Impact of Price Floors: 
A Real Options Based Experimental Approach

Syster Christin Maart*, Oliver Mußhoff and Moritz Maack

Georg-August-Universitaet Goettingen, 
Department of Agricultural Economics and Rural Development, 
Platz der Goettinger Sieben 5, 37073 Goettingen, Germany, Tel: +49 551 394842, 
Fax: +49 551 392030, 
* Corresponding author. E-mail: syster.maart@agr.uni-goettingen.de

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Background and Objectives

Price floors are frequently used in agricultural policies to
- stimulate investments
- assure supply security for certain commodities
**BUT:** some contributions doubt the effectiveness of price floors

Hypotheses

- **H1 ‘NPV consistency’:** The investment behaviour of participants is consistent with the NPV.
- **H2 ‘ROA consistency’:** The investment behaviour of participants is consistent with the ROA.
- **H3 ‘price floor effect’:** Price floors do not significantly stimulate the decision maker’s willingness to invest.
- **H4 ‘order effect’:** The decision maker’s behaviour is dependent on the order of the two investment treatments.
- **H5 ‘learning effect’:** The decision maker’s investment behaviour depends on the number of repetitions of the investment decisions.

Experimental Setting

- Experiment carried out in June 2011
- 101 students mainly of agricultural sciences participated
- Experiment consisted of three parts
  1) Holt- and Laury-Lottery
  2) Real Options experiment
  3) General information about the participants’ characteristics
- 30 minutes per individual
- Incentive compatibility
- Participation allowance

Figure 1: Binomial tree (standard deviation = 2,000 €/ha)

Results

**Focus on price floors’ effects on the investment behaviour**
**Experimental investigation of investment behaviour**
- Explanatory potential of the real options approach
- Impact of price floors

**Figure 2:** Survival functions of actual and optimal investment behaviour according to the ROA and NPV

**Figure 3:** Comparison of the survival functions for WPF and NPF treatment

Conclusions

<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>Validity</th>
<th>Participants’ investment behaviour differed substantially from the predictions made by the NPV and the ROA.</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1 ‘NPV consistency’</td>
<td>Rejected</td>
<td>Actual investment behaviour did not differ significantly in general with respect to the presence of a price floor.</td>
</tr>
<tr>
<td>H2 ‘ROA consistency’</td>
<td>Rejected</td>
<td>Participants who were first faced with the WPF treatment and second with the NPF treatment tended to invest more iner over both treatments than participants who faced the treatments in reverse order.</td>
</tr>
<tr>
<td>H3 ‘price floor effect’</td>
<td>Failed to reject</td>
<td>Participants learned from personal experience during the experiment and approached the ROA benchmarks over time.</td>
</tr>
<tr>
<td>H4 ‘order effect’</td>
<td>Failed to reject</td>
<td></td>
</tr>
<tr>
<td>H5 ‘learning effect’</td>
<td>Failed to reject</td>
<td></td>
</tr>
</tbody>
</table>

Abbreviations:

NPV - net present value  
WPF - with price floor  
ROA - real options approach  
NPF - no price floor

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