

74/15 (A)

Kanyan N

Evaluate the possible consequences of price controls on the stakeholders in a market. [15]

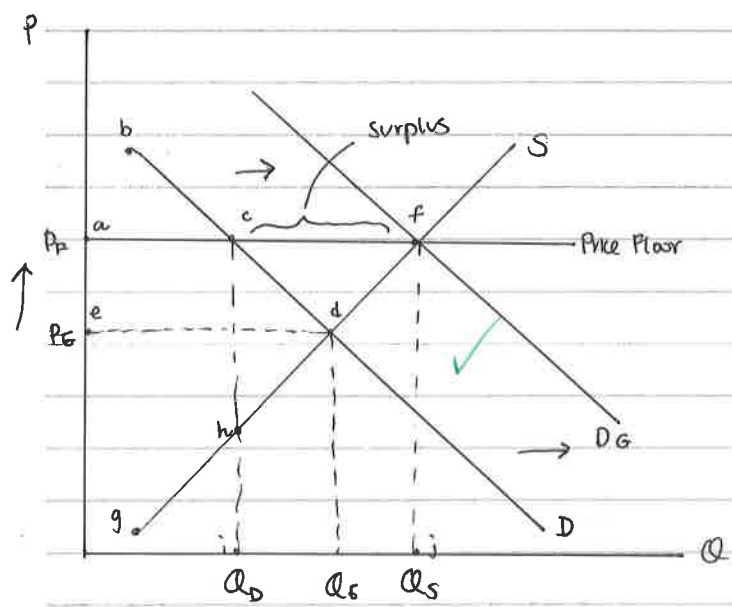
May 13



Discuss possible consequences of a government imposing a price floor on an agricultural product. (15)

May 14

A price floor is a minimum price <sup>for a product</sup> (above the market equilibrium price) <sup>are</sup> determined by the government, imposed to protect the interests of producers. <sup>while</sup> price floors on agricultural products lead to numerous negative consequences such as losses in consumer disposable income, greater inefficiency in the economy, and <sup>costs for</sup> <sup>to</sup> government, <sup>they</sup> <sup>generate</sup> <sup>profit</sup> <sup>guarantee</sup> <sup>food</sup> <sup>revenue</sup> for producers, stabilizing the market for agricultural products.



Prior to the imposition of a price floor, agricultural products a <sup>market</sup> quantity of <sup>of</sup> agricultural products was demanded at a price of  $P_E$ . As a result of the price floor, the price of agricultural products is increased from  $P_E$  to  $P_F$  as shown on the diagram. As

the price received <sup>for</sup> a quantity of agricultural products increases, producers gain in revenue. <sup>(P ↑ to Q ↑)</sup> Additionally, profit motivated producers will increase the quantity of agricultural products supplied from  $Q_E$  to  $Q_S$  (as the price has increased). <sup>hence</sup> producers will be receiving <sup>now</sup> a higher price for a greater amount of quantity supplied, leading to a significant increase in revenue (if all of  $Q_S$  is consumed). <sup>On</sup> the other hand, as <sup>the</sup> price of agricultural products increases to  $P_F$ ,

<sup>★</sup> This is shown on the diagram as an increase in <sup>consumer</sup> <sup>producer</sup> surplus from the triangle  $edg$  to the triangle  $afg$ .

consumers will have to pay more for agricultural products, leaving less disposable income available to spend on other areas of the economy.

The higher price will also cause consumers to reduce demand for ~~the~~ agricultural products

from  $Q_1$  to  $Q_0$ . This will result in a surplus of agricultural goods between  $Q_0$  and  $Q_1$ .

The surplus will have to be bought by the government to ensure that the producers gain revenue for the products produced.

This is shown by the shift in demand from  $D$  to  $D_1$ . However this will incur a cost on the government as agricultural products ~~can~~ cannot be stored for ~~prolonged~~ long periods of time and will need to be disposed of, leading to a reduction in the amount of government revenue left to spend on other areas of the economy.

This could be like in the EU where approximately 60% of its budget is spent on buying up surplus food products.

The fact that unconsumed food is produced is in itself evidence of a misallocation of resources. This is shown on the diagram as the triangle  $cdh$ .

Moreover, once a price floor is set, it may become difficult for producers of agricultural products to end reliance on the price floor and they may lose the incentive to improve production themselves (through, perhaps, adopting new technology), allowing ~~inefficient~~ breeding inefficiency.

Despite the numerous negative impacts on stakeholders other than producers, a price floor on agricultural products does, indeed, stabilize the market of agricultural products (which is even volatile ~~the~~ as agricultural products are susceptible to supply side shocks like natural disasters) by guaranteeing revenue for producers.

Hence, although price floors on agricultural products will lead to negative consequences such as a loss in consumer surplus, inefficiency in the economy and production methods, and government costs to buy up the surplus of products, producers will gain in revenue which will allow them to stabilize output of agricultural products.

OPPORTUNITY COST

the loss in consumer surplus is shown by the triangle  $cdh$  led to the change in loc.

The government expenditure spent is shown on the diagram by the rectangle,  $cfdi$ .

representing dead weight loss.

(IN THE LONG RUN)

Level	Descriptors	Marks
0	The work does not reach a standard described by the descriptors below.	0
1	<ul style="list-style-type: none"> <li>● There is little understanding of the specific demands of the question.</li> <li>● Relevant economic terms are not defined.</li> <li>● There is very little knowledge of relevant economic theory.</li> <li>● There are significant errors.</li> </ul>	1–5
2	<ul style="list-style-type: none"> <li>● There is some understanding of the specific demands of the question.</li> <li>● Some relevant economic terms are defined.</li> <li>● There is some knowledge of relevant economic theory.</li> <li>● There are some errors</li> </ul>	6–9
3	<ul style="list-style-type: none"> <li>● There is understanding of the specific demands of the question. Relevant economic terms are defined.</li> <li>● Relevant economic theory is explained and applied.</li> <li>● Where appropriate, diagrams are included and applied.</li> <li>● Where appropriate, examples are used.</li> <li>● There is an attempt at synthesis or evaluation.</li> <li>● There are few errors.</li> </ul>	10–12
4	<ul style="list-style-type: none"> <li>● There is clear understanding of the specific demands of the question.</li> <li>● Relevant economic terms are clearly defined.</li> <li>● Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively.</li> <li>● Where appropriate, examples are used effectively.</li> <li>● There is evidence of appropriate synthesis or evaluation.</li> <li>● There are no significant errors.</li> </ul>	13–15 14

- (b) Discuss possible consequences of a government imposing a price floor on an agricultural product.

[15 marks]

*N.B.* It should be noted that definitions, theory, and examples that have already been given in part (a), and then referred to in part (b) should be rewarded.

Answers may include:

- definition of price floor ✓
- diagram showing a price floor ✓
- an explanation of the impact of the price floor on market outcomes including: surpluses, government measures to dispose of surpluses, inefficient allocation of resources and welfare impacts on various stakeholders ✓
- examples of a price floor or of its consequences ✓
- synthesis or evaluation (discuss).

Command term

“Discuss” requires candidates to offer a considered and balanced review that includes a range of arguments, factors or hypotheses.

Discussion may include: the advantages and disadvantages to different stakeholders of price floors.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

14 / 15

INEFFICIENT ALLOCATION OF RESOURCES

↳ SUPPORTING INEFFICIENT FARMERS ✓

→ LAND THAT IS CURRENTLY BEING UTILIZED FOR FARMING COULD BE USED FOR OTHER ASPECTS OF THE ECONOMY.