 Province of the

EASTERN CAPE

EDUCATION

**DIRECTORATE SENIOR CURRICULUM MANAGEMENT (SEN-FET)**

**HOME SCHOOLING SELF-STUDY ANSWER SHEET**

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| **SUBJECT** | **ECONOMICS** | **GRADE** | **12** | **DATE** | **21/04/2020** |
| **TOPIC** | **MICROECONOMICS MARKS: 40** | **TERM 2**  **REVISION** |  | **TERM 2 CONTENT** | **X** |

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| **QUESTION 1:** |  |
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| **DBE Nov 2018**   * **Discuss, with the aid of graphs, the consequences of market failure under the following headings: −.** * **Producer subsidies (8 marks)** * **Maximum prices (8 marks)** * **Minimum wages (10 marks) (26)** * **With reference to the graph below, analyse how a negative externality can result in the misallocation of resources. (10) [40]** |  |
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| **INTRODUCTION** |  |
| * Market failure is when the market fails to produce sufficient (optimum) quantities that people want. 🗸🗸   Accept any other relevant introduction (Max 2) | (2) |
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| **BODY** |  |
| **MAIN PART** |  |
| **Producer Subsidies** |  |
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| * A subsidy is a form of financial grant to support the production of a good or service by the government by lowering the cost of production🗸🗸 * Subsidies can be direct (e.g. cash grants) or indirection (e.g. depreciation write-off). 🗸🗸 |  |
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| * The market price decrease from P to P2, and the quantity consumed will increase from Q to Q1 due to the subsidy paid by government 🗸🗸 * The producer benefits from a subsidy/producer's profit increases (the difference between P and P2) 🗸🗸 * The consumer benefits from a subsidy by paying less (price decreased from P to P1) 🗸🗸 * Producer subsidies are often given to suppliers of agricultural products such as milk, wheat and maize🗸🗸   (Max 6) |  |
| **Maximum Prices** |  |
| * Sometimes the government will set the price of a good or service at a maximum price that is below the market price/The government intervenes and passes a law that suppliers may not charge more than the maximum price 🗸🗸 * Maximum price are usually set on basic goods, such as food and transport so that citizens have access to certain goods and services and achieve a certain minimum standard of living 🗸🗸 |  |
| * In the figure above, the maximum price is set at P1, while the market price is at P🗸🗸 * The immediate effect would be that the quantity supplied will drop from Q to Q1🗸🗸 * The shortage caused by the price ceiling creates a problem of how to allocate the good since the demand will exceed the supply🗸🗸 * Black markets often develop where illegal goods are bought or sold 🗸🗸 (Max 6) |  |
| **Minimum Wages** |  |
| * When the government enforces a minimum wage, it means workers have to be paid a certain minimum remuneration that will lead to a higher standard of living / increased satisfaction of wants.🗸🗸      * The graph shows that if the wage rate is set at W, the corresponding demand and supply of labour will be Q 🗸🗸 * If a minimum wage of W1 is set, the demand for labour will decrease from Q to Q1. Some people may become unemployed 🗸🗸 * However, the supply of labour will increase from Q to Q2. As more people will offer their labour because of a higher income 🗸🗸 * Minimum wages will lead to more bargaining power of workers 🗸🗸 (Max 8)   (Accept any other correct relevant response) (Allocate a maximum of 8 marks for the mere listing of facts/examples). (Max. 26) | (26) |
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| **ADDITIONAL PART** |  |
| A negative externality results in the misallocation of resources:   * + Because external costs are not included in the price when the market produces 150 units 🗸🗸   + If external costs are included the supply will decrease and market will produce at 100 units at a higher price of R50, that is socially desirable 🗸🗸   + Since the market does not take external cost into account it over-produces thus more resources than it socially desirable is used 🗸🗸   + harming other producers or consumers through the behaviour of certain producers that impact negatively on the cost structure of other participants 🗸🗸   + charging a price of R40 for quantity 150 sold, that represents only private cost (MPC) 🗸🗸   + reaching the socially optimal point of production if social cost is taken into account, that will lead to a price increase to 50 and the quantity reducing to 100 🗸🗸   + producing too much of a good which has a negative externality (welfare loss) indicated by the shaded area on the graph 🗸🗸   + at R40 if the market is left to its own devices, a quantity of 150 will be produced (socially insufficient) 🗸🗸 (Max 10) | **(10)** |
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| **CONCLUSION** |  |
| * Government involves itself directly in the market when the market does not act in the interest of society 🗸🗸   (Accept any other correct relevant conclusion.) (Max 2) | **(2)** |
|  | [40] |
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