2.7 Role of government in microeconomics (Subsidies)

Objectives

Government intervention in markets

- Subsidies

Government intervention in markets—consequences for markets and stakeholders

Subsidies

A **subsidy** is an amount of money paid by the government to a firm, per unit of output.

- Lower the price of essential goods

- Guarantee the supply of goods that are necessary for the economy

- Enable producers to compete with overseas trade

Specific subsidies and percentage subsidises are available (although the latter are rare)

A subsidy shifts the supply curve to the right.

e.g., agricultural, transport, energy, education, healthcare

Subsidies

Agricultural subsidies

Renewable energy subsidies

Education subsidies

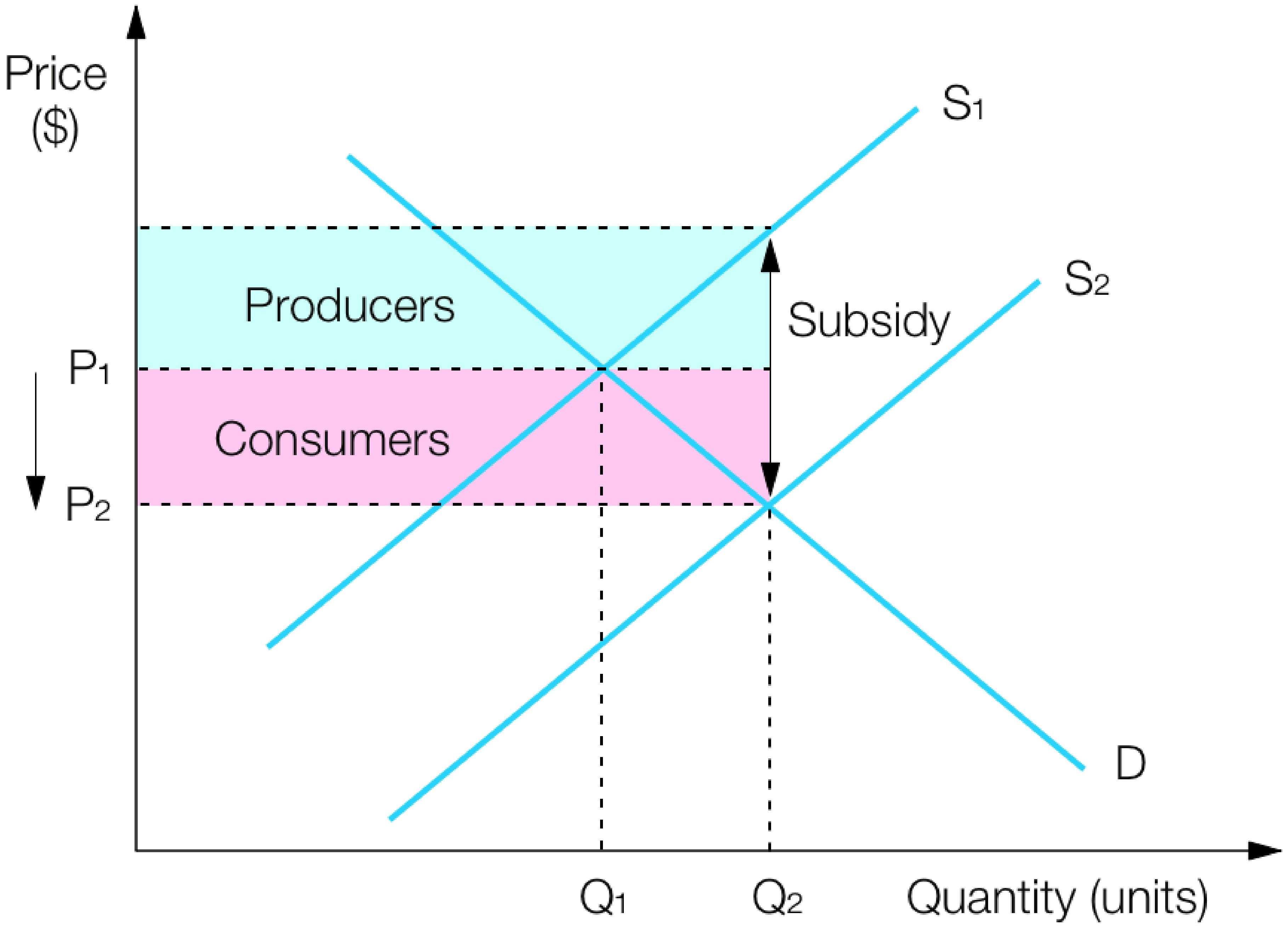
Healthcare subsidies

Housing subsidies

Export and production subsidies

Fuel and utility subsidies

Subsidies



Subsidies

Example

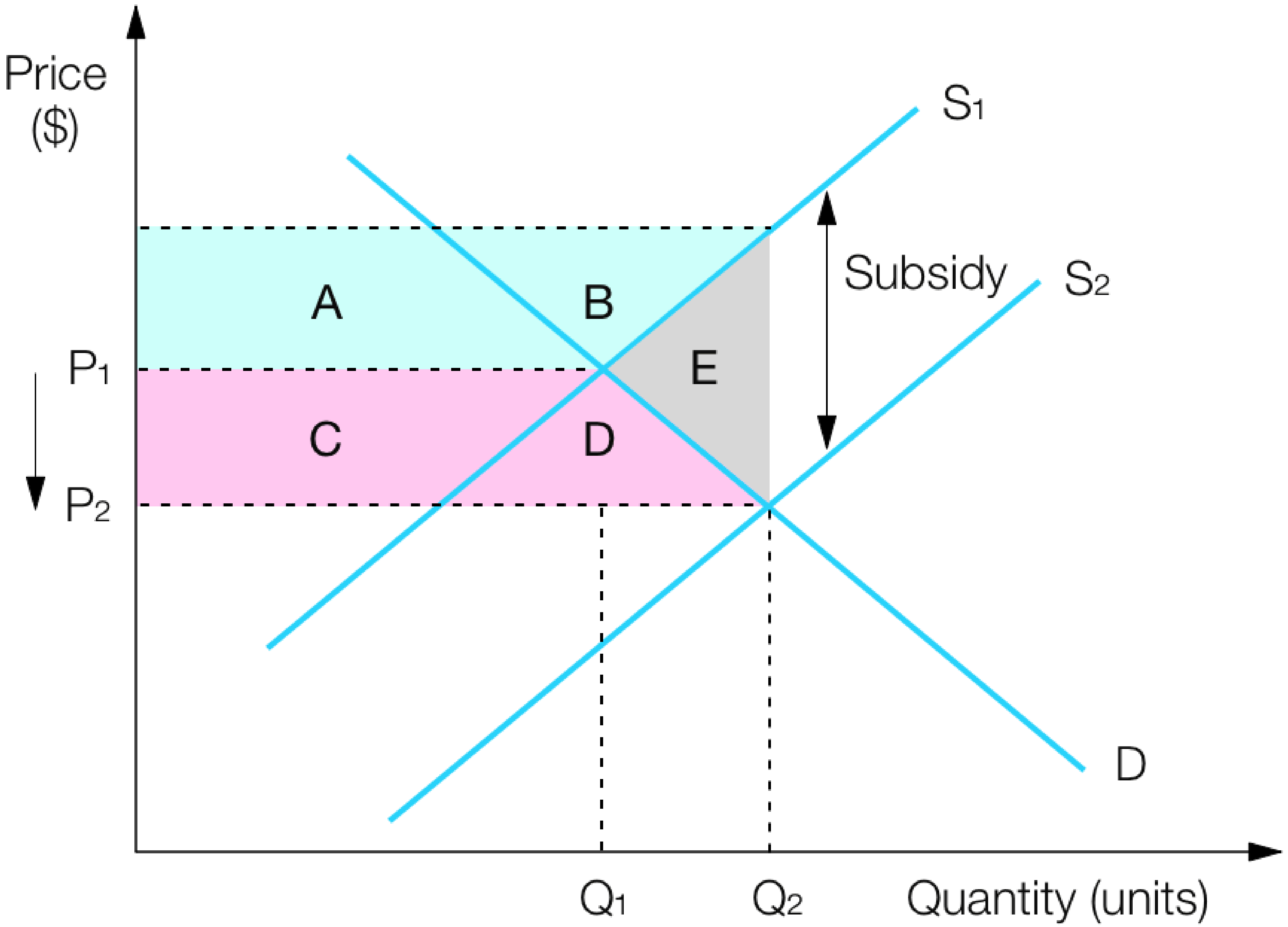
- $5 subsidy

- $2.50 is passed onto the consumer (cheaper prices)

- $2.50 is retained by the producer

These values are dependent on the PED and PES of the product.

Subsidies



Subsidies

Change in surplus

Consumer surplus increases by the area C + D

Producer surplus increases by the area A + B as their production costs are reduced

Area E is deadweight loss; market inefficiencies caused by the subsidies

Disadvantages of government subsidies

Opportunity cost

It is expensive for the government

Taxpayer funded

Reduce incentives for firms to cut costs or to be more competitive

Protect inefficient firms

Damage to the sales of foreign producers

Subsidies

Paper 1 style questions

Explain why governments provide subsidies [10 marks]

Using real-world examples, evaluate the view that the government should never provide subsidies to firms [15 marks]

Using real-world examples, discuss how the introduction of a subsidy in a market will affect stakeholders [15 marks]

Subsidies

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