



NATIONAL JUNIOR COLLEGE  
SH2 Preliminary Examinations for General Certificate of Education Advanced Level  
Higher 2

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## ECONOMICS

**9732/01**

**Paper 1**

**30 August 2016**  
**2 hour 15 minutes**

Additional Materials: Answer Paper, Cover Pages

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### READ THESE INSTRUCTIONS FIRST

Write your name and subject class on all the work you hand in.  
Write in dark blue or black pen.  
You may use an HB pencil for any diagrams or graphs.  
Do not use staples, paper clips, glue or correction fluid.  
DO **NOT** WRITE IN ANY OF THE MARGINS.

Answer **all** questions.

**Start each question on a new piece of paper.**

**Start parts (c), (d) and (e) for both case studies on a new piece of paper.**

Fill in the necessary information on the cover pages.

At the end of the examination, fasten all your work securely with the cover pages given.  
The number of marks is given in brackets [ ] at the end of each question or part question.

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

Answer **all** questions.

### Question 1

#### Competition in the Grocery Market

**Table 1: Grocery Market Share (%) from August 2012 to August 2014**

	Great Britain	12 weeks to 19 August 2012 (%)	12 weeks to 17 August 2013 (%)	12 weeks to 18 August 2014 (%)
"The Big Four" supermarkets	Tesco	30.9	30.2	28.8
	Asda	17.5	17.1	17.2
	Sainsbury's	16.4	16.5	16.4
	Morrisons	11.5	11.3	11
Discounters	Aldi	3	3.7	4.8
	Lidl	2.8	3.1	3.6
	Iceland	2	2	2
	Others	13.9	14	14.1

Source: Adapted from Statistica and Roy Morgan

#### Extract 1: Tesco suffers biggest fall in sales for decades

Tesco has reported its largest fall in sales for decades as shoppers turn away from Britain's biggest retailer. The supermarket chain reported that like-for-like sales fell by 3.7percent in the UK in the three months to May 25 which threatens Tesco's profit for the year. Tesco is losing sales as the German discounters Aldi and Lidl attract shoppers at a rapid pace. Industry analyst, Planet Retail said, "in the context of 20 years when Tesco's just been powering ahead, they didn't really made provisions for when times were tough". When asked whether the performance was due to strategic errors, Philip Clark, Tesco's chief executive, said the company should have been quicker in shifting the focus of its expansion from supermarkets to convenience stores. Tesco is looking to revamp 650 of its stores this year.

Source: Adapted from *The Telegraph*, 04 Jun 2014

#### Extract 2: Aldi's price plan shook up Tesco, Morrison's, Asda and Sainsbury's

The message that Aldi is getting cheaper and bigger will be welcomed by British shoppers battered by years of austerity and stagnant wages. But for the German supermarket's suffering rivals, it is another turn of the screw. A steely focus on price and simplicity, against a backdrop of falling living standards that has sharpened customers' eye for a bargain, has seen the discounter grab market share from competitors and transform what we expect from our weekly shop.

With shoppers now fully aware of the low prices at Aldi and its fellow German discounter Lidl, mighty Tesco, the giant British retailer, which came close to controlling a third of all grocery sales in the UK, is in disarray, while Morrisons and Sainsbury's are also suffering. All have been forced to cut prices in a bid to stop shoppers leaking away. Competing on price is difficult for the large supermarket groups, which can stock more than 40,000 different products in their largest stores, but are up against the limited range of goods in discounters like Aldi.

Source: *The Guardian*, 29 September 2014

### **Extract 3: A supermarket price war is bad news for Britain's ability to feed itself**

For consumers struggling with food bills, last week seemed to bring a glimmer of hope, as bad news for retailers promised good news on prices. Tesco chief executive Philip Clarke announced £200m worth of price cuts. Spurred by sales down 7.1%, Morrison's has also been offering bargains. A supermarket price war is under way, with Asda and Sainsbury's piling in, which can only be good news for shoppers.

Or perhaps not. For just as Tesco was sharing its dismal trading figures, the Department for the Environment, Food and Rural Affairs (Defra) was releasing statistics on Britain's food self-sufficiency. They revealed the cumulative effect of those price wars on our ability to feed ourselves. For the third year in a row, self-sufficiency was down, from a peak in 1984 of 78% to 60% now. And many believe that's an overestimate. What's more, when one calculates in products exported, the amount that we consume in the UK that is actually produced here falls to around 50%.

Much of that decline is being attributed to the brutal deals on price enforced by the mighty supermarkets. In the mid-80s we grew 4 million hectares of wheat. Now it's 3.14 million. The national sheep flock has fallen by a third. "Much of this is land that would have shown a small profit a few years ago and simply doesn't now because of the prices being paid," said Guy Smith, vice-president of the National Farmers Union.

Why does this matter? After all, we live in a globalised world. Clearly we're supplying our needs from the international markets.

The problem is twofold. First, in the future those international markets will be far less reliable. There has been a global explosion of affluence, especially in Asia. At the beginning of this century, 14% of the world's middle classes were there. By 2050, 68% will be in Asia, and they are insisting on eating as we do, with meat consumption in China alone almost quadrupling over the past three decades. Already Chinese retailers are willing to pay more for ungraded, unpacked apples than British supermarkets will pay for graded and packed. The simple laws of supply and demand mean that all edible commodities are going to be under pressure. At least if we have access to a robust internal food market we'll be protected from some of the worst price excesses.

But there is another, more moral issue. The global population is expected to rise from seven billion now to more than nine billion by 2050. The United Nations estimates that by 2030 we will need to be producing 50% more food globally on the same or even less land. What's more, the latest report from the UN Panel on Climate Change actually predicates a 2% drop in food production. In short, every country needs to do its bit. And we aren't.

It's noticeable that the decline has resulted from the wars on price by large supermarkets that have forced so many British farmers to give up farming. The European Union's Common Agricultural Policy (CAP) emphasised direct subsidies. EU, which included UK as a member, spends around €59 billion a year on farm subsidies, called the Single Farm Payment which subsidised farmers on a per-hectare basis. The Single Farm Payment is a large proportion of income for many farmers, who say they could not profit without subsidies. However, farm subsidies in developed countries push down food prices and impoverish third-world farmers.

Tesco chief executive Philip Clarke did say in an interview last year that food prices would have to rise. He also told farmers that the retailer had changed and would be looking after producers and paying them better. But that was before Aldi and Lidl eroded his market share. The problem is that Tesco is now fighting a battle it simply cannot win. The assumption had long been that if you shopped at a discounter such as Aldi or Lidl you were compromising on quality. Consumers now know this isn't the case. By stocking single lines of products – one type of unbranded chocolate biscuit or ham against the 15 or 20 big-name brands in Tesco or Morrison's – the discounters have economies of scale that enable them to charge less without eroding quality. And it turns out

consumers are more than willing to trade choice for price. Meanwhile, the big four keep trying to add value through choice and service while also competing on price, which simply isn't possible.

Source: Adapted from *The Guardian*, 8 June 2014

#### **Extract 4: Why do Australians love Aldi?**

The supermarket industry is dominated by a select group of retail entities, of which Coles and Woolworths are Australia's largest. Both companies have experienced substantial growth over the last four decades; more than doubling their combined market share to over 70 per cent of the country's supermarket/grocery sector. The profitability of Coles and Woolworths has increased substantially; by 40 per cent and 24 per cent respectively. Further growth remains a real possibility. However, a German discount supermarket is now forcing them into a corner.

Since it opened in 2001, Aldi has grown like wildfire. A cultural shift is taking place, as we grow tired of traditional shopping experiences and become more accepting of bargain-hunting. Aldi has refined its business model over the years to help keep those prices extremely low. The minimal product range, functional store design and lack of short-term promotions besides the "Special Buy" means it is the no-frills airline of supermarkets.

An Aldi spokesperson said: "We've eliminated all costly extras and overheads by selecting only the best products in each category, displaying products in reusable crates and not giving out plastic bags, which encourages customers to recycle. We concentrate on selling our select range of exclusive brands rather than spending money on customer loyalty programs or expensive point of sale displays." Aldi picks prime geographic locations, to ensure it is easily accessible. Stores often appear close to the other leading supermarkets, but outside of the busy shopping centres, and have car parks.

Source: Emma Reynolds, *News.com.au*, 23 November 2014

#### **Questions**

- (a) (i) Compare the change in the market share of the Big Four supermarkets with the change in the market share of the discounters in the grocery market from August 2012 to August 2014. [1]
- (ii) Explain the factor for the change in the market share identified in a(i). [2]
- (b) Explain whether the Single Farm Payment paid to the UK farmers is justified in terms of economic theory. [3]
- (c) (i) Using an appropriate elasticity concept, explain why 'global explosion of affluence' will lead to significant concern over world food prices. [3]
- (ii) With the aid of a diagram, explain how the change in world food prices can affect UK domestic food production. [3]
- (d) As a consultant economist, evaluate the options you would recommend to Tesco in response to the threat from discounters. [8]
- (e) If you were an economic advisor to the Australian government, would you recommend that it should encourage the growth of supermarkets or the entry of new discounters? [10]

[Total: 30]

## Question 2

### European Union and The World's Largest Economies

**Table 2: Net trade in goods and services: US\$ at current prices (millions)**

	2010	2011	2012	2013	2014
China	223023	181903	231844	235379	284022
United Kingdom	-66695	-41968	-53552	-53755	-56573
United States	-494659	-548629	-536773	-478398	-508321

Source: *World Bank*

**Table 3: Growth in real gross domestic product: % change per annum**

	2010	2011	2012	2013	2014
China	10.4	9.3	7.7	7.7	7.4
United Kingdom	1.7	1.1	0.3	1.7	3.2
United States	2.5	1.6	2.3	2.2	2.2

Source: *International Monetary Fund: World Economic Outlook Database*

### Extract 5: The car industry shows how Europe's relationship with China is bearing fruit

This year Zhejiang Geely Holding Group will celebrate the fourth anniversary of its acquisition of Volvo Cars from Ford Motor Company. Under Chinese ownership, Volvo has returned to profitability and is investing €11 billion in new products, plants and technologies. It is not alone. Geely has also acquired the London Taxi Company, where more than £200 million is being spent on new technologies and the next generation of famous black cabs.

From being an export destination, China is now emerging as a direct investor and active owner of European companies in numerous industries. Currently, China is now the European Union (EU) countries' second trading partner behind the United States and the EU is China's biggest trading partner.

Last year Chinese companies acquired 120 European companies, a third of them in the UK, Germany and France. These acquisitions symbolise the overseas growth potential of Chinese companies. Under Chinese ownership, companies in different sectors are benefiting from increased investment as well as research collaboration that will benefit both European subsidiaries and Chinese parent companies. These transactions form part of a changing business relationship between China and the West.

To be successful, these deals must preserve the corporate culture and brand identity of the companies acquired. A strong corporate culture is an important intangible asset that comes with a takeover. So China's corporate approach, at least in making foreign acquisitions, has so far focused on safeguarding the national identities of new subsidiaries, to invest in localised R&D, maintain product segmentation and then to marry these local strengths to a global procurement and market-growth strategy. This has also help to lessen China's dependence on foreign investment in the economy.

Source: Adapted from *The Times*, 26 June 2014

### **Extract 6: Language has the power to disarm the concerned citizen**

Let's say you want to push through a massive programme of anti-democratic corporate protection over two continents. It might be a good idea to festoon your official explanations with tedious-sounding acronyms, and with any luck concerned citizens will fall asleep before realising what is going on under their noses.

Consider the case of the US-EU trade deal called TTIP, with its controversial provisions for ISDS (Investor-State Dispute Settlement), and its reassuring talk of removing "barriers" and consulting "stakeholders". George Monbiot, a British writer and others has made clear, this threatens to constitute an enormous transfer of power from public to private hands. Private companies will be allowed to sue national governments for doing things that harm their bottom line.

TTIP is short for the Transatlantic Trade and Investment Partnership. It sounds benign enough. Its point is to remove "barriers" or "obstacles" to trade between the continental blocs. As it happens, the normal kinds of trade "barriers", i.e. import and export duties, are already very low between the US and EU. So TTIP is focusing on the reduction of "non-tariff barriers".

Things begin to appear more worrisome when a persistent reader realises that most of the "non-tariff barriers" being targeted by TTIP are regulations: those annoying profit-blocking rules erected by governments to stop their citizens being poisoned or killed, or to prevent rampant pollution. TTIP's advocates say they just want to make regulations more compatible on both sides of the Atlantic, so that a car manufacturer, say, will not have to pass two different expensive procedures, one for the US and one for the EU, that are aimed at ensuring similar safety levels.

TTIP is an excellent idea, say its champions, because it will be a magical GDP bonanza for both economic blocs. In case anyone is worried that jobs might be at risk, the language of the economic models cited is careful to speak not of job losses, still less of job destruction; instead they refer to possible "job displacements".

Source: *The Guardian*, 21 November 2014

### **Extract 7: Weak US + slowing China = big EU trouble**

After having initially predicted a 1 per cent economic slowdown for the first quarter of this year, US official economic statistics were massively adjusted downwards. Moreover, this is happening in spite of the most accommodative monetary policy on record, with interest rates down to zero. The incipient rise in US consumer prices is a cause for serious concern. Higher prices are not being driven by swelling consumer demand. We are dealing rather with "bad inflation", where companies are charging more for goods with inelastic demand in an attempt to offset low sales volumes.

If that happens, Europe can expect major, palpable trouble. The contribution of external demand to GDP is the EU's most important source of growth at the moment.

Mario Draghi, European Central Bank president has done an excellent job of reassuring investors that the Euro is here to stay, but his efforts have had no impact so far on growth in the real economy. The axing of government spending projects and the bolstered taxes that have throttled public and private investment across southern Europe have also not helped. And even if fiscal austerity proves less damaging in 2014 than in 2013, European growth will be crimped by the disastrous state of France's economy where taxes weigh too heavily on income. Faced with high external and domestic public sector debt, the EU's peripheral countries are being forced to balance their budgets and current accounts.

The trouble is that the disappointing US growth figures came when demand from emerging markets is waning, most notably in China. Until recently China has thrived by restricting

households' spending. The financial crisis showed that the world couldn't afford to go on buying. To keep the wheels turning, Chinese authorities were allowed to borrow. Last year the Chinese leadership said it recognised that plan was flawed, but the policy was quickly reversed and public sector debt needed to be cut as part of China's structural reforms to lessen state investment. George Soros, chairman of Soros Fund Management said: "China's leadership was right to give precedence to economic growth over structural reforms, because structural reforms, combined with fiscal austerity, push economies into a deflationary tailspin. But there is an unresolved contradiction in China's current policies."

Looking further out, the main threat to the Eurozone is that nominal growth will remain too low for member countries to reverse their public debt trajectories.

The economic structures in Europe also tend to be less conducive to technology adoption than in the US, a channel which has been highly favourable for productivity growth. An explanation why Europe has lagged behind the US in terms of productivity growth is the slower adoption of information and communication technology, in particular in the services sector. One reason is the relatively closed nature of services markets within Europe, which slows down the diffusion of new technologies. The second reason is the relative rigidity of national labour markets. Reaping the productivity gains from adopting new technology requires fundamental organisational restructuring. Hence firms need to have the flexibility to reallocate workers to different tasks, which in turn requires them to have access to adequate training – something which European firms do not seem to be able to excel in.

Source: Adapted from *Financial Times*, 16 July 2014

## Questions

- (a) (i) Compare the change in the United Kingdom's balance of trade in goods and services with that of United States between 2011 and 2014. [2]
- (ii) With reference to the data in Table 2 and Table 3, explain the effect of the United Kingdom's growth rates on the United Kingdom's balance of trade between 2011 and 2014. [2]
- (b) Explain the advantages of the 'changing business relationship between China and the West' on China's economy. [3]
- (c) Using a diagram, explain how 'structural reforms, combined with fiscal austerity, push economies into a deflationary tailspin'. [5]
- (d) 'TTIP is an excellent idea, say its champions, because it will be a magical GDP bonanza for both economic blocs' (Extract 6). Using your own knowledge and the data where relevant, assess the validity of this statement. [8]
- (e) Using the evidence in the data, discuss whether China's slowdown will be the biggest worry to European Union countries. [10]

[Total: 30]

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