



H2 Economics

9732/01

Case Study Questions

15 September 2016

2 hours 15 minutes

Additional Materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

Do not open this booklet until you are told to do so.

Write your name, class and register number in the spaces at the top of the answer sheets.

Write in dark blue or black pen.

You may use an HB pencil for any diagrams or graphs.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A

Answer **all** questions.

Begin each question on a fresh sheet of paper.

At the end of the examination, fasten all your work securely to the cover sheet with the string provided.

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

[Turn Over]

This document consists of **7** printed pages and **2** cover sheets.

Question 1 Who is winning the chocolate war?

Extract 1 Higher costs bite chocolate makers

Hershey Co.'s rebuff of a \$23 billion bid by Mondelez International Inc. this month comes as rising commodity prices are making it more expensive to produce a chocolate bar. Cocoa-butter prices are at multiyear highs as cocoa-bean processors struggle with unusually small cocoa beans in West Africa, where about 70% of the world's cocoa is grown. Still, the bulk of the costs of making chocolate are in transportation and marketing costs.

The cocoa crop in Ghana, the world's second-largest producer, experienced an unusually high drop in 2015, after farmers applied key pesticides late in the crop's development. Moreover, it takes a cacao tree five years before it produces its first beans. Hershey reported that price increases had hurt demand and was in part to blame for a 3.6% drop in sales volume in the second quarter of 2016.

Retail prices are expected to rise 2.2% this year in the U.S., the lowest year-over-year percentage increase in a decade. That modest price increase is because chocolate makers feel they have to absorb rising costs because they can't pass them on to consumers, analysts say.

Source: *Wall Street Journal*, 11 July 2016

Extract 2 Retailers appeal anti-trust call

Buyers accused the three confectionery giants, Nestle, Hershey and Mars, of conspiring to raise chocolate prices in US between 2002 and 2007 during discussions at trade shows and association events. However, the case was dismissed because they failed to provide evidence that the firms' actions were concerted and collusive. In light of the court's ruling, over 20 pharmacies and food retail chains filed appeals against the judgment.

Jeff Beckham, spokesperson for Hershey, said that the company had expected the appeal but it was pleased the court recognised that there is no basis for the case and misconduct. The chocolate firms said that any pricing increases were due to rising ingredient, manufacturing cost and denied price fixing.

Source: *William Reed Business Media*, 22 May 2014

**Table 1: Confectionery market share in the United States, 2015
(by value of total sales)**

| Company | Share of confectionery sector (%) |
|-----------|-----------------------------------|
| Hershey's | 31.3 |
| Mars | 29.1 |
| Mondelez | 5.4 |
| Lindt | 5.4 |
| Nestle | 5.0 |
| Others | 24.0 |

Source: Statista, 2015

Extract 3 Sales pressure could bolster case for merger of Mondelez and Hershey

Rival snack makers Mondelez International Inc. and Hershey Co. are both expected to show sales pressure when they report quarterly earnings this week, bolstering some arguments that the two giants could benefit from joining forces. Both Mondelez and Hershey are grappling with changing consumer tastes toward healthier and more natural foods, and in some cases the trend has sent a few companies in search of deals that help them reduce overall costs. Revenue is expected to be \$6.34 billion, down 17% from the same period last year, according to consensus estimates from Thomson Reuters.

Last year's megamerger of Kraft Foods Group Inc. and H.J. Heinz Co. helped the packaged food conglomerates save on overhead expenses and distribution costs. The combined company, Kraft Heinz Co., has posted double-digit increases in profits in recent quarters, despite continued sales decline. Analysts said the appeal for Mondelez to buy Hershey lies in the money the combined company could save by pooling resources and ingredient purchasing. Mondelez could also profit from expanding the Hershey brands overseas, which include Reese's peanut butter cups and Twizzlers, as they are heavily concentrated in the U.S. In fact, many of Hershey's brands have global brand recognition and distribution upside.

However, Bernstein analyst Alexia Howard feels that an acquisition of Hershey would be "strategically unsound" for Mondelez. "Our strongly held view that health and wellness trends will play a key part in the U.S. food industry's future makes us naturally skeptical of this transaction," she said. Hershey has said its sales and profit for the year will be lower than expected as its chocolate bars struggle to compete with newer snacks like fruit-and-nut bars considered by many consumers to be healthier.

Source: *Wall Street Journal*, 26 July 2016

Extract 4 Not so sweet if Mondelez buys Hershey

While Hershey has a strong U.S. presence, Mondelez has a global network. A marriage of the two would create the world's largest confectionery company with an estimated 18 percent of the market share, said market research firm Euromonitor International Ltd. In addition, because almost 75% of Mondelez's business is concentrated outside of U.S., a potential Hershey takeover may not raise many antitrust concerns within the U.S.

However, while Mondelez has vowed to keep Hershey's name and preserve jobs, some said such promises would ring empty. U.S. food giant Kraft drew controversy in 2010 after it shut a factory in southwest England following its takeover of Cadbury, now owned by Mondelez, going back on an earlier promise to keep the factory open.

Mondelez's bid for Hershey to create the world's largest cocoa buyer, could also hand the bargaining chips in the volatile niche market back to the candy makers. With more buying power, candy makers could demand lower prices from traders already operating on thin margins. The consolidation among chocolate makers creates larger buyers of commodities including cocoa and sugar, worrying middlemen who have already seen their margins squeezed. Mondelez is already the world's largest cocoa consumer, and after a tie-up with Hershey it would consume 650,000 tonnes per year, 50 percent more than the No. 2 consumer, Nestle.

Adapted from: *Reuters 2016 and Fortune 2016*

Figure 1: Cocoa Prices from 2000-2014



Source: CNBC, 13 Feb 2015

Questions

- (a) (i) With reference to Figure 1, describe the trend in cocoa prices. [2]
- (ii) With reference to Extract 1, use a diagram to explain how an increase in demand for chocolate affects the market for cocoa. [3]
- (b) (i) Identify and justify the type of market structure operating in the confectionery sector. [2]
- (ii) Explain how the firms in this market structure compete against one another. [2]
- (c) Explain why food retail chains are concerned with price fixing by the three confectionery giants mentioned in Extract 2. [3]
- (d) With reference to Extract 3 and 4, discuss the impacts of Mondelez and Hershey “joining forces”. [8]
- (e) Assess the options open to the government to manage the possible detrimental effects that could result if Mondelez successfully takes over Hershey. [10]

[Total: 30]

Question 2 Rebalancing to generate growth

Extract 5: China's economic growth misses target

China's economy grew 7.4 percent in 2014, at its slowest pace in 24 years as property prices cooled and companies and local governments struggled under heavy debt burdens, keeping pressure on Beijing to take aggressive steps to avoid a sharper downturn.

A further slowdown in China could hinder the chances of a revival in global growth in 2015, given the major role it plays, in particular for commodities and high-tech. China's property market - a major driver of demand across a range of industries - has proven stubbornly unresponsive to policy support, and lending data from the banking system shows enduring weakness. At the same time, there may be a looming fiscal crisis among debt-sodden local governments, which depend on land sales for most of their revenue. And more companies, especially small property developers, could flirt with default.

Policymakers also are concerned about the potential onset of a deflation aggravated by plummeting energy prices, industrial overcapacity and sluggish demand. Systemic deflation is an economically toxic cycle in which investors and consumers hold off on fresh spending on the assumption prices will drop further in the future. This is cited as a major reason why Beijing will need to put more money into the system.

Nevertheless, the International Monetary Fund's chief economist Olivier Blanchard said slower growth seen for 2015 reflects a welcome decision by the Chinese government to rebalance the economy away from a heavy reliance on investment and exports to a more consumption-based growth model.

Source: Kevin Yao and Pete Sweeney, *Reuters*, 20 Jan 2015

Extract 6: Why China's economy is slowing

Structurally, China's economy faces headwinds. In the long run, growth is a function of changes in labour, capital and productivity. When all three increase, as they did in China for many years, growth rates are superlative. But they are all slowing now. China's working-age population peaked in 2012. Investment also looks to have topped out. Finally, China's technological gap with rich countries is narrower than in the past, implying that productivity growth will be lower, too.

Another important development has been its credit binge. Total debt, including government, household and corporate, has climbed to about 250% of GDP, up 100 percentage points since 2008. This debt allowed China to power its economy through the global financial crisis but also saddled it with a heavy repayment burden. Most worrying, much of the credit flowed to property developers. China's inventory of unsold homes sits at a record high. The real-estate sector, which previously accounted for some 15% of economic growth, could face outright contraction. From this vantage point, the abruptness of China's current slowdown looks more cyclical than structural.

Whereas previous leaders propped up growth whenever it slowed, Xi Jinping, China's president since 2013, has instead spread the gospel of the "new normal", by which he means less emphasis on growth and faster structural reform. As a result, the central bank has been hesitant to ease monetary policy. Changes to fiscal rules have also made it harder for local governments to spend money.

Extract 7: Fears mount that UK's plan to rebalance the economy is failing

Britain's recovery remained on track in the third quarter but fresh figures revealed growth was heavily reliant on the consumer, leaving the government's much hoped-for rebalancing of the economy elusive. Companies have become increasingly concerned about the economic outlook and falling business investment once again leaves the economic upturn in the hands of the consumer.

Exports fell by 0.4%, while imports increased by 1.4%, worsening Britain's trade position. The UK's trade deficit with the rest of the world widened to £11.2bn in the third quarter from £8.9bn in the second. Business investment, which the government is banking on to drive a sustainable recovery, actually fell by 0.7% or £300m compared with the second quarter. On the other hand, household spending, increased by 0.8% over the third quarter, extending the run of growth to 13 consecutive quarters. Services sector output was revised up to 0.8% from an initial estimate of 0.7%, reinforcing the picture of a UK recovery reliant on the consumer.

A spokesman for the Treasury repeated its persistent line that growth in the third quarter was a sign the government's long-term economic plan is working, and that the UK economy was under threat from factors abroad. "The UK is not immune to weakness in the euro area and instability in global markets, so we face a critical moment for our economy. We need to carry on working through our economic plan that is securing a resilient economy and a better future."

Source: Angela Monaghan, *The Guardian*, 26 November 2014

Extract 8: Deflation in the Euro zone is all too close

The euro area is on the verge of tipping into its third recession in six years. The zone's overall inflation rate has slipped to 0.3% and may well go into outright decline next year. A region that makes up almost a fifth of world output is marching towards stagnation and deflation.

Some price falls are welcome. Tumbling oil prices, in particular, have given consumers' incomes a boost. But slowing prices and stagnant wages owe more to weak demand in the economy and roughly 45 million workers are jobless in the rich OECD countries. Worse, short-term interest rates are close to zero in many economies, so central banks cannot cut them to boost spending.

If Europe is to stop its economy getting worse, it will have to stop its self-destructive behaviour. France and Italy should be allowed to slow the pace of their fiscal cuts; in return, those countries should accelerate structural reforms. Reducing the fiscal deficits has been difficult to achieve because reductions in government spending and increases in taxes depress economic activity. Lower economic activity causes increased transfer payments and reduced tax revenue, offsetting the original fiscal contraction. A cheapening euro would be an important boost for eurozone countries such as Spain, Italy and France that have very large fiscal deficits. Although the lower euro would not change the relative prices among the eurozone countries, it would have a powerful effect because nearly half the trade of the eurozone countries is with countries outside the eurozone.

Table 2: GDP growth rates (Annual % change at constant prices in local currency)

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|-----------|------|------|------|------|------|
| China | 10.6 | 9.5 | 7.8 | 7.7 | 7.4 |
| UK | 1.5 | 2.0 | 1.2 | 2.2 | 2.9 |
| Euro Area | 2.1 | 1.6 | -0.9 | -0.3 | 0.9 |

Table 3: Inflation rates (Annual % change in consumer price index)

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|-----------|------|------|------|------|------|
| China | 3.3 | 5.4 | 2.6 | 2.6 | 2.0 |
| UK | 3.3 | 4.5 | 2.8 | 2.6 | 1.5 |
| Euro Area | 1.5 | 3.3 | 2.5 | 1.4 | 0.2 |

Source of Tables 2 & 3: *World Bank*

Table 4: Government Budget Balance (% of GDP)

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|-----------|------|------|------|------|------|
| China | -2.5 | -1.1 | -1.5 | -2.1 | -2.1 |
| UK | -9.7 | -7.7 | -8.3 | -5.6 | -5.6 |
| Euro Area | -6.2 | -4.2 | -3.7 | -3.0 | -2.6 |

Source: www.tradingeconomics.com

Questions

- (a) Which economy in Table 2 shows the least variation in its growth rate? [1]
- (b) (i) Besides the balance of trade in goods and services, state one other component of the current account on the balance of payments. [1]
- (ii) With reference to Extract 5, explain how a trading partner's current account on the balance of payments is affected by China's slowdown. [2]
- (c) How might UK's multiplier size change with the rebalance of the UK's economy? [4]
- (d) Comment on the usefulness of GDP growth rates in measuring UK's standard of living. [4]
- (e) Discuss whether policymakers should be concerned about the onset of deflation. [8]
- (f) Both UK and China are experiencing slow growth and have plans to rebalance their economies. In light of the data, assess the most appropriate policy approaches their governments can adopt to achieve high and sustained growth. [10]

[Total: 30]

- End of Paper -



MERIDIAN JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATION 2016

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H2 ECONOMICS

Section A: Case Study Question 1

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

15 September 2016

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At the end of the examination, fasten this cover sheet to your answer scripts for Case Study Question 1 with the string provided before submission.

| QUESTIONS ATTEMPTED | | MARKS |
|---------------------|------|-------|
| (a) | (i) | |
| | (ii) | |
| (b) | (i) | |
| | (ii) | |
| (c) | | |
| (d) | | |
| (e) | | |
| TOTAL | | /30 |



MERIDIAN JUNIOR COLLEGE
JC2 PRELIMINARY EXAMINATION 2016

9732/01

COVER SHEET

H2 ECONOMICS

Section A: Case Study Question 2

Name: _____

Civics Group: _____

Register Number: _____

Tutor: _____

15 September 2016

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| QUESTIONS ATTEMPTED | | MARKS |
|---------------------|------|-------|
| (a) | | |
| (b) | (i) | |
| | (ii) | |
| (c) | | |
| (d) | | |
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| TOTAL | | /30 |