# TAXES

- Governments levy taxes to raise revenue for public projects.

# How Taxes on Buyers (and Sellers) Affect Market Outcomes

- Taxes discourage market activity.
- When a good is taxed, the quantity sold is smaller.
- Buyers and sellers share the tax burden.

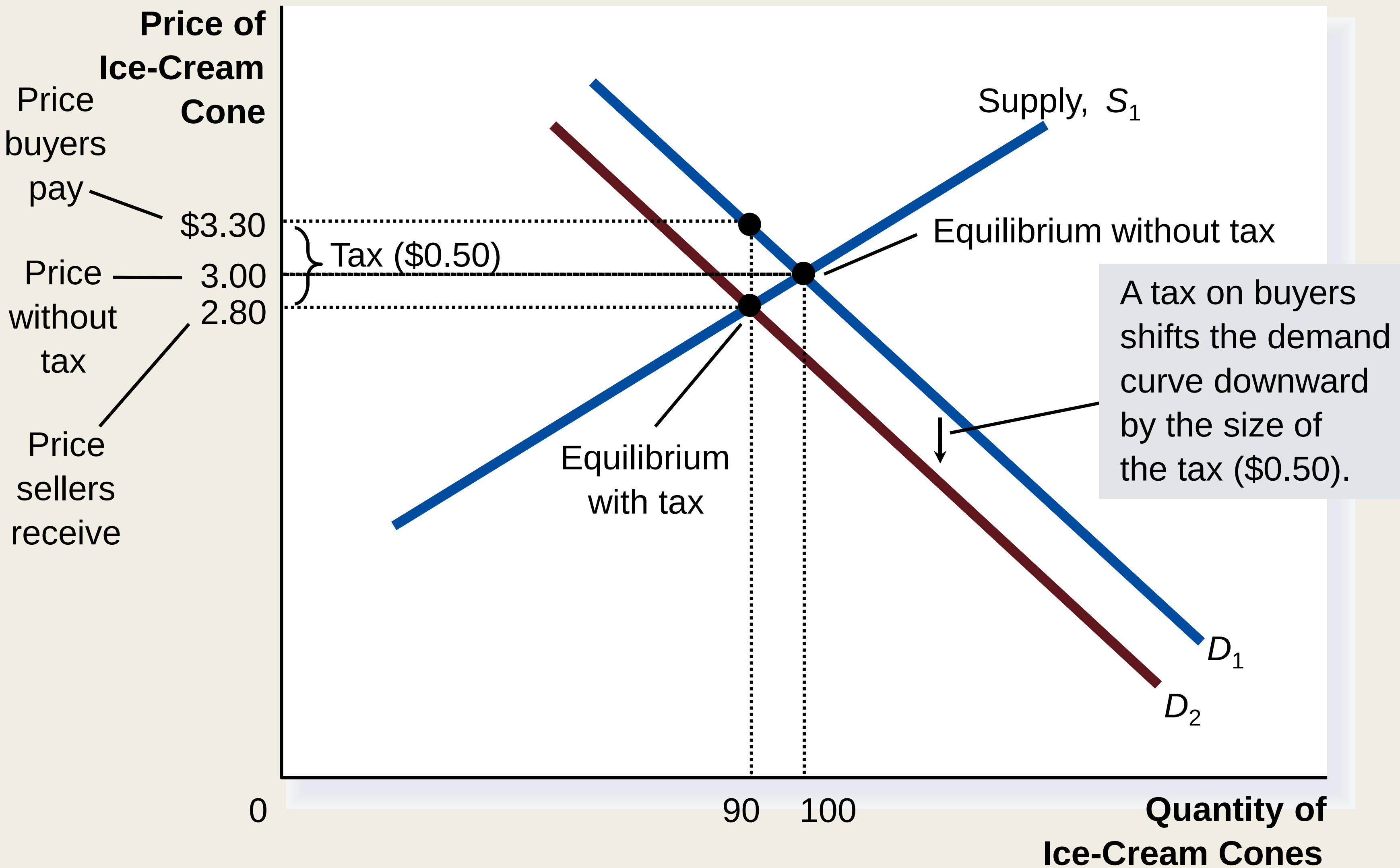
# How Taxes on Buyers Affect Market Outcomes

- Elasticity and tax incidence
  - *Tax incidence* is the manner in which the burden of a tax is shared among participants in a market.

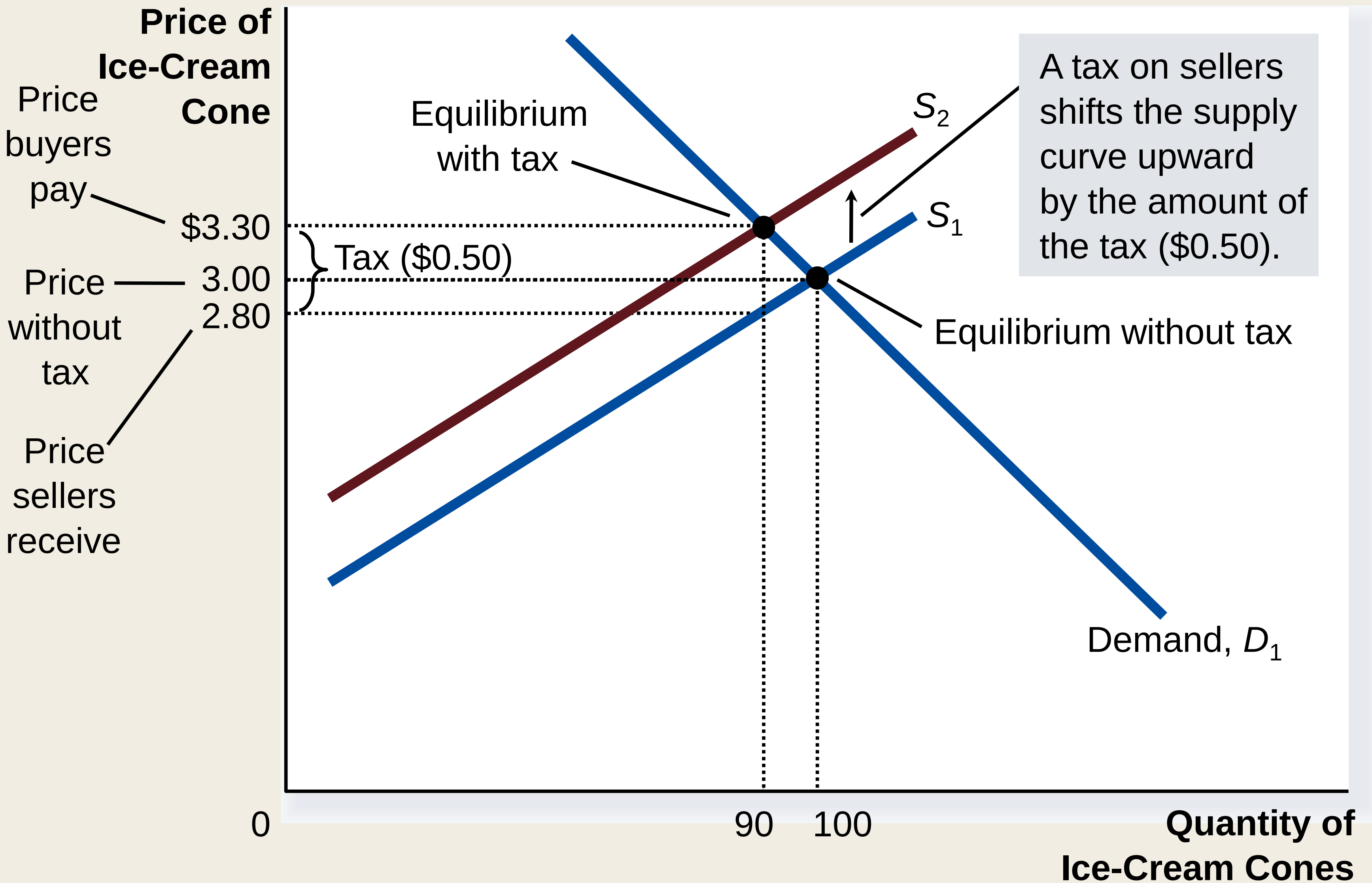
# How Taxes on Buyers Affect Market Outcomes

- Elasticity and Tax Incidence
  - Tax incidence is the study of who bears the burden of a tax.
  - Taxes result in a change in market equilibrium.
  - Buyers pay more and sellers receive less, regardless of whom the tax is levied on.

# Figure 6 A Tax on Buyers

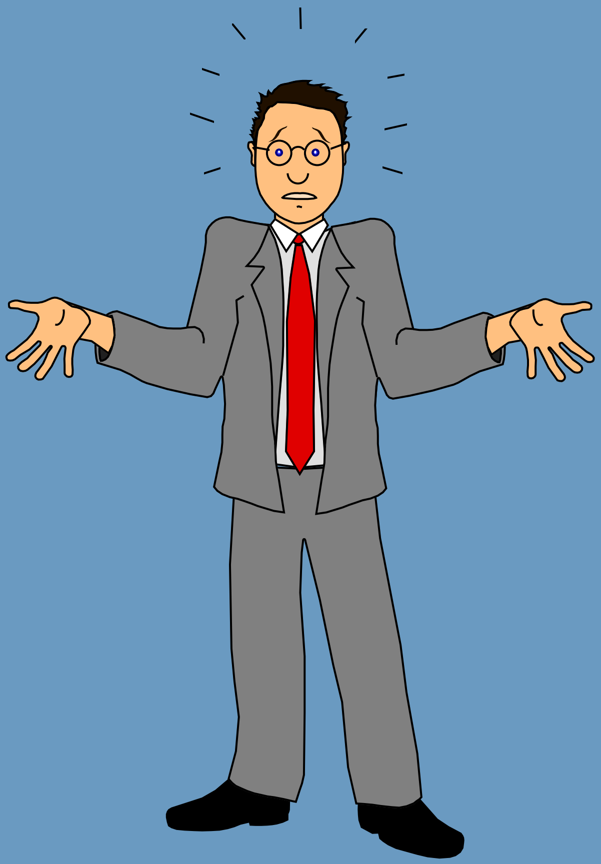


# Figure 7 A Tax on Sellers

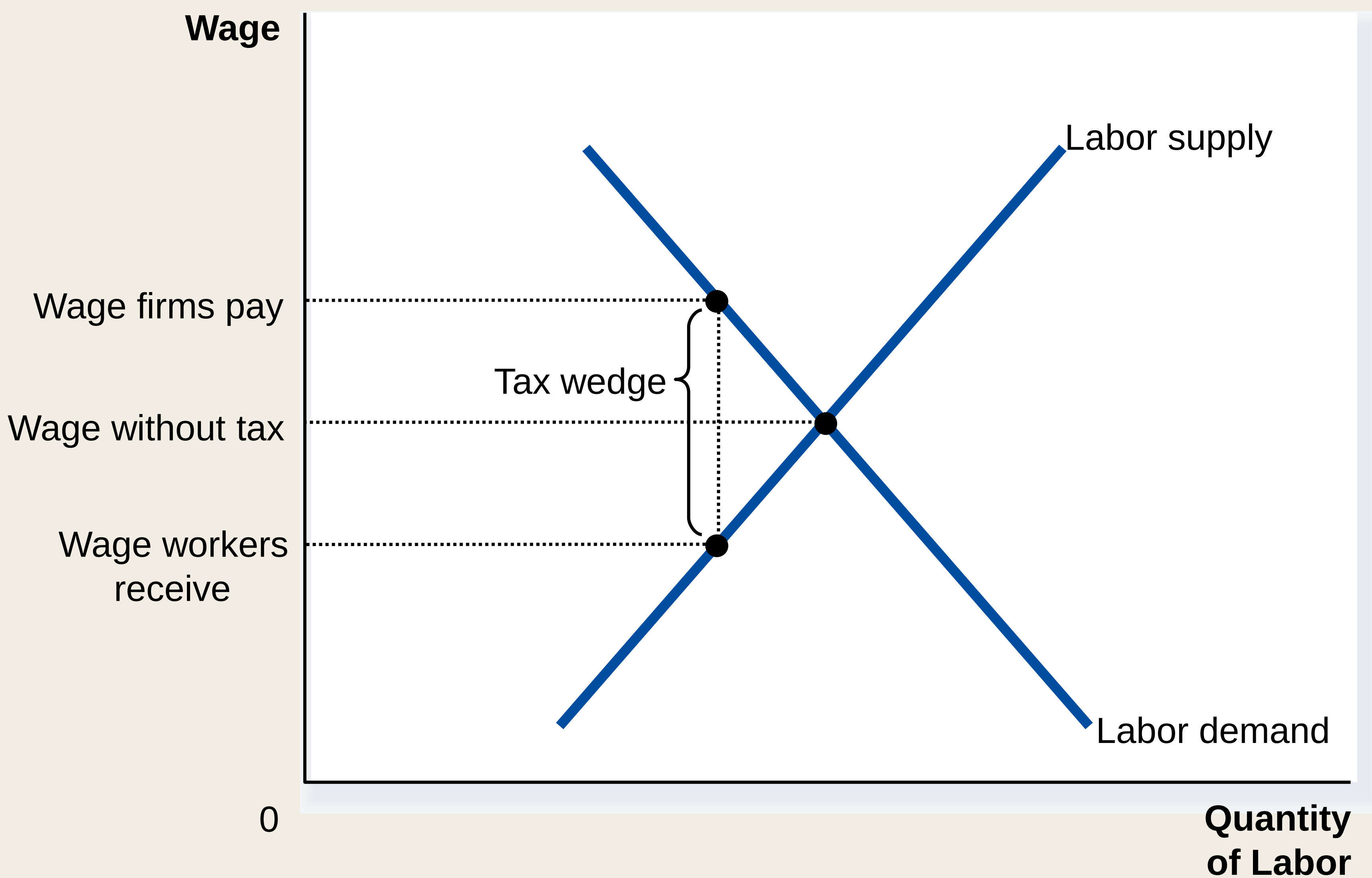


# Elasticity and Tax Incidence

- What was the impact of tax?
  - Taxes discourage market activity.
  - When a good is taxed, the quantity sold is smaller.
  - Buyers and sellers  share the tax burden.



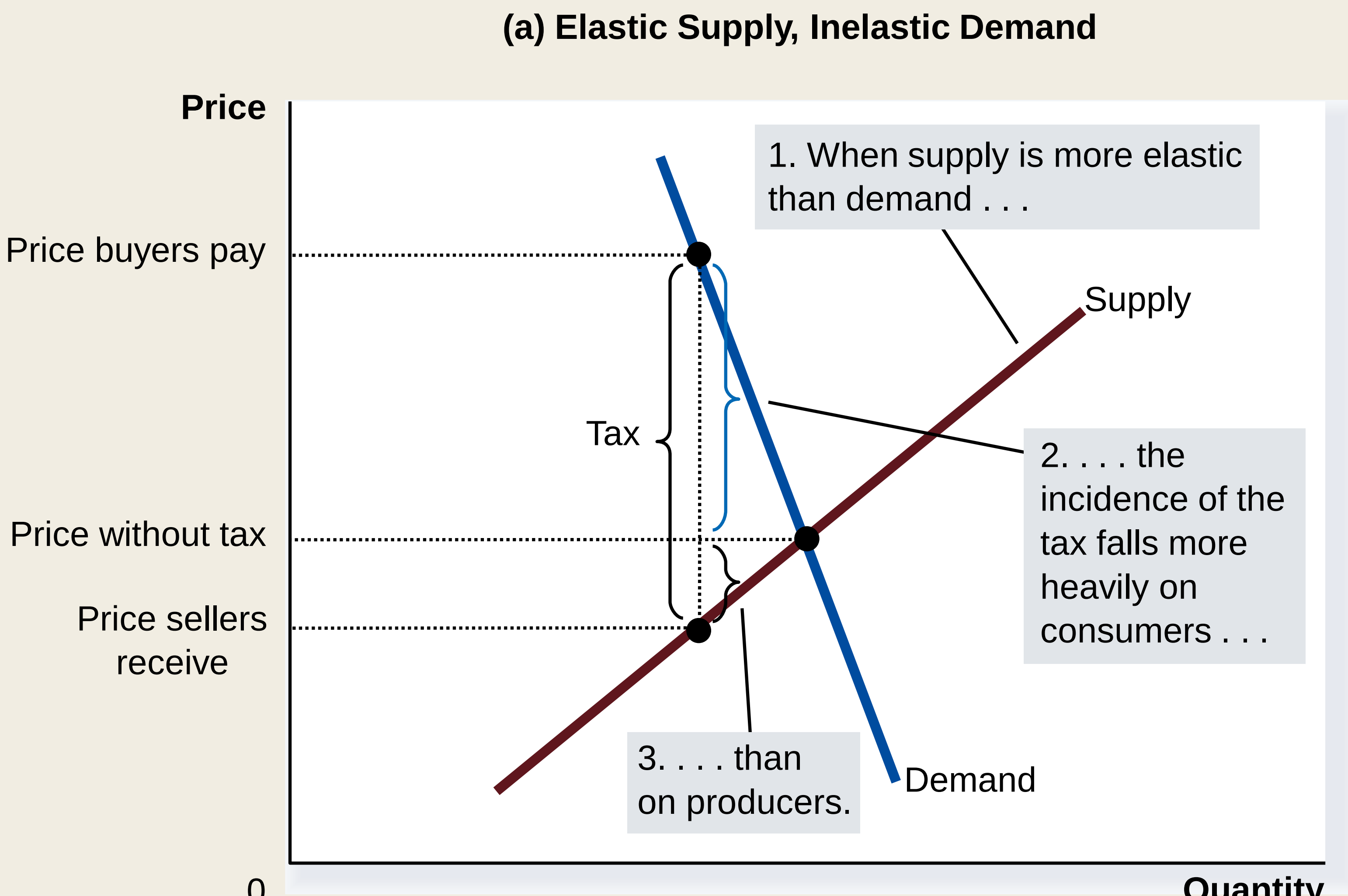
# Figure 8 A Payroll Tax



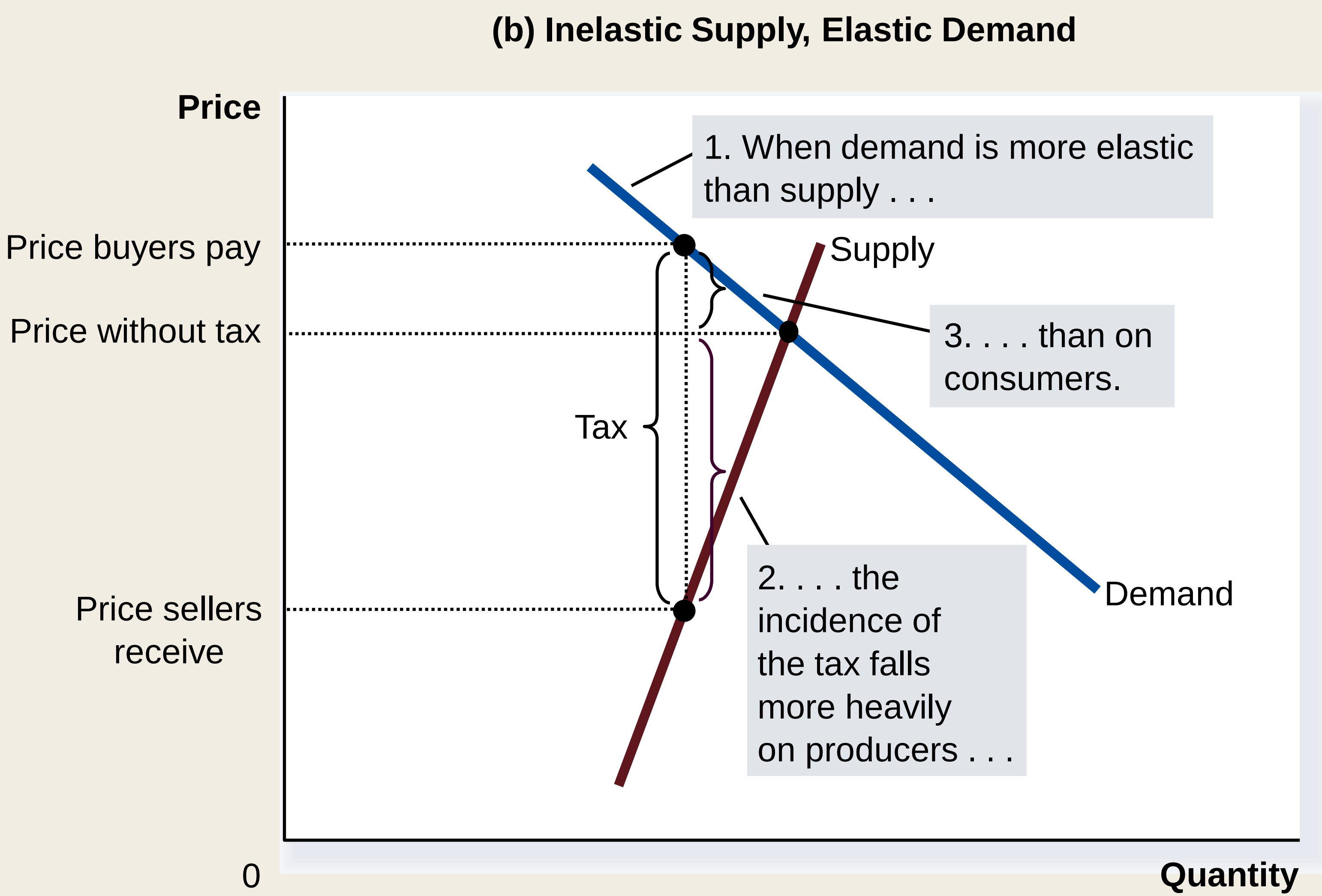
# Elasticity and Tax Incidence

- In what proportions is the burden of the tax divided?
- How do the effects of taxes on sellers compare to those levied on buyers?
- The answers to these questions depend on the elasticity of demand and the elasticity of supply.

# Figure 9 How the Burden of a Tax Is Divided



# Figure 9 How the Burden of a Tax Is Divided



# Elasticity and Tax Incidence

So, how is the burden of the tax divided?

The burden of a tax falls more heavily on the side of the market that is less elastic.

# Summary

- Price controls include price ceilings and price floors.
- A price ceiling is a legal maximum on the price of a good or service.
  - An example is rent control.
- A price floor is a legal minimum on the price of a good or a service.
  - An example is the minimum wage.

# Summary

- Taxes are used to raise revenue for public purposes.
- When the government levies a tax on a good, the equilibrium quantity of the good falls.
- A tax on a good places a wedge between the price paid by buyers and the price received by sellers.

# Summary

- The incidence of a tax refers to who bears the burden of a tax.
- The incidence of a tax does not depend on whether the tax is levied on buyers or sellers.
- The incidence of the tax depends on the price elasticities of supply and demand.
- The burden tends to fall on the side of the market that is less elastic.