Business Tax Activity 4 Explaining business taxes

Years 11-12

TASK 4 GOVERNMENT INTERVENTION IN THE MARKET PLACE

Worksheet

Focus: Economics

YOU WILL:

- consider why the government intervenes in the market place
- sketch fully labelled and annotated demand-supply diagrams showing how equilibrium prices and quantities traded in the market adjust in response to government intervention

YOU WILL NEED:

- *Fact sheet: Explaining business taxes*

GOVERNMENT INTERVENTION IN THE MARKET THROUGH VARYING SUPPLY

Governments intervene in the market to vary the quantity of goods and services produced due to either the social costs (negative externalities) or benefits (positive externalities) of their production and consumption. They can do this imposing taxes, paying subsidies and enforcing regulations to vary supply.

EXAMPLE OF GOVERNMENT'S IMPACT ON SUPPLY

An example of government intervention in the market is the case of subsidies that some governments around the world provide to producers of electric cars. Electric cars can be considered merit goods because of their low environmental impact. Subsidies have the effect of reducing the cost of production and are designed to increase production and consumption. Let's see how the subsidy changes market equilibrium.

1. Assuming that the subsidy is a per unit subsidy and all other things being equal, the supply curve will shift vertically downwards by the amount of the subsidy. In this case the new supply curve will be parallel to the original. Figure 1 illustrates this increase in supply as a shift of the supply curve from S1 to S2.
2. The shift in the supply curve results in a surplus (QS>QD) of electric cars at the initial equilibrium price. This excess exerts downward pressure on the price of electric cars, resulting in an expansion in the QD (upward movement along D1) and a contraction in the QS (downward movement along the new supply curve, S2) until a new equilibrium price is reached.
3. The shift of the supply curve for electric cars from S1 to S2 results in a change in equilibrium price paid by consumers. As Figure 1 shows, the shift in the supply curve reduces the equilibrium price from P1 to P2 and increases the quantity traded from Q1 to Q2. In other words, the price of electric cars decreased, and the quantity traded increased.

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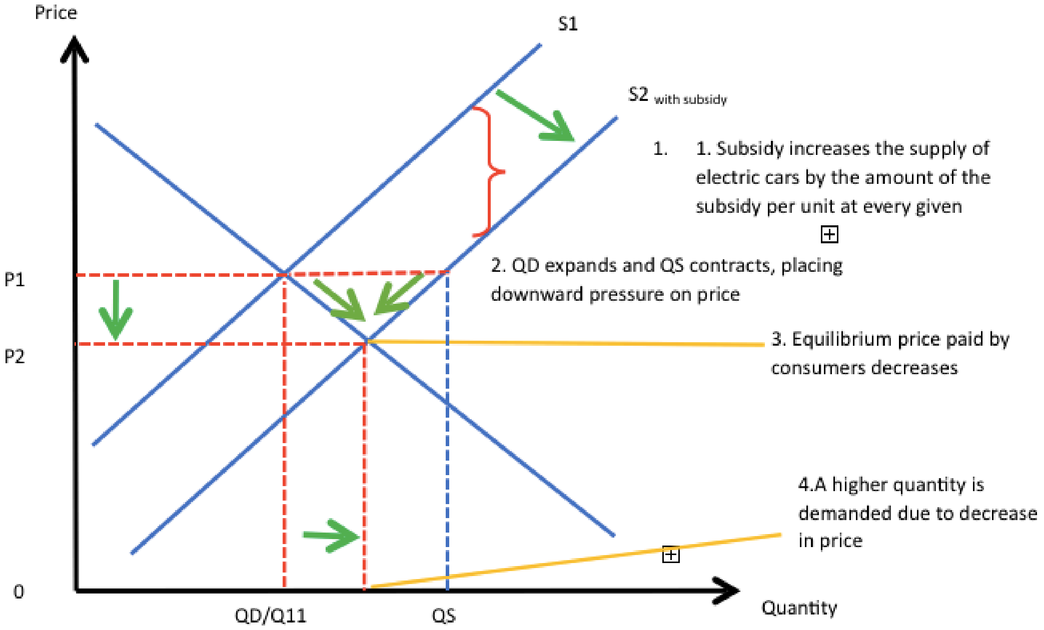
DRAW AND INTERPRET ECONOMIC DIAGRAMS

Sketch fully labelled and annotated demand-supply diagrams showing how equilibrium prices and quantities traded in the market adjust in response to each of the following government decisions. Describe what is shown in each sketch.

a. An increase in the rate of excise tax on alcoholic beverages.
b. More regulations on the production of plastic
c. Fewer regulations on the provision of child care

Figure 1: Market for electric cars



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