GCE AS

B520U20-1

S19-B520U20-1

ECONOMICS – AS component 2
Exploring Economic Issues

THURSDAY, 16 MAY 2019 – MORNING

2 hours

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ADDITIONAL MATERIALS

In addition to this examination paper, you will need a calculator and a WJEC pink 16-page answer booklet.

INSTRUCTIONS TO CANDIDATES

Answer **all** questions.

Use black ink or black ball-point pen.

INFORMATION FOR CANDIDATES

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

Answer **all** *questions.*

1. TRUMP: "LETS MAKE AMERICA GREAT AGAIN"

When Donald Trump won the American Presidential election in 2016, the word on everyone's lips was Trumponomics. Whilst the exact meaning of the term is hard to determine, there seem to be several key elements:

- Sizeable cuts in direct taxes for both individuals and businesses
- A $1 trillion infrastructure programme to rebuild roads and bridges
- Deregulation in the form of reduced red tape (bureaucracy) across a range of industries including transport and power
- Trade reform –
  - o Trump has pulled out of the Trans Pacific Partnership (a free trade agreement between Japan, Australia and Canada, amongst others).
  - o Trump is seeking to renegotiate NAFTA (The North American Free Trade Agreement, between the US, Canada and Mexico).
  - o Trump is threatening to impose import tariffs on a range of products such as solar panels and steel.
- Tougher immigration control on the border with Mexico, including tougher action on illegal immigrants and the possibility of building a 3000 km border wall, paid for by 20% tariffs on Mexican goods. Some commentators have suggested that all this really means is that the wall will be paid for by US consumers.

Steel tariffs to protect US industry
US regulators are expected to rule in favour of the imposition of tariffs on imported steel to the US later this year on the grounds of national security. President Trump has also accused Chinese manufacturers of 'dumping' steel below cost of production in the US, causing unemployment in the US 'rustbelt', an area where a significant proportion of US steel is made. Industry experts, however, have warned that tariffs will hurt steel-using industries and cause retaliation by America's trade partners, meaning that more jobs will be lost than created.

Critics of Trumponomics have suggested that the fiscal expansion may be unsustainable because of the large size of US public sector debt (national debt). Also the tax cuts announced tend to favour higher income earners. If the fiscal expansion were successful in stimulating economic growth, this might also lead to an even wider trade deficit (see Chart 1).

CHART 1

Source: http://www.imf.org/external/pubs/ft/fandd/2001/09/dollar.htm

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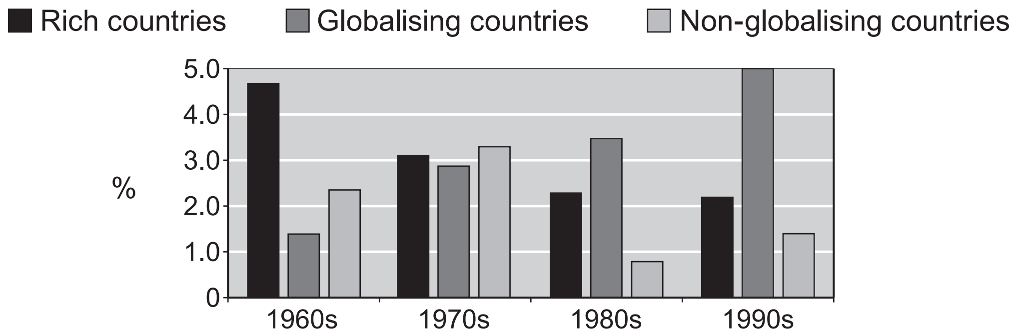
In addition, although Trump's goal is to increase US economic growth from 2% a year to 3%, research (see Chart 2) suggests that greater openness to global free trade is associated with higher growth rates; a more protectionist position might reduce rather than increase US economic growth.

CHART 2 – Real per capita GDP growth
(annual rate)



Source: Trading economics

In any case, some critics argue that Trump's focus on the manufacturing industry is missing the point – the manufacturing industry employs only 8.5% of the US workforce and contributes 12% of GDP. It is the technological revolution in services that is more likely to drive economic growth in the US in the near future.

(a) With the use of a tariff diagram, outline: [6]

(i) How US imports from Mexico will be affected by tariffs on Mexican goods.

(ii) How Trump plans to finance the border wall.

(iii) Why some commentators argue that it will be US consumers who actually pay for the border wall.

(b) (i) Outline what economists mean by economic growth. [2]

(ii) With reference to economic theory and Chart 1, discuss the extent to which economic growth is a major influence on the US Balance of Trade (part of the current account of the Balance of Payments). [10]

(c) Using the data, discuss whether President Trump's trade reforms and immigration controls will be good for the US economy. [8]

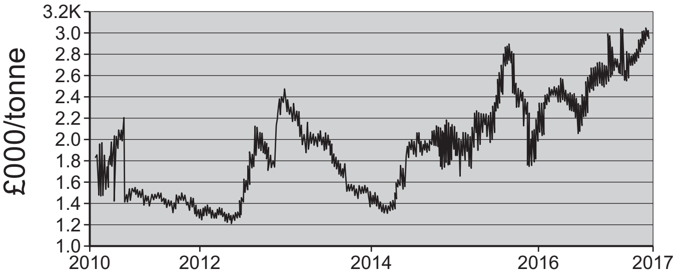
(d) (i) Outline what is meant by fiscal expansion. [2]

(ii) Outline what is meant by public sector debt (national debt). [2]

(iii) Discuss whether the proposed fiscal expansion and greater deregulation are likely to increase the long term rate of US economic growth from 2% to 3%. [10]

2. OLIVE OIL ON THE UP

OLIVE OIL PRICES GO UP, AND UP, AND UP



The price of olive oil has risen by almost 25% this year (2017), as drought affects Mediterranean producers. Production in Greece, Italy, Tunisia and Spain is forecast to fall sharply.

World production is forecast to fall 14%, with Italian output expected to fall by almost 50% in the 12 months to September 2017, according to the International Olive Council (IOC). Greece is likely to see a 20% fall, Tunisia a 17% fall, while production in Spain is predicted to decline 7%. The fall in supply is happening at a time when demand remains strong; Australia, Brazil and China are among the markets where sales are growing rapidly, according to the IOC.

Unfavourable weather conditions have been affecting olive oil production in Mediterranean countries more frequently, experts have noted. “We have had bad weather affecting production three years out of the last five,” said Vito Martielli, an industry expert. While the production level is higher than that of 2012 and 2014, when a drought in Spain and pests in Italy were the cause of poor harvests, the more frequent declines in output and lower stock levels have made price rises more likely.

Adding to the problem is that olive harvests work on a cycle in which trees generally produce a strong harvest one year and then a weaker harvest the following year as the trees take a bit of a rest. Furthermore, newly planted trees take at least five years before they start producing olives in sufficient quantity to be harvested. Some would say that olive oil has inelastic price elasticity of supply, although olive oil, if stored in the right conditions, can last for up to two years after harvesting.

The price of olive oil is likely to hit a seven-year high in Britain after post-Brexit changes in the value of the pound against the euro helped drive up prices of imported olive oil by around 20%. However, retailers and suppliers are able to hold stocks of olive oil which means price rises take time to feed through to supermarket shelves. The US imports more than 300,000 tons of olive oil a year, more than half of which comes from Italy and Spain. US consumers have so far enjoyed lower prices thanks to a stronger dollar. Nonetheless, many consumers in developed economies have in the past switched from expensive olive oil to the relatively cheaper substitute sunflower oil.

Chart 1
World % Change in Price

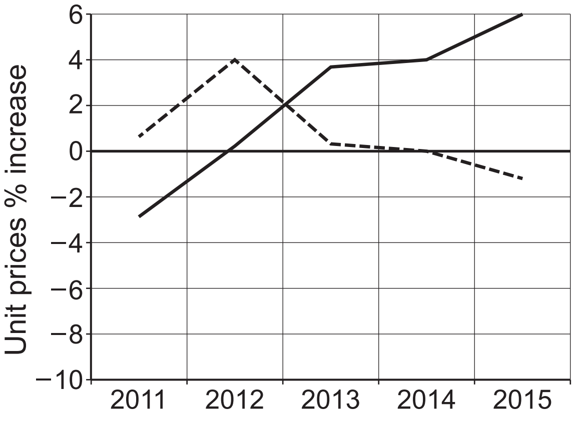
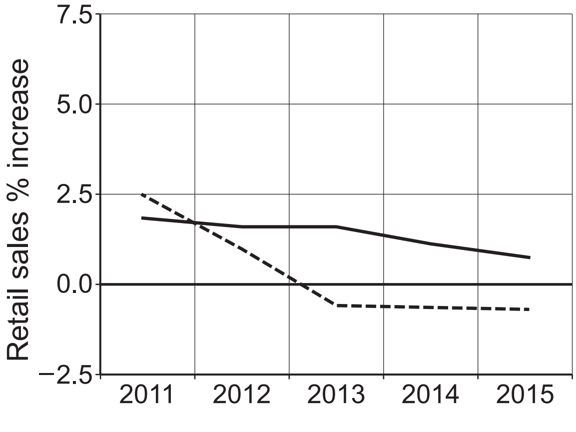


Chart 2
World % Change in Sales



Olive Oil ----- Sunflower Oil

While the production of two of the biggest producers (Spain and Italy) in the global olive oil market has fallen, the UK demand for olive oil has grown rapidly. From 6,200 tons in 1990, demand soared to 65,000 tons in 2015. Britain's restaurants have felt the impact of more expensive olive oil. Several chefs spoke out about the impact of having to pay more. Francesco Mazzei, owner of the London-based Sartoria restaurant, said that he had increased his menu prices to cover the extra cost of buying olive oil. Ben Tish who runs Salt Yard (a London tapas restaurant), said he had recently paid $648 for 100 litres of olive oil that cost $573 three months ago. Russell Norman, co-owner of an Italian restaurant chain, voiced his dismay over the high price of olive oil and the impact of Brexit in 2019 on the staffing of his restaurants, as EU nationals leave or stop coming to work in the UK.

Adapted source: www.thesun.co.uk

(a) (i) Calculate the percentage change in the demand for olive oil in the UK between 1990 and 2015. [2]

(ii) With reference to the data and using a demand and supply diagram, outline why the price of olive oil has been rising in recent years. [5]

(b) With the aid of the data, discuss the likely cross elasticity relationship between olive oil and sunflower oil. [6]

(c) (i) Outline what is meant by inelastic price elasticity of supply. [3]

(ii) Using the data, discuss whether the price elasticity of supply of olive oil is likely to be more elastic in the long run than the short run. [7]

(d) With the aid of a diagram, discuss the effects on the UK restaurant sector if EU migrants leave the UK labour market as a result of Brexit. [7]

(e) Using a diagram, discuss whether governments should intervene to stabilise agricultural prices. [10]

END OF PAPER