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ROLE OF GOVERNMENT IN DETERMINATION OF PRICE AND QUANTITY

We have studied in the previous lesson that the equilibrium price of a commodity is determined by the forces of demand and supply without any intervention of the government. But the price so determined may be so high that some consumers may not afford to buy the commodity at this price or it may be so low that the producers may not be willing to sell their products at this price or it may not even cover their cost of production of the commodity. In such a situation government intervenes and fixes the price either below the equilibrium price or above the equilibrium price to save the interests of consumers or producers as the case may be.

OBJECTIVES

After completing this lesson, you will be able to:

- *understand the role of government in production and distribution of goods and services;*
- *explain how government controls the price;*
- *understand the concept of minimum support price;*
- *explain how and why government helps consumers and producers.*

13.1 ROLE OF GOVERNMENT IN PRODUCTION AND DISTRIBUTION OF GOODS AND SERVICES

As explained earlier, the equilibrium price of a commodity is determined by the free play of the forces of demand and supply of the commodity without any intervention of the government. But sometimes the price so determined is very high when there is shortage of some commodity in the market. In such a situation some consumers can not afford to buy the commodity due to its high price. So in order to protect the interest of consumers the government has to fix the price of the commodity which is generally lower than the equilibrium price. In the same way when there is bumper crop of food grains, the price of food grains is determined at a lower level. At this price the farmers are unable to meet their cost of production even. So, the farmers are badly affected due to heavy fall in price. In such cases the government fixes the price of food grains which is higher than the equilibrium price in order to protect the interest of producers specially farmers. So, sometimes the government does not allow free play of the forces of demand and supply for determination of price of some commodities in order to protect the interest of consumers or producers. Government can fix the price of the commodity either below the equilibrium price or above the equilibrium price. Such a price is called administered price (Government determined price). Administered price may be in the form of:

(i) Control Price

(ii) Support Price

(iii) Token Price

(iv) Dual Price

13.2 CONTROL PRICE

In order to protect the interest of consumers government fixes the maximum price of the commodity. This maximum price is generally lower than the equilibrium price. This is called control price or ceiling price. This price is fixed by the government because poor people can not afford to buy the commodity at equilibrium price. This situation arises when the production of a commodity is less than its demand. As the price of the commodity fixed by the government is less than the equilibrium price, it may create excess demand of the commodity which means the buyers are willing to buy more than what the sellers are willing to sell. In India government has a control price or ceiling price of the commodities which it considers essential for the masses. For examples some goods such as wheat, rice, sugar, kerosene oil etc. have a control price. Due to excess demand for the commodity at ceiling price government resorts to rationing. Rationing means fixing of quota per head per unit of time. Due to excess demand of the commodity at ceiling price the problem of black marketing may also arise. Black marketing is a situation in which the seller illegally charges the price of the commodity which is much higher than the control price. The problem of black marketing can be solved through dual price policy which will be discussed in the later part of this lesson.

INTEXT QUESTIONS 13.1

1. Why does government fix the price of some commodities below the equilibrium price?

2. Name the problems faced in fixing the price of a commodity below the equilibrium price.
3. What is meant by rationing?
4. What do you mean by black marketing.
5. What policy is adopted by the government to check black marketing arising due to price control?

13.3 SUPPORT PRICE

Sometimes, in order to protect the interests of producers specially farmers government fixes the minimum price of the commodity which has to be paid to the producers. This price is generally higher than the equilibrium price. This problem arises when the producers do not cover even their cost of production at equilibrium price. This price fixed by government to safe guard the interests of producers, is called support price. It may create the situation of excess supply of the commodity. It means the sellers are willing to sell more than what the buyers are willing to buy.

In India low price of food grains such as wheat, rice etc. adversely affects the farmers. They may loose their interest in producing food grains. This may result in acute shortage of food grains. Therefore, the system of support price is usually followed in case of agricultural products. The system of support prices assures the farmers that they will be able to sell their products at least at this price.

In case of excess supply of the commodity at support price government is ready to purchase any quantity of the commodity to make buffer stock of the commodity.

INTEXT QUESTIONS 13.2

1. What is support price?
2. Why does the government fix the price of a commodity higher than the equilibrium price?
3. Suppose the farmers are unable to sell their total output of wheat at a price which si fixed by the government higher than the equilibrium price what policy is adopted by the government?
4. Name the two commodities which have support price in India?

13.4 TOKEN PRICE

There are some goods and services which are considered necessary for the existence of life e.g. medical services, health services and education services. Poor people are unable to make use of these services at prevailing market prices. Therefore, government and some private 'Charitable Institutions' provide these services at a price which is much below even their per unit cost of production. Such a price is called token price for these goods and services. The tuition fees charged in government schools is much below the cost incurred per student by the government.

Token price is charged in order to prevent the wasteful use of these services. Otherwise these services can be made available free of cost also. If these services are provided free some people may try to stay in hospital for a longer period in order to get free shelter and free food.

13.5 DUAL PRICE

As explained earlier in this lesson that price control may lead to the shortage of the commodity because sellers are not willing to supply adequate quantity of the commodity at the price fixed by the government as the price is lower than the equilibrium price. This may also lead to black marketing of the commodity. To avoid this situation government adopts dual price policy under this policy a part of the production of the good is sold at control price through fair price shops and the remaining part is sold at prevailing market price which is determined by the forces of demand and supply. At this market price any quantity of the commodity can be bought. For example government sells wheat, rice and sugar to BPL (Below poverty line) card holder at control price through fair price shops and the producers are also allowed to sell their remaining production at equilibrium price in open market.

INTEXT QUESTION 13.3

1. What is a token price?
2. What is meant by dual price?
3. Why does the government not supply some commodities free? Why does it charge a token price for them?
4. Tick mark (√) the correct answer
   (a) Token price is the price fixed by the government which is higher than the per unit cost of production.
   (b) Token price is the price which is much below the per unit cost of production.
   (c) Token price is the price which is charged from rich persons
   (d) Token price is equal to the per unit cost of production.

13.6 EFFECT OF TAXES AND SUBSIDIES ON MARKET PRICE

Government imposes various types of taxes on production and sales of the commodities and also on the imports of raw material etc. in the form of excise duty, sales tax and import duty respectively. These taxes are paid to the government by producers, sellers and importer of these commodities. The producers, sellers and importers of these commodities recover them from the buyers of these commodities. So these taxes increase the market price of the commodities. If the government increases the rate of these taxes, the market price of the commodities will also increase.

On the other hand government gives subsidy to the producers to sell some goods at a lower price in order to make the commodity available to the common men at a reasonable price. Thus an increase in subsidy leads to decrease in market price of the commodity. For example, government gives subsidy on kerosene oil, cooking gas etc.

13.7 PUBLIC DISTRIBUTION SYSTEM (PDS)

Poor people cannot afford to buy even the essential commodities at their market price. To help these people, one of the methods adopted in India is public distribution system under this system essential commodities like wheat, rice, sugar etc. are made available to the common man at cheaper rate through fair price shops called ration shops. These commodities are sold through an identification paper called ration card. Following are the essential elements of public distribution system in India.

1. **Subsidy:** Government gives subsidies on the commodities sold through public distribution system. Therefore, the prices of the commodities sold under this system are relatively lower.
2. **Fixed quantity (Rationing):** Government fixes the quantity (quota) per head per unit of time on the basis of minimum requirement of a person. Every household is issued a ration card mentioning the number of persons in the family. Every household can buy the fixed quantity of the commodity according to the number of persons in the family from the fair price shops.
3. **Fair price shops (FPS):** Government sells these commodities through fair price shops popularly known as ration shops. These shops are opened in all parts of the country. The government supplies these commodities to the owner of these shops according to the number of ration cards registered with each shop. The owner of these shops are paid a commission on their total sales.

INTEXT QUESTIONS 13.4

1. Name the three elements of public distribution system.
2. How does increase in tax affect the price of a commodity?

3. How does increase in subsidy affect the price of a commodity?

4. What is meant by the term 'rationing'?

5. On what basis are the fair price shops allotted the quota of goods to be distributed by them?

6. Write the full form of

   (i) BPL

   (ii) FPS

   (iii) PDS

WHAT YOU HAVE LEARNT

- Administered prices are the prices which are fixed by the government below or above the equilibrium price to protect the interests of consumers or producers.
- Control price is the price which is fixed by the government below the equilibrium price to protect the interest of consumers.
- Support price is the price which is fixed by the government above the equilibrium price to protect the interest of producers specially farmers.
- Token price is the price which is fixed by the government/private charitable institutions far below the per unit cost of production of the commodity.
- Under dual price system, a part of the total output is sold at control price through fair price shop and the remaining output is sold in the open market at the prevailing market price which is determined by the forces of demand and supply without any intervention of the government.
- An increase in tax on a commodity increases the market price of the commodity.
- Subsidy given on a commodity decreases the market price of the commodity.
- Commodities are sold through public distribution system on the basis of ration cards.

TERMINAL EXERCISE

1. What is control price? How does it affect the consumers?
2. What is support price? How does it affect the producers?

3. What is token price? What is the purpose behind fixing token price of a commodity?
4. Explain the system of dual price policy. How does it help the poor?
5. How do taxes and subsidies affect the market price of a commodity?
6. What is meant by public distribution system? Explain its essential elements in brief.

ANSWERS TO INTEXT QUESTIONS

Intext Questions 13.1

1. To protect the interest of consumers.
2. (i) problem of excess demand or shortage of the commodity.

   (ii) problem of black marketing
3. Rationing means fixing quota per head per unit of time
4. Black marketing is a situation in which the seller illegally charges a price which is much higher than the control price
5. Dual price policy

Intext Questions 13.2

1. Support price is the price fixed by the government higher than the equilibrium price to protect the interests of producers especially farmers.
2. To protect the interest of producers especially farmers.
3. Government is ready to purchase any quantity of the commodity at that price to make buffer stock of the commodity.
4. (i) Wheat

   (ii) Rice

Intext Questions 13.3

1. Token price is the price which is fixed by government and some private charitable institutions much below the cost of production per unit of the commodity.
2. Dual price is a policy in which a part of the production of a good is sold at control price through fair price shops and the remaining part is sold at prevailing market price determined by the forces of demand and supply.

3. Government does not supply some commodities free in order to avoid the misuse of these commodities.

4. (b)

Intext Questions 13.4

1. (i) Subsidy (ii) Fixed quantity or rationing (iii) Fair price shops

2. Price of the commodity increases.

3. Price of the commodity decreases.

4. Rationing means fixing quota per head per unit of time.

5. On the basis of the ration cards registered with the shop

6. (i) Below poverty line (ii) Fair price shops (iii) Public Distribution System