H

ST ANDREW'S JUNIOR COLLEGE
PRELIMINARY EXAMINATIONS – 2013
General Certificate of Education Advanced Level
Higher 1

ECONOMICS **8819/01**

Paper 1 **29 August 2013**

3 hours

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your name and class on all the work you hand in.
Write in dark blue or black pen on both sides of the paper.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **all** questions.

Section B
Answer **one** question.

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

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

[Turn Over

Section A

Answer **all** questions in this section.

Question 1 Chocolate and Soda – Love them, Hate them

Extract 1: Higher Chocolate Prices May Follow Africa's Cocoa Shortfall

Villagers in West Africa, which produces 70 percent of the world's cocoa, are abandoning the crop because its price is volatile, farms are too small to be economical, yields haven't risen for decades, and alternative crops such as rubber are more lucrative. "They produce half a ton per hectare of cocoa, and it has been that way forever. All major agricultural products have improved their yields by a factor of 5 to 10 in the last 50 years, and cocoa hasn't," says Barry Parkin, the head of global procurement and sustainability at Mars, whose products include M&M's, the best-selling chocolate candy in the U.S. He reckons that demand will outpace production by 1 million tons by the end of the decade.

To deal with more frequent cocoa shortages, confectioners have been shrinking the size of chocolate bars, adding more air bubbles to chocolate, or simply substituting more vegetable oil for cocoa butter. They also can pull from global stockpiles, which stood at 1.8 million metric tons as of Sept. 30, according to the International Cocoa Organization. But experts say it will be tougher to cope beyond 2020 without improved production.

Source: Bloomberg Business Week, 7 February, 2013

Extract 2: **Tax chocolate to beat obesity, say doctors**

Chocoholics face a fight with doctors who want to slam heavy taxes on their favourite treat. Doctors say too much chocolate makes them fat and it should be priced up – like alcohol and tobacco – so they buy less.

Nutritionist Dr David Walker yesterday claimed chocolate is a big factor in the obesity epidemic and the explosion of conditions such as Type 2 diabetes. "I see chocolate as a major player in this and the related medical conditions and I think a tax on products containing chocolate could make a real difference."

But the sweet-toothed masses and industry chiefs branded the idea unfair and stupid. Julian Hunt, of the Food and Drink Federation, declared: "Taxes on foods that consumers love would result only in lighter wallets, not smaller waists. We already have to pay VAT on all our chocolates. While good for grabbing headlines, there is no evidence to suggest such 'fat taxes' would work in reality. Such a tax won't make people lose weight, it will just make them spend more money."

"Education and information are needed to help make the right food choices and people should be encouraged to increase physical activity."

Source: Mirror News, Mar 13, 2009

Extract 3: Chocolate bars to be made smaller in Government anti-obesity drive

The Government is set to order manufacturers to shrink the size of chocolate bars and fizzy drinks. The Health Secretary will tell firms such as Mars, Coca-Cola and Nestlé that smaller versions of their products should be available in all garages and corner shops to help stop people piling on weight. He will also say small packs of dried fruit, nuts and fresh fruit should be widely available at places where people buy on impulse and warn that sugar levels must be cut in all products.

The obesity drive is part of the Change4 Life campaign and could lead to tougher regulation if the warnings go unheeded. The Government believes businesses can create a new world leading 'healthy market' to help drive down obesity.

Source: The Daily Mail, 5 February 2009

Extract 4: Chocolate price hikes won't put off consumers, predict analysts

Confectioners will probably get away with increasing prices on chocolate bars without significantly denting demand because they are generally low ticket items bought as treats in an area with high brand loyalty, analysts have predicted.

Everybody is raising prices in this industry right now; the million dollar question is to what extent retailers will absorb rises or pass them on to the consumer. The consumer will ultimately decide whether he will pay. But while 10 percent is a pretty hefty and aggressive increase, they will probably get away with it.

Source: http://www.foodnavigator-usa.com, 4 Apr 2011

Extract 5: The Battle Over Taxing Soda

This soda debate is probably going to be around for some time. Cities and counties, desperate to find money to pay for schools and roads, are starting to see a soda tax as a way to raise revenue. The tax also appears to be one of the most promising ways to attack obesity, given the huge role sugary drinks play in the epidemic.

The argument for a soda tax is the same as the argument for a tax on tobacco or pollution. When an activity imposes costs on society, economists have long said that the activity should be taxed. Doing so accomplishes two goals: it discourages the activity, and it raises money to help pay society’s costs.

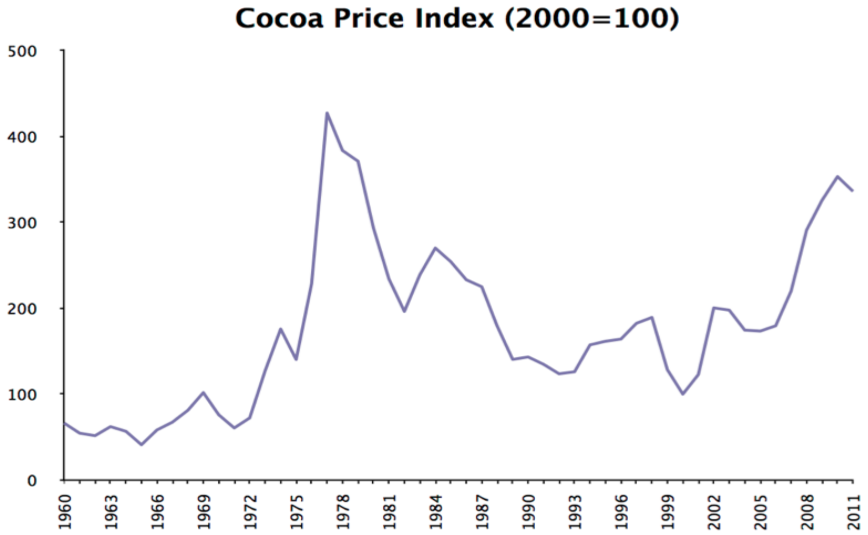
In the case of soda, those costs come in the form of medical bills for diabetes, heart disease and other side effects of obesity. We’re all paying these bills, via Medicare, Medicaid and private insurance premiums. Obesity has become a significant cause of our swelling long-term budget deficit.

However, small tax changes don’t always change behavior, as a recent study by the RAND Corporation found. So a small soda tax could actually have a worse impact on some families’ budgets than a substantial one — by raising the price of soda without affecting consumption.

Such a tax would certainly raise the cost of living for some heavy soda drinkers, just as cigarette taxes have stretched the budgets of some smokers and mandatory seat belts have added costs to car production. But consider the benefits from those other public health initiatives. They have vastly outweighed the costs.

Source: The New York Times, 19 May 2010

Figure 1: Cocoa Prices (1960 – 2011)



Source: UNCTAD

Questions

(a) **(i)** Describe the trend in the price of cocoa from 1990 onwards. [2]

(ii) Explain how the above trend can affect the market for chocolate candy bars. [2]

(b) Explain the impact of the following on the market for cocoa:

(i) a more lucrative rubber production; [1]

(ii) the greater availability of "small packs of dried fruit, nuts and fresh fruit". [3]

(c) Is the information in Extract 1 sufficient to suggest that West African countries have a comparative advantage in the production of cocoa? Explain your answer. [4]

(d) **(i)** Do you agree that government should intervene in the market for chocolate and soda? Justify your answer. [6]

(ii) With reference to relevant case material, discuss the factors that the government needs to take into consideration when intervening in the market for goods like chocolate and soda. [12]

[Total: 30]

Question 2 Eurozone Crisis – Within and Beyond

Table 1: Budget Position as a percentage of GDP

	2010	2011	2012
India	-7.3	-7.8	-8.4
Spain	-9.7	-9.4	-10.6
Germany	-4.2	-0.8	0.2
Greece	-10.8	-9.6	-6.9
UK	-10.0	-7.9	-6.5
Singapore	7.7	9.5	2.0
China	-0.7	0.1	-2.0

Adapted from OECD Economic Outlook No. 92 as of December 2012

Table 2: GDP figures (US$ billions)

	2010	2011	2012
India	1,710	1,842	1,872
Spain	1,380	1,476	1,349
Germany	3,284	3,600	3,400
Greece	292	289	245
UK	2,256	2,444	2,435
Singapore	217	245	254
China	5,930	7,321	8,227

Source: data.worldbank.org

Table 3: Human Development Index

	2010	2011	2012
India	0.547	0.551	0.554
Spain	0.884	0.885	0.885
Germany	0.916	0.919	0.920
Greece	0.866	0.862	0.860
UK	0.874	0.875	0.875
Singapore	0.892	0.894	0.895
China	0.689	0.695	0.699

Source: hdr.undp.org

Extract 6: Eurozone's Second Crisis: Inflation At Six Month High

As if the recession is not bad enough, the Eurozone is hit with another crisis.

According to Eurostat, prices in the Eurozone were 2.7 per cent higher in September 2012 compared with the year before, and up from the previous month's 2.6 per cent rate. Eurostat did not provide any reasons for the increase as the figure was only a preliminary estimate, although higher energy costs are likely to blame. Economists believe that a sales tax in Spain could have also contributed to the increase.

The increase will likely prove to be another headache for European Central Bank (ECB) rate setters in the run up to their next policy meeting. The ECB has had to contend with a faltering eurozone economy and turbulent financial markets in trying to stick to its mandate of keeping inflation just below two per cent.

Six Eurozone economies[1] are in recession and more are expected to follow in coming months. The Eurozone economy has struggled recently as the region's debt crisis has knocked investor and consumer confidence and caused governments to introduce tough austerity measures.

[1] France, Italy, Spain, Finland, Portugal, Cyprus

Many believe that quantitative easing measures would help the Eurozone economy pick up. Usually, central banks try to raise the amount of lending and activity in the economy indirectly, by cutting interest rates. But when interest rates can go no lower, a central bank's only option is to pump money into the economy directly. The central bank does this is by buying assets - usually government bonds. The institutions selling those bonds will then have "new" money in their accounts, which then boosts the money supply.

A number of economists forecast another interest rate cut this year from the current record low of 0.75 per cent. “We continue to see the ECB leaving policy rates unchanged at next week’s meeting – a view that is (at the margin) reinforced by this latest increase in inflation,” said James Ashley, an economist at RBC Capital Markets.

Adapted from European Business News Portal, 2012

Extract 7: Living beyond our means

The UK and US’s governments face a conundrum. To achieve economic recovery, aggregate demand needs to expand. But the government is introducing tough austerity measures to reduce the size of the public-sector deficit and debt; exports are being held back by the slow recovery, or even return to recession, in the Eurozone and the USA; and investment is being dampened by business pessimism. For recovery, High Street spending needs to rise.

But herein lies the dilemma. For consumer spending to rise, people need to save less and/or borrow more. But UK and US saving rates are already much lower than in many other countries. Also, household debt is much higher in the UK and USA. This has been largely the result of the ready availability of credit through credit cards and other means. The government is keen to encourage people to save more and to reduce their reliance on debt – in other words, to start paying off their credit-card and other debt. But this will hardly help recovery.

Adapted from John Sloman, Economics

Extract 8: Going beyond the Eurozone

The outcome has been as expected: Two years into the crisis, at the mid-year mark in 2012, Europe is indeed in deep denial and recession, and uncertainty looms large in both its policy spheres and decision-making ability.

In Asia, especially China has been impacted only modestly by the slowdown, and is now positioned to begin a consolidated phase of growth leadership in Asia. Singapore, Hong Kong and Taiwan – the region’s most open or export-dependent economies – are likely to take the biggest economic hit and India's foreign trade account is hovering around a negative $10 billion per month. Foreign indirect investment flows do appear to have come down near term, due to the widely predicted monetary tightening performance during this period has been mixed.

Adapted from The Wall Street Journal, 2012

Extract 9: How can the world move forward?

The European Central Bank is banking on the lowering of interest rates and introduces a programme of quantitative easing.

This plan may help some states but will, of course, be terrible for Germany. Unlike the rest, Germany’s economy has resurged thanks to its incredible competitiveness – Germany now runs a bigger external surplus than China. The loose monetary policy would save Italy, but the bulk of the inflation would be in Germany, where there is no spare capacity. German exports would decline and the businesses that produce them would lose out and have to sack workers.

But for Europe overall, that is ideal. Indebted countries like Greece, Italy and Spain and even the UK, need to export their way back to prosperity. For this to happen, Germany needs to start importing. The easiest way to achieve that is to make German goods more expensive – exactly what a big dose of inflation would do.

The Asian countries have their own battle at home to fight with in light of the rampant food and energy shortages. Central banks of these market countries need to determine how fast they will tighten monetary policy. In Asia, authorities have lifted interest rates to slow double-digit inflation, reduce credit growth and narrow the trade deficit. On top of that, this crisis has amplified the need for Asia countries to look beyond reliance on the Western markets for trade.

Adapted from Telegraph.co.uk, 2012

Questions

(a) **(i)** Compare the budget position as a percentage of GDP of India with that of Greece from 2010 to 2012. [2]

(ii) With reference to Table 2, how might the observation in **(a) (i)** explain the changes in national income in India and Greece? [3]

(b) Using AD-AS analysis, explain how the Eurozone can suffer from a recession and yet still face inflation as seen in Extract 6. [3]

(c) With reference to Extract 7, explain the possible factors that may hinder economic recovery in the UK and the US. [4]

(d) Discuss how the living standards in Asian economies could be affected by the Eurozone Crisis. [8]

(e) Assess the appropriateness of the policy options adopted by the European Central Bank and the Asian economies in solving the macroeconomic problems they are facing. [10]

[Total: 30]

Section B

Answer **one** question from this section.

3 The use of e-cigarettes, a battery-powered device that provides inhaled doses of nicotine vapour and flavorings, has been growing rapidly. This comes at a time where the Australian government announced a 60 per cent increase in tobacco taxes over the next four years, dealing another blow to cigarette manufacturers.

Adapted from *Yahoo News*, 1 August 2013

(a) Explain how the increasing use of e-cigarettes and a rise in tobacco tax affect the market for cigarettes. [10]

(b) Assess the degree to which the above measures are able to improve welfare of a society. [15]

4 **(a)** Explain the possible causes of unemployment in an economy. [10]

(b) Comment on the view that globalisation has increased employment opportunities in developing countries more than in developed countries. [15]

~ End ~