INNOVA JUNIOR COLLEGE
JC 2 PRELIMINARY EXAMINATION
in preparation for General Certificate of Education Advanced Level
Higher 2

ECONOMICS **9757/01**

Paper 1

29 August 2018

2 hours 15 minutes

Additional Materials: Writing Paper and Cover Page

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/tape.

Answer **all** questions.

Please begin each question on a **fresh sheet of paper**.

At the end of the examination, **submit each case study question separately**.

Attach a **cover page** to **each case study question** and write the **question number** on the cover page.

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.

You are advised to spend several minutes reading through the data before you begin writing your answers.

You are reminded of the need for good English and clear presentation in your answers.

This document consists of **7** printed pages and **1** blank page.

Answer **all** questions

Question 1

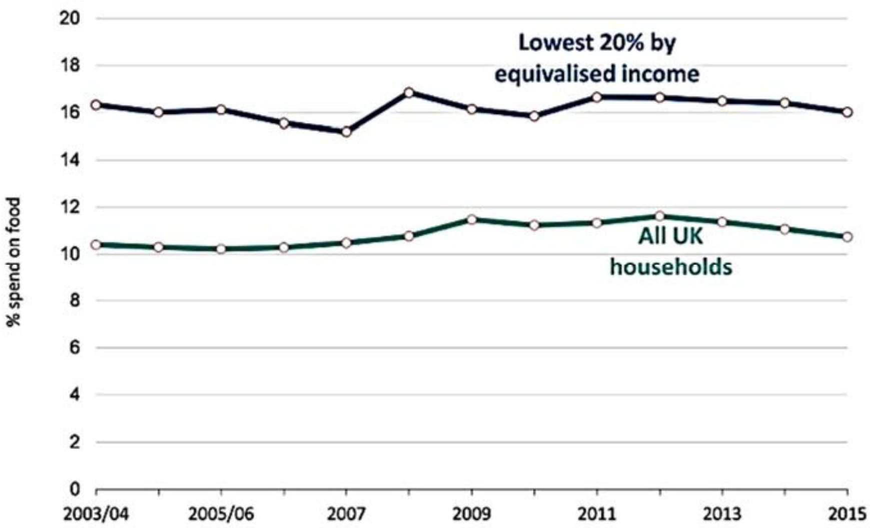
United Kingdom's Food and Drinks Industry and Brexit

Table 1: Estimates for elasticities of demand for various items in the UK

	Price elasticities of demand	Income elasticities of demand
Bread and cereal	-0.14	0.17
Fruit and vegetable	-0.22	0.28
Meat	-0.28	0.35
Beverage and tobacco	-0.35	0.43

Source: Economic Research Service, United States Department of Agriculture

Figure 1: Trend in share of spending going on food in low income and all UK households



Source: https://www.gov.uk, accessed 10th August 2018

Extract 1: Trends in UK food and non-alcoholic drinks prices

In the UK, food and non-alcoholic drinks have risen in price since 2007, with rises ranging from 17% to 41%. Successive spikes in the price of agricultural commodities since 2007 have led to higher retail food prices. They have not returned to the low price levels of pre-2007. Food price rises have a strong effect on food shopping for low income households.

Source: https://www.gov.uk, accessed 10th August 2018

Extract 2: Food industry shaken by Brexit prospects

Business and consumer confidence in the food and drink industry, by far the largest manufacturing sector in the UK, is increasingly fragile since the upheaval caused by the Brexit vote, with the UK voting to leave the European Union (EU). Despite climbing sales, three-quarters of Food and Drink Federation (FDF) members have reported soaring ingredient prices, plummeting product margins and concerns for the future raised by their EU workforce. This trend is expected by most companies to continue over the next year.

The FDF's UK-based members range from giant brands such as Coca-Cola and McVitie's to small-scale producers such as the oatcake maker Maclean's Highland Bakery. The above findings reflected the sentiment of a third of its members including small, medium and large food and drink manufacturers.

It is calling for an "industrial strategy partnership" with government and for urgent assurances for the industry's workforce from the EU that they will have the right to remain in the UK. 71% of companies employing EU staff say these employees have expressed concerns about Brexit, with about 8.7% businesses reporting that their EU employees intend to leave the UK. An estimated 130,000 of the industry's 400,000 workforce are non-UK nationals – many from Eastern Europe, often doing valued seasonal work in agriculture and factories.

"We share government's view that we need to make the best of Brexit," said the FDF's director general Ian Wright. "Food and drink industry confidence is low. Slower revenue growth, coupled with prolonged business uncertainty, is affecting the industry's ability to invest."

The FDF is also calling for urgent action from the government to ensure that essential imports of ingredients and raw materials from the EU and EU Free Trade Agreement (FTA) countries do not face tariffs or costly non-tariff barriers. Some British-based businesses have benefited from the weaker pound, which makes their exports more competitive – as long as they still have tariff-free access to the single European market.

Source: The Guardian, 12 Oct 2016

Extract 3: Industry leaders' views on the implications of Brexit

Ian Wright of FDF said Brexit could lead to price increases by as much as 10%, and would result in reduced choice, availability and profitability of food and drink for UK consumers and businesses alike.

Andrew Kuyk, Director General of PTF highlighted that any tariffs would have major implications across the food chain. He said that could result in shortages and increased prices, particularly in the short term, as the UK is not self-sufficient in many areas of the food chain. Even where the UK produces enough raw material to supply the demand they may not have physical production capacity or labour ability to make that work – and developing this all takes time and needs a level of confidence. Food manufacturers and retailers often need 12 - 18 months' supply agreements particularly for certainty of supply through their relationships with primary producers.

Source: https://www.bordbia.ie, accessed 10th August 2018

Extract 4: UK exports and trading partners

International trade really matters to UK economy and the government must use all resources available to boost exports in a post-Brexit UK. About 28% goods produced in the UK are sold abroad, with the main trading partners being the EU countries and the United States. The one exception to Western countries dominance of the top UK trade partners is China, which comes in sixth for exports. UK export a wide range of goods, including food and drink, machinery and parts, cars, jewellery, medicines and plastics. While export of goods are still ahead, service exports, which include financial services, IT services and tourism are increasingly important and they have grown every year.

Source: www.bbc.com/news/business, accessed 10th Aug 2018

Extract 5: New directions for post-Brexit UK

At present, products move freely across the border between the UK and other EU member states. As all EU member states have access to the Single Market, there are no tariffs, quotas or taxes on trade and the free movement of goods, services, capital and people. As the UK leaves the EU, the UK government will need to negotiate several new trade deals with her European trade partners and with other countries.

Brexit will therefore allow the UK to set its own trade and investment policies, however there could be costs in doing so on its own rather than as part of a group of countries, meaning whether the UK's trade negotiating strength and efficiency would be greater outside the EU is uncertain. On the one hand, concluding deals might be easier for the UK alone, given the greater diversity of interests involved when the EU negotiates as a group. On the other, the smaller size of the UK market may mean other countries give higher priority to deals with the EU. There are claims that Brexit will offer UK the opportunity to grow their exports. For example, the food and drinks sector can improve the national defences against plant and animal diseases and benefit from the latest scientific advances with the UK government supporting the nation's food producers more effectively. However nothing will be certain until negotiations formally begin.

Source: willistowerswatson.com, accessed 10th August 2018

Questions

(a) Explain why all the price elasticities of demand values in Table 1 are negative. [2]

(b) With reference to Table 1, explain the impact on UK consumers' spending on meat when there is

- **(i)** an increase in the price of meat, [2]
- **(ii)** a recession. [2]

(c) With reference to Figure 1 and the use of the concept of opportunity cost, compare the effect of a rise in price of food on lower income UK households and other UK households. [4]

(d) Explain the likely impact of Brexit on the UK consumers' welfare. [2]

(e) Discuss the extent to which the survival of firms in the UK food and drinks manufacturing sector will be adversely affected "as the UK leaves the EU". [8]

(f) Extract 4 mentions that international trade really matters to UK economy and the government must use all resources available to boost exports in a post-Brexit UK.

Discuss the measures that the UK government can adopt to boost their exports. [10]

[Total: 30]

Question 2

World Second Largest Economy

Extract 6: China overtakes Japan as world's second-largest economy

China has leapfrogged Japan to become the world's second-largest economy, a title Japan has held for more than 40 years. Despite Japan's displacement from second slot, its leadership welcomed the figures as a boost to Asia and as an opportunity for the country's beleaguered exporters.

Chinese incomes are rising: a record 1.41 million Chinese tourists visited Japan in 2010, eager to flaunt their newfound wealth by buying Japanese brand-name goods, from Canon digital cameras to Shiseido cosmetics. Japan now exports more goods to China than to any other country. Shipments to China accounted for 19.4% of total exports last year, with the US accounting for 15.4%.

Source: The Guardian, 14 Feb 2011

Extract 7: Key drivers of China's economic growth

The official view in Beijing is that since 2014 the economy has entered a "new normal condition" of steadier, albeit slower growth. As the economy downshifts, Beijing is trying to wean its dependence on credit-fueled investment and government spending and move instead to a consumer-driven growth model.

In addition, four years after China has declared war against pollution on 4 Mar 2014, China cities have cut concentrations of fine particulates in the air by 32 percent on average. It was reported that in order to reach pollution reduction targets set, China had prohibited new coal-fired power plants in the country's most polluted regions, including the Beijing area. Existing plants were told to reduce their emissions. If they didn't, the coal was replaced with natural gas. Large cities, including Beijing, Shanghai and Guangzhou, restricted the number of cars on the road. The country also reduced its iron- and steel-making capacity and shut down coal mines.

Of course, the current air pollution levels still exceed China's own standards and far surpass World Health Organization recommendations for what is considered safe. Bringing all of China into compliance with its own standards would increase average life expectancies by an additional 1.7 years. Complying with the stricter World Health Organization standards instead would yield 4.1 years.

Source: The New York Times, 19 Jan 2015 & 12 Mar 2018

Table 2: GDP Composition breakdown by percentage

	China		Japan	
	2010	2017	2010	2017

Consumption Expenditure	48%	53%	77%	76%
Government Expenditure	13%	14%	19%	20%
Export Revenue	26%	20%	15%	16%
Import Expenditure	23%	18%	14%	15%

Source: World Bank

Table 3: Government debt (percentage of GDP)

Year	China	Japan
2010	33.7	207.9
2016	44.3	235.6

Source: International Monetary Fund

Extract 8: The Fiscal Consequences of Shrinking Population

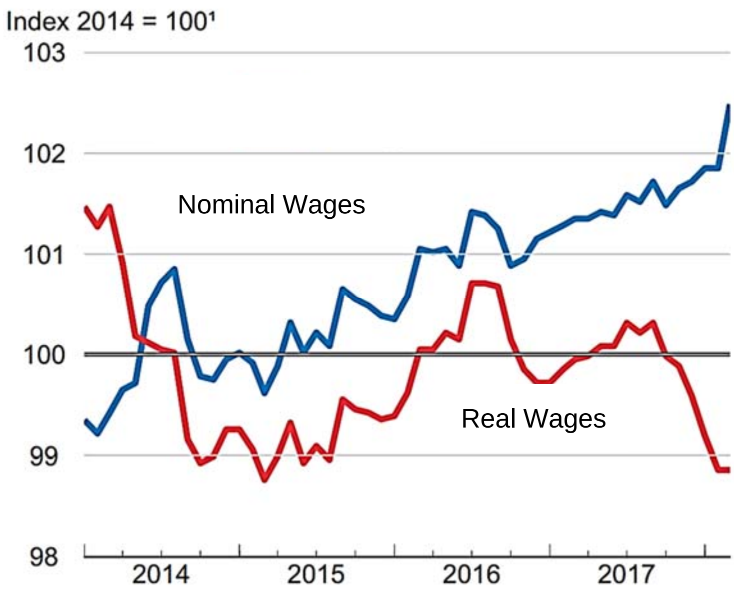
Japan's population of 127 million is forecast to shrink by about one-third in the next five decades. The proportion of over-64-year-olds — currently about a quarter — is expected to reach 38 percent in that time frame, intensifying the financial and care burden on the working-age population.

Currently, in Tokyo, there are twice as many job vacancies as applicants. The government is scrambling to cope, with policies aimed at boosting fertility and support for working mothers, a push for greater job automation and a softening of the nation's traditional aversion to immigration.

Shrinking populations pose a formidable fiscal challenge. Swelling spending on health and pensions mean Japan's unable to rein in public debt that's more than double its gross domestic product. In the government budget, social security accounts for one-third of spending and debt servicing one-quarter.

Source: Bloomberg, 17 May 2017

Figure 2: Japan: Real Wage vs Nominal Wage



Source: OECD

Extract 9: Accelerating Pace of Innovation in China

In recent years, China has become a major hub of innovative products and services.

There are two major categories of innovations in China. The first consists of innovations in manufacturing. In recent years, there has been a remarkable increase in the number of Chinese companies focusing on research and development, of which Huawei Technologies has consistently placed among the top five companies worldwide for the number of patent applications filed for the past decade. In addition to Huawei, Chinese companies like Xiaomi, Oppo, and Vivo are among the global leaders by market share for android smartphones.

The second category involves innovations led by platform companies that have arisen from the digital economy. In the mobile age, major online players like Baidu, Alibaba, and Tencent have used their core applications as launching pads for developing and expanding new services. For instance, Alibaba expanded the functions of its e-commerce site Taobao to launch digital pay app Alipay while Tencent drew on knowhow gained through its desktop messaging software QQ to develop its mobile app WeChat. In addition to small money transactions, these applications allow users to make train, airline, and hotel reservations, access ride sharing and food delivery services and pay for public services.

Among other factors explaining this rush of innovation are China's huge domestic market, the widespread availability of wireless Internet service, government policies supporting innovation, relaxed regulations, and a strong foundation in basic research. China is aiming to become a world leader in such areas as artificial intelligence and use of big data.

Adapted: Nippon.com, 30 Apr & 21 Jun 2018

Questions

(a) (i) Using Figure 2, account for the difference in Japan's real and nominal wage from 2016 to 2017. [2]

(ii) Explain **one** demand and **one** supply factor to Japan's nominal wage trend from 2014 to 2017. [4]

(b) China's policymakers' has attempted 'to wean its dependence on credit-fueled investment and government spending and move instead to a consumer-driven growth model'.

Explain the possible short-term and long-term consequences of the above attempt on China's living standards. [6]

(c) In the light of the fiscal consequences of the shrinking population, assess the options in which Japan could reduce its government debt. [8]

(d) Discuss the view that China will eventually achieved sustainable economic growth just because it has become 'a major hub of innovative products and services'. [10]

[Total: 30]

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