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Price Stabilisation Schemes

Produced for the CRC for Premium Quality Wool undergraduate program by;
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Buffer Stock Schemes

Reserve Price Scheme

- governing body buys at set price
- stocks held until market rises
- stocks sold into market
- speculative schemes
  - buying and selling decisions vital
    - forecasting
  - buying is public knowledge
  - selling is usually private

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Buffer Stock Operation

price

D_2

D_1

hidden loss

P_2

P'_2

P'_1

P_1

E

F

L

J

H

K

G

visible speculative profit

hidden gain

D_2

D_1

0

A

Q

B

quantity

Figure 8.1 The operation of a buffer stock or reserve-price scheme

Peter Auer

Source: Campbell, K. D. and Fisher, B. S. (1991)

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Buffer Stock Disadvantages

- stock shifting
  - governing body will carry risk
- funding
  - must be adequate for support
- price determination
  - buying (rent seeking)
  - selling
- stock-disposal (selling) strategy
  - not too fast
  - moderate subsequent high demand

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Why do these schemes fail?

For a buffer stock to work, the buy-in price must be set so that supply equals demand over the long term.

For demand to equal supply it must be possible to accurately forecast the long run price.

Economic events are so uncertain that this price cannot be accurately forecast.

Therefore a buffer stock scheme will fail..

There are political forces at work causing the buy-in price to be set at unrealistic levels.

Changes in the exchange rate and other changes make the job of forecasting difficult.

Peter Auer

Source: reproduced from Stoeckel, A. et al. (1990

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Buffer Fund

- taxes, levies in high times
  - marketing agency
  - trust fund
- payments made to producers in low times
- critical decisions
  - levy size
  - fund size limit
  - stabilisation price
  - underwriting if inadequate

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Buffer Fund Disadvantages

- stabilisation price determination
  - difficult to get right
  - forecasting
- distortion of resource allocation
  - stabilised vs. unstabilised
- supply is more unresponsive
  - higher price, higher taxes

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Price Pools

- equalisation funds
- all proceeds to pool
- disbursement at average price
- set time period
  - usually not > 1 year
- payments in parts
  - 1st 70 to 90% of return
  - 2nd adjustment for final returns
- disincentive to quality?

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Supply Control

- cotton (US)
  - subsidies NOT to grow
- poultry
  - quotas
- cane-growers
  - quotas
- wool
  - proposed quotas after RPS collapse
    - 75% of previous season (1990 / 1991)
    - not enacted

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Price Risk Management

- forward contracts
  - deliverable
  - negotiated with mill
  - negotiated with intermediate
- futures
  - usually non-deliverable
  - futures exchange
- options
  - option to buy and sell later
  - private RPS scheme

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