

## Supply and Demand, cont

Reading: Chapter 4

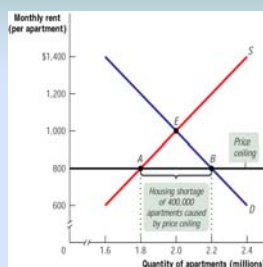
## Supply and Demand

- Demand
- Supply
- Market Equilibrium
- Model of a competitive market
- Changes in supply and demand
- Application of supply-demand model
- Price controls
- Quantity controls
- Taxes
- Applications on controls

2

## Price Controls

### Effect of price ceiling



Often leads to inefficiency in the form of

- Inefficient allocation to consumers: those who want it more intensely do not get it – examine explicitly later under consumer surplus
- Wasted resources due to search
- Excessively low quality
- Illegal activities

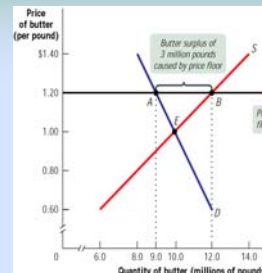
Why are price controls imposed?

- Lobbying by those benefiting
- Lack of understanding
- Fairness

3

## Price Controls

### Effect of price floor



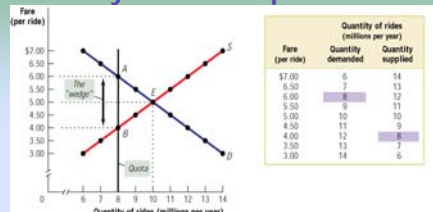
Often leads to inefficiency in the form of

- Wastage if surplus is actually produced and disposed off
- Inefficient allocation of sales among sellers
- Wasted resources due to search
- Excessively high quality
- Illegal activities

Minimum wage  
Why?

4

## Quantity Controls: quotas



■ Demand price, supply price and wedge

■ Quota rents

■ Costs

■ Mutually beneficial transactions don't occur

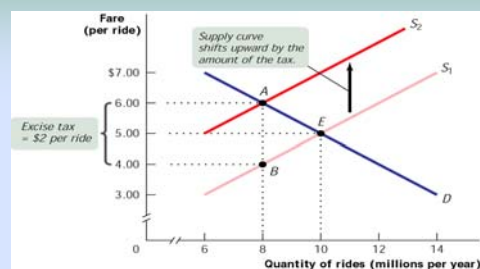
■ Incentives for illegal activities

■ Why? Raise revenues; restrict quantity

5

## Taxes

### Effect of Excise Tax Levied on Sales

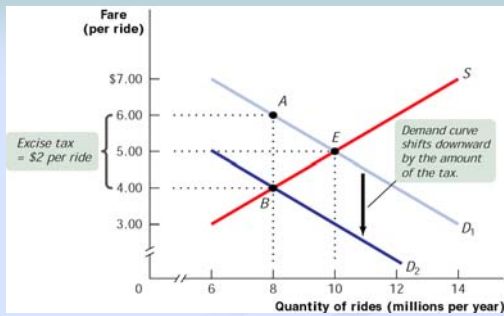


Similarity between quota and tax

6

## Taxes

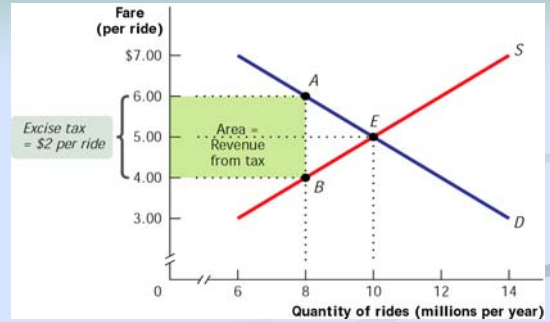
### Effect of an Excise Tax Levied on Purchases



7

## Taxes

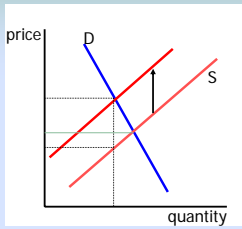
### Revenue from an Excise Tax



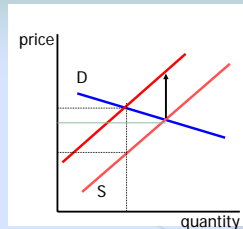
8

## Taxes

### Who really pays the tax - incidence



- Buyers bear more of the burden
- Why?

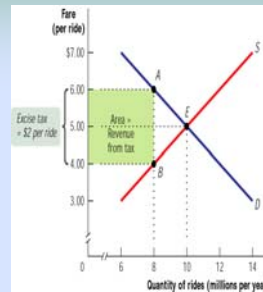


- Sellers bear more of the burden
- Why? Elasticity – next topic

9

## Taxes

### Inefficiency

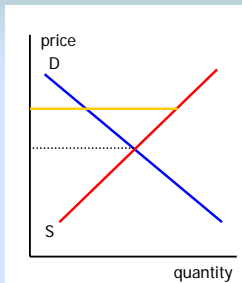


- Cost of tax: what is paid to government?
- Excess burden or deadweight loss – mutually beneficial trades
- Illegal activities
- Why taxes?
  - Reduce quantities
  - Raise revenues

10

## Applications of controls

### Farm price floor

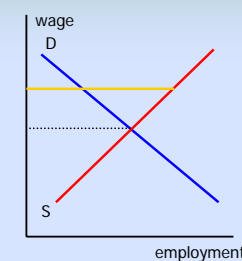


- Price floor
- Why?
  - Income for farmers
  - Farm lobby
- Effects
  - High price
  - Oversupply
  - Inefficiency
  - Food aid

11

## Applications of controls

### Minimum wage



- Price floor
- Why?
  - Guarantee minimum income
  - Labor lobby
- Effects
  - Inefficiency and unemployment
  - Actually measured effects
- Why?
  - Imperfect competition
  - Macroeconomic effects

12

## Congestion charges



- 13