 24 November 2013

Extract 3: Australia blocks GrainCorp takeover bid from ADM

Rising global food demand has seen agriculture firms become takeover targets. Australia has blocked US conglomerate Archer Daniels Midland's (ADM) A$3.4bn ($3.1bn; £1.9bn) takeover of Australian-owned GrainCorp - its biggest grain merchant. The grain business has evolved to be an industry dominated by foreign grain giants like Cargill, Viterra and Agrium in an open market.

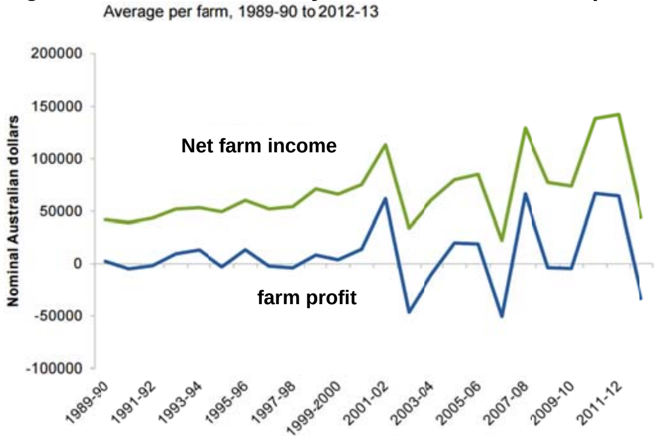
Australia is one of the world's largest exporters of wheat. ADM’s (the world's biggest processor of corn) bid to fully acquire GrainCorp had been opposed by some farm groups, who raised concerns over the impact of such a move on competition in the sector.

"Many industry participants, particularly growers in eastern Australia, have expressed concern that the proposed acquisition could reduce competition and impede growers' ability to access the grain storage, logistics and distribution network (including port facilities) which GrainCorp originally owns," Treasurer Joe Hockey said. However industry analysts believe there’s no reason for ADM to keep ports and receival sites close if the takeover materialises. After all, ‘it’s a matter of making money’, and allowing as many growers as possible to use their facilities.

Patricia Woertz, chief executive of ADM, said "We are confident that our acquisition of GrainCorp would have created value for shareholders of ADM and GrainCorp, as well as grain growers and the Australian economy." Growers and industry analysts hope that the takeover can result in rail freight improvements, equal access to ports and injection of much needed funds into assets like grain storage facilities.

Sources: *ABC News*, 2 May 2013 and *BBC News*, 29 November 2013

Figure 1: Australia net dairy farm income and farm profit



Source: *Productivity Commission, Relative Costs of Doing Business in Australia, Dairy Product Manufacturing*

Questions

(a) With reference to Figure 1,

(i) describe the changes in farm profit from 1989 to 2012. [2]

(ii) account for the falling number of farms. [2]

(b) (i) Using demand and supply analysis, explain how factors identified in Extract 1 might affect the market for fresh produce in Australia. [5]

(ii) Given the above analysis, explain how the price elasticity of demand (PED) of fresh produce might affect the income of fresh produce farmers in Australia. [3]

(c) To what extent can small Australian farmers maintain their profits in the dairy industry? [8]

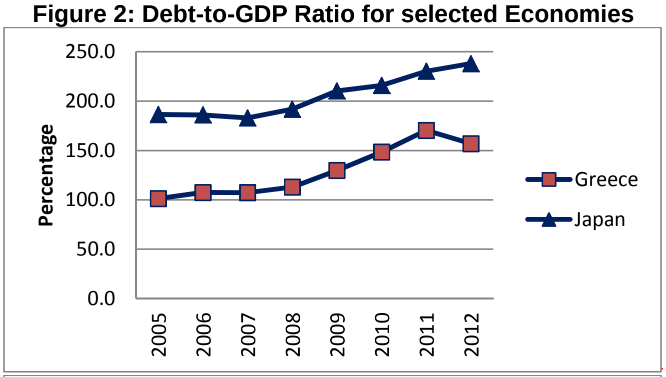
(d) Discuss whether the domination of large foreign firms in the Australian agriculture sector is beneficial to the Australian consumers and producers. [10]

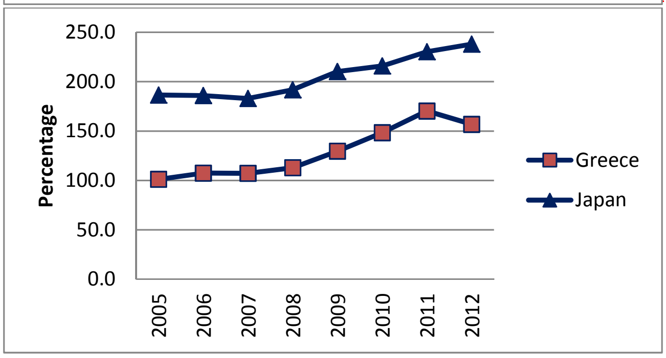
[Total: 30]

Question 2

Government Debt Crisis in Greece and Japan

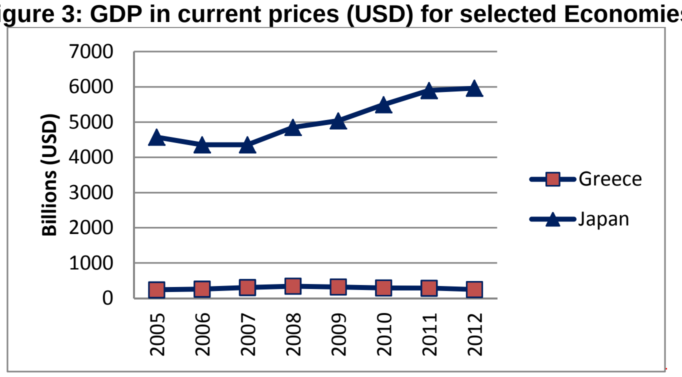
Figure 2: Debt-to-GDP Ratio for selected Economies

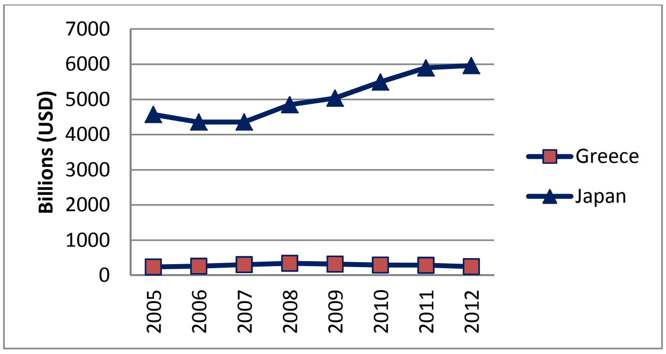




Source: *IMF World Economic Outlook Database*

Figure 3: GDP in current prices (USD) for selected Economies





Source: *IMF World Economic Outlook Database*

Extract 4: Japan to learn whether Abenomics will live up to pro-growth rhetoric

There are three strands to Abenomics – a more activist monetary policy from the Bank of Japan (BoJ), a fiscal boost from increased spending on public works and structural reform to make the economy more productive.

In reality, the BoJ will be expected to do most of the heavy lifting. The new government has announced an expansionary budget but fiscal policy is constrained by the dire state of Japan's public finances. A debt-to-GDP ratio in excess of 200% is the result of more than two decades of sluggish growth and repeated attempts to pump-prime the economy. Meanwhile, structural reforms will take time to work, leaving Japan's central bank with responsibility for boosting short-term growth.

Despite the need for larger quantities of imported oil after the Fukushima nuclear disaster two years ago, consumer prices have been falling almost continually since the Great recession of 2008-09. The central bank's challenge is to bring up the rate of inflation to 2%, so that companies and individuals can take advantage of negative real interest rates – borrowing costs lower than the annual increase in the cost of living – and to drive down the value of the yen.

Source: *The Guardian*, 2 Apr 2013

Extract 5: Weak Japanese GDP data highlights flaws in Shinzo Abe's three 'arrows'

Problems have emerged with every bit of the three-quiver policy. Firstly, driving down the value of the yen was supposed to boost the Japanese economy by making life easier for its key export sector. But it has also raised the cost of imports, particularly fuel, at a time when domestic energy production remains hampered by the Fukushima nuclear plant. Dearer energy raises business costs and eats into consumers' real incomes. As some analysts noted, Japan is getting higher inflation as planned, but it is the wrong sort of inflation.

A second problem is that doubts are starting to surface about the government's commitment to structural reform. Japan is an elderly and conservative country where the dynamics of an ageing population make it mightily difficult to raise participation rates in the labour market or reduce subsidies to farmers, even if ministers were prepared to make themselves unpopular.

But the biggest immediate problem for Japanese Premier Shinzo Abe is that the weak growth has raised doubts about whether he will go ahead with the increase in consumption tax next year, designed to show markets that Tokyo is serious about tackling Japan's public debt, currently 240% of GDP. The increase in sales tax from 5% to 8% is chunky and, with a second increase to 10% planned for 2015, clearly has the capacity to derail economic recovery.

Source: *The Guardian*, 12 August 2013

Extract 6: What is the Greek debt crisis all about?

The first sign of trouble in Greece was when George Papandreou took over as prime minister in October 2009 and found that the government had been understating its public debts for years.

Despite being poor, the Greek government has for decades sought to be generous to its people: the Greek state has tried to soothe its people by creating a big welfare state and generous pay and pensions - including low retirement age and the famous 13th and 14th monthly salaries.

When it came to joining the euro in 2001, it should have been obvious that Greece did not meet the debt conditions. But, by spinning the numbers, Greece gained entry, not just to the single market but to debt markets that allowed it to borrow as though it was as dependable as Germany.

Greece went on a spending spree on infrastructure, services and public sector wages. Meanwhile, the Greeks stopped paying taxes. To Greece's delight, banks and the financial markets filled the gap by lending billions of euros. With the onslaught of the credit crunch, Greece's vast debts were exposed - but so was the exposure of European banks. If Greece went bust, untold damage could be unleashed across Europe and beyond: for a global economy still shattered from the 2008 banking crisis, the prospect of another one was intolerable.

Politicians have been driven by a determination to make Greece pay for its overspending. Mr Papandreou unveiled the first austerity package in January 2010. Meanwhile, Eurozone leaders resolved that despite being called "bailouts" the help would be in the form of loans. Their other key strategy has been to persuade others to buy the debt - from banks, central banks and governments.

Or, as critics point out, they decided to solve the debt crisis with more debt - and a highly contagious situation with an even more complex web of exposure. In May 2010, leaders unveiled a €110bn (£93bn) bailout with money from the European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF). But the so-called troika set tough conditions in return: the money would be released in 10 tranches and only once Greece had met tough austerity targets of spending cuts, tax rises and structural reforms.

Source: *The Telegraph*, 23 Feb 2012

Extract 7: Greece Crisis: Is there a solution?

The impact of Greece's financial woes is being felt ever more keenly in European financial markets as fears grow that some kind of debt default may be inevitable. Experts say a default could have a dire impact on other weak economies in the 17-nation Eurozone and fuel doubts about the single currency's viability.

The Greek government is racing against time to fulfil the demands of international lenders and qualify for a new lifeline to avoid default. But even if the Greek parliament adopts the new austerity measures - tax rises, spending cuts and privatisation - necessary to secure a new loan package, it will only bring temporary relief. In the meantime, Greece would need to restructure its economy, boost much-needed tax revenue and eventually return to commercial lenders.

In the event of an outright default by Greece, the consequences would be felt mainly by the big EU economies that have lent to Greece. German and French financial institutions are thought to hold up to 70% of Greek debt and would be severely hit. International investment in the Eurozone would also be hurt significantly.

Source: *BBC News*, 21 June 2011

Questions

(a) (i) Compare the debt-to-GDP ratio from 2005 to 2012 of Japan and Greece in Figure 2. [2]

(ii) Explain whether the above data explain the changes in economic growth of Japan and Greece as shown in Figure 3. [4]

(b) Explain one possible reason for the increase in government debt in economies like Japan and Greece. [2]

(c) With reference to Extract 4, explain why bringing up the rate of inflation will cause 'negative real interest rates' and 'drive down the value of the yen'. [4]

(d) Examine the consequences on Greece and other economies in the Eurozone when the Greek government "sought to be generous to its people". [8]

(e) Discuss whether Greece should adopt the same approach as Japan in solving its own economic problems. [10]

[Total: 30]

End of paper

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Suggested answers

CSQ1: Australian Agriculture Sector

(a) **With reference to Figure 1,**

(i) **describe the changes in farm profit from 1989 to 2012.** **[2]**

General – Fluctuations over the period 1989 to 2012 [1]

Refinement – Increase in magnitude of fluctuation after 2000 [1]

Marker's Comments

(ii) **account for the falling number of farms?** **[2]**

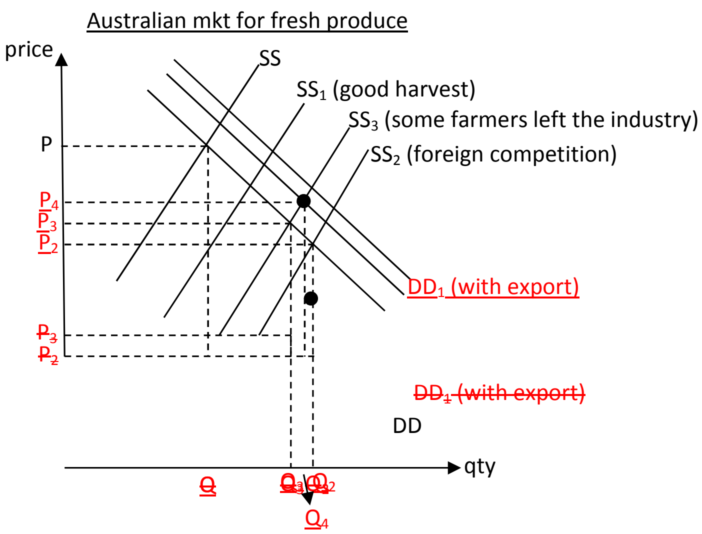
- *Vertical distance between the income and profit lines is the (total) cost. Cost seemed to remain fairly stable (vertical distance over the period seemed to be fairly consistent). Thus income/revenue affects the profit to a large extent.*
- *With volatile income and hence unstable profits, there were periods when profits fell below zero ie negative/subnormal profits. [1]*
- *With such volatility (with periods of high supernormal profits and subnormal profits), some farms, especially the small farmers*

could not cope (with the subnormal profit) and therefore chose to leave the industry. This could account for the falling number of farms. [1]

Marker's Comments

(b) (i) Using demand and supply analysis, explain how factors identified in Extract 1 might affect the market for fresh produce in Australia. [5]

- *Within the country, local farmers enjoyed a bumper crop ie good harvest, hence domestic supply of fresh produce increased. (SS to SS_1 in diagram below)*
- *Externally, foreign producers were entering the Australian market, hence the total mkt supply of fresh produce in Australia was further raised. (SS_1 to SS_2 in diagram below)*
- *Together, the large increase in mkt ss caused the mkt price of fresh produce to fall to a large extent, ceteris paribus. (P to P_2)*
- *This substantial fall in mkt price caused farmers to earn lesser (falling) revenue. If cost remains constant (ceteris paribus), profits would fall and if subnormal profits were earned, some farmers would choose to leave the industry.*
- *Even if some farmers left the industry (SS_2 to SS_3), the total mkt ss would still be larger than the original situation (before good harvest and foreign producers entering the mkt, SS_3 compared to SS), hence the final mkt eqm price would still be relatively lower (P_3, lower than P) with higher eqm qty (Q_3, higher than Q).*



- *On the other hand, if farmers were able to create external demand (ie export to overseas markets like what Tasmanian farmers are doing), then the total (mkt) DD for Australian fresh produce may increase (DD to DD_1 in diagram). [optional response]~~.~~*
- *With both DD & SS increasing and SS curve shifting more than the shift in DD curve (the rise in DD from overseas mkt would be limited as there is more competition and only Tasmanian fresh produce enjoy a rising DD), the final price would still be lower than the original price (P_4 < ~~,~~ P) and, the eqm qty would be larger than the original one (Q_4 > ~~,~~ Q).~~.~~*

2 adequately-elaborated SS/DD reasons would suffice (to gain the 4m). 1m for extent of shift and final eqm.

Marker's Comments

(b) (ii) Given the above analysis, explain how the price elasticity of demand (PED) of fresh produce might affect the income of fresh produce farmers in Australia. [3]

- *DD for fresh produce tends to be inelastic given they are basic necessity (food). [1]*
- *With inelastic DD, increase in SS would lead to a relatively larger fall in price and a less than proportionate increase in eqm qty. Thus revenue or income of farmers would fall. (Hence in Ext. 1, farmers are 'complaining that they are being paid less at wholesale markets than the cost of harvesting') [2]*
- *However, for the case of Tasmanian farmers, their successful effort in product differentiation, making DD for such specialised category of fresh produce even more inelastic (compared to the 'normal' fresh produce which is subjected to foreign competition). With small-scale production on such specialty fresh produce ie restricted SS, price is rising and TR is increasing too (as overseas DD for specialty fresh produce from Tasmania increases). [optional response]*

Marker's Comments

(c) To what extent can small Australian farmers maintain their profits in the dairy industry? [8]

- *Thesis – small dairy farmers could maintain their profits*
  - *Small dairy farmers strive to remain cost efficient. According to Extract 2,*
    - *input prices can affect their profits. Yet small farmers may not be able to engage in bulk purchase to reap marketing EOS.*
    - *unless through the efforts of co-operative to engage in bulk purchase and/or integrate vertically to control input prices, then these small farmers, can lower AC, and profits can be maintained (ceteris paribus).*
  - *Small dairy farmers could try to boost/maintain their individual DD/AR*
    - *learn from their fresh produce counterpart to differentiate their products to make their individual DD curve more price & income inelastic and increasing their individual DD to secure profits*
    - *as overseas (especially Asia) DD for milk increase, small farmers could consider supplying milk to these overseas mkts to increase revenue. (this could also help small farmers to enjoy EOS as they increase production)*

- *Anti-Thesis – small dairy farmers could not maintain their profits*
    - *Milk processors/dairy product manufacturers control farm gate milk prices and distribution channels. Such firms with monopoly power down the supply chain would erode the profits of small dairy farmers.*
    - *Small-scale farmers may not be able to afford the expensive capital to boost productivity and lower AC.*
    - *Unpredictable drought (unfavourable weather conditions) could lower the milk production and limit farmers' ability to maintain revenue*
- *Evaluation – given the above challenges, only the cost efficient small farmers can maintain decent (normal) profits to remain in the industry. Unless these small farmers are exploited by the larger firms that control the distribution channels, govt would continue to let mkt forces prevail (ie govt would not consider regulating).*

L3 [5 – 6]	*A balanced discussion with good attempt to apply correct content knowledge with elaboration, and to use data to substantiate the discussion.*
L2 [3 – 4]	*A one-sided discussion with some attempt to apply relevant content knowledge. The explanations may have gaps/errors, with limited use of data.*
L1 [1 – 2]	*A brief and/or limited relevant discussion with no use of data.*
E1 [1 – 2]	*An attempt to arrive at a reasoned/explained conclusion.*

Marker's Comments

(d) Discuss whether the domination of large foreign firms in the Australian agriculture sector is beneficial to the Australian consumers and producers. [10]

- *Thesis: domination of large foreign firms is beneficial*
    - *(internal) EOS, can benefit consumers. As large firms engage in large-scale production, it is hoped that these large firms can reap (perhaps) technical, marketing and (even) financial EOS. With lower AC, it is desirable if such cost savings can benefit consumers as lower prices.*
    - *Boost X competitiveness (as Australia is one of the world producers for grains), and therefore promote growth & employment. When foreign large firms expand the production in Australia to cater to overseas emerging markets, they would be employing more capital and labour which can boost overall employment and AD (via an increase in investment and export). Through the multiplier effect, national income could increase significantly (assuming Australia's multiplier, k, is substantial). These positive impacts would benefit both Australian consumers and producers.*
    - *If after the takeover, ADM injects funds to improve existing facilities, previously owned by GrainCorp, then (small) farmers who access these facilities can benefit.*
- *Anti-thesis: domination of large foreign firms is not beneficial*
    - *(Mkt failure) mkt dominance by ADM, impact on other firms in industry & consumers. As ADM would takeover the ownership of the logistic and distribution network previously owned by GrainCorp, this*

can be exploited by ADM to earn higher profits, especially at the expense of small local grain growers (restrict access to port facilities and levying a high surcharge for usage by small local farmers). The case is similar in the dairy industry where large milk processors/dairy product manufacturers control the farm gate price of milk (paying a lower price for the raw milk produced by small local dairy farmers) and controlling the distribution network, preventing the small local dairy farmers to maintain decent (normal) profits.

- *Theoretically, large firms could also experience internal diseconomies of scale. Moreover, being large and able to control some logistic facilities (in the case of ADM taking over Graincorp), hence the ability to establish some barriers to entry, the monopoly power enjoyed by these large firms may not motivate them to carry out cost-cutting exercises. Thus there could be a possibility that X-inefficiency and dynamic inefficiency may occur.*
- *(Mkt failure) inequity, as profits are accrued to shareholders only (at the expense of consumers and small producers)*

- *Evaluation: the fact that Australia govt blocked the takeover bid suggests that the costs could outweigh benefits. Small local farmers need to assess the short-term investment gains against their long term interest.*

L3 [5 – 6]	*A balanced discussion with good attempt to apply correct content knowledge with elaboration, and to use data to substantiate the discussion.*
L2 [3 – 4]	*A one-sided discussion with some attempt to apply relevant content knowledge. The explanations may have gaps/errors, with limited use of data.*
L1 [1 – 2]	*A brief and/or limited relevant discussion with no use of data.*
E2 [3 – 4]	*An attempt to arrive at a reasoned/explained conclusion.*
E1 [1 – 2]	*An unexplained judgement*

Marker's Comments

CSQ 2: Government Debt Crisis in Greece and Japan

(a)(i)	**Compare the debt-to-GDP ratio from 2005 to 2012 of Japan and Greece in Figure 2. [2]**
	• Similarity: The debt-to-GDP ratio of both Greece an Japan has increased from 2005-2012 • Difference: The debt-to-GDP ratio of Japan is always larger than Greece throughout this period. •
Markers' Comment	
(a)(ii)	**Explain whether the above data explain the changes in economic growth of Japan and Greece as shown in Figure 3. [4]**

	• Economic growth in Japan is increasing from 2005-2012 while economic growth in Greece has stagnated, as shown in Figure 2. GDP is a measure of economic growth. The data explains the changes in economic growth in **Japan.** [2m] • Increasing debt-to-GDP ratio means that G>T, expansionary fiscal impact on the economy. • This is supported by the increase in economic growth as an increase in AD causes increases in national income. The data does not explain the changes in economic growth in **Greece.** [2m] • The economic growth in Greece has stagnated despite an expansionary fiscal impact due to G>T. ***Possible reasons (any 1):*** • This may be due to other internal (C,I) and external shocks (X) to AD causing NY to fall. This is especially so as the government is experiencing a large and unsustainable public debt. • This may also be due to a small multiplier in Greece causing minimal impact on NY.
Markers' Comment	
(b)	**Explain one possible reason for the increase in government debt in economies like Japan and Greece. [2]**
	Identify and explain lower taxation or higher government spending (any 1) • Lower tax receipts [1m] due to increased unemployment [1m] OR • Higher government spending [1m] due to increased unemployment benefits, fiscal stimulus, etc [1m] • Other alternative reasons: E.g. The country is currently in debt and the government wants to continue with expansionary fiscal policy (leading to continued G > T) / investors lose confidence in the economy and NY falls (leading to fall in tax receipts)
Markers' Comment	
(c)	**With reference to Extract 4 (Japan to learn…), explain why bringing up the rate of inflation will cause 'negative real interest rates' and 'drive down the value of the yen'. [4]**
	Negative real interest rates [2m] • Real interest rates = nominal interest rates – inflation • Assuming that nominal interest rates are low or close to zero, an increase in rate of inflation would mean that real interest rates will become negative. • Interest rate is the cost of borrowing • Intuitively, a higher rate of inflation will reduce the value of money borrowed. If the nominal cost of borrowing is low (nominal interest rate), a high rate of

	inflation may cause the real value of the loan to be less than the initial value borrowed, even after the nominal interest rate has been accounted for. Reduction in the value of the yen [2m] • When there is inflation, the price of domestic goods and services will be higher than other countries. • This will lead to a fall in exports, and cause the demand for domestic currency to fall. • Therefore, the value of domestic currency (yen) falls. • At the same time, demand for imports will rise since foreign goods are relatively cheaper. • As a result, there will be higher supply of domestic currency as the locals will sell their currency in exchange for foreign currencies to pay for imports. • This causes the value of domestic currency (yen) to fall.
Markers' Comment	
(d)	**Examine the consequences on Greece and other economies in the Eurozone when the Greek government "sought to be generous to its people". [8]**
	"sought to be generous to its people" • Greek government increased government spending by creating a welfare state, offering generous pay and pensions, and lowered the retirement age in its economy. • The effect of a sustained budget deficit (G>T) caused public debt to spiral out of control. Effect on Greek economy • Potential expansionary impact through AD increasing (from increasing C, I and G) • Sustained budget deficit causes public debt, this increases the interest rates government has to pay, creates uncertainty in the economy, affects government provided pensions and jobs. • These have contractionary effects in both AD (in reducing C, I and X) and AS (increase cost of production, lower investments resulting in lower growth of capital/labour quantity and quality) Effect on developed economies like Germany and France • "German and French financial institutions are thought to hold up to 70% of Greek debt and would be severely hit" (Extract 8: Greece crisis) • Investments returns are affected because the financial institutions are unable to recoup their loans. • If Greece were to default on the loans, these financial institutions may require bail out from their government. • This will limit government spending and increase taxation in their own countries, resulting in contractionary impacts on the economy Effect on all economies in the Eurozone • Lower international investments in the Eurozone [Extract 8: *Greece crisis…*] due to greater uncertainty in the Eurozone and fears of debt contagion. • Also lower investment due to possibly fluctuations in the value of the Euro currency. This leads to a fall in AD and NY. • Large public debt will cause the government to pay high interest payments.

- Large public debt also crowds out private investments.
- Lower volume of trade overall amongst the EU countries, since there are contractionary impacts on bigger economies such as Germany and France.

Knowledge, Application, Understanding and Analysis		
~~L2~~L3	A balanced and elaborated discussion that discusses effects on **both** Greece and other economies in the Eurozone.	~~4~~5 – 6
~~L2~~	~~An elaborated discussion that discusses effects on **either** Greece **or** other economies in the Eurozone.~~	~~3 – 4~~
L2	An elaborated discussion that discusses effects on **either** Greece or other economies in the Eurozone.	3 – 4
L1	~~undeveloped~~Undeveloped answer and/or without economic analysis.	1 – ~~3~~2
Evaluation		
E1	Evaluative comments~~, unexplained.~~ with justifications 1m for evaluative comments without justifications	1 – 2

Markers' Comment

(e) **Discuss whether Greece should adopt the same approach as Japan in solving its own economic problems. [10]**

Policies adopted by Japan
1. Expansionary monetary policy
2. Expansionary fiscal policy with SS-side approach through increase in G
3. Structural reforms

Expected effects of policies in Japan

1. Expansionary monetary policy
- Lower interest rates should have an expansionary impact on C and I
- Lower interest rates will lower the ER, resulting in greater export earnings (assuming Marshal-Lerner condition holds) [Extract (weak Japanese GDP…)]
- Both should increase AD, which would cause NY to increase through the muiltiplier effect

2. Expansionary fiscal policy with SS-side approach
- Increase in fiscal spending should have expansionary impact on G
- Improved infrastructure would cause LRAS to shift outwards as productive capacity of the country improves
- Outward shifts in AD and LRAS resulting in sustained economic growth

3. Structural reforms
- Increase labour participation rates (either by delaying retirement age or encouraging women to work)
- Reduction in subsidies to agriculture would encourage farmers to be more efficient and divert precious resources towards more productive uses
- Overall increase in AS

Thesis: Yes, Greece should adopt the same approach

1. Structural reforms

	• Greece should also adopt structural reforms focusing not just on the supply-side but also its government spending and taxation policies • Firstly, it should increase the retirement age in order to increase labour participation rates to increase AS [Extract *what is the Greek debt…*] • Secondly, it should also cut back government spending on pay and pensions but instead divert it towards developing its capital and human resources. • Thirdly, it could reform its taxes towards a broader base from income taxes to indirect taxes and enforce more stringent tax collection to ensure there is enough revenue to cover the existing spending. Anti-thesis: No, Greece should not adopt the same approach **1. Expansionary fiscal policy** • The large public debt in Greece may mean that the government do not have enough resources to finance an increase in spending. It will result in Greece having to pay punitive interest rates to foreign creditors. Moreover, the 'troika' of the EU, ECB and IMF may not allow Greece to spend more than it already has in order to qualify for new loans to help Greece pay for its initial debt • Increase in government debt may also crowd-out private investments, with the phenomenon known as the 'crowding-out' effect. • Greece is also not collecting enough taxes in order to pay for additional spending **2. Expansionary monetary policy** • Theoretically, lowering interest rates to boost consumption, investment and exports should work for Greece as it does not require the government to use its limited budget, since its debt is already increasing. • At the same time, lowering the interest rates will cause the ER of a country to fall, leading to an improvement in BOP, assuming Marshall-Lerner condition holds. • *However, Greece is not able to lower its interest rate unilaterally as it is in a currency union with other Eurozone economies. The interest rate (and hence monetary policy) is decided by the European Central Bank for all the Eurozone countries • *Moreover, the effectiveness of interest rate changes depends on the interest elasticity of consumption and investment in the country. **<u>Evaluation</u>** 1. Structural reforms take time to take effect, so Greece would have to suffer from existing economic recession as it is unable to undertake any demand-side policies due to its membership in the single currency (restricting monetary policy) and the huge government debt (restricting fiscal policy). - Alternatively, it could consider abandoning the Euro and using its own currency so that it can have more leeway in implementing expansionary monetary policy. However, this could also have dire impacts on external trade as it also loses its participation in the common EU market. 2. Given the huge economic recession the policies implemented would bring, and the almost complete restrictions on demand-side policies, the Greek government may inadvertently have to rely on other Eurozone countries to lend them money to pay for existing spending, or to forgive their debt either partially or completely. The policy of pushing for debt forgiveness may not necessary be met with resistance, given the fears of "debt contagion" now

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that the rest of Europe and large parts of the developed world is exposed to the Greek debt.

3. As the government of Greece is democratically elected, the people of Greece would need to support these policies, or the government may not have the mandate to push through any austerity measures that the people reject.

<table>
<tr><td colspan="3">Knowledge, Application, Understanding and Analysis</td></tr>
<tr><td>L3</td><td>A balanced and well-elaborated discussion that evaluates the suitability of policies implemented by Japan for the Greek economy.</td><td>5 – 6</td></tr>
<tr><td>L2</td><td>For an undeveloped~~/imbalanced~~ answer that may not have referred closely to policies implemented by Japan.

OR

A one-sided answer.</td><td>3 – 4</td></tr>
<tr><td>L1</td><td>Very undeveloped answer and/or without economic analysis.</td><td>1 – 2</td></tr>
<tr><td colspan="3">Evaluation</td></tr>
<tr><td>E2</td><td>Evaluative comments, with justification.</td><td>3-4</td></tr>
<tr><td>E1</td><td>Evaluative comments, unexplained.</td><td>1-2</td></tr>
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