

Chapter 6

Supply, Demand and Government Policies

Introduction

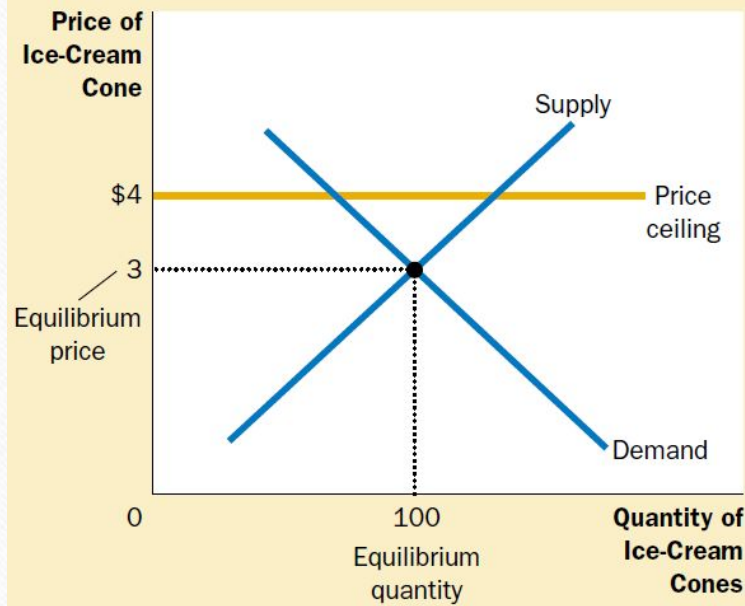
- Role of an economist
 - Constructing and examining theories
 - Using the conclusion for policy making
- Supply-demand tools are used for policy making
- Price control policy- buyers and sellers
 - Maximum rent
 - Minimum wage

Controls on prices

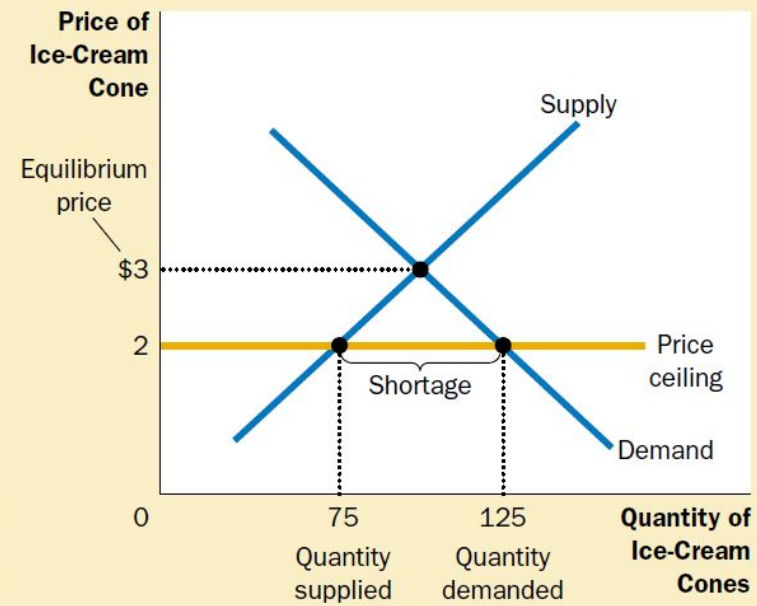
- An ice-cream is sold at \$3
- Neither the buyers are happy nor do the sellers
- Govt. intervenes to control
 - Price ceiling
 - Price floor

Price ceiling and market outcome

(a) A Price Ceiling That Is Not Binding



(b) A Price Ceiling That Is Binding

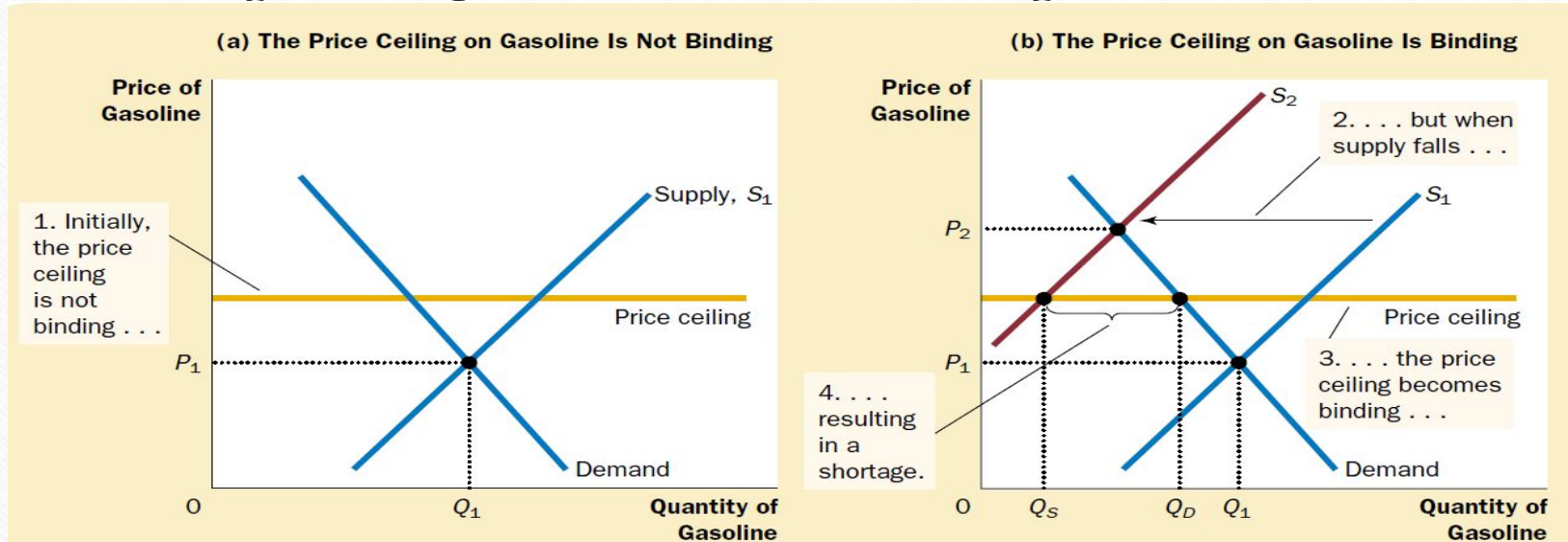


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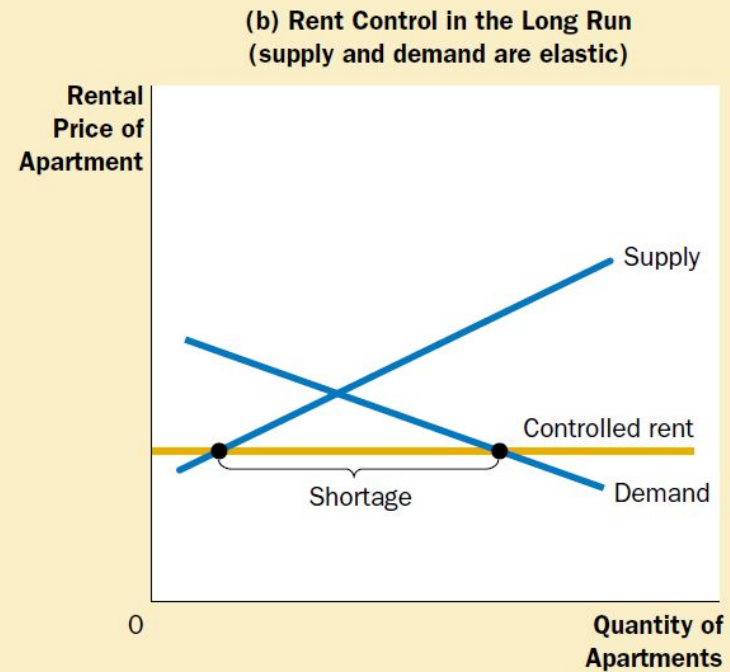
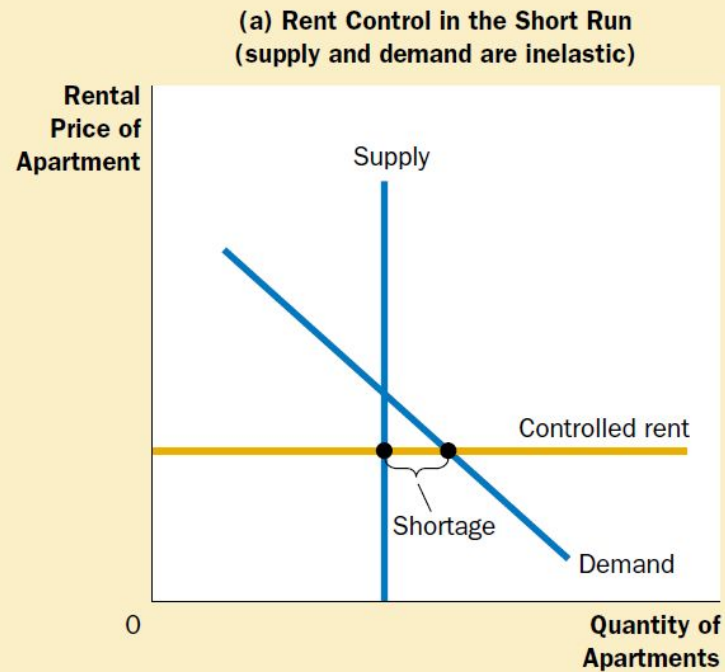
- The binding problem leads to supply shortage, and thereby, rationing
- Either it will be first come and first serve basis, or producers choice whom to sell
- Even if price ceiling is implemented for the betterment, it affects a certain section

Case study I: Lines at gasoline market

- OPEC has increased oil price which is a input to gasoline and govt. puts restriction on gasoline price that led to rationing

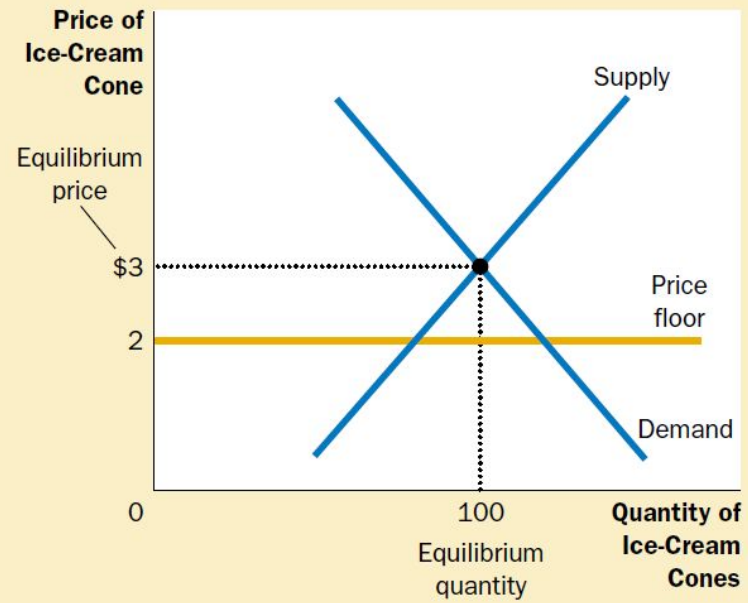


Case study II: Housing issue

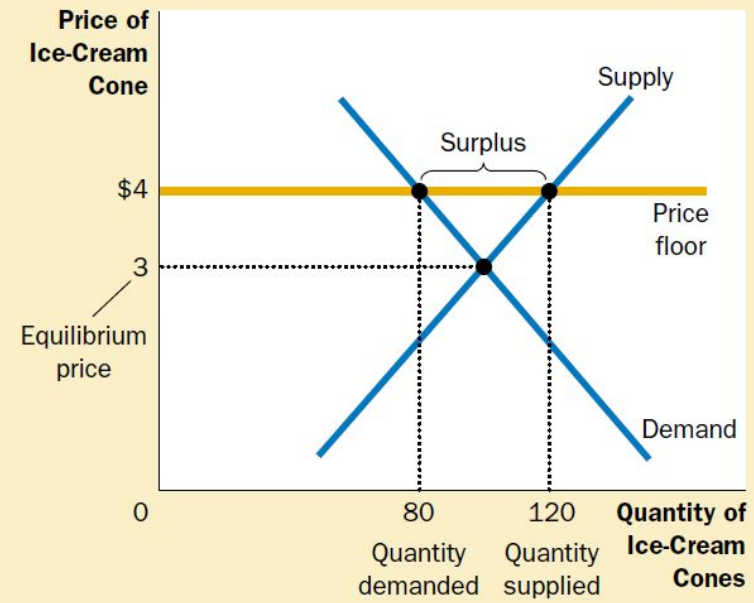


Price floor

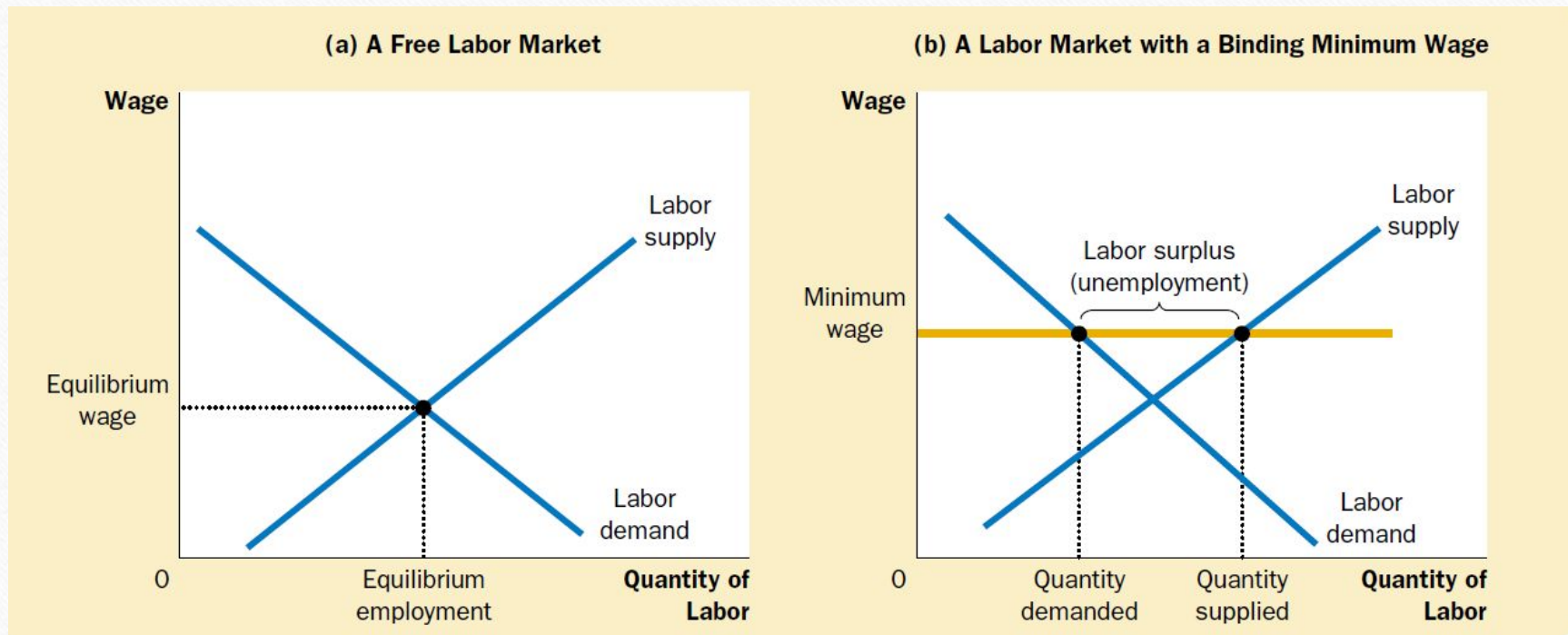
(a) A Price Floor That Is Not Binding



(b) A Price Floor That Is Binding



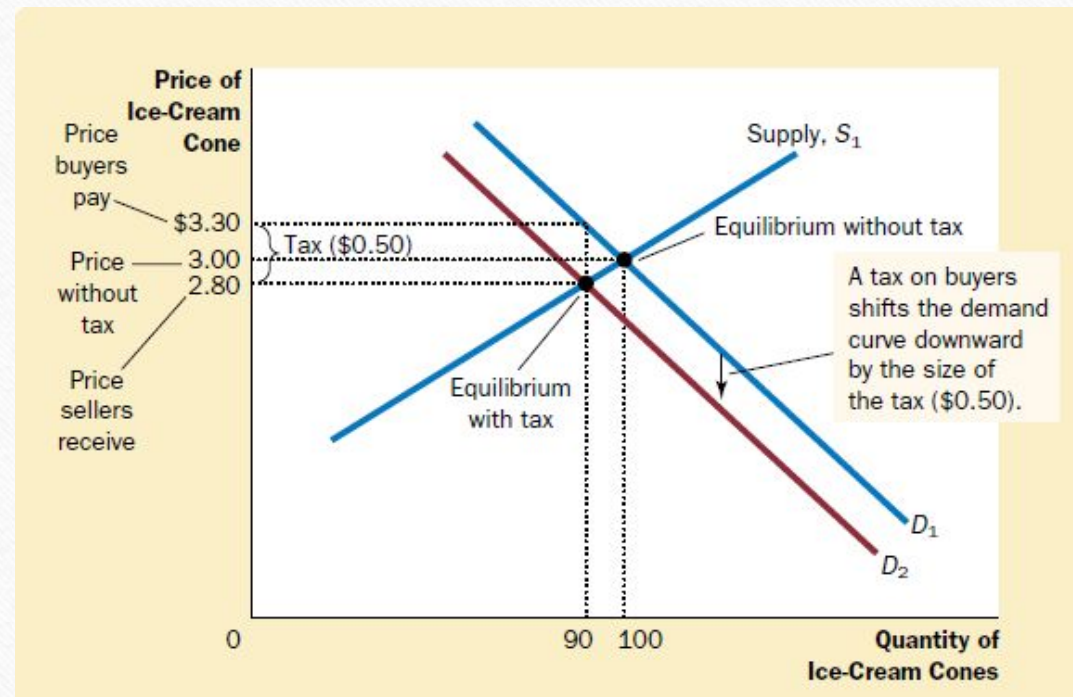
Case study I: Minimum wage



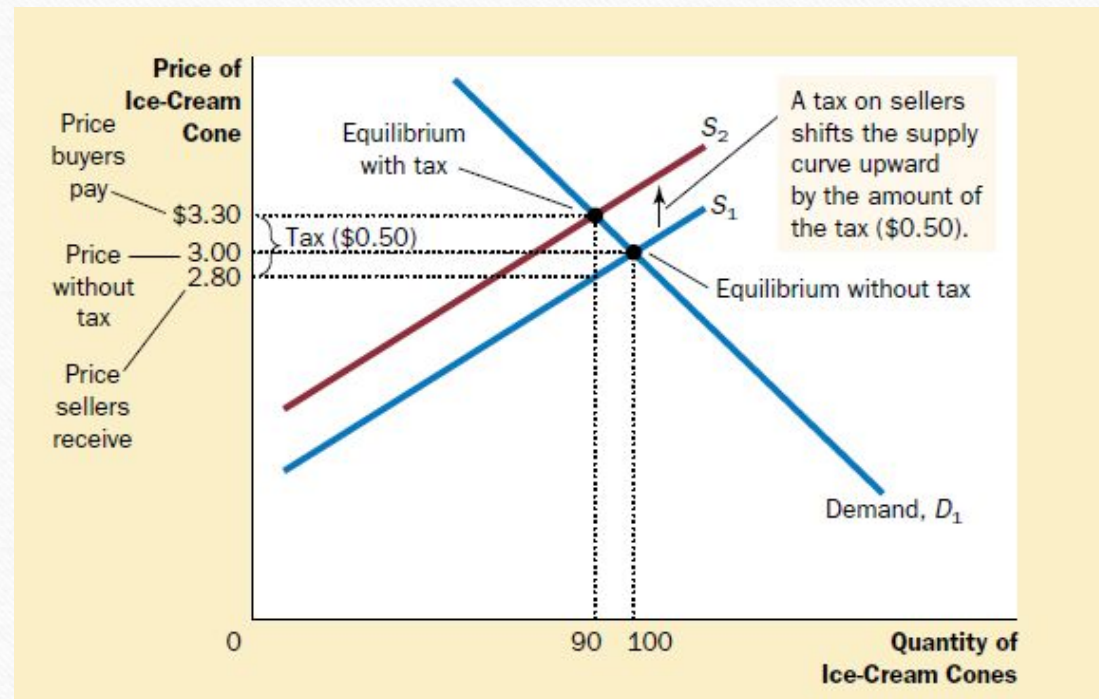
Taxes

- If price of a commodity increases due to tax, consumers want the producers to pay for that, and producers think the opposite
- Who should pay? - Tax incidence is an important phenomena

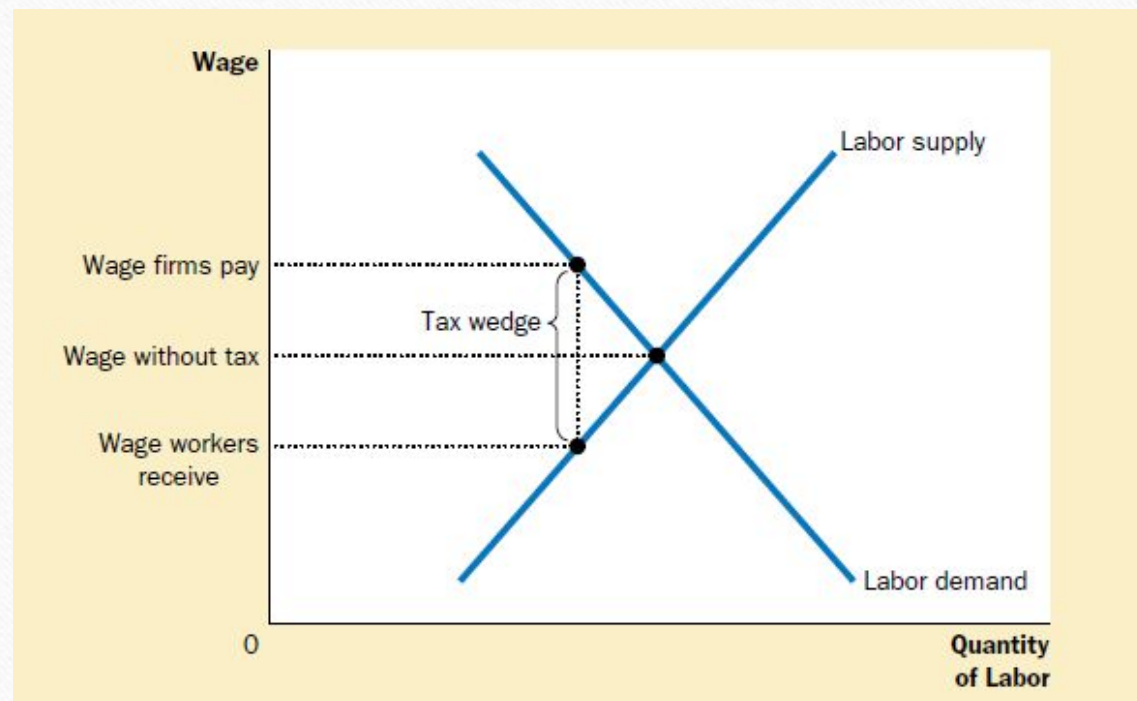
Tax on consumers



Tax on Sellers



Payroll taxes



Elasticity and tax incidence

- If the supply is elastic, buyers pay more and vice-versa
- Tax on yacht made the seller worse-off as the supply was inelastic but the demand was elastic