Analysis of the banana market in australia economics essay

In a perfectly competitive market, there is no government intervention in the market. The price is usually established when the equilibrium price and quantity is achieved (Jackson, J &McIver. R 2007). Equilibrium means that consumers are willing to buy at this price and producers are willing to supply. By referring to the graph Figure 1, we can see the equilibrium is at the intersection point between demand curve and supply curve. Pe means the price equilibrium and Qe means quantity equilibrium. In an equilibrium state, problems like shortage and surplus will not happen in the market because the quantity demand and quantity supply are in balance. Shortage will usually happen when the price is below the price equilibrium, we can see that when price drops from Pe to P0, the quantity supply will decrease because suppliers are willing to supply at this price where they have low revenue while quantity demand will increase because consumers find bananas is really cheap and they should buy it. Demand exceeds supply. Surplus will happen when the price is above the price equilibrium. From the graph, when price increase from Pe to P1, the quantity demand drops because consumers find it very expensive and the bananas doesn't worth that price while quantity supply increase because the suppliers are willing to supply as much as they could as the high price of bananas would help them to generate more revenue. Demand exceeds supply.

The natural disaster, cyclone has caused the supplies of bananas to decrease tremendously. The price elasticity of demand in bananas market is said to be inelastic when we look into the determinants. First of all, Bananas are Australia's No. 1 selling fruit, it means there is a huge demand for bananas in Australia.(ABGC n. d) Bananas industry appears to be one of the largest fruit growing industries in Australia and also an important contributor to the economies. Bananas are among Australia's top 10 supermarket lines. First determinant would be the availability of substitute goods and for bananas, there is lack of substitutes for it. Apparently the demand would be inelastic when there is no substitutes. Second determinant is proportion of income. Bananas price has shot up from around $3 per kg to $15 per kg (ABCG n. d). Consumption of bananas would be still a small fraction of income although the price has increased. Therefore, consumers are not sensitive towards the price changing. Third is Luxury versus necessity. Bananas can be considered as a necessity in Australia because people still consume bananas although the price has increased. According to the Australia Banana Growers' Council, they estimated that 28 million of bananas are consumed each week, which means a person consume 60-70 bananas and is around 13kg averagely (ABCG n. d). Fourth determinant would be time. The time would be in a short run because consumers are difficult to change income and preference immediately right after the cyclone. People would still think that the price is acceptable and they will still buy it in short run. It would be an elastic supply for bananas market because there are around 800 banana growers in Australia (mainly from Queensland and New South Wales) that are estimated to produce about 23 million 13 kilogram cartons of bananas (ABCG n. d). When there are a lot of supplies, its price elasticity of supply would be elastic and long run. However, the supply has decreased as the cyclone has caused a critical damage on banana farms. The price has shot up because there is a shortage in bananas market. Banana consumers will tend to compete and bid up the market price for bananas. As the supply curve shifted to left, it shows that the price has gone up from P0 to P1 and quantity demanded has decreased from Q0 to Q1.(refer to figure 2) It then moves to the new price equilibrium from e0 to e1 and it shows that a large change in price has resulted a small proportionate change in quantity. Quantity demanded falls means many customers can't afford the new equilibrium price. Total expenditure on bananas is equal to total revenue gained by sellers. From the graph, the R1 shaded area means revenue gained, R2 shaded area means revenue loss. Since the demand is inelastic, the revenue gained will be more than revenue loss when the price increases. Therefore, the total revenue of sellers increased.

In economy, whenever the supplies is found limited and couldn't satisfy all the demands in market, suppliers would tend to increase the price as high as possible to maximize their profit. It would be a benefit to suppliers but a disadvantage for the consumers. In such situation, government intervention is needed to set up a price ceiling in the market of bananas. Price ceiling means a maximum legal price level that suppliers can set for the goods they are selling Jackson, J &McIver. R 2007). Price ceiling for this case would be a protection for the consumers as they don't have to pay for unreasonable high price set by suppliers. However, putting a ceiling price in the market doesn't settle the problems. It may cause a bigger shortage. The shortage would cause difficulty in rationing the limited supply of bananas. From graph Figure 3, we can see that quantity supply is falling further from Qe to Qs and Quantity demand has increased from Qe to Qd. Apparently, the quantity supply contributed more to shortage compare to consumers. Besides that, black market price will increase further. Setting a ceiling price is actually encouraging black market. All these consequences such as black market and shortage will cause the market efficiency to become inefficient. Supplier will not be happy to supply because they have low income selling bananas at ceiling price. The government will receive less sales tax from banana industry as well.

In conclusion, there are pros and cons if government intervenes the market by implementing price ceiling. However, the price ceiling would only have short-term effects because the supply could recover in within 6months to 12 months period.

Reference Lists

Australian Banana Growers Council Inc. (ABCG) n. d, Media Kit, available through www. australianbananas. com. au/public/media/downloads/media_kit. pdf, viewed at 2 September 2010.

Jackson, J &McIver. R 2007, Microeconomics , 8th edn, McGraw-Hill, Australia.