



ST. ANDREW'S JUNIOR COLLEGE
PRELIMINARY EXAMINATIONS – 2017 (JC2)
General Certificate of Education Advanced Level
Higher 2

ECONOMICS

9757/01

Paper 1

28 August 2017

Additional Materials: Answer paper

2 hours 15 minutes

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

Answer **all** questions.

At the end of the examination, fasten your answers for each question separately.
The number of marks is given in brackets [] at the end of each question or part question.

This document consists of **8** printed pages.

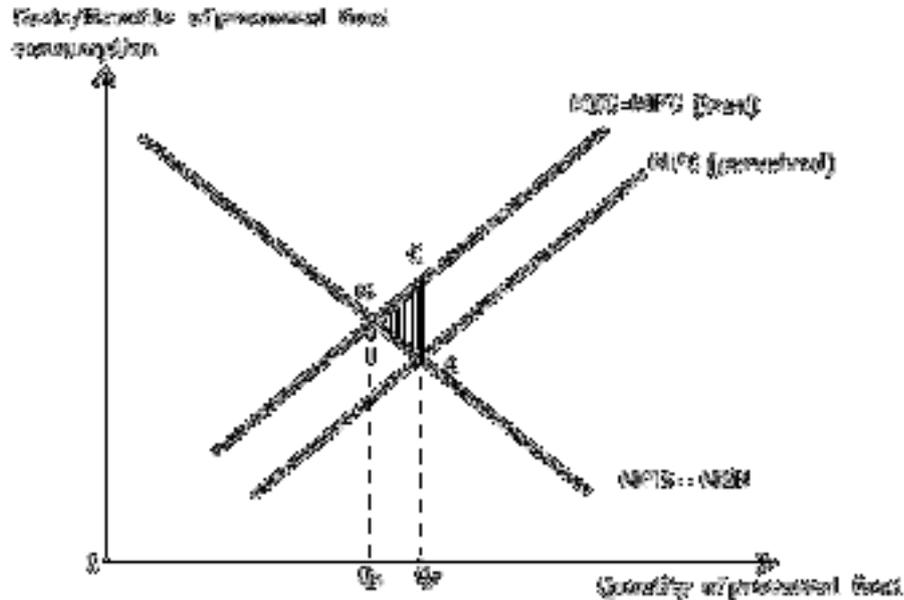
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[Turn Over]

Suggested Answer for CSQ 1

(a)	(i)	Using Figure 1, describe the type of market structure operating in the UK grocery sector in 2014.	[2]
		<p><u>Suggested Answer:</u></p> <p>The type of market structure is that of an oligopoly. [1]</p> <p>The 4 firm concentration ratio for the grocery sector is 73%- a case of an oligopoly. This means that the market is dominated by a few large firms, which are likely to be mutually-interdependent as well. [1]</p>	
	(ii)	Explain one possible reason why new entrants into the UK grocery sector such as Aldi and Lidl may not necessarily seek to maximise profits.	[2]
		<p><u>Suggested Answer:</u></p> <p>As a new entrant into the UK grocery sector, Aldi may not necessarily seek to maximise profits as they seek to increase their market share given the competitive nature of the UK grocery sector. [1]</p> <p>Thus Aldi and Lidl would be willing to make lower levels of profits in order to increase in size and gain more market share. [1]</p>	
(b)		Explain the case for “traffic light” labelling in the food industry.	[4]
		<p><u>Suggested Answer:</u></p> <p><u>From Extract 2</u></p> <p><i>“the information on the nutritional facts panel is usually devoid of any meaningful cognitive context for decision-making resulting in consumers who lack understanding of the nutritional information presented. Additionally, manufacturers may provide only “relative information” which while useful for deciding among competing brands of the same item, may not be sufficient for consumers in making their decisions.”</i></p> <p>The above quote suggests that there is asymmetric information/ imperfect information in the food industry. [1]</p>	

As mentioned in the quote, consumers do not know the true cost/ benefit from consumption of food item based on information provided. [1]
E.g. perceived private cost is less than true private cost from consuming processed food.



Consumers would consume at OQ_p where $MPB = MPC$ (perceived) while socially optimal equilibrium quantity should be at OQ_s where $MSB = MSC$. There is overconsumption in this instance as $OQ_p > OQ_s$. [1]

“Traffic light” labelling” therefore seeks to correct the information asymmetry between the consumers and producers. It seeks to provide the consumers a clearer understanding of what is in their food. [1]

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(c)	Explain whether the proposed surge pricing strategy mentioned in Extract 3 is a form of price discrimination.	[4]
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Suggested Answer:

Price discrimination is the practice of selling a given product at different prices to different consumers and these price differences are not caused by cost differences. [1]

Either
 For a successful practice of price discrimination, the good/service should not be easily re-sold and that the firm is able to effectively charge its consumers different prices based on some clearly stated criteria, depending on which degree of price discrimination it decides to undertake. [1]

Or

	<p>Surge pricing or “peak-time” pricing is when, assuming ceteris paribus, higher prices are charged at peak periods and this is done so, as demand tends to be relatively price inelastic during peak periods. [1]</p> <p>As such, this is a form of price discrimination (3rd degree) as it is the practice of charging different prices due to difference in price elasticity of demand (PED). [1]</p> <p>However, if the higher price charged during peak period is due to higher marginal cost incurred during this period, then it would not qualify as price discrimination. [1]</p>							
(d)	Discuss the extent to which the price war undertaken by the UK supermarkets is in the best interests of the UK consumers.	[8]						
	<p><u>Question Analysis:</u></p> <table border="1"> <tr> <td>Command Word</td> <td>Discuss</td> </tr> <tr> <td>Content</td> <td>price war best Interests of UK consumers</td> </tr> <tr> <td>Context</td> <td>UK supermarkets</td> </tr> </table> <p><u>Schematic Plan:</u></p> <div style="text-align: center;"> <pre> graph TD PW[Price War] --> Thesis[Thesis: Price war is largely in the best interests of UK consumers] PW --> AntiThesis[Anti-Thesis: Price war may not be in the best interests of UK consumers] </pre> </div> <p><u>Suggested Answer:</u></p> <p><u>Introduction</u></p> <p>A price war is characterized by the repeated cutting of prices below those of competitors as mentioned in Extract 4.</p>	Command Word	Discuss	Content	price war best Interests of UK consumers	Context	UK supermarkets	
Command Word	Discuss							
Content	price war best Interests of UK consumers							
Context	UK supermarkets							

In addressing this question, we will look at the impacts of the price war on UK consumers.

Thesis: The price war undertaken by the UK supermarkets is largely in the best interests of UK consumers

The lowering of prices amongst the UK supermarkets mentioned in Extract 4 would increase the affordability of groceries. This fall in prices will result in an increase in consumer surplus. Consumer surplus is the difference between what consumers are willing and able to pay for a good or service and the amount that they actually pay.

This is especially welcome news for UK consumers given that Extract 1 highlighted that they had been battered by years of austerity and stagnant wages.

As such, the price war undertaken by the UK supermarkets is in the best interest of UK consumers.

Anti-Thesis: The price war undertaken by the UK supermarkets may not be in the best interests of UK consumers

The price war could eventually lead to predatory pricing in which could result in competitors being driven out of the industry. Predatory pricing is considered to be anti-competitive and this may limit the choices that UK consumers have in the grocery industry and this would cause a fall in consumer welfare. Therefore it may not be in the best interests of UK consumers.

Additionally, as mentioned in Extract 4, there are concerns arising in terms of the long-term safety and sustainability of food due to the price war.

“Sustainable production methods can also be expected to give way to highly destructive, yet profitable monoculture farming.” (Extract 4)

Due to the price war, there would be pressure on food producers to take short cuts and reduce the cost of production and thus leading to producers moving away from sustainable production methods, switching towards monoculture farming, as well as the use of pesticides and fertilisers, which would cause harm to the environment.

This would not be in the best interests of UK consumers as UK consumers would eventually bear the brunt of the environmental damage.

“Tight margins will inevitably restrict food producers’ ability to deal with diseases and the effects of climate change, which UK supermarket Asda says could impact 95% of its fresh produce range.” (Extract 4)

The impact of the price war can impact UK consumers as Asda, one of the UK supermarket estimated that 95% of their fresh produce range could be impacted due to the climate change threat.

The price squeeze would have an effect all the way down the supply chain, with persistent pressure on prices at the farm level.

Due to the price war, farmers would be limited in their ability to invest in their agricultural base to improve the sustainability and safety of food.

This suggests that UK consumers could end up with lower quantity and/or quality of food as a result of the switch to non-sustainable way of production, raising questions about both the long term safety and sustainability of food.

“Yes their wallets might be lighter today, but their fridges could become a lot sparser and their health a lot worse as hyper-industrialised agriculture takes root.” **(Extract 4)**

The above suggests that due to the price war, the unhealthy practice of hyper-industrialised agriculture could lead to the UK consumers’ health to suffer as the safety of the food items that come out from this process is questionable. Thus, it would not be in the best interests of UK consumers.

Synthesis:

To conclude, while the price war may seem to be in the best interests of UK consumers, however, if one were to delve deeper and analyse the effects of the price war on the production of food, it would be apparent that the price war compromises on the sustainability and safety of the food product.

This is especially so, due to the mounting pressure to reduce the cost of production, given how competitive the UK grocery market is.

Levels	Knowledge, Understanding, Application, Analysis	Marks
L2	Answers provide a sound analysis of both positive and negative impacts of the price war undertaken on the interests of UK consumers.	4 – 6
L1	Answers provide a descriptive explanation that shows some basic but largely unexplained knowledge of the impacts of the price war on the interests of UK consumers.	1 - 3
E2	Well-reasoned overall assessment on the extent of the price war and its impacts on the interests of UK consumers.	2
E1	Some attempt at assessing the extent of the price war and its impacts on the interests of UK consumers.	1

(e)	<p>Amazon raised concerns that protectionist measures might hinder its ability to grow in Extract 5.</p> <p>Assess whether the decision to introduce protectionist measures by the US government can ever be justified in today's globalised world.</p>	[10]						
	<p><u>Question Analysis:</u></p> <table border="1" data-bbox="357 528 1311 669"> <tr> <td style="text-align: center;">Command Word</td> <td style="text-align: center;">Assess whether</td> </tr> <tr> <td style="text-align: center;">Content</td> <td style="text-align: center;">protectionist measures globalized world</td> </tr> <tr> <td style="text-align: center;">Context</td> <td style="text-align: center;">Today's globalised world</td> </tr> </table> <p><u>Schematic Plan:</u></p> <div style="text-align: center;">  </div> <p><u>Suggested Answer:</u></p> <p><u>Introduction</u></p> <p>Protectionism is the setting up of trade barriers with the intention of protecting domestic firms from foreign competition.</p> <p><u>Thesis: The decision to introduce protectionist measures can be justified in today's globalised world</u></p> <p>Governments may resort to protectionist measures to address problems the economy may be facing.</p> <p>In the context of US, some of these reasons are given in Extract 5, which include the following:</p> <p style="padding-left: 40px;">i. To correct a balance of trade deficit</p> <p><i>“The United States of America’s (USA) trade deficit has encouraged President Trump to take a hard stance towards trade with countries such as China, Mexico and Germany.” (Extract 5)</i></p> <p>A balance of trade deficits occur when a country's total expenditures exceeds its total earnings in its external trade.</p> <p>This is undesirable as it may lead to a depletion in foreign currency reserves of a country.</p>	Command Word	Assess whether	Content	protectionist measures globalized world	Context	Today's globalised world	
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Context	Today's globalised world							

	<p>Thus, in this context, the US government may try to reduce import expenditure to correct the balance of trade deficit by practicing protectionism.</p> <p>ii. To protect jobs</p> <p><i>“President Trump has vigorously championed protectionism as a way of saving US manufacturing jobs.....” (Extract 5)</i></p> <p>This is based on the notion that protectionism can result in higher employment in US.</p> <p>Protectionism can be done in terms of restricting the quantity of imports, or imposing a tariff on cheaper imports, thus imports will become more expensive than locally-made goods.</p> <p>This would induce domestic consumers to switch to locally-made goods, with the resultant increase in domestic demand for domestically produced goods generating demand for domestic factors of production, including labour. This will help to save jobs in the US.</p> <p><u>Anti-Thesis: The decision to introduce protectionist measures cannot be justified in today’s globalised world</u></p> <p>The argument for protectionist measure to correct a balance of trade deficit cannot be justified in today’s globalised world as it does not adequately address the root problem of the matter. It may be used as a measure in the short-run, however, in the long-run, it would be imperative to examine the cause of the balance of trade deficit.</p> <p>A more sustainable way of addressing the deficit would be to make locally-made goods more competitive in the international markets in order to boost export earnings. This can be done through supply-side policies where subsidies are given to encourage research and development to improve the quality of the exports.</p> <p>Globalisation is the process that leads to a deeper integration of the world’s economy into a single international market in terms of freer movement of goods and services, labour and capital across international borders.</p> <p>Supporters of globalisation argue that greater economic integration can bring about positive effects on the balance of trade as it can help bring about an improvement in the balance of trade through an increase in export revenue assuming ceteris paribus.</p> <p>Through embracing globalisation and free trade rather than protectionism, the market is expanded and this can help to bring about larger cost savings for firms in these countries as they increase their scale of production to meet the higher global demand.</p> <p>Additionally, in today’s globalised world, given how integrated US is with the global supply chains, it would be counterproductive to implement</p>	
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protectionist trade measures given how dependent US firms are on imports of intermediate goods produced abroad and vice versa.

“However, in an era of global supply chains, such a focus on bilateral trade deficits is meaningless.” (Extract 5)

The protectionist measures adopted could come back to hurt US firms as it would lead to increase in cost of production, thereby hurting its competitiveness in the international markets.

Additionally, the argument for protectionism to protect jobs cannot be justified in today’s globalised world as mentioned in Extract 5, *“One in five jobs in the US is linked to its imports and exports, so a tit-for-tat trade war with America’s main trading partners threatens to weaken the US job market rather than bolster it”.*

Given the nature of US’s job market distribution, if US were to adopt protectionist measures and the affected trade partner do likewise, it would lead to unemployment increasing instead.

Additionally, in previous instances where US adopted protectionism in 2002 to protect jobs in the US steel industry, jobs were however lost in the related industries that used steel due to the tariff that were imposed on imports of steel.

Instead of adopting protectionism in this instance, US should seek to consider the use of supply-side policies to improve the competitiveness of its exports and look to compete as protectionism may end up encouraging inefficiency. In the long term, protectionism may weaken the industry as with little competition, firms in the industry may have little incentive to be efficient and innovate.

Subsidies can be provided instead for firms to undertake research and development purposes or for workers to go for re-training and upgrading which can help to improve the competitiveness of the locally-made goods.

Synthesis & Conclusion

Final Stand + any economic judgment relevant to case materials

In considering whether the decision to introduce protectionist measure can be justified in today’s globalised world, we would need to consider the cost and benefits of doing so.

As discussed, even though there are justifications for protectionist measures by the US, these measures, if used, should be for a short period of time as the long term use of protectionist measures will lead to larger problems and thus not justifiable.

This is especially so, when we consider the context of today’s world. Given how integrated the world supply chains are today, the decision to introduce protectionist measures may backfire and hurt US instead of benefiting it as explained earlier.

		<p>Protectionism may not be justified as it does not solve the root of the problem and may result in retaliation from trading partners.</p> <p>Rather, US should consider more open and well-governed markets coupled with policies that enable more room for adjustments to enable them to better address the challenges faced.</p> <table border="1"> <thead> <tr> <th>Levels</th> <th>Knowledge, Understanding, Application, Analysis</th> <th>Marks</th> </tr> </thead> <tbody> <tr> <td>L2</td> <td>Answers provide a sound analysis of the costs and benefits of protectionism in the context of US.</td> <td>5 – 7</td> </tr> <tr> <td>L1</td> <td>Answers provide a descriptive explanation that shows some basic but largely unexplained knowledge the costs and benefits of protectionism in the context of US.</td> <td>1 - 4</td> </tr> <tr> <td>E2</td> <td>Well-reasoned overall assessment about whether protectionist measures can be justified for US.</td> <td>2-3</td> </tr> <tr> <td>E1</td> <td>Some attempt at assessing about whether protectionist measures can be justified for US.</td> <td>1</td> </tr> </tbody> </table>	Levels	Knowledge, Understanding, Application, Analysis	Marks	L2	Answers provide a sound analysis of the costs and benefits of protectionism in the context of US.	5 – 7	L1	Answers provide a descriptive explanation that shows some basic but largely unexplained knowledge the costs and benefits of protectionism in the context of US.	1 - 4	E2	Well-reasoned overall assessment about whether protectionist measures can be justified for US.	2-3	E1	Some attempt at assessing about whether protectionist measures can be justified for US.	1	
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[Total: 30 marks]

Suggested Answer for CSQ 2

(a) (i)	Compare the trend in the balance of trade between UK and EU between 2012 and 2015 with that of UK and non-EU over the same period.	[2]
	<p><u>Suggested Answer:</u></p> <p>There was an increasing trade surplus between UK and non-EU [1] while an increasing trade deficit between UK and EU over the period of 2012 to 2015. [1]</p>	
(ii)	Using economic analysis, explain one possible reason for the trend observed in balance of trade between UK and EU between 2012 and 2015.	[2]
	<p><u>Suggested Answer:</u></p> <p><u>Any demand or supply factors is acceptable:</u></p> <p>As observed in (a)(i), balance of trade between UK and EU has seen an increasing trade deficit.</p> <p>One possible reason could be UK's export revenue to EU has fallen, assuming import expenditure remains constant. [1]</p> <p>A <i>persistent fall</i> in the demand for UK's exports to EU could be due to a change in tastes and preferences towards UK's goods, contributing to an increasing fall in UK's export revenue between 2012 and 2015, assuming ceteris paribus, this would lead to a rising trade deficit between UK and EU. [1]</p> <p><i>Or candidates can explain via UK's demand for EU's imports has risen between 2012 and 2015.</i></p>	
(b)	Explain how a change in UK's trade balance could affect UK's budget balance.	[4]

	<p><u>Suggested Answer:</u></p> <p>As stated in Extract 6, UK has been facing a budget deficit from 2010 and current account deficit has widened.</p> <p>A rising trade deficit meant that there was a fall in net exports ($X - M$) which would continue to fall which would lead to a fall in AD, ceteris paribus, resulting in negative economic growth. [1]</p> <p>This had also affected UK's budget balance, which was having a budget deficit. This implied that UK's government expenditure was greater than tax revenue. [1]</p> <p><u>Either ONE of the Answer Below: [1]</u></p> <ul style="list-style-type: none"> • UK's government tax revenue from personal and corporate income tax could decrease due to negative economic growth from a fall in net export and thus leading to a fall in wages and profits respectively. • UK's government may also be required to distribute greater unemployment benefits as more people could be unemployed due to a fall in exports, hence increasing welfare spending. <p>Thus, a change in UK's trade balance, in this case trade deficit, could also affect UK's budget balance negatively, resulting in large budget deficit. [1]</p>	
(c)	<p>Use the concept of opportunity cost to explain one effect on each of firms and government arising from the inflow of migrants in UK.</p>	[4]
	<p><u>Suggested Answer:</u></p> <p>Opportunity cost means the next best alternative foregone when a choice / decision is made by the different economic agents.</p> <p><u>Effect on Firms:</u></p> <p>With a rising inflow of migrants in UK, firms may employ cheaper migrants to produce goods and services which would allow the firms to drive down their cost of production, thus leading to higher profits, assuming ceteris paribus. This can be seen from Extract 7, as many migrants tend to depress wages in low wages sectors.</p> <p>Thus, the opportunity cost of hiring migrant workers could be better quality goods and services being compromised as they could have been produced by hiring better skilled domestic workers. This could also lead to forgone profits that could have been generated from better quality products.</p>	

	<p><u>Effect on Government:</u> With a rising inflow of migrants in EU, there would be an increase in government spending to provide services such as healthcare and housing benefits to the migrants' workers. This can be seen from Extract 7 as these migrants were entitled to a range of benefits such as housing, healthcare and financial assistance.</p> <p>Thus, the opportunity cost of funds directed towards migrants to provide such benefits would be the forgone benefits such as higher productivity could have been achieved if the funds had been spent on training instead.</p> <p>Note: any relevant opportunity cost example with sound economic analysis is accepted. However, the choice being made and the next best alternative that firms and governments need to forego has to be clearly explained.</p>							
(d)	<p>To what extent can theory of comparative advantage be used to explain UK's pattern of trade?</p>	[8]						
	<p><u>Question Analysis:</u></p> <table border="1" data-bbox="432 943 1267 1048"> <tr> <td>Command Word</td> <td>To what extent</td> </tr> <tr> <td>Content</td> <td>Theory of CA/ pattern of trade</td> </tr> <tr> <td>Context</td> <td>UK</td> </tr> </table> <p><u>Schematic Plan:</u> Introduction: Define pattern of trade Thesis: Theory of CA can be used to explain UK's pattern of trade Anti-thesis: Other demand factors can be used to explain UK's pattern of trade instead Evaluation: Justified stand on the extent of whether theory of CA can be used to explain UK's pattern of trade.</p>	Command Word	To what extent	Content	Theory of CA/ pattern of trade	Context	UK	
Command Word	To what extent							
Content	Theory of CA/ pattern of trade							
Context	UK							

Suggested Answer:

Introduction:

- Pattern of trade refers to the volume and composition of trade between a country and the rest of the world.
- Determinants of pattern of trade are based on both demand and supply factors.
- Supply factors such as the differences in factor endowment, government policies, FTAs
- Demand factors such as tastes and preferences, rising affluence and changes in population sizes and demographics.

Body 1: Theory of Comparative Advantage (CA) can be used to explain UK's Pattern of Trade

Differences in Factor endowment – Theory of Comparative Advantage

- Theory of comparative advantage states that, under certain conditions, countries can benefit from specialisation of producing goods and services which they have comparative advantage in and trade for goods and services in which they do not have comparative advantage in.
- It is an important factor in determining the relative productivity of an economy in production of certain goods and services based on their factor endowments, which thus affect a country's CA.
- This means that countries with relatively lower opportunity cost of producing certain goods and services compared to other countries should specialise in the production of those goods and services they are more efficient in
- Countries should then import goods and services that they do not have comparative advantage in as opportunity cost of producing these goods within that country is higher.
 - ➔ E.g. UK could have a lower opportunity cost in the production of more capital and skilled intensive products.
 - ➔ As stated in **Extract 7**, UK experienced 'brain drain' due to thousands of talented workers leaving the country.
 - ➔ With relatively abundant amounts of such capital / technology / skilled labours. UK could export capital / knowledge-intensive goods such as motor vehicles and pharmaceutical products as shown in **Table 1**.
 - ➔ UK could also have a higher opportunity costs in the production of more labour-intensive products. UK should thus import more labour intensive and lower value-added electronic equipment and mechanical products.
 - ➔ Also in **Table 1**, UK has imported precious metals and mineral fuels which could imply that they lack such natural resources.

All the above showed that due to theory of CA, it has affected UK's pattern of trade
→ i.e. in term of the volume and composition of goods and services they export and import.

Body 2: DD Factors could also be used to explain UK's Pattern of Trade

Differences in Affluence (particularly in emerging economies)

- ❖ Emerging economies such as China has experienced relatively stronger rates of economic growth. This can be seen from **Extract 8, para 2** which stated that there is remarkable growth of emerging markets.
 - ➔ This could lead to higher demand for goods and services produced overseas e.g. tourism-related services ➔ resulted in greater export of such goods and services from UK to these emerging economies.
 - ➔ This can be seen from **Table 1**, which showed that China is one of UK's top export partners.

Differences in Tastes and Preferences

As seen in **Table 1**, although UK exports motor vehicles, mechanical appliances and pharmaceutical products, they also import them. This could be due to UK citizens' preference for foreign products in these categories, seeking greater choice and wider variety.

Other possible reasons could be due to globalisation which leads to greater FDI flows and outsourcing such that lower value-added products / processes are made in lower cost developing countries and then exported back to UK. These exports could be further processed into higher value-added products and exported from UK to trade partners such as Germany and France.

For example, electronic equipment parts can be made in other countries but the final processes could be assembled in UK and then exported from UK to its trade partners.

Evaluative Conclusion:

From the data given, theory of comparative advantage can only be used to explain UK's pattern of trade to a small extent. As seen from **Table 1**, most of the UK's top export and imports products are largely similar. Thus, other factors such as tastes and preferences, coupled with increasing globalisation could have been a more plausible explanation that affect UK's pattern of trade more accurately.

Knowledge, Application, Understanding and Analysis		
L2	<ul style="list-style-type: none"> • Both theory of comparative advantage (CA) and other factors are well-explained, linking it to the pattern of trade in UK. • Case materials / examples are well-utilised. • Both theory of CA and other factors explained but no linking to UK's pattern of trade – Max 4m 	4 – 6
L1	<ul style="list-style-type: none"> • Either theory of CA or other factors identified and explained. • Both factors explained but not well-developed. • Case materials / examples given or stated but are not well-explained. 	1 – 3
Evaluation		
E2	A substantiated judgment given to justify whether theory of CA can be used to explain UK's pattern of trade to a larger or smaller extent.	2
E1	A judgment without substantiation.	1

(e)	Discuss whether the potential problems faced by UK are likely to be more serious than problems faced by EU members' countries if Brexit were to take place.	[10]						
	<p><u>Question Analysis:</u></p> <table border="1"> <tr> <td>Command word</td> <td>Discuss</td> </tr> <tr> <td>Content</td> <td>Impact on the macroeconomic aims Brexit</td> </tr> <tr> <td>Context</td> <td>UK and EU member countries</td> </tr> </table> <p><u>Schematic Plan:</u></p> <p style="text-align: center;"><u>Introduction:</u></p> <p>Explain what is Brexit and brief description of the potential problems faced by UK and EU members' countries (A good approach is to look at the benefits enjoyed by UK as part of the EU. With Brexit, such benefits (eg preferential treatment) would be removed and hence the negative effects)</p> <p><u>Thesis: Potential Problems faced by UK are likely to be more serious than problems faced by EU members' countries if Brexit were to take place</u> Explain the potential problems faced by UK in term of the negative impact on the macroeconomic aims</p> <p><u>Anti-thesis: Potential Problems faced by EU members' countries are likely to be more serious than problems faced by UK if Brexit were to take place</u> Explain the potential problems faced by EU members' countries in term of the negative impact on the macroeconomic aims.</p> <p style="text-align: center;"><u>Evaluation:</u></p> <p>Conclude stand on whether UK or EU members' countries are likely to face a more serious problem</p>	Command word	Discuss	Content	Impact on the macroeconomic aims Brexit	Context	UK and EU member countries	
Command word	Discuss							
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Suggested Answer:

Introduction:

Brexit refers to Britain leaving the European Union (EU).

The potential problems facing UK and EU member countries are likely to have negative impact on their macroeconomic aims.

Body:

Potential Problems faced by UK

As stated in **Extract 8, para 3**, UK could lose preferential trade access to EU.

- If trade barriers are imposed on UK's exports to EU, it could lead to a fall in export revenue and assuming ceteris paribus, worsen net exports →
↓ AD → ↓ real national income → leading to negative economic growth. This is especially detrimental to UK's economy given the strong trade ties between UK and EU.
- At the same time, a fall in export revenue would worsen current account position → ceteris paribus → leading to worsening of balance of trade → eventually affecting its balance of payments account.
- Loss of preferential trade access to EU may also reduce UK's attractiveness as an investment destination as stated in both **Extract 6** and **8** → Fall in foreign direct investment (FDI) would impact both actual and potential economic growth negatively since investment expenditure is a component of AD and a fall in FDI would also mean a fall in productive capacity or a smaller increase in productive capacity, leading to a fall in long run aggregate supply or a smaller increase in long run aggregate supply.
- Plummeting stock markets might lead to an outflow of portfolio investment → worsening its capital and financial account (KFA) position → thus BOP, ceteris paribus.
- Weakening pound might lead to imported price inflation. This is because weakening pound would cause imported goods and services to be relatively more expensive in domestic currency. Price of imports increases for both consumer and factors of production. The latter will lead to an increase in COP, leading to cost-push inflation. This would reduce UK's price stability.
- Restriction in labour flow might lead to higher cost of production (COP) in UK → short run aggregate supply curve would shift to the left → this would further increase UK's general price level → leading to inflation. At the same time, result in a fall in real national income → worsen UK's economic growth and increase unemployment.

Potential Problems faced by EU Members' Countries

As stated in **Extract 8, para 4**, UK is the second largest economy in the EU.

- ➔ If UK leaves EU, EU members might suffer from a fall in export revenue due to the *'possible rise in trade barriers'* by the UK on EU's goods and services. Data from **Table 1** also shows that EU members are enjoying trade surplus with UK and this might be reversed if UK were to exit from the EU.
- ➔ Fall in net exports could similarly lead to negative economic growth or recession and higher unemployment in EU due to a fall in AD. The extent of the negative impact could be more strongly felt in EU members' countries with stronger trade links with the UK, such as Germany and France as shown in **Table 1**.
- ➔ Uncertainty and diminished image of EU as stated in **Extract 8** could lead to a fall in FDI due to bleak economic outlook of the investors. This might further worsen recession and BOP [*as explained above*]
- ➔ Restriction in labour into UK from the EU might worsen unemployment in EU especially in Eastern European economies shown in **Extract 8**.

Thesis: Potential Problems faced by UK are likely to be more serious than problems faced by EU members' countries if Brexit were to take place:

As stated in **Extract 8, para 4**, more than 50% of Britain's trade flows with EU and in **Extract 8, para 2**, it also showed their deep integration in terms of economy, military and culture between UK and EU → thus, leaving EU might lead to potential shrinking of market for UK.

As such, UK might not be able to exploit economies of scale significantly, leading to higher COP and could lead to a loss of export competitiveness.

On the other hand, EU members' countries belong to a single market and are able to trade freely among themselves, thus they might choose to import similar goods and services from within the EU rather than import from the UK.

Given UK's reliance on FDI especially to cover their current account deficit, it might be a more serious problem for the UK as loss of access to EU might lead to a fall in FDI in UK → instead there might be an increase of FDI in some EU members' countries such as Germany to gain access to EU markets.

Further, as stated in **Extract 6, para 2**, it stated that if there were to be Brexit, investors might diminish markedly as Britain would be a less attractive destination for FDI if the UK has lost their preferential trade access to the EU.

Not only FDI in UK would be negatively affected, 'European investors also hold most of Britain's short-term liabilities' → all these would worsen UK's KFA position.

Anti-thesis: Potential Problems faced by EU members' countries are likely to be more serious than problems faced by UK if Brexit were to take place

Weakening pound might lead to a fall in EU net exports to UK assuming PED of exports and imports are greater than one while it may lead to rise in UK net exports to EU, thus benefiting UK.

EU proposed regulation such as tax on financial services as stated in **Extract 8, para 2** might make UK financial services more attractive and lead to a fall in export competitiveness of EU financial services as compared to UK financial services.

By 'striking better deals' with emerging markets such as China and US, UK goods and services could be more export competitive than EU goods and services in these markets, thus worsening EU's net exports, ceteris paribus.

Redirection of Eastern European migrants from UK into EU member countries such as Germany as stated in **Extract 8, para 4** might depress wages and lead to structural unemployment in these countries.

Evaluation:

In the short-term, both UK and EU members' countries are likely to face potential problems due to possible Brexit. However, the potential problems seem to be more serious for UK as it might see an immediate greater fall in FDI and net exports as compared to EU members' countries.

In the longer-term, problems faced by EU might be more serious as UK competes with EU for trade deals and might be able to negotiate better deals as compared to EU. EU regulations might harm key sectors such as financial services. Diminished EU image might eventually lead to a fall in FDI, worsening economic growth as well as BOP. Greater burden on EU budget due to a fall in contribution as well as increase in spending on benefits as EU migrants flow out of UK into EU might reduce its ability to manage Eurozone problems as well as policies to enhance competitiveness of EU.

Knowledge, Application, Understanding and Analysis		
L2	<ul style="list-style-type: none"> • Potential problems faced by BOTH UK and EU members' countries if Brexit were to take place are well-elaborated with economic framework and analysis. • Well-developed answers addressing the seriousness of the problems faced by BOTH UK and EU members' countries – without this explanation, max 5m. • Analysis supported with strong evidence from the case materials. 	5 – 7
L1	<ul style="list-style-type: none"> • Potential problems of UK and EU are stated and explained. • Case materials / examples may or may not be given. 	1 – 4
Evaluation		
E2	A substantiated judgment which considers whether UK or EU members' countries would face a greater problem if Brexit were to take place.	2 – 3
E1	A judgment without substantiation.	1

[Total: 30 marks]

~ End of paper ~