

SYLLABUS REFERENCE: 1.3 MARKETS- Price Control + Buffer Stock Intervention + Guaranteed Price Scheme

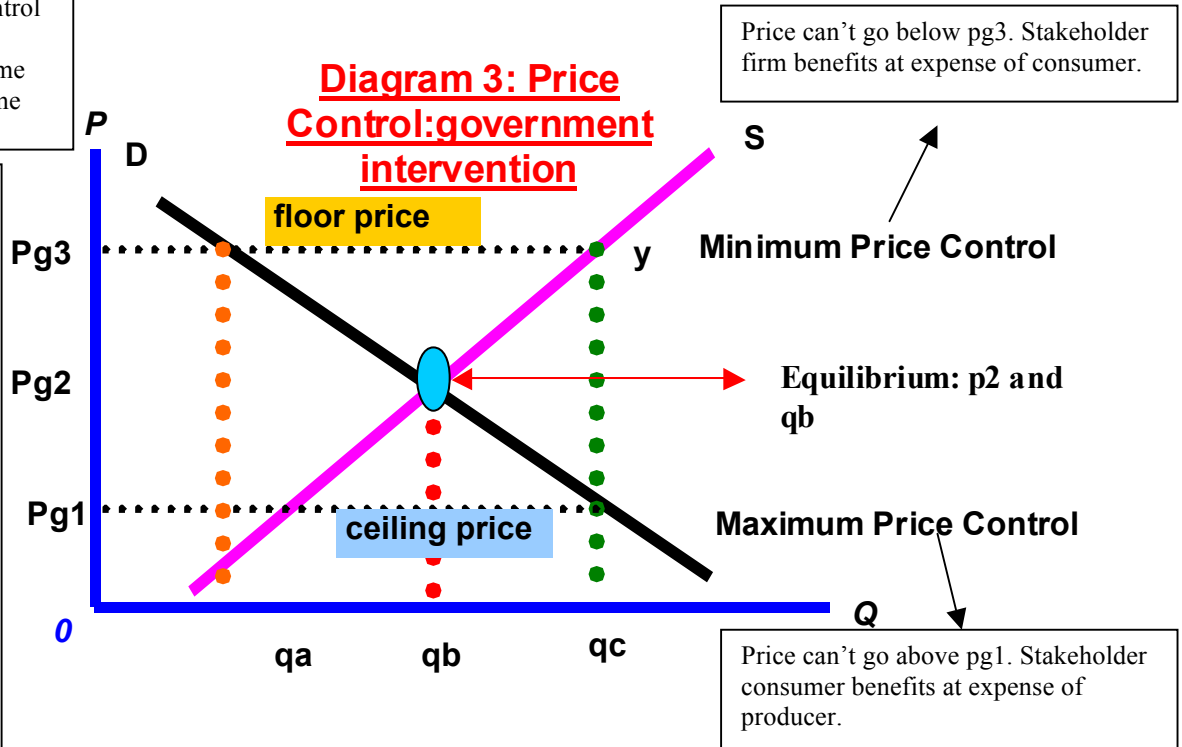
• **Main Course theme: Government intervention in the economy**

1. Single price –price control
2. buffer stock scheme
3. commodity price scheme
4. guaranteed price scheme

This webnote:

- Price control
- Buffer stocks scheme
- Guaranteed price scheme

- See also webnote 233 for taxes and subsidies



▪ **Notes:**

1. **Minimum / Maximum prices result in disequilibrium in the market. This intervention does not work well to allocate resources (L,L,C+E) effectively and is usually used in crisis situations such as current day Zimbabwe.**

2. **Buffer stock scheme is a more effective system for stabilising incomes/prices as it allows market forces to operate inside the band or range of prices. It is only when the market pushes prices outside the band that Intervention takes place.**

Tasks: Study page 2 carefully

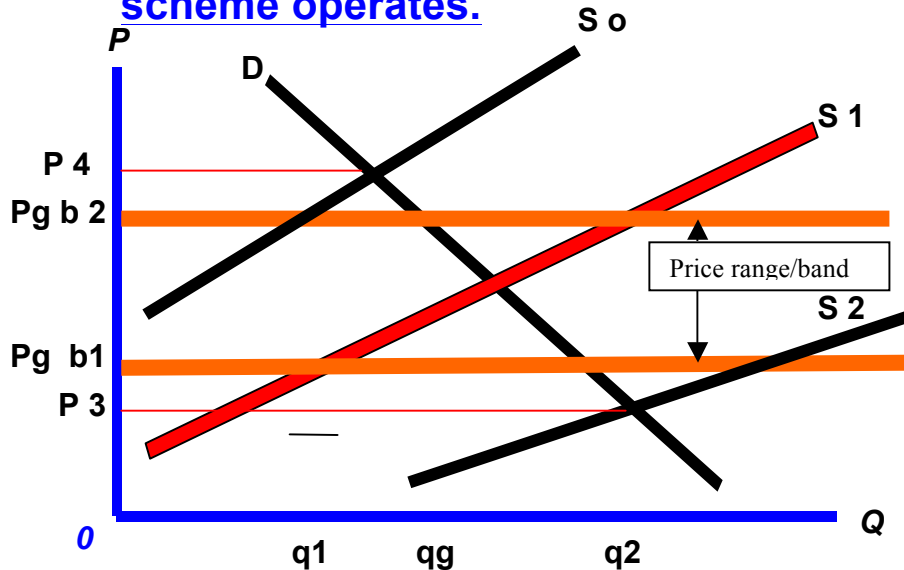
- Select a partner and evaluate a buffer stock scheme.
- Select one argument for and one against
- Consider stakeholders or any other method of evaluation

IB Questions: May 05 SL 1 Q1

- (a) Explain how a buffer stock system might be used to stabilize agricultural prices (10 marks)
- (b) Discuss the view that intervention in agricultural markets causes more problems than it solves. (15 marks)

Webnote 131

Diagram 1: how a buffer stock scheme operates.



Buffer stocks:

Why **yes**?

1. farm income support
2. price stability
3. social policy
4. protect domestic industry from structural decline (cheap imports)

Why **no**?

1. storage costs
2. administration costs
3. if the government sets the price too high as in the EU it leads to continuous excess supply (glut)
4. use of 'set aside'
5. 1, 2 + 4 may lead to higher direct/income taxes

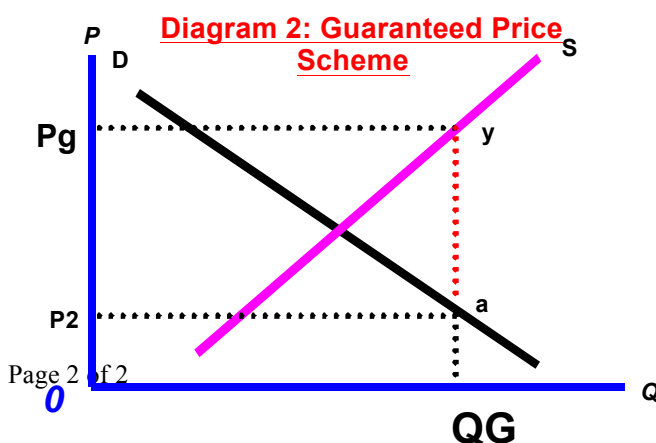
Buffer stock scheme and Guaranteed prices

- highlights the interference of government in the market
- it is another example besides indirect taxation and subsidies of how government interferes with the price mechanism

Note for the diagram 1:

- Pgb1 and Pgb2 is the buffer stock agreed range of prices. Agreed between stakeholder government and stakeholder firm.
- The scheme allows prices to vary within a band e.g. pgb1-pgb2. (see also Glanville p 510 figure 5.14)
- When supply is low (S0)(price is high: p4) the government sells buffer stocks to reduce scarcity and this reduces price back into the buffer price range i.e. pgb1 to pgb2.
- When supply is high (S2) then the government buys up the excess supply to increase the price back into the agreed price range set by the stakeholders. (see also Glanville p 510 figure 5.14)
- When supply is excessive – possibly due to a bumper crop as a result of good weather- the government must pay to store the goods in large warehouses in order to preserve the goods for supply to the market at a later date.
- Buffer scheme involves therefore intervention and measures to control the quantity entering the market in order to stabilise prices.

Read:
McGee pp 122-131



Guaranteed Price Scheme

Points to note for Diagram 2:

1. Scheme offers an alternative to the buffer stock system.
2. Government guarantees price at Pg then output = Qg
3. market clearing price for this quantity is P2 i.e. to sell Qg consumers want p2
4. The advantage of this scheme is that no storage required as the market clears at P2
5. The end result is that the government is effectively giving the farmer a subsidy/revenue equal to the area of

Pg P2 a y