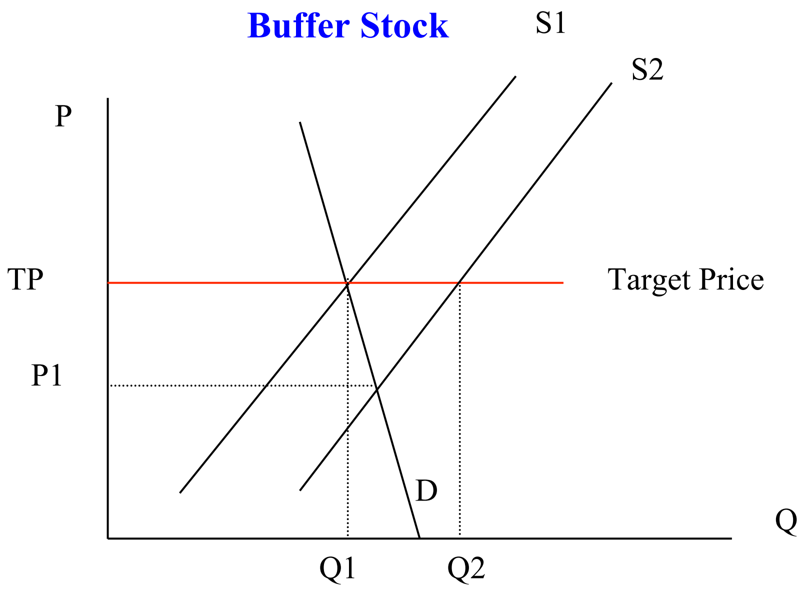
1. Evaluate the case for and against governments intervening to try to stabilise the price of copper, for example, through setting up a buffer stock scheme.

The price of copper can be volatile for various reasons. Firstly, in the short term, the supply of copper is inelastic. Demand can change rapidly due to speculation causing prices to rise or fall rapidly. A buffer stock scheme is a government policy which aims to stabilise prices and therefore benefit both consumers and producers from excess volatility in the price.

For example, if there was an unexpected increase in supply or a fall in demand, the government could intervene to buy the excess supply and keep prices high. If the government allowed prices to fall, then some producers would go out of business. It is not desirable to allow firms to go out of business because of falling prices. It would lead to unemployment and could lead to a shortage of supply in future years.

Diagram of Buffer Stock



To maintain price at TP the government buy Q1 to Q2 * TP

Similarly, if prices increase significantly, then consumers will be faced with higher prices, therefore, there will be a decline in consumer surplus. Also copper is an important raw material for electric wiring. If the price of copper increases firms would be faced with unexpected costs which can cause problems and decrease confidence to invest. If the government bought copper, when prices were falling they could increase supply when prices are rising. This greater stability of prices would be beneficial for both producers and consumers.

However, governments tend to be more concerned about falling prices. Falling prices could cause producers to go out of business leading to unemployment.

Rising prices create some discomfort for consumers, but it is not as damaging. Though, if the product was a basic food necessity like rice, it may become important to prevent price rises

However, there are problems with implementing buffer stocks.

Firstly, it can be difficult for a government to set up a buffer stock scheme for a commodity produced in many countries. For example, several countries may try to prevent prices falling, but, one or two countries may continue to increase supply benefiting from higher prices. Therefore, if not all countries take part in the buffer stock scheme, the price will remain low. The difficulty of stabilising prices of commodities can be seen by the failure of OPEC to stabilise oil prices.

Buffer stocks can be expensive to implement. The government will need to buy excess supply and there is no guarantee they will be able to sell for a profit; especially if government intervention encourages more firms to enter the market.

Buffer stocks may distort market incentives. For example, if prices fall this may be an indication of oversupply in the market. By buying this supply, it may encourage oversupply even more. Therefore, it doesn't address the fundamental problem in the industry. Also government intervention may encourage the firms to be inefficient because they can rely on the government intervention to boost supply.

Finally, the government may have poor information about future prices and supply; therefore, they may end up buying too much or too little.

In conclusion, a buffer stock scheme is fine in practice, but is often much more difficult to practically implement. Also, for a commodity like copper, it requires international co-operation, which is unlikely to exist.

1. Evaluate government policies which might improve the UK balance of trade in goods and services

The balance of trade in goods and services measures the value of exports minus the value of imports. An improvement in the balance of trade in goods and services requires the value of exports to increase faster than the value of imports, and therefore reduce the trade deficit.

The first policy is to reduce import spending. This can be done through contractionary fiscal policy. Higher tax rates and lower government spending should reduce consumers' disposable income. Therefore, there will be a fall in spending on imports of goods and services. In the UK, we have a high propensity to import, therefore any increase in taxes (e.g. higher income tax rates) might be effective in reducing demand for luxury goods (which are often imported).

The main problem with this policy is that it would lead to lower aggregate demand and therefore lower rates of growth and higher unemployment. These objectives are arguably more important than improving the balance of trade in goods and services. However, if the economy is booming and is experiencing inflation, then reducing consumer spending, through higher tax rates, may improve the balance of trade and also help reduce inflation.

A second policy would be to influence the exchange rate. If the government could devalue or depreciate the value of the Pound, exports would become more competitive and this would help improve the balance of trade. The government could devalue the exchange rate by selling pounds, increasing money supply or cutting interest rates. However, cutting interest rates may boost consumer spending on imports. Also, the UK governments no longer set interest rates, instead rates are set by the independent Bank of England who seek to maintain an inflation target, rather than target the balance of trade.

Also, the effect of a depreciation in the value of the pound, depends on the elasticity of demand for imports and exports. If demand for exports is inelastic, a lower price of exports will lead to a fall in the value. A depreciation will only be effective, if demand is relatively elastic.

To increase the level of exports the government could try implement supply side policies to improve the competitiveness of exports. Supply side policies could include promoting privatization and deregulation. Privatisation (shifting state owned assets to private sector) creates more profit incentives to cut costs. Deregulation increases competitive pressures and may lead to lower prices. Another supply side policy could involve better education and training, especially in vocational training. A more productive labour force would help increase the productivity of exports and make UK goods more competitive. This would lead to higher exports and improve the balance of trade over a period of time. However, it takes a long time to improve education and training standards. Also there is no guarantee that government spending on education would actually improves labour productivity – the money needs to be well targeted on training schemes that are useful for firms. If labour productivity doesn't improve, there will be no improvement in the trade balance and the government spending will be ineffective.

The most effective way to tackle the trade deficit is to reduce consumer spending through contractionary fiscal policy. Reducing consumer spending through higher taxes, will reduce imports. However, this policy also has the biggest drawback of leading to lower economic growth and higher unemployment. The best policy would be effective supply side policies, such as education, more flexible labour markets and increased competitiveness - which should help make UK exports more attractive. This will improve the balance of trade over time. The drawback to this supply side approach is that, in practice, it is not so easy for the government to improve the productivity of UK industry through supply side policies.