1.3 Government Intervention
Terms & Objectives

TERMS

- Indirect Taxes
- Excise Taxes
- Specific Taxes
- *Ad Valorem* Taxes
- Welfare Loss
- Tax Incidence
- Subsidy
- Price Controls
- Price Ceiling
- Rent Control
- Non-Price Rationing
- Underground (or Parallel) Markets
- Price Floor
- Minimum Wage

OBJECTIVES

I. INDIRECT TAXES

Specific (fixed amount) taxes and ad valorem (percentage) taxes and their impact on markets

- Explain why governments impose indirect (excise) taxes.
- Distinguish between specific and *ad valorem* taxes.
- Draw diagrams to show specific and *ad valorem* taxes, and analyse their impacts on market outcomes.
- Discuss the consequences of imposing an indirect tax on the stakeholders in a market, including consumers, producers and the government.

Tax incidence and price elasticity of demand and supply **(HL)**

- Explain, using diagrams, how the incidence of indirect taxes on consumers and firms differs, depending on the price elasticity of demand and on the price elasticity of supply. **(HL)**
- Plot demand and supply curves for a product from linear functions and then illustrate and/or calculate the effects of the imposition of a specific tax on the market (on price, quantity, consumer expenditure, producer revenue, government revenue, consumer surplus and producer surplus). **(HL)**

II. SUBSIDIES

Impact on markets

- Explain why governments provide subsidies, and describe examples of subsidies.
- Draw a diagram to show a subsidy, and analyse the impacts of a subsidy on market outcomes.
- Discuss the consequences of providing a subsidy on the stakeholders in a market, including consumers, producers and the government.
- Plot demand and supply curves for a product from linear functions and then illustrate and/or calculate the effects of the provision of a subsidy on the market (on price, quantity, consumer expenditure, producer revenue, government expenditure, consumer surplus and producer surplus). **(HL)**

III. PRICE CONTROLS

Price ceilings (maximum prices): rationale, consequences and examples

- Explain why governments impose price ceilings, and describe examples of price ceilings, including food price controls and rent controls.
- Draw a diagram to show a price ceiling, and analyse the impacts of a price ceiling on market outcomes.
- Examine the possible consequences of a price ceiling, including shortages, inefficient resource allocation, welfare impacts, underground parallel markets and non-price rationing mechanisms.
- Discuss the consequences of imposing a price ceiling on the stakeholders in a market, including consumers, producers and the government.
- Calculate possible effects from the price ceiling diagram, including the resulting shortage and the change in consumer expenditure (which is equal to the change in firm revenue). **(HL)**

Price floors (minimum prices): rationale, consequences and examples

- Explain why governments impose price floors, and describe examples of price floors, including price support for agricultural products and minimum wages.
- Draw a diagram of a price floor, and analyse the impacts of a price floor on market outcomes.
- Examine the possible consequences of a price floor, including surpluses and government measures to dispose of the surpluses, inefficient resource allocation and welfare impacts.

- Discuss the consequences of imposing a price floor on the stakeholders in a market, including consumers, producers and the government.
- Calculate possible effects from the price floor diagram, including the resulting surplus, the change in consumer expenditure, the change in producer revenue, and government expenditure to purchase the surplus. **(HL)**