Additional case study: Government intervention

The price of raw sugar recently reached its highest level since 1981 due to problems with supply. Historically, raw sugar has traded at between 10 and 12 US cents per pound at the New York Board of Trade. But the price increased to over 18 cents last month.

Growing demand in Brazil for sugar to be turned into ethanol for fuel, coupled with a sharp fall in Indian production have both been factors in the price increase.

Sugar production in India for 2008-09 fell 45% year-on-year due to less rain in the monsoon season damaging a number of agricultural crops.

The London-based International Sugar Organisation predicts that global consumption of sugar is likely to outstrip production by 9m tonnes next year, forcing food companies and governments to dig into stockpiles. In the US, snack producers including Mars, Nestlé and Krispy Kreme Doughnuts put pressure on the US government to relax import controls, warning that otherwise they might run out of sugar.

Commentators predict that most shoppers will be unaffected because sugar is such a small part of a consumer’s typical spending in a week that no one will notice an increase in price.

Source adapted from: http://news.bbc.co.uk/1/low/business/8193390.stm

Questions

1. Explain, using supply and demand analysis, why the price of sugar has been increasing recently.

2. Do you think a) the supply and b) the demand for sugar is price elastic or inelastic? Justify your choices and explain whether this means any given change in supply or demand will have a bigger effect on the equilibrium price of quantity.

3. In what ways is the market for sugar used in confectionery related to the market for ethanol?

4. How might companies such as Mars and Nestlé react to an increase in the price of sugar?