

# **National Junior College Economics Department**

## **Preliminary Examination 2016 Paper 1 Answer Booklet**

**Senior High 2  
H2 Economics  
(9732/01)**

## Case Study 1 Suggested Answers:

<b>(a)</b>	<b>(i)</b>	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.	<b>[1]</b>
		The market share of the Big Four supermarkets in the grocery market has generally decreased while the market share of the discounters has generally increased.	
	<b>(ii)</b>	Explain the factor for the change in the market share identified in a(i).	<b>[2]</b>
		There has been falling income or stagnant income in UK for a number of years. The Big Four supermarkets offer normal to luxurious goods and services, while the discounters offer more inferior services. Normal to luxury goods/services have positive income elasticity of demand while inferior goods/services have negative income elasticity of demand. Hence, the demand thus the market share for the Big Four supermarkets has decreased while the demand thus the market share for discounters has increased.	
<b>(b)</b>		Explain whether the Single Farm Payment paid to the UK farmers is justified in terms of economic theory.	<b>[3]</b>
		The subsidy paid to the UK farmers is justified as it helps to protect the income of the farmers and allow them to continue in their farming activities. However, the subsidies paid to the UK farmers is not justified. This is a form of unfair trade practices and may impoverish the farmers in the third world countries. Whether the subsidies paid to the farmers is justified or not will depend on the extent of the impact it has on the farmers from the third world countries.	
<b>(c)</b>	<b>(i)</b>	Using an appropriate elasticity concept, explain why 'global explosion of affluence' will lead to significant concern over world food prices.	<b>[3]</b>
		The demand for food has increased significantly due to the "global explosion of affluence". The value of the price elasticity of supply for food is less than 1. The significant rise in demand combined with a low PES will be a significant concern to world food prices as it will result in a rapid rise in world food prices	
<b>(c)</b>	<b>(ii)</b>	With the aid of a diagram, explain how the change in world food prices can affect UK domestic food production.	<b>[3]</b>

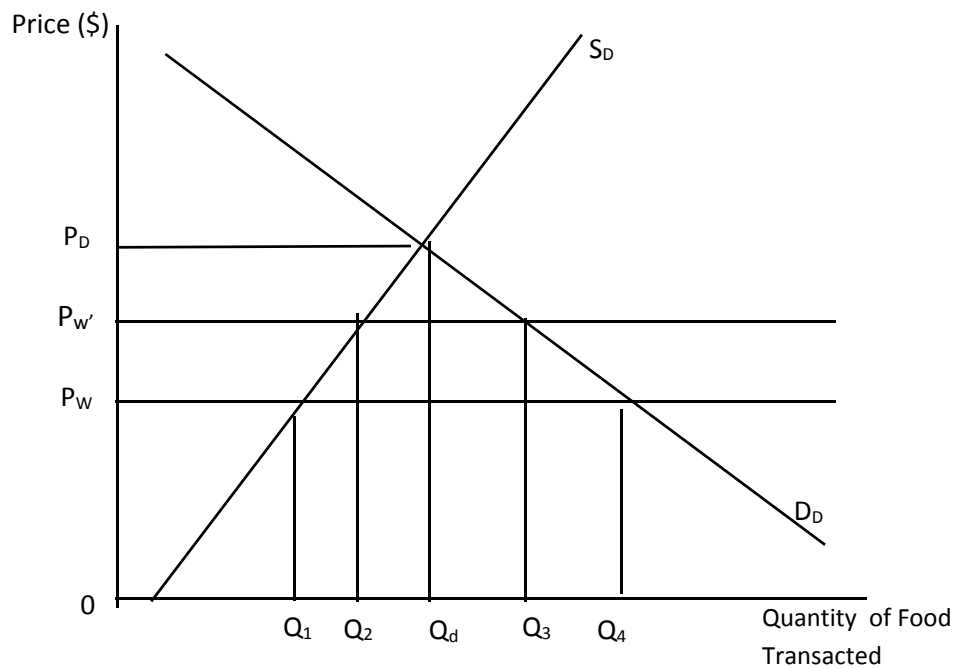


Figure: UK Food Market

Higher prices increase the producers ability to supply more of a good/service. Since producers face a higher marginal cost, they must receive a higher price for the additional units of output to be able to increase the quantity supplied. With the increase in world price of food from  $P_W$  to  $P_W'$ , UK domestic food production increased.

**(d)** As a consultant economist, evaluate the options you would recommend to Tesco in response to the threat from discounters. **[8]**

**Introduction:**

- One of Tesco's main challenges is the threat from the discounters who are attracting shoppers at rapid pace.
- The aims of these strategies include helping Tesco to regain their sales and market share from the discounters in the short run and to maximise their profits in the long run.

**Body 1:**

**Pricing Strategy**

- With the entry of more firms into the grocery market, demand for Tesco's service falls. The demand for Tesco has become more price elastic in demand with the increase in competition.
- Hence, Tesco should lower its prices to increase total revenue.
- The strategy of a price competition should result in increase in sales revenue for Tesco.

**Limitation:**

- A price competition might not work for Tesco given their higher operating cost such as the higher rentals for the larger space occupied by the larger supermarkets.
- It could also lead to price wars among the different supermarkets and this will hurt all the supermarkets profits in the long run.

**Body 2a:**

**Non-price strategy**

- Tesco could compete with Aldi for strategic location and accessibility as seen, which might be an important consideration to consumers facing falling income who may not be keen to spend too much on transportation to visit a larger supermarket that is located further away.

**Limitation:**

- However, this strategy may not guarantee a reduction in the intensity of the competition that Tesco is facing from the discounters.

**Body 2a:****Non-price strategy**

- Hence, Tesco could produce more of inferior goods and less of luxury goods to attract consumers to buy inferior goods, increasing demand and hence, TR. Tesco could also focus more on marketing efforts on groups that view certain goods as inferior, promoting the good as 'value for money' for the budget conscious.

**Limitation:**

- However, demand for inferior goods may not increase if consumers taste and preference towards luxury goods remains. Even in times of falling or stagnant incomes, consumers may still continue to consume luxury goods due to a specific taste and preference for it.

**Body 3:****Strategy to lower Tesco's cost of production**

- Whether Tesco is considering a pricing strategy against the discounters or simply to achieve profit maximisation, a strategy to lower Tesco's cost of production would be necessary.
- To achieve a lower cost of production, Tesco can consider a merger with the food producer or acquiring the food producers.
- The lower cost of production will allow Tesco to engage in price competition. Ceteris paribus, the lower cost will also help Tesco to increase its profits earned.

**Limitation:**

- Such a vertical merger may not result in significant cost saving for Tesco as the cost of food as the extract 3 shows that the supermarkets are already paying low prices to food producers to support the price wars among the grocers.

**Conclusion:**

- Tesco, a profit maximising supermarket is faced with the problems of declining sales and declining market share.
- Strategies recommended to Tesco should help her to increase her revenue or lower her cost of production.

**Mark Scheme**

Level	Descriptors
<b>L2</b> <b>4-6</b>	For an answer that exhibits: <ul style="list-style-type: none"> <li>➤ <b>Good depth in analysis.</b> <ul style="list-style-type: none"> <li>✓ Accurate, precise and clear use of economic concepts and analysis in <b>most</b> explanations.</li> <li>✓ <b>Most</b> explanations are <b>well-developed</b>.</li> </ul> </li> <li>➤ <b>Good breadth in analysis: Contains</b> <ul style="list-style-type: none"> <li>✓ well explained options for Tesco</li> </ul> </li> </ul>
<b>L1</b> <b>1 – 3</b>	For an answer that exhibits: <ul style="list-style-type: none"> <li>➤ <b>Insufficient depth</b> in analysis.               <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts and analysis in <b>some</b> explanations e.g. most explanations are descriptive.</li> <li>✓ <b>Most</b> explanations are <b>under-developed</b>.</li> </ul> </li> <li>➤ <b>Insufficient breadth</b> in analysis: Contains               <ul style="list-style-type: none"> <li>✓ well-explained option</li> </ul> </li> </ul>
<b>E2</b> <b>(2m)</b>	For a well-reasoned criteria-based judgement

		E1 (1m)	For an unexplained criteria-based judgement			
(f)		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]		
		<p><b>Introduction:</b></p> <p>Government makes decision to maximise the welfare of society. It is important that before deciding on whether to encourage the growth of supermarkets or the entry of new discounters, the benefits should be weighed against the cost of development in the Australian grocery market.</p> <p><b>Body 1: Encouraging the Growth of Supermarkets</b></p> <p><b>Benefits to society:</b></p> <ul style="list-style-type: none"><li>Large supermarkets such as Woolworth and Coles tend to offer more variety of goods and provide premium service to their consumers. Encouraging the growth of supermarkets will increase society's welfare.</li><li>Larger supermarkets are able set up higher barriers to entry and consequently will be able to keep the supernormal profits earned in the long run.</li></ul> <p><b>Costs to society:</b></p> <ul style="list-style-type: none"><li>The Australian grocery market is currently dominated by Coles and Woolworths who among them has more than 70 per cent share of the country's supermarket/grocery sector. This gives them significant market dominance and power.</li><li>Market dominance may lead to inefficient allocation of resources in the economy. Resulting <b>deadweight loss</b> to society due to an allocatively inefficient level of production</li><li>If the government encourage the growth of supermarkets, they will gain more market power and dominance. Without the competitive pressure on profit margins, these firms could be lax on cost controls. Hence, they are said to be suffering from X-inefficiency.</li><li>The profitability of the supermarkets have increased substantially. These profits are not widely distributed and will contribute to a worsening of the income distribution in society.</li></ul> <p><b>Body 2: Encouraging the Development of discounters</b></p> <p><b>Benefits to society:</b></p> <ul style="list-style-type: none"><li>In contrast to the substantive market power of the larger supermarkets to set higher prices, the development of more discounters will ensure the lessening of such power. To compete in the industry and be profitable, these discounters will have more motivation to keep their cost low.</li><li>The no frills shopping also help to eliminate the all the costly extras and overheads. Since they enjoy lower costs, the discounters will be able to pass on cost savings to consumers in terms of lower prices and hence, increasing the consumers welfare.</li></ul> <p><b>Costs to society:</b></p> <p>(For costs of the development of discounters, refer to the earlier discussion points: lack of variety, lack of R&amp;D and innovations)</p> <p><b>Conclusion:</b></p> <ul style="list-style-type: none"><li>As an economic advisor any recommendation to the government should consider the impact on the welfare of society after considering the benefits and cost.</li></ul> <p><b>Mark Scheme</b></p> <table><tr><th>Levels</th><th>Descriptors</th></tr></table>		Levels	Descriptors	
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<p><b>L3</b></p> <p><b>7-8</b></p>	<p>For an answer that exhibits:</p> <ul style="list-style-type: none"> <li>➤ <b>Very good depth</b> in analysis. <ul style="list-style-type: none"> <li>✓ Accurate, precise and clear use of economic concepts and analysis in <b>most</b> explanations.</li> <li>✓ <b>Most</b> explanations are <b>well-developed</b>.</li> </ul> </li> <li>➤ <b>Very good breadth</b> in analysis: Contains <ul style="list-style-type: none"> <li>✓ <b>Costs and/or benefits</b> analysis in the development of supermarkets</li> <li>✓ Costs and/or benefits analysis in the development of discounters.</li> </ul> </li> </ul>
<p><b>L2</b></p> <p><b>4-6</b></p>	<p>For an answer that exhibits:</p> <ul style="list-style-type: none"> <li>➤ <b>Good depth</b> in analysis. <ul style="list-style-type: none"> <li>✓ Accurate, precise and clear use of economic concepts and analysis in <b>most</b> explanations.</li> <li>✓ <b>Some</b> explanations are <b>under-developed</b>.</li> </ul> </li> <li>➤ <b>Good breadth</b> in analysis: Contains <ul style="list-style-type: none"> <li>✓ <b>Costs and/or benefits</b> analysis in the development of supermarkets</li> <li>✓ Costs and/or benefits analysis in the development of discounters.</li> </ul> </li> </ul>
<p><b>L1</b></p> <p><b>1-3</b></p>	<p>For an answer that exhibits:</p> <ul style="list-style-type: none"> <li>➤ Insufficient depth in analysis. <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts and analysis in <b>some</b> explanations e.g. most explanations are descriptive.</li> <li>✓ <b>Most</b> explanations are <b>under-developed</b>.</li> </ul> </li> <li>➤ Insufficient breadth in analysis: Contains <ul style="list-style-type: none"> <li>✓ Costs and/or benefits analysis in the development of supermarkets <b>OR</b></li> <li>✓ Costs and/or benefits analysis in the development of discounters.</li> </ul> </li> </ul>

Levels	Descriptors
<p><b>E2</b></p> <p><b>2</b></p>	<ul style="list-style-type: none"> <li>• For a well-reasoned criteria-based judgement that answers the question</li> </ul>
<p><b>E1</b></p> <p><b>1</b></p>	<ul style="list-style-type: none"> <li>• For an unexplained criteria-based judgement that answers the question</li> </ul>

## Case Study 2 Suggested Answers:

(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]
		Similarity: Both countries' balance of trade are in deficits from 2011 to 2014. Difference: UK's balance of trade is worsening whereas US's balance of trade is improving from 2011 to 2014.	
(a)	(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]
		With reference to Table 3, UK's growth rate increases between 2011 and 2014, which explains for the increase in demand for imports due to the rising income assuming $YED > 0$ for imports/import goods are normal goods. The increase in import expenditure will lead to a fall in net exports, assuming ceteris paribus, hence explaining for the worsening in UK's BOT observed in Table 2.	
(b)		Explain the advantages of the 'changing business relationship between China and the West' on China's economy.	[3]
		The changing business relationship refers to the increasing number of Chinese firms acquiring foreign firms in China and/or acquiring foreign firms overseas.  Therefore, there is an increase domestic investments by domestic firms in China. Hence, China's AD and LRAS is likely to increase thus promoting economic growth in China. In addition, there might be lesser income outflow in terms of profit remittance hence China's balance of payments/capital-financial account is likely to improve.	
(c)		Using a diagram, explain how 'structural reforms, combined with fiscal austerity, push economies into a deflationary tailspin'.	[5]
		Structural reforms refer to efforts to decrease government/public expenditure on infrastructure and increase private consumption expenditure. Fiscal austerity as suggested refers to a policy of reducing government/public spending and raising taxes. An increase in personal income tax is likely to decrease consumers' disposable income and hence consumption expenditure. An increase in corporate tax will reduce investment expenditure.  Hence it would lead to a fall in consumption and investment expenditure as well as fall in government expenditure, which in turn would lead to a decrease in AD. The fall in AD leads to a fall in real national and GPL.  (diagram to illustrate)	
(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	[8]

validity of this statement.

### Introduction:

- TTIP is an excellent idea according to its champions due to its perceived benefits. However it is likely to bring about problems that will affect both macro and micro aims.

### Body 1: TTIP is an excellent idea

- Increase in trade thus for both US and EU thus leads to an increase in net exports for both Eu countries and US. Coupled together with the increase in FDI, this will increase AD and hence real national output. The increase in FDI can also lead to an increase in LRAS, bringing about potential growth. This is supported with Extract 6 that quoted how TTIP will be a magical GDP bonanza for both economic blocs, which will result in an improvement in material SOL of the citizens in both countries.
- TTIP increases the amount of imports and therefore the choice of goods and services available to consumers. The reduction of non-tariff barriers means that exporters may increase their products to the importing country, which results in an increase in consumer choice, which has a positive impact on consumer welfare.

### Body 2: TTIP is not an excellent idea due to its limitations

- Loss of jobs and increased unemployment – With increased restructuring of economies according to CA (as mentioned earlier), there might be prolonged and substantial dislocation of jobs under TTIP.
- TTIP's biggest threat to the citizens is its inherent assault on democracy. As mentioned in Extract 6, one of the main aims of TTIP is the introduction of Investor-State Dispute Settlements (ISDS), which allow companies to sue governments if those governments' policies cause a loss of profits. Hence this could imply a decrease in those annoying profit-blocking rules erected by governments to stop their citizens being poisoned or killed, or to prevent rampant pollution.
- TTIP could bring about an enormous transfer of power from public to private hands as mentioned 6, since private companies will be allowed to sue national governments for doing things that harm their bottom line.

### Synthesis:

- Indeed TTIP is an excellent idea, because it will be a magical GDP bonanza for both economic blocs. However TTIP can be an excellent idea due to its other benefits.
- Hence the pros and cons of TTIP must be carefully considered and weighed before coming to a stand that TTIP is an excellent idea because it will a magical GDP bonanza for both economic blocs.

### Mark Scheme

Level	Descriptors
<b>Level 2</b> <b>4 – 6</b>	<p>For an answer that exhibits:</p> <ul style="list-style-type: none"> <li>➤ <b>Good</b> depth in analysis. <ul style="list-style-type: none"> <li>✓ Accurate, precise and clear use of economic concepts and analysis in <b>all</b> explanations. Answer shows <b>good</b> knowledge of effects of TTIP.</li> </ul> </li> <li>➤ <b>Good</b> breadth in analysis: <ul style="list-style-type: none"> <li>✓ Addresses <u>both</u> positive and negative effects of TTIP</li> </ul> </li> </ul>



		<table><tr><td><b>Level 1</b> <b>1 – 3</b></td><td>For an answer that exhibits:<ul style="list-style-type: none"><li>➤ <b>Insufficient</b> depth in analysis.<ul style="list-style-type: none"><li>✓ Accurate and clear use of economic concepts and analysis in <b>some</b> explanations. Answer shows <b>insufficient</b> knowledge of effects of TTIP.</li></ul></li><li>➤ <b>Insufficient</b> breadth in analysis:<ul style="list-style-type: none"><li>✓ Addresses positive <u>and/or</u> negative effects of TTIP</li></ul></li></ul></td></tr></table>	<b>Level 1</b> <b>1 – 3</b>	For an answer that exhibits: <ul style="list-style-type: none"><li>➤ <b>Insufficient</b> depth in analysis.<ul style="list-style-type: none"><li>✓ Accurate and clear use of economic concepts and analysis in <b>some</b> explanations. Answer shows <b>insufficient</b> knowledge of effects of TTIP.</li></ul></li><li>➤ <b>Insufficient</b> breadth in analysis:<ul style="list-style-type: none"><li>✓ Addresses positive <u>and/or</u> negative effects of TTIP</li></ul></li></ul>						
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<b>(e)</b>		Using the evidence in the data, discuss whether China’s slowdown will be the biggest worry to European Union countries.		<b>[10]</b>						
		<p><b>Introduction:</b></p> <p>A slowing China could be a worry to EU countries, however it may not be the biggest worry as the weakening of US and the domestic problems in EU countries could be a bigger worry to them.</p> <p><b>Thesis: China’s slowdown will be the biggest worry to EU countries</b></p> <ul style="list-style-type: none"><li>• A slowing China means that income will be rising at a slowing rate and hence this will lead a slowdown in demand for imports by the Chinese if <math>YED&gt;0</math> for these imports. This is equivalent to a slowdown in demand for EU exports. CA and BOP of EU countries will worsen, assuming ceteris paribus.</li><li>• The fall in EU countries’ net exports will also lead to a fall in AD and real national output. Hence cyclical unemployment will increase due to the fall in production which results in a fall in demand for labour since labour is a derived demand.</li><li>• Slowdown in the inflow of FDI will lead to a slower increase in AD and a increase in real national output.</li></ul> <p><b>Anti-thesis : There are other worries to EU countries</b></p> <p>(1) Weakening US:</p> <ul style="list-style-type: none"><li>• As mentioned, bad inflation in US where companies are charging more for goods with price inelastic demand in an attempt to offset low sales volumes shows signs of profit price-push inflation in US, illustrating stagflation in US which will lead to a fall in external demand in EU countries.</li></ul> <p>(2) Domestic problems in EU countries:</p> <ul style="list-style-type: none"><li>• Debt problem. The axing of government spending on projects and the bolstered taxes that have throttled public and private investment across southern Europe has 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 and moves to rein in public spending are coming far too late.</li><li>• EU countries tend to be slower in adopting new technology and hence face a relatively</li></ul>								

slower productivity growth compared to US due to a slower increase in LRAS. This might hinder EU countries in achieving high and sustainable economic growth.

**Synthesis:**

- Whether or China's slowdown is the biggest worry to EU countries depends on how dependant EU countries are on China for trade.

**Mark Scheme**

Level	Descriptors
<b>Level 3</b> <b>7 – 8</b>	For an answer that exhibits: <ul style="list-style-type: none"> <li>➤ <b>Excellent</b> depth in analysis.               <ul style="list-style-type: none"> <li>✓ Accurate, precise and clear use of economic concepts and analysis in <b>all</b> explanations.</li> </ul> </li> <li>➤ <b>Excellent</b> breadth in analysis: Contains               <ul style="list-style-type: none"> <li>✓ <b>Excellent</b> knowledge of the reasons why China's slowdown will be a worry to EU countries and other factors that are worries to EU countries.</li> </ul> </li> </ul>
<b>Level 2</b> <b>4 – 6</b>	For an answer that exhibits: <ul style="list-style-type: none"> <li>➤ <b>Sufficient</b> depth in analysis.               <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts and analysis in <b>some</b> explanations i.e. some explanations are descriptive.</li> </ul> </li> <li>➤ <b>Good</b> breadth in analysis: Contains               <ul style="list-style-type: none"> <li>✓ <b>Good</b> knowledge of the reasons why China's slowdown will be a worry to EU countries and other factors that are worries to EU countries.</li> </ul> </li> </ul>
<b>Level 1</b> <b>1 – 3</b>	For an answer that exhibits: <ul style="list-style-type: none"> <li>➤ <b>Insufficient</b> depth in analysis.               <ul style="list-style-type: none"> <li>✓ Inaccurate or insufficient use of economic concepts and analysis in most explanations.</li> <li>✓ Conceptual errors in analysis.</li> </ul> </li> <li>➤ <b>Insufficient</b> breadth in analysis: Contains               <ul style="list-style-type: none"> <li>✓ Lack of knowledge of the problems</li> </ul> </li> </ul>

Level	Descriptors
<b>E2</b> <b>2</b>	<ul style="list-style-type: none"> <li>• For a well-supported judgement with good consideration on whether China's slowdown will be the biggest worry to EU countries.</li> </ul>
<b>E1</b> <b>1</b>	<ul style="list-style-type: none"> <li>• For an unexplained judgement on whether China's slowdown will be the biggest worry to EU countries.</li> </ul>