

Indirect taxes

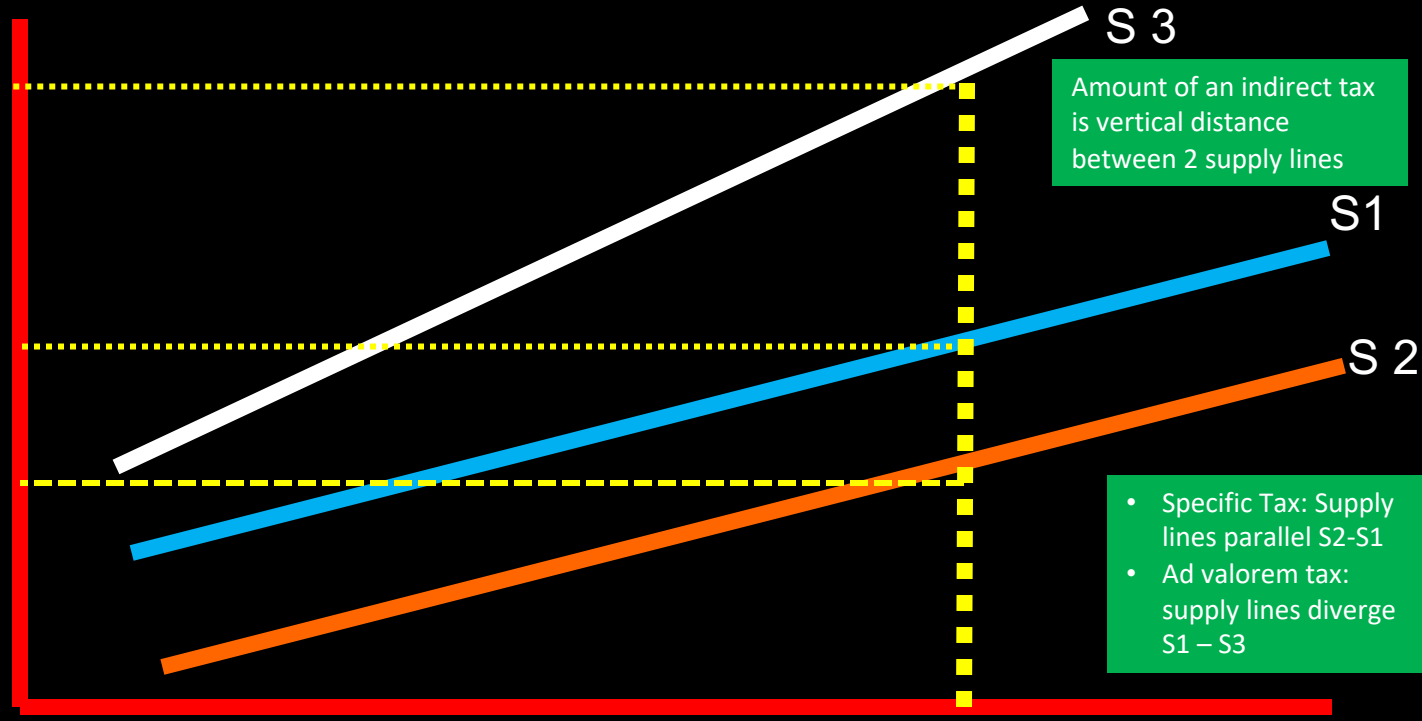
Section 2.2 Markets

The **BIG** ideas! Supply

Big Idea
2

Supply Function: $q_S = f(P_X, P_f, P_s, G, \text{technology, weather, etc})$
G: (indirect taxes + subsidies),

Price of X

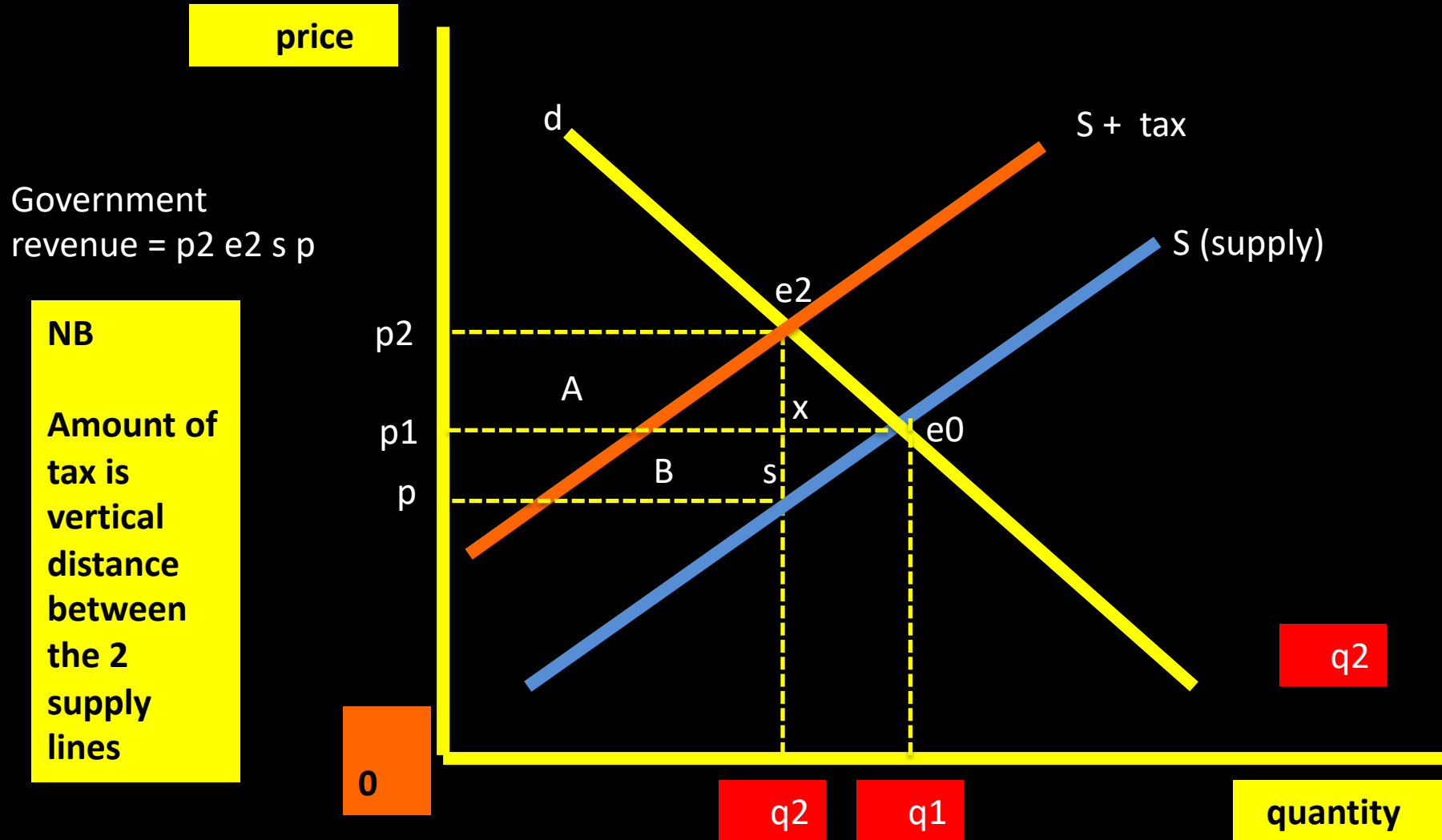


Law of supply:

P ↑ Qs ↑
P ↓ Qs ↓

See webnote 203 for examples of each component

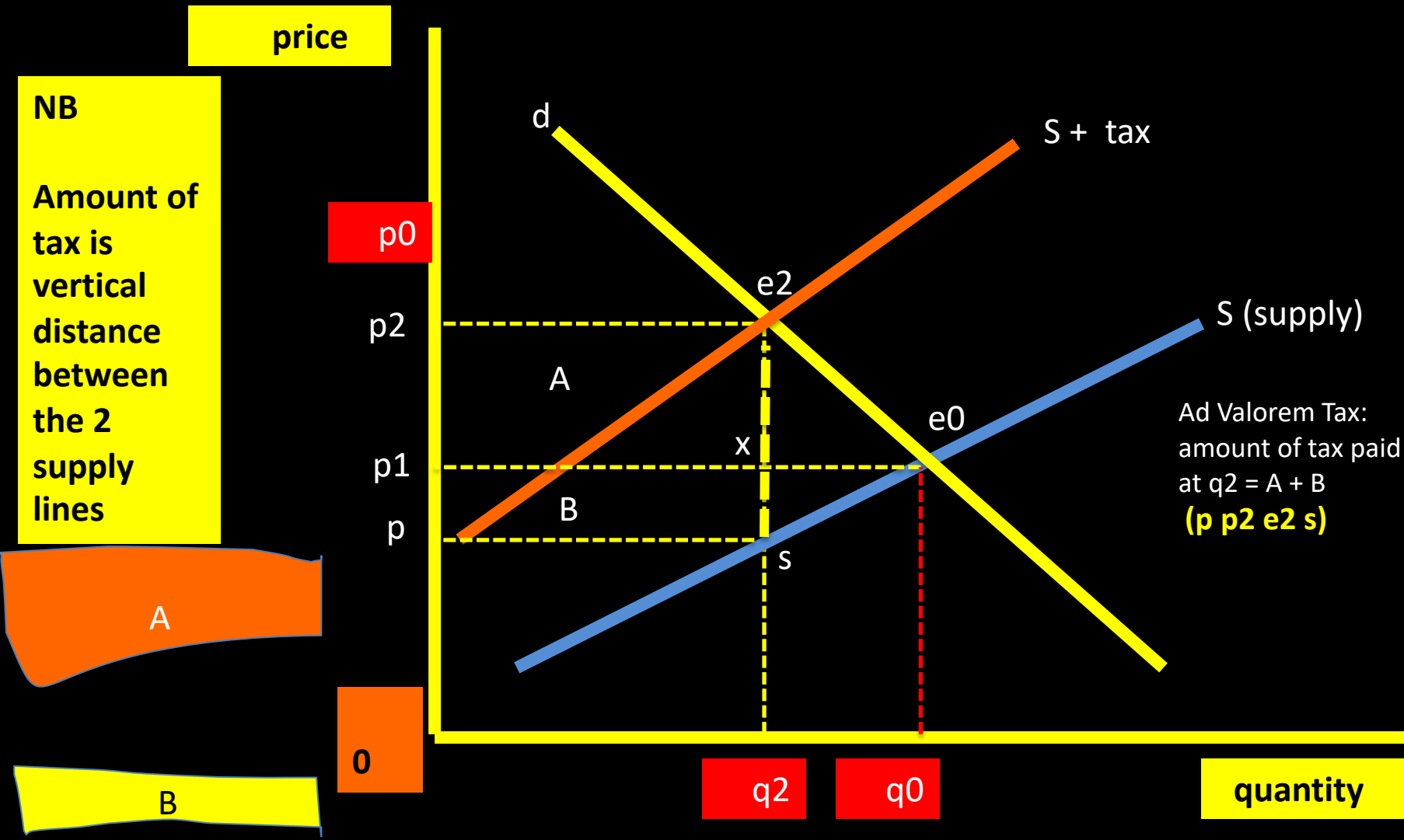
indirect tax (specific / parallel)



A

B

indirect tax ('ad valorem' tax - % tax)



See Webnote
132

Tax Burden is shared between the firm and the consumer with the firm taking the burden of the tax. Also known as tax incidence.

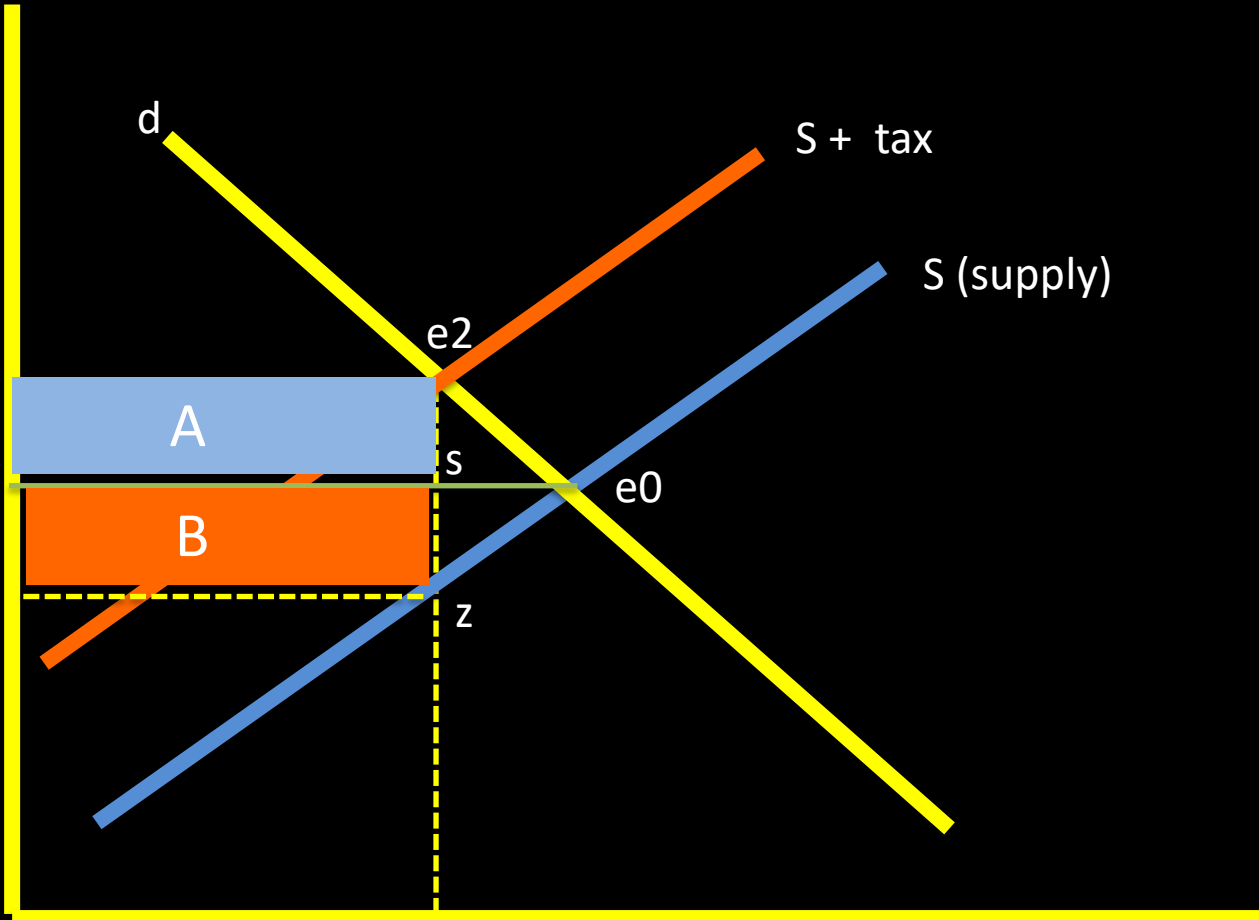
price

Government
revenue = A+B
revenue = $p_2 e_2 z p$

(A)
Consumer burden =
 $p_2 e_2 s p_1$

(B)
Producer burden =
 $p_1 s z p$

0



q2

q0

quantity

Subsidy

Big Idea

3

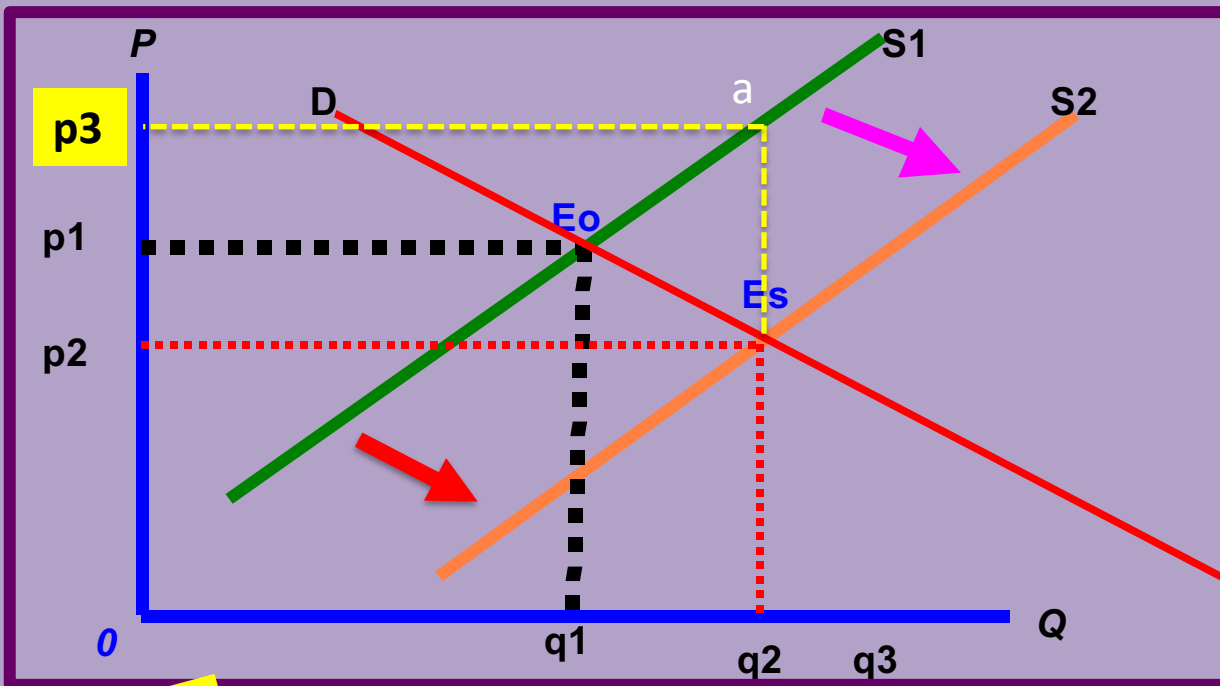
Who carries the burden of a
subsidy?

Who pays for the
subsidy?

What is the real cost
of a subsidy?

Government. Be able to show who takes the burden of a subsidy on a diagram.

Subsidy – 2 questions



In your analysis be sure to note that the analysis commences at a specific point. In this case the analysis commences at E_o and q_1 . the subsidy shifts production to q_2 and the cost of the subsidy is E_s a p_3 p_2

Who pays for the subsidy?
= Government (tax payers)

What is the real cost of a subsidy?
= P_3 a e_s p_2