Taxes and Subsidies

Taxes

- A **tax** creates a wedge between the **price buyers pay** and the **price sellers receive**.
- It **doesn't matter** whether the tax is imposed on buyers or sellers: the outcome is the same. What matter is who bears the burden:

Tax Incidence (Who Bears the Burden?)

- The **less elastic side** of the market bears the **greater tax burden**:
    - **Inelastic demand** → buyers pay more
    - **Inelastic supply** → sellers pay more
- **Intuition:** You can't avoid paying a tax on something if you can't easily change your behavior. You don't pay a tax on a good if you don't buy it.

Subsidies

- A **subsidy** is when the government pays buyers or sellers to encourage production or consumption.
- Just like taxes, the **distribution of benefits** depends on elasticity.
- But is more than that:
    - The **less elastic side** of the market captures the **greater subsidy benefit**:

Price Controls

- **Price controls** are legal restrictions on prices.
- Two main types:
    - **Price ceiling:** A **maximum** price allowed (e.g., rent control).
        - May create **shortages** ($Q_d > Q_s$).
    - **Price floor:** A **minimum** price required (e.g., minimum wage).
        - May create **surpluses** ($Q_s > Q_d$).