WELSH JOINT EDUCATION COMMITTEE
General Certificate of Education
Advanced Subsidiary/Advanced

CYD-BWYLLGOR ADDYSG CYMRU
Tystysgrif Addysg Gyffredinol
Uwch Gyfrannol/Uwch

372/01

ECONOMICS – EC2

A.M. MONDAY, 14 June 2004

(1 hour)

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

This paper contains **one** compulsory question.

INFORMATION FOR CANDIDATES

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

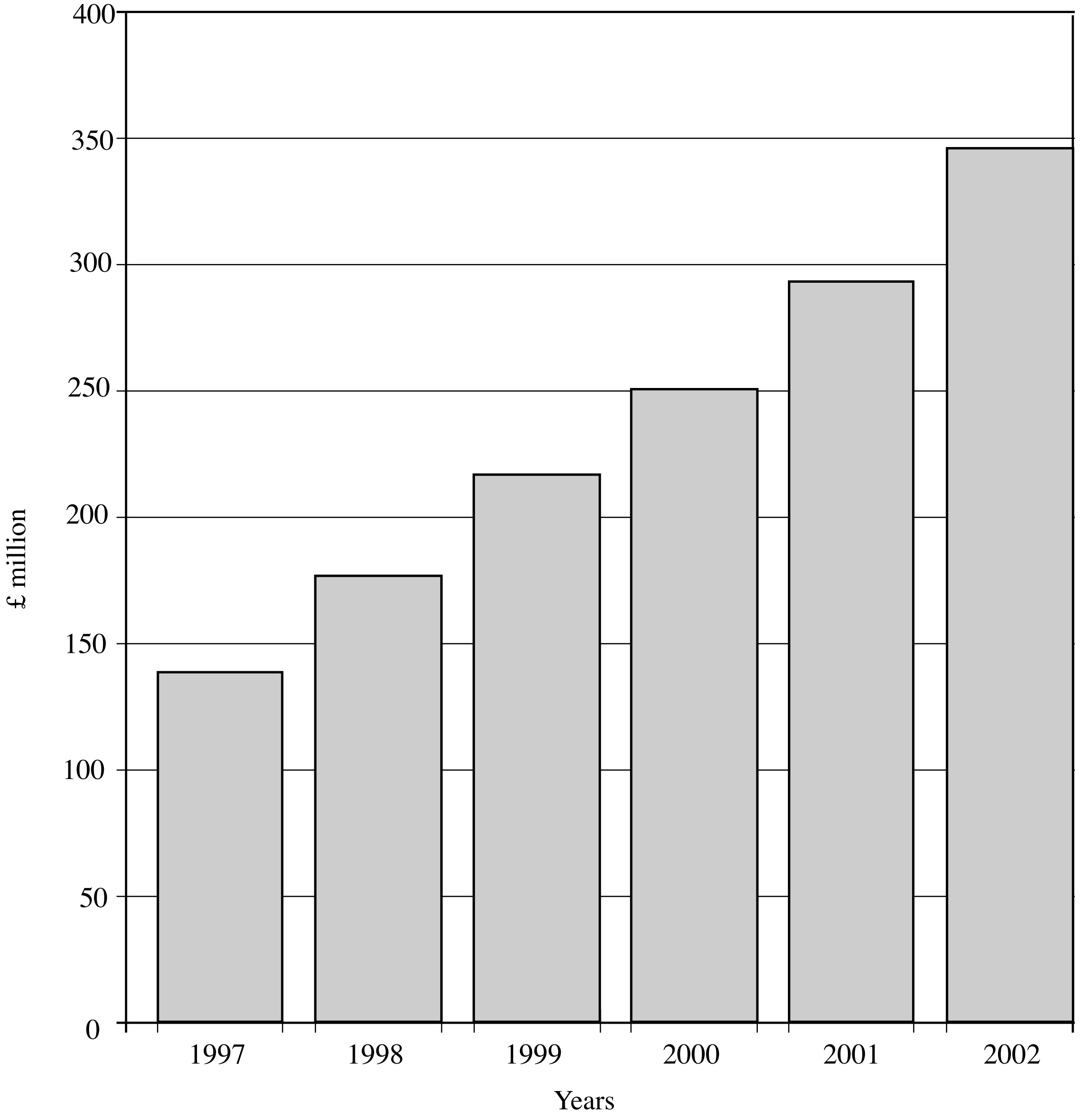
You are reminded of the necessity for good written communication and orderly presentation in your answers.

COFFEE BEAN PRICES ON THE SLIDE.

In 2002 world coffee bean prices reached their lowest level for 30 years having fallen 50% in three years. However, the price of roasted and instant coffee in the shops, as well as the price of a cup of coffee in cafes such as Starbucks, remains high. Indeed the increase in number of these branded coffee shops, as they are called, has been a feature of the high street in recent years. Rising consumer spending in coffee shops has gone alongside the expansion in the number of these outlets.

Figure 1

UK Consumer Spending in Branded Coffee Shops

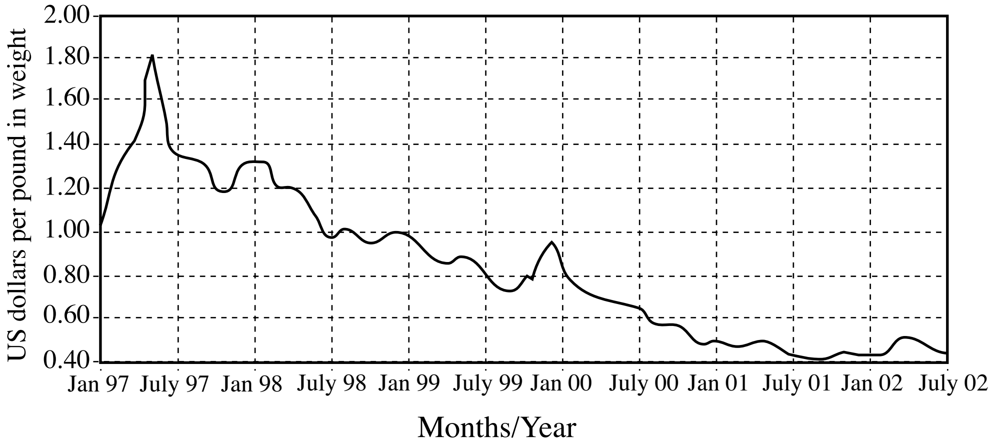


Source: www.tutor2u.net

The fall in the price of raw coffee beans over the last five years has been dramatic. Prices on world markets which averaged $1.20 per pound (in weight) in 1997 are now around 50 cents ($0.50) per pound. Coffee production has been rising at an average annual rate of 3.6%, but demand has been increasing by only 1.5%. The drop in prices is particularly severe for those countries, such as Uganda, where raw coffee provides over half of their export revenues.

Figure 2

World Coffee Prices (in dollars)



Source: International Coffee Organisation (ICO)

The fall in the world price of coffee has been blamed in part on Vietnam which entered the coffee market about ten years ago. Vietnam produced a record 900,000 tonnes in 2000-2001 to become the second biggest supplier after Brazil. However, its 2003 output was expected to be about 520,000 tonnes and in addition Vietnam now plans to destroy one-fifth of its coffee plantations in an attempt to lift prices.

Coffee producing countries used to control the supply and the price of coffee by the International Coffee Agreement. However, in 1989 these countries failed to agree on export quotas which, to keep prices high, limited the supply of coffee on to the world market. The scheme thus involved holding any coffee in excess of that required for export in the form of buffer stocks. The collapse of the agreement meant that many of the coffee producing countries flooded the market with coffee from their stocks. The volatile price of agricultural products such as coffee can be seen above with the price reaching $1.80 per pound (in weight) in 1997 before collapsing to 50 cents ($0.50) per pound in 2002.

Many coffee producing countries rely heavily on their coffee exports as a source of foreign currency with it making up about 75% of their export earnings. Between seven and ten million farmers make a living from growing coffee. Many of them work on small farms which are unable to cope with falls in demand and are too weak to take advantage of the good times. The price of coffee fell so low in 2002 that many farmers were receiving a price that failed to cover the costs of growing the coffee.

Adapted from BBC news website

(a) Explain the factors that might have caused the changes in demand for coffee sold at branded coffee shops such as Starbucks. (Figure 1) [6]

(b) With the aid of a diagram, explain how Vietnam has contributed to the change in the world coffee price between 1997 and 2002. (Figure 2) [6]

(c) Using aggregate demand (AD) and aggregate supply (AS) analysis examine the effects of falling coffee prices on the Ugandan economy. [8]

(d) Using a diagram, explain why the prices of agricultural products such as coffee, are likely to fluctuate more than those of manufactured goods, such as cars. [6]

(e) With the aid of a diagram, evaluate the view that farmers growing crops, such as coffee, should receive a guaranteed minimum price for their product. [14]