IB Economics – Government Intervention

Exam Practice Questions: 1.11 Price Controls

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1.11 PRICE CONTROLS: EXAM PRACTICE QUESTIONS

Answer the questions that follow.

1. IB ECONOMICS PAPER 1 EXAMINATION QUESTIONS

a. Explain why a government might impose a price floor or a price ceiling. **[10 marks]**

b. Explain how price controls can result in the over- **or** under-production of a good **and** the effect on allocative inefficiency in a market. **[10 marks]**

c. Price controls, subsidies and indirect taxes are all forms of government intervention. Only price controls results in market disequilibrium. Discuss. **[15 marks]**

d. Analyse the effects on market outcomes (use diagrams). **[10 marks]**

e. Discuss why for price control policies be effective, a price ceiling must be set below the equilibrium price, and a price floor must be set above the equilibrium price. **[10 marks]**

f. Use diagrams to explain how price floor and price ceilings result in excess demand (shortages) and excess supply (surpluses). **[10 marks]**

The government of country A would like to provide income support for rice farmers and is considering two policies: a subsidy or a minimum price where any excess rice would be purchased by the government.

g. Explain the effects of each policy on the quantity of rice produced and supplied to the market **and** the effect on allocative efficiency. **[10 marks]**

h. Compare and contrast the effects on stakeholders **and** market outcomes. **[15 marks]**

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In the last ten years the Venezuelan government has implemented a policy of setting maximum prices for key staple foodstuffs such as cooking oil, rice and flour.

i. Analyse the effects of the price ceiling in the market for cooking oil. **[10 marks]**

j. Examine the consequences of the policy of regulating price ceilings on staple foods ceilings on the Venezuelan economy (including resource allocation and welfare) and stakeholders. **[15 marks]**

Brazil uses a price floor to support sugar producers.

k. Explain the impacts on the Brazilian market for sugar. **[10 marks]**

l. Analyse the effects on stakeholders and the Brazilian economy (including government measures to dispose of the surpluses, resource allocation and welfare). **[15 marks]**

m. Use diagrams to analyse the effects of a minimum wage on the labour market and the economy. **[10 marks]**

n. Discuss the consequences of the minimum wage for various stakeholders. **[15 marks]**

2. IB ECONOMICS HL PAPER 3 EXAMINATION QUESTIONS **[25 MARKS]**

Question One

The market for good A has the following demand and supply equations: Qd = 10 − P, and Qs = -2 + P, Price is in dollars and quantities in millions of tonnes.

a. Calculate equilibrium price and quantity and draw the demand and supply curves. **[4 marks]**

b. A price ceiling of $4.00 is imposed on the market by the government. On your diagram draw the price ceiling. **[1 mark]**

c. Calculate the shortage (excess demand). **[1 mark]**

d. Calculate the change in producer revenue and the change in consumer expenditure that results from the price ceiling. **[3 marks]**

e. On your diagram show the deadweight/welfare loss resulting from the price ceiling. **[2 marks]**

Suppose that the market defined above is for rice and the government sets a price floor of $8.00 per tonne of rice and agrees to purchase all excess supply at this price.

f. Draw a diagram that illustrates the effects of the price floor relative to the market equilibrium price and quantity. **[1 mark]**

g. Calculate the surplus (excess supply). **[1 mark]**

h. Calculate changes in producer revenue and consumer expenditure, and total government expenditure spent maintaining the price floor by purchasing the surplus output of rice. **[5 marks]**

i. On your diagram, identify the welfare effects (deadweight loss) caused by the price floor. **[2 marks]**

Suppose that it is a market for unskilled labour that is being defined by the supply and demand functions above. P is the hourly wage rate. The government legislates a minimum wage of $7.00 per hour.

j. Draw a diagram that illustrates the effects of the minimum wage relative to the market equilibrium wage rate and quantity of labour. **[2 marks]**

k. Calculate the total number of workers now unemployed in the market, **and** how many of these unemployed are from an increase in the quantity of labour supplied at higher wage rates **and** the decrease in quantity demanded by employers. **[3 marks]**