

School: RATU NAVULA COLLEGE

Level: Year 11

Subject : Economics

Week: 1

Lesson 45

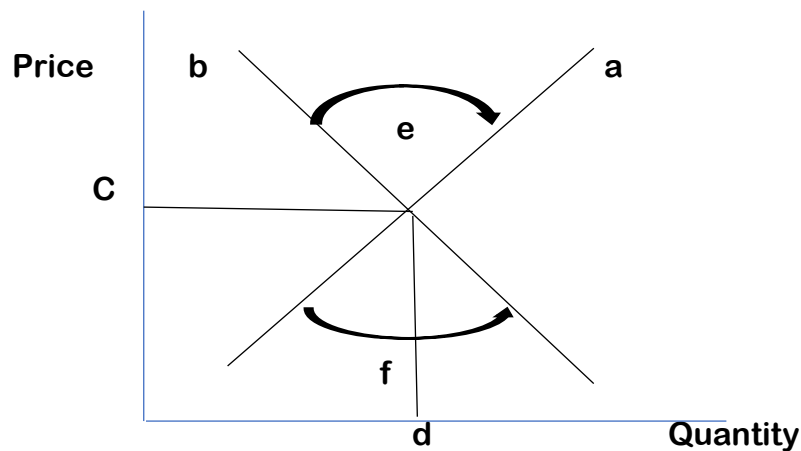
Strand 2: Microeconomics

Strand 2.4 : Price Mechanism

Learning Outcome: Label related curves, identify equilibrium and the market situation.

Activity

1.



Study the diagram above and label a to f.

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____
- f. _____

2. Study the table below and answer the following questions.

Price(\$)	Quantity demanded (Kg)	Quantity Supplied (kg)
10	20	100
9	30	75
8	40	60
7	50	50
6	60	30
5	70	25

- a) What is the equilibrium price and quantity?
- b) What is the total income earned by suppliers at 60 kg.

c) If the government sets a price of \$9, what would be the market surplus?

Lesson 46

Strand 2: Microeconomics

Strand 2.4 : Price Mechanism

Learning Outcome: Evaluate the functions and effects of price control in determining the allocation of resources.

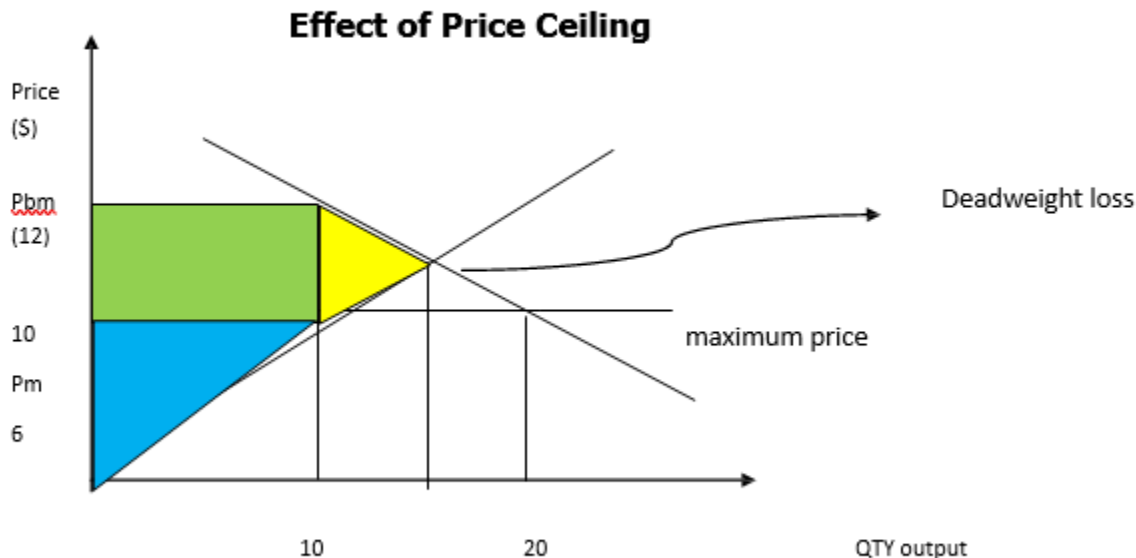
Price Control

is the control of prices by government either at maximum or minimum level.

Price Ceiling

- these legal prices are either set above or below the equilibrium prices.
- set to protect the buyers or consumers. e.g. rent ceiling, interest ceiling

Graphically :



KEY:

- Increased consumer surplus after price ceiling.
- Reduced producer surplus after price ceiling.
- Deadweight loss – is sum of loss of consumer and producer surplus not transferred to any party.

Rent Ceiling: is the maximum price a landlord is allowed to charge for rent. Rent ceilings are usually set by law and limit how high the rent can go in a specified area.

Interest rate Ceiling: is a regulatory measure that prevents banks or other financial institutions from charging more than a certain level of interest.

Effects of Price Ceiling

- creates a shortage
- results in black marketing
- reduces the value of producer surplus and increase in value of consumer surplus

Activity

1. Define the term price ceiling.
2. Why do government fix price ceiling?
3. Give local examples of Price ceiling.
4. Draw a graph to depict price ceiling.

Lesson 47

Strand 2: Microeconomics

Strand 2.4 : Price Mechanism

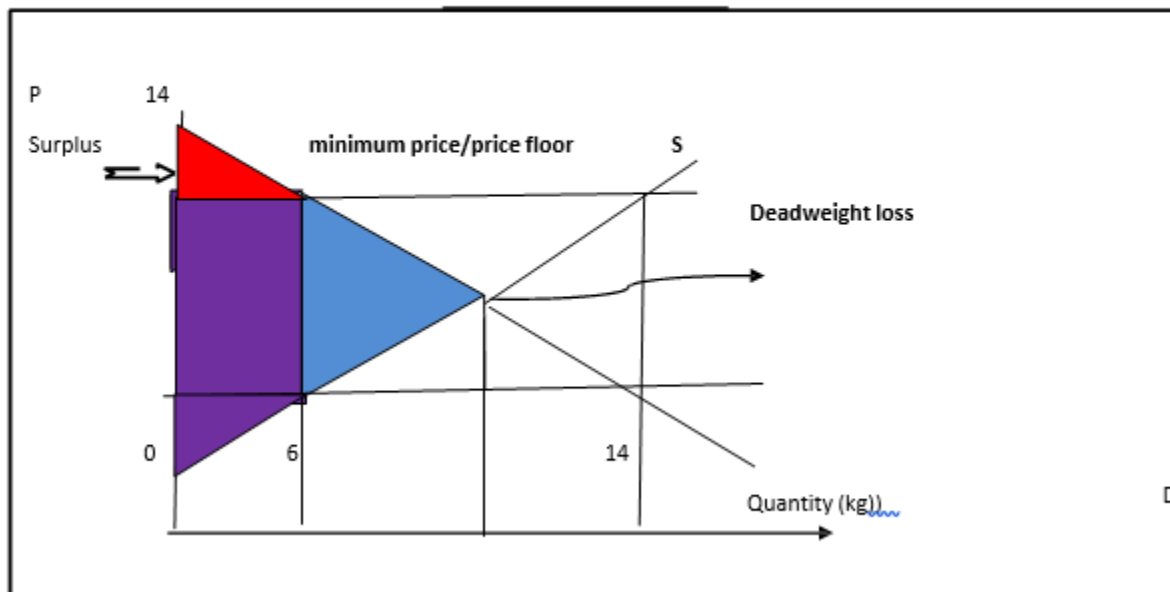
Learning Outcome: Evaluate the functions and effects of price control in determining the allocation of resources.




Price Floor

- it is the minimum price set by government to protect producers.
- e.g. agriculture price floor and minimum wage rate.

Graphically :

Effect of Price Floor



-  Reduced consumer surplus after price ceiling
-  Increased producer surplus after price ceiling
-  Deadweight loss –is sum of loss of consumer and producer surplus not transferred to any party.

Agriculture Price Floor: a minimum allowance price set above the equilibrium to assist farmers in the agricultural markets.

Minimum Wage rate: it is the wage level which keeps basic family income above the poverty line.

Garment Industry rate: currently at \$2.68

Effects of Price Floor

- creates a surplus
- results in illegal lowering of prices in the market
- the surplus created will be wasted if government does not come in to buy up the surplus.

Activity

1. Why will drug companies produce more pharmaceuticals at higher prices?
2. Why will consumers buy more pharmaceuticals at lower prices?
3. What happens to the price if a price floor is imposed?
4. Does a price floor create a surplus or a shortage?

Lesson 48

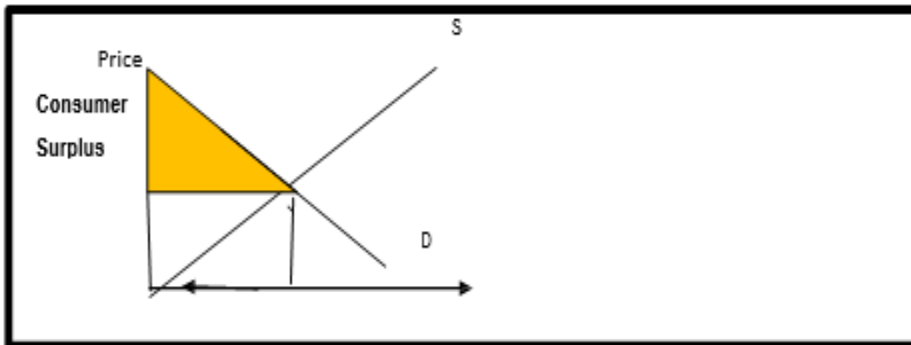
Strand 2: Microeconomics

Strand 2.4 : Price Mechanism

Learning Outcome: Define and describe consumer and producer surplus and deadweight loss.

Consumer Surplus

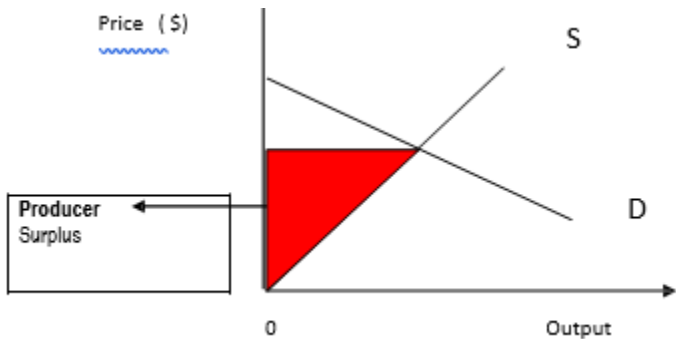
The difference between the price consumers are willing and able to pay and what they actually pay.



For example: if you would be willing to spend \$10 on a good, but you are able to purchase it for just \$7. Your consumer surplus from that transaction is \$3.00.

Producer Surplus

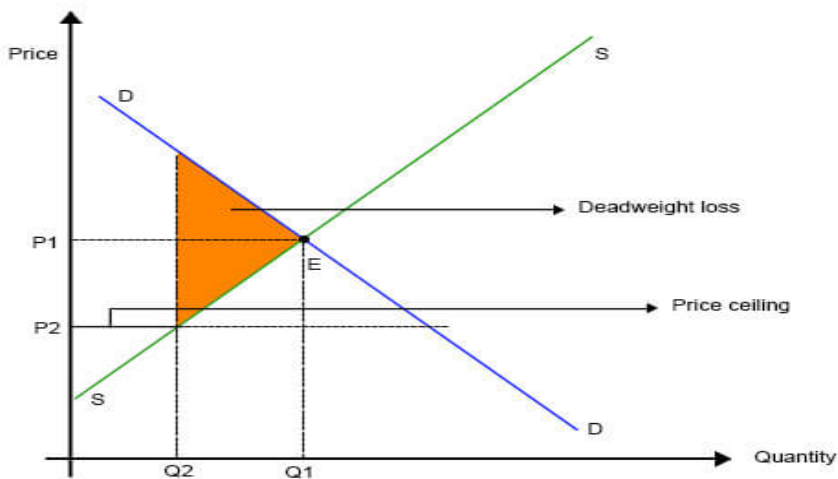
The difference between the price at which producers are willing and able to supply and what they actually receive for selling the commodity.



For example: if a producer sells widgets to consumers for \$8, it receives \$4,000 but it was willing to accept in this \$2500. The producer surplus is \$1,500.

Deadweight Loss

Also known as excess burden or allocative inefficiency that can occur when the free market equilibrium for a good or service is not achieved.



Activity: Circle the best answer.

1. An effective price ceiling creates a _____ and an effective price floor creates a _____.
- A. surplus; shortage
 - B. shortage; shortage
 - C. surplus; surplus
 - D. shortage; surplus
2. A price ceiling _____ lead to a black market and a price floor _____ lead to illegal trading.
- A. cannot; cannot
 - B. can; can
 - C. can; cannot
 - D. cannot; can
3. A price ceiling _____ to increased search activity and a price floor _____ to increased search activity.
- A. leads; does not lead
 - B. does not lead; leads
 - C. leads; leads
 - D. does not lead; does not lead
4. An effective price ceiling creates _____, an effective price floor creates _____, and an effective price support creates _____.
- A. inefficiency; inefficiency; efficiency
 - B. efficiency; inefficiency; inefficiency
 - C. inefficiency; inefficiency; inefficiency
 - D. inefficiency; efficiency;
5. A price ceiling set _____ has no effect and a price support set _____ has no effect.
- A. below the equilibrium price; above the equilibrium price
 - B. above the equilibrium price; below the equilibrium price
 - C. below the equilibrium price; below the equilibrium price
 - D. above the equilibrium price; above the equilibrium price
6. A minimum wage is an example of _____.
- A. neither a price ceiling nor a price floor
 - B. a price floor but not a price ceiling
 - C. a price ceiling and a price floor
 - D. a price ceiling but not a price floor

7. Taking account of the search activity, a rent ceiling _____ consumer surplus and _____ producer surplus.
 A price support in an agricultural market _____ consumer surplus and _____ producers' total revenue.
- A. increases; decreases; decreases; increases
 B. decreases; decreases; decreases; decreases
 C. decreases; decreases; decreases; increases
 D. increases; increases; increases; increases
8. An effective rent ceiling _____ a deadweight loss, an effective minimum wage _____ a deadweight loss,
 and an effective price support _____ a deadweight loss.
- A. produces; produces; produces
 B. does not produce; does not produce; does not produce
 C. does not produce; produces; does not produce
 D. produces; produces; does not produce

Lesson 49

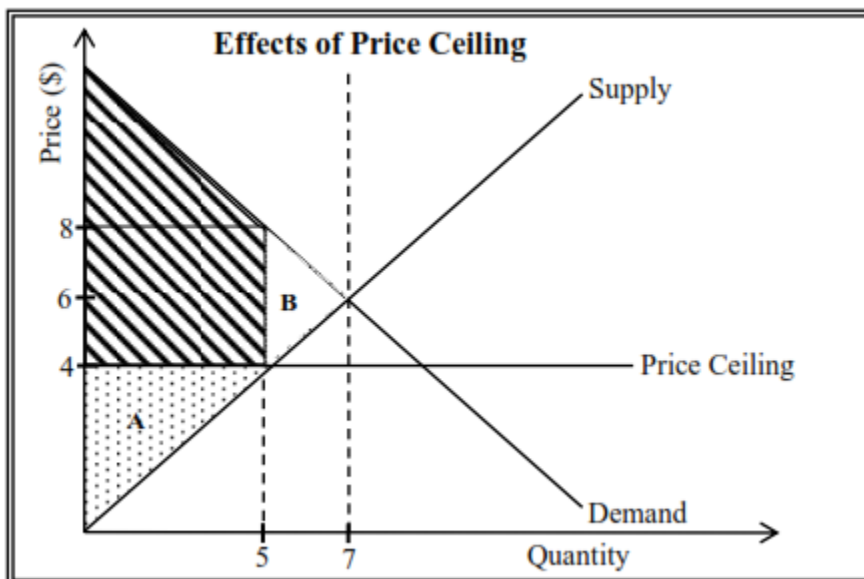
Strand 2: Microeconomics

Strand 2.4 : Price Mechanism

Learning Outcome: Apply knowledge of price mechanism to answer related questions from FYR11CE papers.

Activity – FYR11CE 2016

Use the graph given below and your own knowledge to answer questions (i) - (iii).



- Name the areas A and B.
- State the purpose of setting the price ceiling by the government.
- What is the effect of setting a price ceiling on the price of goods? Formula

Surplus: situation where $Q_S > Q_D$ (to calculate surplus: $Q_S - Q_D$) E.g. quantity supplied is 20units and quantity demanded is 10units, surplus will be 10 units.

Shortage: situation where $Q_D > Q_S$ (to calculate shortage: $Q_D - Q_S$) E.g. quantity demanded is 30units and quantity supplied is 5units, shortage will be 25 units.

The End

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