Brazils intervention in free market

The price mechanism mean is to determine price by the supply and demand of the product, if the demand is higher and production of the product is low so the shortage of the product will occur and price will increase.

Advantages

The price mechanism plays three important functions in any market-based economy the single function prices have a single function. Prices adjust to demonstrate where resources are required, and where they are not. Prices rise and fall to reflect scarcities and surpluses. If market prices are rising because of shortage in supply from seller, this is a signal to suppliers to raise the production of the product. But in the coffee bean case there is a shortage of the product because of short crops so price of the product will increase to meet the higher demand. Producers stand to earn higher revenues and profits from selling more beans but at a higher average price.

In the market if the customer decides to spend their money this will decide what to produce. For example if the demand of the coffee been is increased then this could be another advantage to the seller that they have power to determine the price of that product and can earn more profit for the company by increasing the price of coffee been. Then the company can use that profit to run another business or to produce another product.

Disadvantages

As we discussed advantages of the prices mechanism there also some disadvantages of it for example:

One of the disadvantages of the having the price mechanism is allocating resources but it does not always operate smoothly. In a market economy it depends on individual persons' ability to consume goods & services depend upon their income. Poor people are more effecting with the price increase of coffee bean. In The free market suppliers are not concerns about the average people of the Brazil all they want is good money.

The government can impose price ceiling but in this case there will be more shortage of the product because the seller will not sell the product on that price, it will create black market and people who can afford the product will buy that product by paying higher amount to the seller. Export of coffee beans is another disadvantage more coffee is being export to get revenue instead of providing coffee beans to the local peoples.

Conclusion

Therefore my conclusion is that government should increase tax for rich people to give benefit to the average people of the Brazil. The government can also give subsidy to producers so make coffee beans available to the local people. Government can reduce the amount of coffee beans export to fulfil country's own resources.

Task 2 (500 words)

2. 1 (a) Using a diagram showing the equilibrium price of the coffee beans being charged is determined in a free market.

Price per kg (£)

Quantity demanded (Kg)

Quantity supplied (Kg)

1

3

1

1. 30

2. 5

1. 5

1. 60

2

2

1. 90

1. 5

2. 5

2. 10

1

3

P Supply

D S

2. 10

PE

1. 60

1

Demand

0 1 2 3 Q

(Figure 1)

Figure 1 represents the application of demand and supply model to determine coffee bean's price. Suppose the demand curve for coffee bean is D and the supply is S. At low price of £1 the demand of coffee bean is high as more people can now afford to buy. But at the same time suppliers are not willing to supply in market because of the high profit margin in export. As the result the prices would rise quickly. But now if the price goes up to £2. 10 the demand of coffee beans decreases as people can't afford to buy. At this higher price, more suppliers are willing to sell due to good profit margin and the prices would quickly fall to adjust the forces of demand and supply in the free market. In general we can expect the price of coffee beans to move to the equilibrium price of £1. 60, at this point what is being brought by the seller in the market being bought by the customers.

2. 1 (b) Identifying the factor affecting demand for and supply of coffee beans.

Factors affecting demand

Population

Increase in population of Brazil can increase the demand of coffee beans in the market. More population mean more people will buy the coffee because it’s a favourite drink for the ordinary Brazilian. This will stimulate demand of coffee in the market.

Taste and preference

It is possible that people change their preference, taste and start drinking some other drinks (substitute i. e. tea) which will decrease coffee demand in the market.

Income

If the income of an ordinary Brazilian is increased the demand of coffee beans will also increase because more people can now afford to buy their favourite drink.

Future Expectation

If there is an expectation that the price of specific product is going to increase more people would start buying to avoid extra payment. But vice versa happens if the price of coffee beans is going to decrease, the demand of it will also decrease.

Factors affecting Supply

Cost of Production

If Prices of factors of production (i. e. may be less land for harvest, expensive fertilizers, viruses) of coffee beans increases the supply of coffee beans will be decreased in the market as producers now spending extra to produce standardise coffee beans.

Government Policies

If government will start giving subsidies (i. e. free land allotment, cover fertilizer expense) to producers of coffee beans to encourage production in Brazil which will increase supply in the market.

Natural Calamities

Any natural disasters such as floods, drought, and shortage in crops due to viruses can create a massive gap of supply in the market.

State of art Technology

If the producer will start using sate of the art technology and this will reduce the cost of production (i. e. labour cost) and hence will increase supply of coffee beans in the market.

Task 3 (500 Words)

3. 1(a) Write a section for the local paper explaining why the supply of coffee beans available to buy in the short run is fixed.

The supply of coffee beans is fixed in a short run because of following reasons:

Short crops of coffee beans in Brazil, which can not be increased unless it is a season of coffee.

Suppliers are continuously exporting high volume of coffee beans despite of short crops in the country.

Suppliers are more interested in high profit margin rather than making coffee beans available to ordinary Brazilian.

In the absence of government support (i. e. subsidies) producers are not being encouraged to grow enough coffee beans which are affecting short run supply.

3. 1(b) Explain how the elasticity of supply of coffee beans will change over time and state why this is the case?

In short run the elasticity of supply of coffee beans is not elastic because of short period which is why coffee bean producers can’t quickly respond to the change in market situation. The period of time is not enough to change the output significantly; producers have less time to react to the change as the price of coffee beans rises, in the short run producers are stuck because they cant increase the production of coffee to be able to respond to the price in market.

In long run the elasticity of supply becomes more elastic, because over time, more land can be utilised to produce more coffee beans. New technology will be used to change in price to create more efficiency. Producers can be encouraged to produce more coffee by giving them incentives/subsidies (i. e. free fertilizer, free seeds, state of the art technology for harvesting)

3. 1(c) List of any short-term measures, apart from a price ceiling, that you think the Finance Minister might use to help alleviate the increase in the price of coffee beans.

I think there are several measures apart from the price ceiling that Finance Minister Fernando Fuego can take to low the price of the coffee beans. Such as

He should give subsidy (i. e. fertilizers, prices of crops) to the farmers to grow enough crops to fulfil export demand and also in country demand.

He should also give tax credit to the companies to make companies stable in the market and to avoid black market.

Brazil is one of the main coffee bean producers in the world and it is making foreign exchange from its export, so Finance Minister should impose trade restriction on export which will make enough coffee available to the local people.

Task 4 (500 Words)

4. 1(a) What is price ceiling?

A price ceiling is when a government-imposed limit on the price being charged for a product in the free market. Government intension is to minimise the price to make affordable to the average people.

4. 1(b) Using diagram explanation of how Price Ceiling works?

£P

D S

E

10

Price Ceiling

5

Shortage (50)

0 25 50 75 Q Kg

(Figure 2)

The forces of demand and supply determine the equilibrium price and quantity. In the above figure 2, as the result of these forces the equilibrium price P (E) is set at £10 and equilibrium commodity Q (E) at 50 kg. The demand curve shows that at higher prices, coffee beans' quantity demanded will be low. The supply curve is drawn to show that as prices increases, suppliers will encourage offering more coffee in the market. They will be encouraged to do backward integration where they can harvest their own coffee beans crop on their own land. It will reduce outsourcing cost for the companies. Government intervention at this point introduces price ceiling to £5 now this is going to be the maximum price for the coffee a supplier can charge.

The bold line represents the price ceiling. At the new lower price, demand of the coffee beans increases to 75 kg but supply of coffee beans decrease to 25 kg which causes the overall coffee beans shortage of 50 kg.

4. 1(c) Using diagram, explain what is likely to effect on the demand for coffee beans if government were to introduce a price ceiling?

£P

D S

E

10

Price Ceiling

5

Shortage (50)

0 25 50 75 Q Kg

(Figure 3)

In Brazil's free market, the forces of demand and supply have determined a very high price of coffee beans. As coffee is a main drink for ordinary Brazilin so this price hike made coffee unaffordable for common Brazilin. This unavailability of coffee beans for ordinary people caused government to intervene the free market by imposing price ceiling.

In figure 3, the demand curve shows that at higher price of coffee beans, the quantity demanded will be low. Because of higher prices people tend to find alternatives i. e. tea and also try to reduce their coffee consumption.

In Brazil, higher prices of coffee beans caused by crop shortage, encouraged government to impose price ceiling to make it affordable for public. By imposing new lower price of coffee in the market causes surge in demand.

Suppose government has imposed the price ceiling at £5 lower than market price of £10 as shown in figure 3. Demand of coffee beans was 50 kg, at equilibrium price of £10, because of price ceiling it is shifted to 75kg. As result of rise in demand, coffee bean’s supply falls down to 25 kg but created high demand of 75kg as shown in figure 3. At this point supply of coffee beans reduced to 25kg which created shortage of 50kg (75-25). This shows in figure 3 that how price set lower than market price creates shortage of coffee beans in the market.

The supplier can reduce the supply of the coffee because of low profit margins and it can create scarcity in the country.

Task 5 (500 Words)

5. 1(a) what effects will a price ceiling imposed by the Finance Ministers have on all companies producing coffee beans?

Price ceiling impose by the Finance Minister will make several effects on coffee producing companies.

Suppliers are bound to charge lower price for the coffee beans, which mean less profit and less profit mean less supply for the coffee beans in the market. If the price ceiling imposed for long time it will cause many companies to collapse.

Brazilian economy will no longer attract new companies because of less possibility of making profit.

Brazil is one of main producer of the coffee and it is attracting foreign exchange through it. Because of price ceiling, there will be export restrictions on companies which will in turn affect country's economy.

5. 1(b) what unintended consequences might occur as a result of Finance Ministers price ceiling?

Unintended consequences of Price ceiling imposed by Finance Ministers are as follows:

Following figure 4 shows that at Price ceiling of £5 creates a shortage of 50k (75-25) kg of coffee beans. For 25kg of coffee beans, consumers are willing and able to pay £15, which leads to creation of black markets. Suppliers will only provide coffee to those who will charge their specified high price from consumers.

Figure: 4 The Unintended Consequences of Coffee beans Price Control

P

15

D S

10

Price Ceiling

5

Shortage (50)

0 25 50 75 Q

Demand of coffee beans increases as result of price being set below the equilibrium price but at the same time supplier are no more willing to sell at this new price.

Shortage of crops might lead to scarcity, in which case, even people having enough money won’t be able to buy it.

Because government didn’t specify the time limit for price ceiling, which will start, affecting consumers, suppliers and minimise the effectiveness of price ceiling.

Another consequence will be low quality of the coffee beans in the market.

Many companies will close down because of less profit and more expenses, which will result, in creating unemployment and economic downturn.

5. 1(c) Based on your evaluation of price ceiling, explain why you think the use of a price ceiling by the Finance Minister may only make the situation worse?

According to my evaluation, I think it will only make the situation worse because of following reasons:

Shortage of crops is creating problem regarding availability of coffee beans, instead of addressing this problem government decision of price ceiling is making the situation worse.

People with higher income were managed to buy coffee at equilibrium price or even at high price but now they would be affected along with low income people because of low or no supply of coffee.

Government should give time frame for controlled prices, since because of price ceiling quantity demanded has been exceeding quantity supplied. Demand is inflating because suppliers will not be willing to compromise on their profits.

In the end government's measures of controlled coffee price will end up hurting low and middle income people, who they were intended to help. People will be ending up paying higher than equilibrium price in black markets because of price ceiling.

Government would not interfere with the functioning of free market without considering other potential problems (i. e. black markets) of their imposed decision.