Candidate Name: ______________________________ CT Group: ___________

Index number: __________

PIONEER JUNIOR COLLEGE
JC 2 Preliminary Examination 2011
Higher 2

ECONOMICS 9732/01

Paper 1

Monday 19 September 2011

2 hours 15 minutes

Additional materials: Writing Paper

READ THESE INSTRUCTIONS FIRST

Write your class, index number and name 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 work for Question 1 and 2 separately.
The number of marks is given in brackets [ ] at the end of each question or part question.

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

Answer **all** questions

Question 1

The Tea Boom: Steaming Ahead

Extract 1: No Break for Britons as Tea Price Set to Soar

Unilever, owner of PG Tips have announced price rises of up to 15 per cent on its loose tea and tea bags. Other big-name brands are expected to follow suit, with some analysts predicting rises of around £3 to £3.40 for a box of 160 tea bags.

However the UK Tea Council, which represents both traders and producers, claims tea is currently underpriced and that a rise in prices is long overdue. Bill Goinan, executive chairman of the council, said the increase was reasonable and would ultimately benefit producers in some of the poorest regions of the world. He added: "For the last ten years tea prices have not risen one iota.”

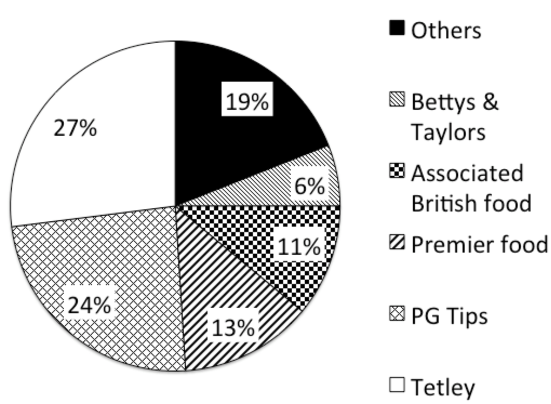
"In 1999 80 tea bags sold for £1.89 and in February of this year we had our first substantial price increase in ten years taking the price to £1.97." He said he did not believe increased prices would deter consumers from enjoying tea. "If you look at the price of tea it is extremely good value for money. It is two pence a bag for a wonderful, natural, healthy drink."

Two years ago the international price of tea dropped to a 30-year low as demand was weak in the face of increased competition from coffee and other drinks.

Manufacturer Unilever said rising costs were responsible for the increase in prices to the consumer.

Source: Adapted from The Scotsman, 19 May 2009

Figure 1: Market Share in UK Tea Market



Source: www.acnielsen.co.uk

Extract 2: Tea Prices Brewing Up to Beat Record

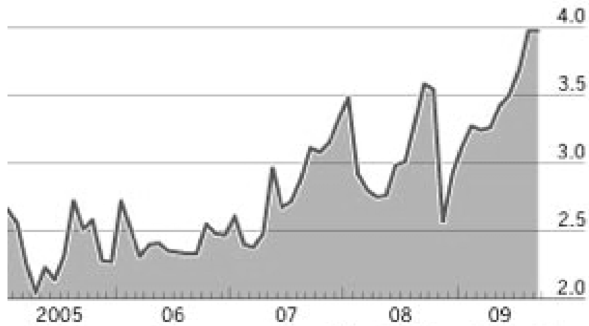
Tea prices are set to climb 10-15 per cent higher next year from current record highs because global inventories are depleted following crop failures by main exporters, the world’s largest tea leaf producer has forecast.

The view of Mcleod Russel, the India-based plantation company, is shared by others in the industry as production has been hit by simultaneous droughts in India, Sri Lanka and Kenya. Demand has remained strong in spite of the global economic downturn as retailers say consumers treat tea as an essential that they are not willing to cut back on.

The forecast comes after prices hit a record high at an auction in the Kenyan city of Mombasa, which sets the world's benchmark. Best quality tea prices rose last week to $3.97 a kilogram, up 36 per cent from January and almost double the price in 2005.

Naveed Ariff, general manager of Global Tea & Commodities in Mombasa, added that prices for top-quality teas could rise beyond the current record of nearly $4 a kilogram owing to the poor weather. "It could even touch $4.50," he said.

Figure 2: Price of Tea ($ per kilogramme)



Source: Adapted from Financial Times, 1 September 2009

Extract 3: Woes in the Tea Sector

Rwanda produces one of the highest quality teas in the world. In 2009 tea became Rwanda's main export by value, generating US$48.2 million (and US$55.7 million in 2010). At the same time, tea exports by volume nearly doubled, thanks to Rwanda tea's high quality. High quality is also the reason for Rwanda tea regularly fetching premium prices. A significant share of medium to high quality teas is sold directly to retail stores in Europe.

Rwanda's tea production and marketing systems is dominated by state-owned companies. Tea is cultivated mainly on large plantations, which are owned and managed by about a dozen tea factories that process green tea into black tea. Approximately two-thirds of the tea produced in Rwanda is grown on industrial estates belonging to a state agency and a few private investors. The remaining one-third is grown by small-scale private growers.

The tea sector faces difficulties in attracting investors that could bring in new technologies and provide access to established distribution chains. At the same time, there is a rapid increase in demand for high quality and niche tea. Given the rapidly growing global consumption of black tea, it is in Rwanda's interest to further increase black tea production and to diversify into higher value niche tea, such as orthodox and green tea, aided by foreign investment.

Labor productivity remains low compared to other tea producing economies, albeit it increased over the last decade. This is related to the fact that Rwanda has the highest proportion of rural population, most of them engaged in labor-intensive agriculture. It appears that most opportunities for future productivity gains lay in the area of making agricultural production less labor intensive.

The agriculture sector suffers from insufficient access to finance and insufficient investment capital for farming, agro-processing and export development. Banks are reluctant to offer financial services to rural farmers due to the lack of information on profitability, low productivity and high vulnerability of the sector. The banking system also imposes heavy collateral requirements and poses inappropriate lending conditions, such as periodicity of repayment not linked to the agricultural cycle. In 2010, the agricultural sector received only 2.1 percent of total new authorized loans.

Source: Adapted from The World Bank: Rwanda Economic Update April 2011

Table 1: Economic Indicators of Rwanda

Economic Indicators/ Year	**2006**	**2007**	**2008**	**2009**
Inflation (Annual %)	8.9	9.1	15.4	10.4
Real GDP Growth (Annual %)	9.2	5.5	11.2	4.1
Literacy Rate (% of people ages 15 and above)	-	-	-	71
Infant mortality rate (per 1000 live births)	82	78	74	70
Life expectancy at birth, total (years)	49	50	50	51

Source: The World Bank Data

Questions

(a) **(i)** Describe the trend observed in tea prices between 2005 and 2009. [2]

(ii) Explain why crop failure in major exporting countries may cause tea prices to rise, showing how tea being an essential good would affect the extent of this rise in the short run. [4]

(b) Explain the type of market structure operating in the UK Tea Market. [4]

(c) **(i)** Describe the trend in the general price level of Rwanda over the period 2006 and 2009. [2]

(ii) Discuss whether the data provided are sufficient to assess changes in the standard of living in Rwanda. [8]

(d) As a consultant economist, what options would you present to the Rwanda government in promoting continuous growth in the agricultural sector? Justify your answer. [10]

[Total: 30]

Question 2

The Price of Green Shoots

Extract 4: 'Deeper' Recession Ahead says IMF

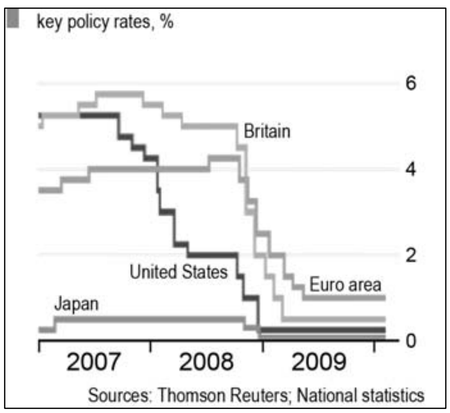
The IMF projects that the UK will see its economy shrink by 4.1% in 2009, but other major economies are predicted to shrink even more, with Germany declining by 5.6%, Japan by 6.2%, and Italy by 4.4%. The IMF says this represents "by far the deepest post-World War II recession" with an actual decline in output in countries making up 75% of the world economy. The prospects for world trade are even gloomier, with the IMF now forecasting world trade volumes to decline by 11% in 2009. After 60 years as the engine of world growth, the sharp fall in trade is now hitting many of the leading exporting nations, particularly in Asia.

Source: Adapted from news.bbc.co.uk, 22 April 2009

Extract 5: Saving the World Economies

The world economy has been injected with the biggest Keynesian cocktail yet seen in peacetime. In the past 18 months governments have pumped cash into their economies to fight financial seizure and recession. Central banks have slashed interest rates (see Figure 3). Finance ministries have cut taxes and boosted public spending.

Figure 3: Interest Rates (Selected Economies)



Note: The euro area currently consists of Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, The Netherlands, Portugal, Slovakia, Slovenia, and Spain.

Source: Adapted from www.economist.com, 11 February 2010

Extract 6: Spanish Illness: Europe's Worst Unemployment Problem

All across Spain, men in overalls dig holes, lay pavements or spruce up public facilities. They proclaim that the work is being paid for by Plan E, the stimulus package pushed through by Spain's Socialist prime minister, José Luis Rodríguez Zapatero. This included €8 billion ($11 billion) for immediate spending by town halls. Plan E was meant to keep Spaniards working. Yet the latest unemployment figures show that it is not enough. In April 40,000 more people joined the dole queues. That was a slower rise than in previous months, but it still leaves Spain with a 17.4% unemployment rate, the highest in the European Union and twice the EU average. The European Commission predicts that unemployment will hit 20.5% next year.

Perhaps the most worrying thing is that Plan E has, in part, worked. The government says it has created some 280,000 jobs, even if few are permanent. The effect is temporary, said Pablo Vázquez of the Foundation for Applied Economic Studies. In August and September unemployment may climb again. Spain is lucky that strong social networks (helped by the black economy) help to prevent civil unrest.

Source: Adapted from The Economist, 7 May 2009

Extract 7: Great Clean-Up - Can Economic Rescue Plans also Save Planet?

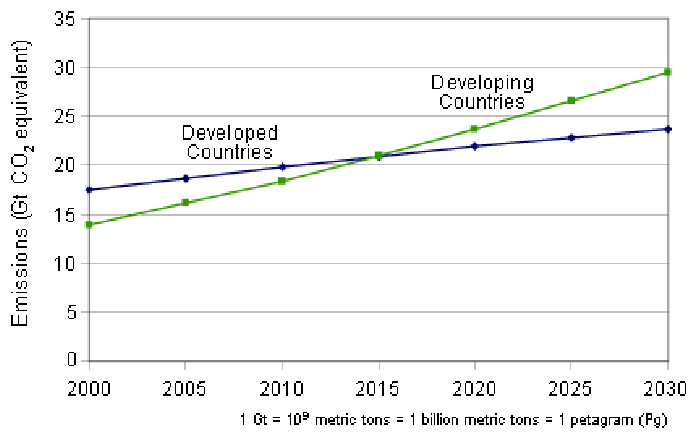
With governments around the world continuing to pump colossal sums of money into their plunging economies, a grand global experiment is under way: can the unprecedented spending provide not only a quick fix for the economic catastrophe but also the measures vital for dealing with global warming? The G20 leading industrialised states will be grappling with those choices when it meets in London in April. Countries are watching the green component of the Obama plan because they are very interested in quick wins.

The US plan's $100bn in green measures represents just under 13% of the total package, falling short of the benchmark set in a recent report led by economist Nick Stern, that green measures should account for 20% of global economic recovery plans. It also fails to meet the UN target of 1% of GDP. China allocated about a third of its $580bn recovery plan to green measures, concentrating on energy efficiency. That is much higher than most European countries. The green portion of the EU recovery plan comes in a notch higher than the US plan at 14%. Germany's green investments account for 19% of its plan, but France is spending just 8%, and Italy's efforts, in its $101bn package, are also negligible. It is suspected that some governments, including European ones, are reluctant to adopt green stimulus initiatives as they are still stuck in the 'old school' thinking that we have to revive the economy first before thinking about long-term low-carbon strategies.

The American plan meets Stern's prescriptions for an effective green stimulus - a concentration on building efficiency and renewable energy. Efficiency measures, such as insulation, sealing, and double glazing, account for the largest share of the $100bn. It is also thought to score well on its most basic purpose: rapid job creation. It is projected to create 2m jobs over the next two years, half of the 4m total envisaged by the package.

Source: Adapted from The Guardian, 24 February 2009

Figure 4: World Carbon Emissions (Forecast)



Source: www.epa.gov

Extract 8: Job Losses From Obama Green Stimulus Foreseen in Spanish Study

Subsidizing renewable energy in the U.S. may destroy two jobs for every one created if Spain's experience with windmills and solar farms is any guide. A study from King Juan Carlos University in Madrid found that for every new position that depends on energy price supports, at least 2.2 jobs in other industries will disappear. Wind turbines provided 11 percent of power demand last year in Spain, earning rates as much as 11 times more for renewable energy compared with burning fossil fuels. The premiums paid for "green" power is charged to consumers in their bills and translates into a $774,000 cost for each Spanish "green job" created since 2000. These figures do not account for job losses accruing to industries moving out of the country due to higher energy prices.

Spain's Acerinox SA, the nation's largest stainless-steel producer, blamed domestic energy costs for deciding to expand in South Africa and the U.S., according to the study. "Microsoft and Google moved their servers up to the Canadian border because they benefited from cheaper energy there," said the professor of applied environmental economics at the university.

Source: Adapted from www.bloomberg.com, 27 March 2009

Extract 9: Climate Change the Biggest Loser of G20 Summit

The $1.1 trillion stimulus package agreed by G20 leaders yesterday risks locking the world into a high-carbon economy in which greenhouse gas emissions continue to rise, environmental groups have warned. Campaigners agreed that the summit's biggest loser was the fight against climate change. British government officials lost the battle to include a commitment to spend a substantial share of the economic stimulus on low-carbon recovery projects. Diplomatic sources said China led the opposition to green language in the final text. There were fears, particularly among emerging economies, that environmental requirements might act as an impediment on trade and the speed of recovery. The buzzword "low-carbon recovery" triggered fears of protectionism through the imposition of import tarriffs on goods from nations with lower environmental standards.

Source: Adapted from guardian.co.uk, 3 April 2009

Table 2: Selected Key Economic Indicators

GDP Growth (%)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Italy	0.66	2.04	1.48	-1.32	-5.22	1.30
Spain	3.61	4.02	3.57	0.86	-3.72	-0.14
Unemployment Rate (%)						
Italy	7.73	6.78	6.09	6.74	7.79	-
Spain	9.16	8.51	8.26	11.34	18.01	-
Budget Balance (% of GDP)						
Italy	-3.52	-2.34	-1.33	-2.35	-4.88	-
Spain	1.31	1.98	2.43	-2.04	-8.58	-

Source: www.worldbank.org

Questions

(a) Compare the trends in unemployment between Spain and Italy. [2]

(b) Account for the high rates of unemployment in Spain. [4]

(c) Explain how the existence of a black economy in Spain affects the accuracy of reported unemployment rates. [2]

(d) Explain why countries' budget balances will worsen in a recession. [4]

(e) Evaluate the use of demand management policies in reviving the economies of Spain and Italy. [8]

(f) Assess the view that a "low carbon recovery" would be beneficial to the global economy. [10]

[Total: 30]

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