

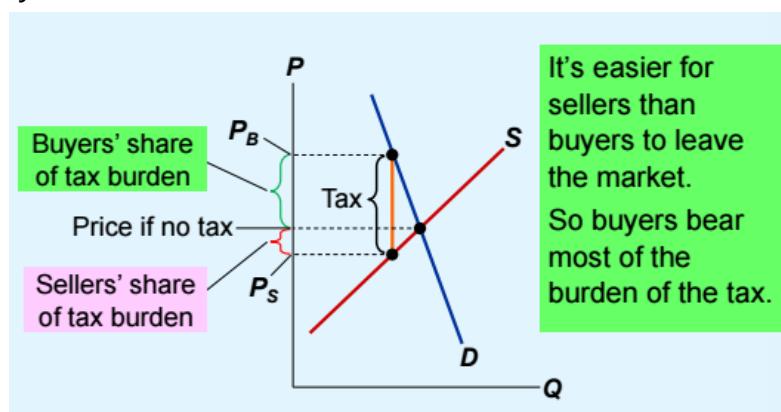
Ch 6. Supply, Demand, and Government Policies

- **Government can change the private market outcome (with price control or taxes)**
- **Price controls**
- **Price ceiling** (=legal maximum on the price), **and Price floor**(=legal minimum on the price)
 - When the equilibrium price is **above** the ceiling, Price ceiling is **binding**, **causes a 'shortage'**. Ex) **Rent-control laws**
 - When there is a shortage... rationing mechanism(long line, discrimination)
 - Unfair and inefficient results.
 - When the equilibrium price is **below** the floor, Price floor is **binding**, **causes a 'surplus'**. Ex) **Minimum wage laws**
 - Economists usually oppose price ceilings and price floors.. Prices are balancing supply and demand. To help those in need, rent subsidies, wage subsidies are better than price controls.
- **Taxes**
 - Government collect taxes to raise revenue for public projects.
 - **Tax incidence:** Manner in which the burden of a tax is shared among participants in a market.
 - Example: The Market for Pizza
 - Case 1: Government impose \$1.5 tax on **Buyers**(=**Buyers pay pizza tax**).
 - **A tax on buyers shifts the D curve down by the amount of the tax.**
 - We have new equilibrium price and quantity(Buyers price and sellers price are different... **Buyers have to pay \$1.0 more**, and **sellers get \$0.5 less** than before... the incidence of \$1.5 tax)

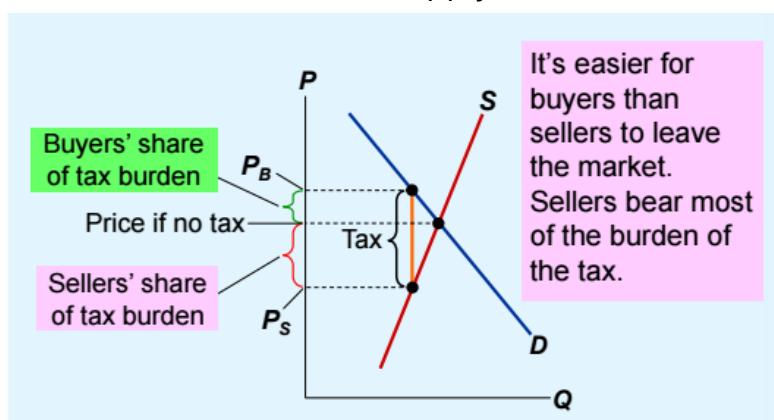
- Case 2: Government impose \$1.5 tax on **Sellers**(=sellers pay pizza tax).
- **A tax on sellers shifts the S curve up by the amount of the tax.**
- We have new equilibrium price and quantity(**Buyers have to pay \$1.0 more**, and **sellers get \$0.5 less** than before... the incidence of \$1.5 tax)
- **The outcome is the same in both cases!** The effects on P and Q, and the tax incidence are the same whether the tax is imposed on buyers or sellers!

- Elasticity and tax incidence

- Case 1: Supply is more elastic than demand



- Case 2: Demand is more elastic than supply



- **Who pays Luxury tax?**

- Luxury items: Demand is quite elastic, supply is relatively inelastic
- Sellers(luxury items producers) pay most of the tax!!