

IB Economics – Government Intervention

Exam Practice Questions: 1.9 Indirect Taxes



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1.9 INDIRECT TAXES: EXAM PRACTICE QUESTIONS

Answer the questions that follow.

1. IB ECONOMICS PAPER 1 EXAMINATION QUESTIONS

- a. Explain why a government might impose an indirect excise tax. **[10 marks]**
- b. Explain how indirect excise taxes can result in an underproduction of a good and a decrease in allocative inefficiency. **[10 marks]**
- The government imposes an excise tax on petrol of \$0.25 per litre.
- c. Analyse the effects on market outcomes (use diagrams). **[10 marks]**
- d. Discuss the consequences for stakeholders of the imposition of this tax. **[15 marks]**
- e. To what extent does price elasticity of demand and price elasticity of supply of a particular product determine the incidence of indirect taxes on consumers and producers? **[10 marks]**

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2. IB ECONOMICS HL PAPER 3 EXAMINATION QUESTIONS

Question One

[25 marks]

- a. A country has a competitive market for good X. The demand function for A is $Q_d = 10 - P$, and the supply function is $Q_s = -4 + P$. Quantities are in units (000 per day). Price is in dollars.
- b. Calculate equilibrium price and quantity in the market for good X. [2 marks]
- c. Draw the demand and supply curves for good X. [2 marks]
- d. The government decides to impose an indirect excise tax on good X of \$2 per unit. Draw the new supply curve. [1 mark]
- e. Determine the new supply function for good X after the tax. [2 marks]
- f. Derive the new equilibrium price for X from the supply and demand functions and plot these in your diagram. [2 marks]
- g. Explain why the tax does not increase the price to consumers by \$2. [2 marks]
- h. Calculate the government revenue generated by the tax. [1 mark]
- i. Calculate the tax incidence on consumers and the tax incidence on producers. [2 marks]
- j. Identify consumer surplus, producer surplus, government revenues and social welfare loss after the tax is imposed. [4 marks]
- k. Analyse the impact of the indirect excise tax on allocative efficiency. [4 marks]
- l. Outline one stakeholder group that is advantaged by the indirect tax and three groups that are disadvantaged by it. [3 marks]

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Question Two

[25 marks]

A country has a competitive market for good A. The demand function for A is $Q_d = 10 - P$, and the supply function is $Q_s = -4 + P$. Quantities are in units (000 per day). Price is in dollars. The government is considering a \$3.00 per unit excise tax on good A to discourage its consumption.

- a. Draw a competitive market at equilibrium and identify the producer and consumer surplus. [2 marks]
- b. Explain why a competitive market equilibrium is necessary to achieve allocative efficiency in the absence of market failure. [2 marks]
- c. Calculate the social surplus in the competitive free market. [3 marks]
- d. Calculate the consumer and producer surpluses if the tax is imposed. [4 marks]
- e. Calculate the change in consumer and producer surpluses that would arise if the tax is imposed. [2 marks]
- f. Calculate producers' total revenues and total consumer expenditure in the competitive free market. [2 marks]
- g. Calculate producers' total revenues and total consumer expenditure in the market if the tax is imposed. [2 marks]
- h. Calculate the change in producers' total revenues and total consumer expenditure in the market if the tax is imposed. [2 marks]
- i. Calculate the government revenue that would be generated by the tax. [2 marks]
- j. Explain why social surplus if the tax is imposed will be less than the social surplus in a competitive free market. [4 marks]