

CSQ1 answers

(a)(i) With reference to Table 1, distinguish the trends in beer consumption in the United States of America with that of China from 2008 to 2012. [2]

- The beer consumption in China is generally increasing while the beer consumption in US is generally decreasing.
- The beer consumption in China is always higher than the beer consumption in US.
- The extent of increase of beer consumption in china is greater than the extent of the decrease of beer consumption in US.
- There is a reversal of consumption trend in China and US from year 2011 to year 2012.

(a)(ii) Account for the trends observed. [4]

General trend:

Increase in demand due to increase in income for China. (Assuming beer is a normal good.)

Increase in demand due to change in taste and preference towards beer.

Americans are more health conscious versus China where there is no guideline on responsible drinking. Ill- informed therefore more harm to them.

Americans are switching their consumption towards wine or other substitutes.

Refinement: Chinese population is higher than US.

(b)(i) Explain the term 'market failure'. [2]

Market failure is when the price mechanism has failed to allocate resources efficiently [1m] in a free market where MSB is not equal to MSC [1m]. The good is either over-consumed or over-produced/ the right goods are not produced in the right amount [1m].

Either 2 points is sufficient.

(b)(ii) With the aid of a diagram, explain how market failure could arise from consumption of beer. [4]

The consumption of beer generates negative externality like drink driving. Assuming there is no external benefit, the $MSB=MPB$. When left to free market, the consumers will consume beer up to the quantity Q_e . [1m] Due to the negative externality like drink- driving [1m] causing accidents to third party is present; there will be a divergence between the MSC and MPC . The social optimal level of consumption, where $MSB=MSC$ is at output Q_s . [1m] Under this circumstance, there is an over-consumption of beer as a result of the negative externality. The over-consumption [1m] leads to a deadweight loss of the shaded area in figure below.

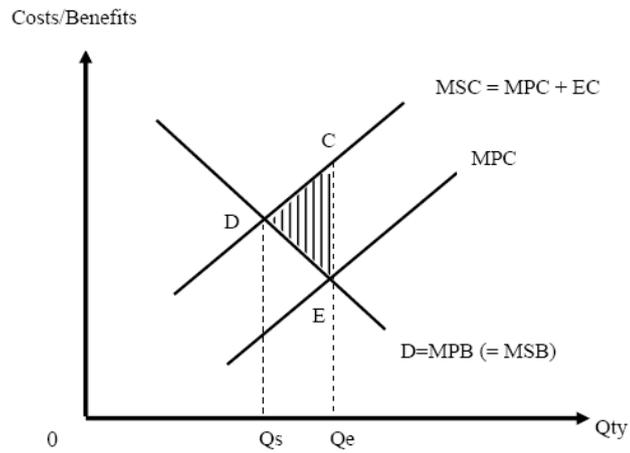


Figure 5: Negative Externalities in Consumption Causing a Divergence between MPC and MSC

Or imperfect information. Perceived cost is smaller than the true cost of consuming beer to individuals.

No reference to extract, max of 3m can be awarded.

- (c) With reference to the data, discuss the effectiveness of taxation in discouraging beer consumption. [8]

How taxation works to discourage beer consumption

Taxation on sale of beer will increase cost of production and result in a lower profit per unit. Supply of beer will decrease and the supply shifts to the left, increasing the equilibrium price of beer. Hence quantity of beer consumed falls towards the socially optimal level. (Diagram) The data given in table 1 shows that the taxes have worked to reduce beer consumption in the UK since 2004.

Limitations (Evaluation)

However, Figure 1 shows that before 2004, a less than 20% rise in beer duty did not affect beer consumption. From 2004 to 2010, when beer duty has increased by 60% compared to 1997, beer consumption fell by 25%. This indicates that the quantity demanded for beer is not very responsive to a price change. One possible reason could be that alcohol is addictive in nature as seen from binge-drinking habits of the Britons (Extract 2) and so the demand for beer tends to be price inelastic. Hence a sharp increase in taxes is required to reduce beer consumption significantly.

Conclusion

Hence, taxes on its own may not be very effective in discouraging beer consumption. Taxes allow the external costs to be internalised but the effectiveness depends on the accuracy in estimating the external costs and the price elasticity of demand for the good. Also it affects the market via supply but not the demand. Tastes and preferences also need to be changed. Therefore the government has to complement taxes with a slew of other measures like reducing demand for beer through national campaigns.

L2	Understanding of how taxation is supposed to work + explains 1 limitation based on the data provided: max 5m Understanding of how taxation is supposed to work + explains at a limitations obtained from the data: max 6m	4 - 6
L1	Understanding that a tax increases COP and hence causes rise in price which leads to fall in quantity demanded. Considers responsiveness of change in quantity demanded to a price change but with no ref to data. One sided/ undeveloped answer.	1 - 3
E	Reasoned conclusion with some suggestions.	1 - 2

- (d) Discuss the impact of the takeover of APB on Heineken and on consumers. [10]

Introduction:

Define takeover.

Body:

Impact on Producers:

Positive impact:

- (i) "Cut shipping time to Japan from Singapore..." this can help the firm to reduce their cost of production, hence increasing the amount of profits which the firms

can earn.

- (ii) Consolidated financial ability to expand production. Able to use increased market power and financial ability to export more to emerge new markets internationally. This results in an increase in export revenue and an increase in profits for the producers.
- (iii) Singapore is a more flexible trading hub for Heineken and APB after takeover. This allows for more aggressive expansion of the company.
- (iv) Able to use the expertise from APB group consolidated financial ability to improve products constantly, ensuring there is dynamic efficiency.
- (v) “we can look at the development and supply chain arrangements” The firm might enjoy economies of scale (financial EOS, marketing EOS), reducing the cost of production, now that the quantity they produce is greater as a result of the takeover. Firms might be able to use the increase profits from cost savings to partake in research and development. In the long run, better quality beer can be produced/ the process of production can be more efficient.
(Candidate should explain with reference to 1 economies of scale and provide e.g. relevant to the case.)

Evaluation:

- *Heinenken might be complacent and not willing to partake in R&D.*
- *Theory of contestable market may not hold.*

Negative Impact:

- (i) The firm also suffer from diseconomies of scale like inefficient management as the firm might be too large. This could cause an increase in the cost of production of the firm.

Impact on Consumers:

Positive impact:

- (i) “same consumer can drink two different brands” Better variety of beer. Consumers have more choices of beer to consume, increasing their non-material standard of living.
- (ii) Consumers might enjoy lower prices if the EOS is passed onto consumers.
Evaluation: EOS might not be passed onto consumers.

Negative impact:

- (i) Unemployment due to the retrenchment of repeated roles in the same company after takeover.
- (iii) Possibility of exploitation of consumer’s welfare if the firm is not constantly regulated. However, this fear might be insignificant in Singapore because of the stiff Competition Act in Singapore to ensure that there is minimal market failure

arising from excessive market power.

- (iv) Exploitation of consumer's welfare due to the larger market power which APB now possesses with the takeover. Consumers might now have to pay for higher prices should APB choose to exploit these consumers using their increased market power.

Synthesis:

The takeover has more positive impact than negative impact. As the European beer market is not performing well, the takeover of APB might allow the firms to have more benefits than cost.

L3	Developed and well discussed impact on BOTH consumers and producer as a result of APB's takeover.	5 – 6
L2	Undeveloped discussion on the impact of takeover of APB. Developed one-sided answer (either discussed on impact on consumers or on producer); Max 3m	3 – 4
L1	Little or no discussion on the impacts of takeover of APB on producer or consumer. One sided argument is given.	1 – 2
E1	Reasoned conclusion with little or no elaboration.	1 – 2
E2	Reasoned and well elaborated conclusion.	3 – 4