



Skoolumy

**CAMBRIDGE A LEVEL ECONOMICS TOPICAL ESSAY
QUESTIONS**

**MAXIMUM PRICE, MINIMUM PRICE AND BUFFER
STOCK**

PAST QUESTIONS

1. Discuss whether the introduction of maximum prices by a government would solve the problem of scarcity. [10]

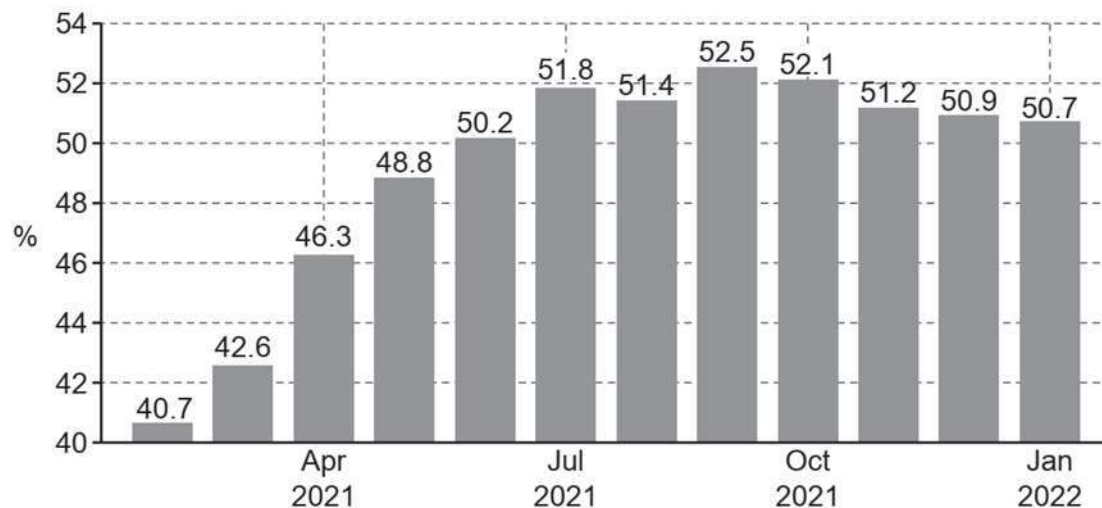
2. Discuss whether attempts to help poorer consumers through the introduction of a maximum price for necessities can ever be successful. [12]

3. Discuss the difficulties of introducing a widespread system of maximum prices for essential food to protect low-income families in a period of high inflation. Consider whether this system is likely to be successful. [12]

4. Explain, with the help of a diagram, the disadvantages to consumers of introducing a maximum price in a market for an essential food item. [8]

5. Inflation in Argentina

Argentina's annual inflation rate increased from just over 40% in February 2021 to just over 50% in January 2022. Argentina's annual inflation rate, as measured by changes in the consumer price index (CPI) over 12 months is shown in Fig. 1.1.



Source: *tradingeconomics.com*, 19 October 2022

Fig. 1.1 Annual rate of inflation in Argentina, February 2021 to January 2022

Argentina has the fifth highest inflation rate in the world after Venezuela, Sudan, Suriname and Zimbabwe. It is forecast to continue to rise during 2022 to reach an annual rate of between 55% and 58% by the end of the year. One of the main reasons for this high rate of inflation is excessive growth of the money supply. The need to lower the rate of inflation in Argentina is considered essential by many economists.

The government of Argentina has tried to control the increase in the rate of inflation by imposing maximum prices on 1432 products. This has the advantage of limiting price increases, but such a policy can also have a number of disadvantages. One such disadvantage is the creation of excess demand in markets.

Another policy has been to increase interest rates. In January 2022, Argentina's central bank raised its main interest rate from 38% to 40%, but many economists argued that this increase was insufficient to control inflation. This is because the

real interest rate will be negative. A more appropriate monetary policy would be to lift the interest rate above the inflation rate so that the real interest rate will be positive.

Source: Adapted from: Buenos Aires Times, 15 February 2022

Assess whether the potential benefits of introducing maximum prices on 1432 products in Argentina are likely to outweigh the potential disadvantages. [6]

6. Global coffee bean prices reach a new high

Coffee is big business, especially in the United States (US). The global market was worth nearly US\$110bn in 2020, with production around 10m tonnes of coffee beans. 95% of this production came from thousands of small-scale producers in South America, Central America, Asia and Africa. If present trends continue, production is forecast to triple by 2050. The Arabica coffee bean price was at a 10-year high in January 2022, having more than doubled in 2021. Fig. 1.1 shows the world price of coffee in United States dollars (US\$) per pound (lb) weight. A pound is 454 grammes.



Source: *tradingeconomics.com*, 18 February 2022

Fig. 1.1: Arabica coffee bean price, 2002 to 2022

So how can this huge price increase be explained? The main cause was a series of weather events affecting Brazil, the world's largest producer of high quality Arabica coffee beans. Its market share is 35% of total global supply. There was severe drought in early 2021 that reduced the number of 'cherries', which contain the beans on coffee bushes. The crop yield was further damaged by frosts that followed the drought. As a result of these weather events, Brazil produced its smallest volume of quality coffee beans for ten years.

In addition, the production of cheaper low-quality Robusta coffee beans in Vietnam was badly affected by storms which stripped the bushes of their 'cherries'. Overall, there was a very large decrease in the global supply of all coffee beans.

Supply issues affecting major producing countries like Brazil and Vietnam mean that the volume of coffee beans produced regularly fluctuates between 'high' years and 'low' years. Producers try to reduce their risks through buffer stock schemes in order to maintain a regular income stream. This type of scheme is particularly important for the many small-scale subsistence producers who have no other source of income.

The dramatic weather events of 2021 have been exceptional, although a few large-scale producers in Brazil who survived the immediate impact of drought and frost should gain from the huge rise in the price of coffee beans. But what about the thousands of other producers elsewhere who lack power in the market? The most likely outcome is that they will once again become victims of the unpredictable global market for coffee beans.

Consider whether a buffer stock scheme is likely to be successful in reducing the price fluctuations shown in Fig. 1.1. [4]

7. With the help of a diagram, assess whether the introduction of a minimum price in a market can be justified. [12]

8. With the help of a diagram, assess whether the benefits of a buffer stock scheme for an agricultural product always outweigh its disadvantages. [12]

9. A government wishes to keep the price of an essential food, such as rice, affordable to help low-income households.

Assess whether a policy of fixing the maximum price for an essential food is likely to be more effective than a policy of making transfer payments to low-income households. [12]

10. Assess the effectiveness of government intervention through buffer stock schemes in agricultural markets. [12]

11. Governments sometimes fix maximum prices on goods for different reasons. Assess whether the use of a maximum price is always advantageous. [12]

MARK SCHEME

Table A: AO1 Knowledge and understanding and AO2 Analysis

Level	Description	Marks
3	- A detailed knowledge and understanding of relevant economic concepts is included, using relevant explanations. Explanations are supported by examples, where appropriate. - The response clearly addresses the requirements of the question and explains economic issues, and fully develops these explanations. - Analysis is developed and detailed and makes accurate and relevant use of economic concepts and theories. Where necessary, there is accurate and relevant use of analytical tools such as diagrams and formulae, and these are fully explained. - Responses are well-organised, well-focused and presented in a logical and coherent manner.	6–8
2	- Knowledge and understanding of some relevant economic concepts is included, using explanations and examples that are limited, over-generalised or contain inaccuracies. - The response addresses the general theme of the question and the relevant economic issues, with limited development. - Analysis is generally accurate with some development but little detail. Uses analytical tools such as diagrams and formulae where necessary. Use of these tools is partially accurate or not fully explained. - Responses are generally logical and coherent but are sometimes lacking in focus or organisation.	3–5
1	- A small number of relevant knowledge points are included and the response is limited by significant errors or omissions. - The response has little relevance to the question. - Analysis where provided is largely descriptive. Use of analytical tools such as diagrams and formulae, where necessary, may contain significant errors or be omitted completely. - Responses show limited organisation of economic ideas.	1–2
0	No creditable response.	0

Table B: AO3 Evaluation

Level	Description	Marks
2	- Provides a justified conclusion or judgement that addresses the specific requirements of the question. - Makes developed, reasoned and well-supported evaluative comment(s).	3–4
1	- Provides a vague or general conclusion or judgement in relation to the question. - Makes simple evaluative comment(s) with no development and little supporting evidence.	1–2
0	No creditable response.	0

1. Scarcity results from scarce resources and unlimited wants. An effective maximum price would be set below the market equilibrium. Unless the government took additional measures it would result in excess demand and a smaller quantity sold at a lower price. While some would benefit from lower prices others would now go without the good. Overall the action would not reduce the level of scarcity.

For understanding scarcity and a maximum price up to 3 marks

For analysing the effects of a maximum price up to 4 marks

For discussing the link to scarcity up to 3 marks

2. For analysis showing the impact of a maximum price below equilibrium, the consequent shortage and the likely emergence of black markets. (Up to 8 marks)

In this case, there will need to be an alternative system of resource allocation, such as rationing.

For evaluative comment making a judgement about whether this can ever be successful.

(Up to 4 marks)

3. For analysis that explains:

- How maximum prices operate when imposed below equilibrium. (Up to 2 marks)
- The difficulties that arise when maximum prices operate during a period of high inflation. (Up to 6 marks)

(8 marks maximum)

For evaluation:

- commenting on whether difficulties can be overcome (Up to 3 marks)
- and for reaching a conclusion on the likelihood that this will be successful. (1 mark)

(4 marks maximum)

Guidance:

The difficulty in imposing maximum prices below equilibrium is that shortages will occur. These shortages will become more pronounced as inflation occurs unless the maximum prices are continually moved upwards.

Other difficulties include the administrative costs and the extent to which the price legislation can be policed.

The problems could be overcome, e.g. with rationing, but whether this will be successful depends upon a number of factors.

4. Knowledge and Understanding:

1 mark for correct diagram:

- Vertical axis correctly labelled: P/Price;
- Horizontal axis correctly labelled: Q/Quantity
- Equilibrium price shown.

1 mark for maximum price shown below the equilibrium price.

(KU: up to 2 marks)

Application:

Application to a situation of excess demand. Up to 2 marks

Explanation of two possible disadvantages to consumers, such as: queuing, black market, rationing or seller preferences.

Up to 2 marks each

(APP: up to 6 marks)

Guidance:

Disadvantages to consumers:

- A maximum price will lead to a situation of excess demand in the market
- This could lead to a queue or waiting list
- A secondary, informal or black market could emerge with prices well above the maximum price

5. Up to 4 marks for explanation/analysis:

- Explanation of potential **benefits** of a maximum price, including keeping prices of the products, such as the prices of essential foods/basic necessities, lower than they would otherwise be and so contributing to a possible lowering of the rate of inflation in the economy. **(Up to 3 marks)**
- Explanation of potential **disadvantages** of a maximum price, including the creation of excess demand and a shortage, the possibility of a queue or waiting list, the creation of rationing and the existence of an informal market. **(Up to 3 marks)**

The question does not explicitly require a diagram to be drawn, but credit can be given for one if it aids the explanation/analysis.

Max: 4 marks

Up to 2 marks for evaluation:

Relevant evaluation of whether the potential benefits of introducing a maximum price on 1432 products in Argentina will outweigh the potential disadvantages, such as excess demand, the need for rationing and the possibility of an unofficial economy arising (1) leading to a conclusion. (1)

6. Buffer stocks schemes occur when governments buy and sell coffee beans to stabilise prices (1). Governments will supply surplus stocks of coffee beans in the event of a poor yield to minimise excessive price rises (1) and buy excess supplies of coffee beans when yields are sufficiently high enough to cause significant price reductions. (1)

For valid evaluation

- For example: If the coffee beans cannot be stored in a way that maintains its quality, it may not be sold at the intended market price (1).

- Other relevant factors include the government's budget/ability to finance the scheme.

7. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

Diagram of a minimum price in a market, correctly labelled with an equilibrium price and an equilibrium quantity and showing the existence of a minimum price above what would be the case with no government intervention.

Explanation of the potential advantages and benefits of a minimum price, such as making the prices of demerit goods more expensive to discourage consumption and protecting the incomes of producers in that market.

Explanation of the potential disadvantages and limitations of a minimum price, such as the creation of excess supply and the greater likelihood of producers becoming less efficient, and of why the introduction of a minimum price might be ineffective.

Note: Omission of a diagram/inaccurate diagram can only achieve a maximum of Level 2.

A one-sided response can only gain a maximum of Level 2.

AO3 Evaluation

- Evaluation of the potential effectiveness of the introduction of a minimum price in a market.

- Evaluation may contain an assessment of alternative policies but may only be rewarded if the advantages and disadvantages of minimum pricing policy have been discussed.
- In conclusion, whether the introduction of a minimum price in a market can be justified.

A one-sided response cannot gain any marks for evaluation.

Accept all valid responses.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

8. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

Diagram of a buffer stock scheme, correctly labelled with an equilibrium (target) price and quantity and with changes to price and quantity when there is an increase and a decrease of supply.

Explanation of the potential benefits of a buffer stock scheme.

Explanation of the disadvantages and limitations associated with a buffer stock scheme and of why such a scheme might be ineffective.

AO3 Evaluation

- Consideration of the potential effectiveness of a buffer stock scheme.

- Consideration of whether the benefits of a buffer stock scheme always outweigh its disadvantages.
- In conclusion, whether such a scheme will always be effective for all agricultural products.

Accept all valid responses.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

9. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis (max 8 marks)

The advantages and disadvantages of using a maximum pricing policy may include:

- If the price is set below the equilibrium price and quantity, then it will make e.g., rice more affordable.
- This will help low-income consumers and improve their living standards and improve their health BUT
- It will create a shortage and informal markets may arise.
- Governments may have to increase their spending to enforce the legislation.
- Rich and poor households gain equally.

Transfer payments may include:

- Unemployment benefits
- Pensions
- Food vouchers etc.

The advantages and disadvantages include:

- They can be targeted at those most in need.
- They can be targeted at the purchase of basic foodstuffs BUT
- May be costly and have an opportunity cost.
- The policies may not be used for their intended purposes (even vouchers may be sold in illegal markets)

A one-sided response can only gain a maximum of Level 2.

AO3 Evaluation (max 4 marks)

- Consideration of the relative effectiveness of a maximum pricing policy compared with the use of transfer payments.
- Consider the impact on low-income consumers of basic foodstuffs
- In conclusion, which policy is most likely to be effective in helping low-income consumers.

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

10. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis (max 8 marks)

The advantages and disadvantages of a buffer stock scheme in agricultural markets may include

- Effective in smoothing out price changes, particularly where these are volatile
- Responsive to market conditions
- Involves minimum and maximum prices
- Storage of products can be used to influence price changes
- Can be inefficient when surplus stocks build up
- Little incentive for producers to change what they produce
- Could lead to waste of perishable products

Other methods of intervention can include

- Subsidies paid to agricultural producers
- Tariffs on imports
- Export controls

Advantages and disadvantages include

- Less intervention, more emphasis on market forces
- Improved security of supply for domestic market
- Reduced dependence on imports
- Income of efficient farmers can increase

- Subsidies involve an opportunity cost

Level 2 max for 1 sided answers

AO3 Evaluation (max 4 marks)

- Consideration of relative effectiveness of buffer stock schemes compared to other methods of intervention
- How to determine minimum prices for government intervention
- Problem of over-supply and impact on future market prices
- Informal markets and scale of subsistence producers can be issues in low-income countries

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

11. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

The **advantages** of a maximum price might include:

- The price of certain products, such as essential foods, can be limited by the establishment of a price ceiling.

- The effect of this will be to make such items more affordable to people.
- This will reduce the extent of poverty in a country.

The **disadvantages** of a maximum price might include:

- The impact of the maximum price will be to create a situation of excess demand in the market (this needs to be clearly explained).
- This could lead to queuing or rationing.
- It could lead to the creation of a black or illegal market.

(Up to 8 marks)

AO3 Evaluation

- Consideration of the relative balance of advantages and disadvantages of the policy.
- Consideration of the impact of this policy on producers and consumers.
- In conclusion, consideration of whether the policy will be effective and always advantageous.

Accept all valid responses.

(Up to 4 marks)

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4