Chapter 9

Put into practice questions

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Which of the following statements are true and which are false? Explain your answer.

a. In a free market negative externalities lead to overproduction. TRUE
b. A government is likely to subsidize negative externalities. FALSE
c. If the social benefit is greater than the private benefit there is a positive externality. TRUE
d. A monopoly in the UK is defined as a business with more than 50 per cent share of the market. FALSE

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Using supply and demand diagrams, illustrate the possible effect on overall earnings of introducing a minimum wage.

Look at figure 9.2; imagine this is the labour market and P1 is the minimum wage. The number employed would be Q2. The earning would be the rectangle around P1 0 Q2.

What might influence the overall effect on employees' total earnings?

The wage elasticity of demand.

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Which of the following statements are true and which are false? Explain your answer.

a. In a buffer stock scheme the government buys up excess demand in a good year. TRUE
b. In a buffer stock scheme the government sells more when the market supply is limited. TRUE
c. A minimum price above equilibrium leads to excess supply. TRUE
d. A maximum price above equilibrium leads to excess supply. FALSE

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Which of the following statements are true and which are false? Explain your answer.

a. A nationalized organization is in the public sector. TRUE
b. A privatized business is likely to have social objectives. FALSE
c. Regulatory capture reduces the effectiveness of the regulators. TRUE
d. One reason for privatization is to create natural monopolies FALSE

End of chapter put into practice questions

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Show the effect of a minimum price set below the equilibrium price using a supply and demand curve diagram.

This has no effect.

Show the effect of an indirect tax imposed on a market on the equilibrium price and quantity. Show the tax revenue for the government. Assume demand is relatively price inelastic and supply is relatively price elastic.

It will increase prices and reduce the equilibrium quantity. Price will be affected more than quantity.

Show on a diagram the effect of a maximum price above the equilibrium market price.

No effect

Show on a diagram why a government might want to intervene to prevent monopolies

See figure 8.6. The diagram should show the loss of community surplus created by a monopoly.

Referring to Figure 8.5—which shows that an indirect tax has been imposed on a product—the tax revenue gained is:
a. —£2,000
b. £30,000
c. £200,000
d. £10,000.

Explain your answer.

£100,000 (£10 on 10,000 units).

Show the effect of a production subsidy imposed on a market on the equilibrium price and quantity. Assume demand is relatively price elastic and supply is relatively price inelastic.

A subsidy shifts supply outwards reducing the equilibrium price and increasing the equilibrium quantity.

With reference to Figure 8.6 what is the specific tax per unit? Explain your answer.

The subsidy is WT.

What is the incidence of tax per unit on the consumer? On the producer?

The consumer incidence is WU; the producer incidence is UT.

Using a diagram illustrate how forcing a monopolist to set the price equal to the marginal cost would affect consumer surplus, producer surplus, and community surplus.

This would reduce the price and increase the quantity. It would increase consumer and community surplus and reduce producer surplus.