

MICROECONOMICS AT WORK EXERCISE

SUBSIDIES

REFERENCE: 'Farmer anger over subsidies' (by John Breusch), *Australian Financial Review*, 27 January 2005, p.5.

CHAPTERS RELEVANT TO THIS EXERCISE: 3, 18

CONTEXT

In a free-market situation the price of a commodity is set according to the forces of supply and demand. This price is then paid by consumers and received by producers. Either of these prices (i.e. the price paid by the consumer or the price received by producers), or both, can be modified – upwards or downwards – if an organisation (e.g. a government) has the power to intervene in the operation of the market. Of the many possibilities of such intervention the one referred to in this article is that where the price *received by producers* of the commodity (in this case European producers of wheat in respect of that portion of their total output that is *exported*) is *increased* by virtue of a *subsidy* being paid by the government.

QUESTIONS

1. Explain the nature of the perceived problem being addressed, and the objective of the policy, as discussed in the article.
2. Explain the mechanics of the policy and the suggestion (quoted in the article) that the 'policy could further depress world wheat prices'.
3. Who benefits from this policy, and who pays?
4. Explain and discuss the criticism of the policy as 'market corrupting'.
5. What is the term 'farmer anger', used in the heading to the article, referring to?