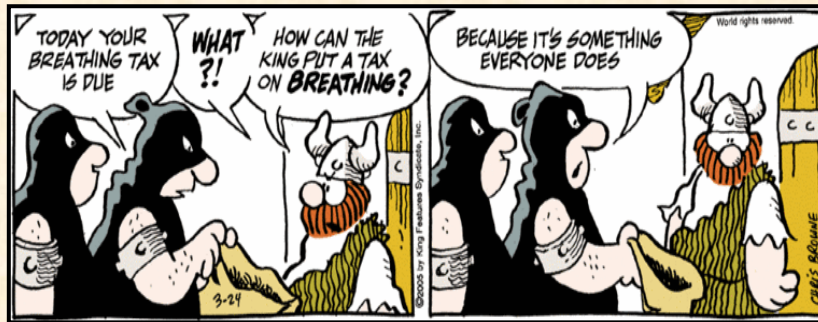


Chapter 5: Market Outcomes & Tax Incidence



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1

Efficiency in Macklemore's "Wings"

2

Welfare Economics

- Consumer surplus: difference between the WTP for a good & the amount that is P_M to get it.
- It measures the CS that accrues to the buyer.
- Its size is determined by the market price.
- Producer surplus: difference between the P_M a good & the price that the seller P_S receives.
- Producer surplus represents the PS of the seller in the market.
- Total surplus is the sum of CS & PS.

3

Just Go With It

4

Market Efficiency

- Total surplus (or social welfare) measures the overall welfare of the society
 - Total surplus =
- An outcome is efficient when an allocation of resources maximises total surplus.

5

Consumer & Producer Surplus

Price
(per slice)

Quantity
(millions of slices
of coconut cream pie)

6

Efficiency

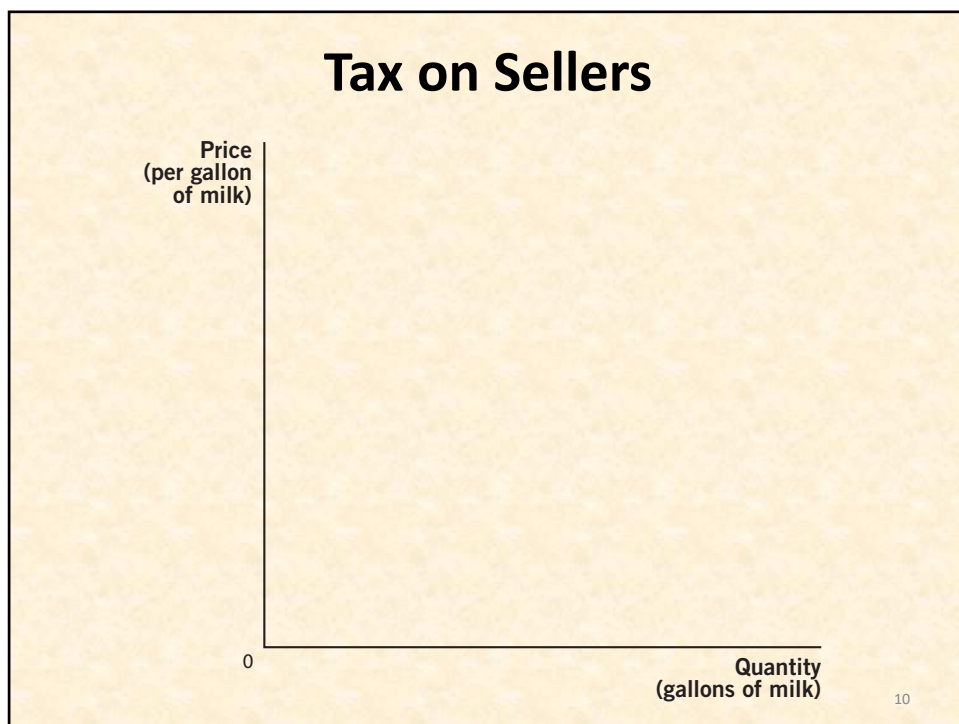
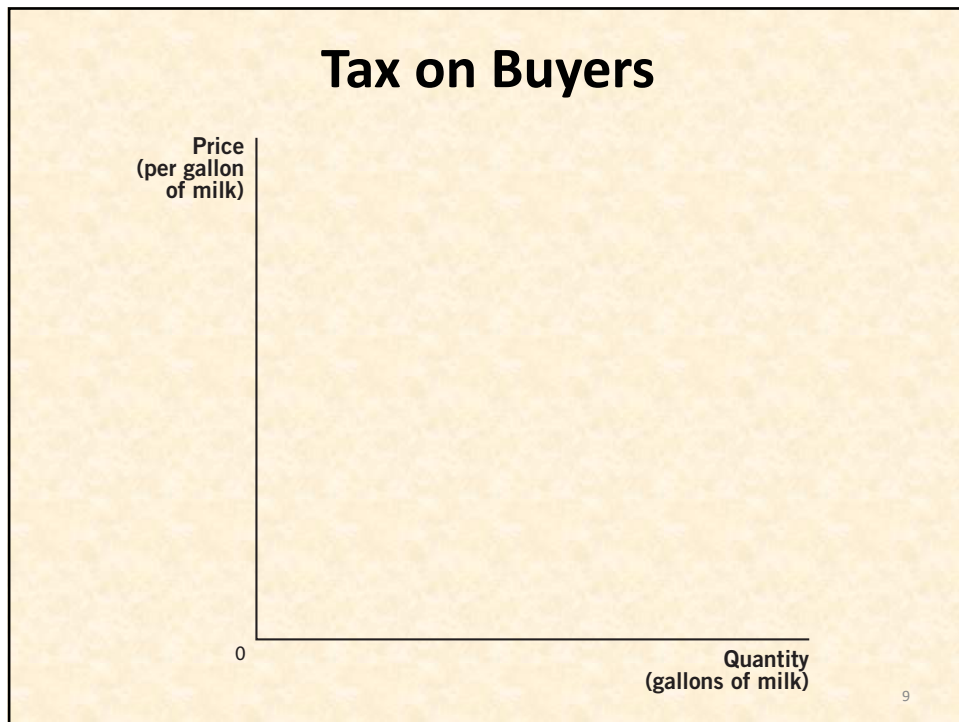
- How efficient is gift giving?
- What's the worst gift you have ever received?

7

Taxation, Welfare & Deadweight Loss

- Excise Tax: a tax on a specific good, e.g.
- Excise taxes:
- Tax incidence: refers to the party (consumers or producers) who bears the

8



End Result

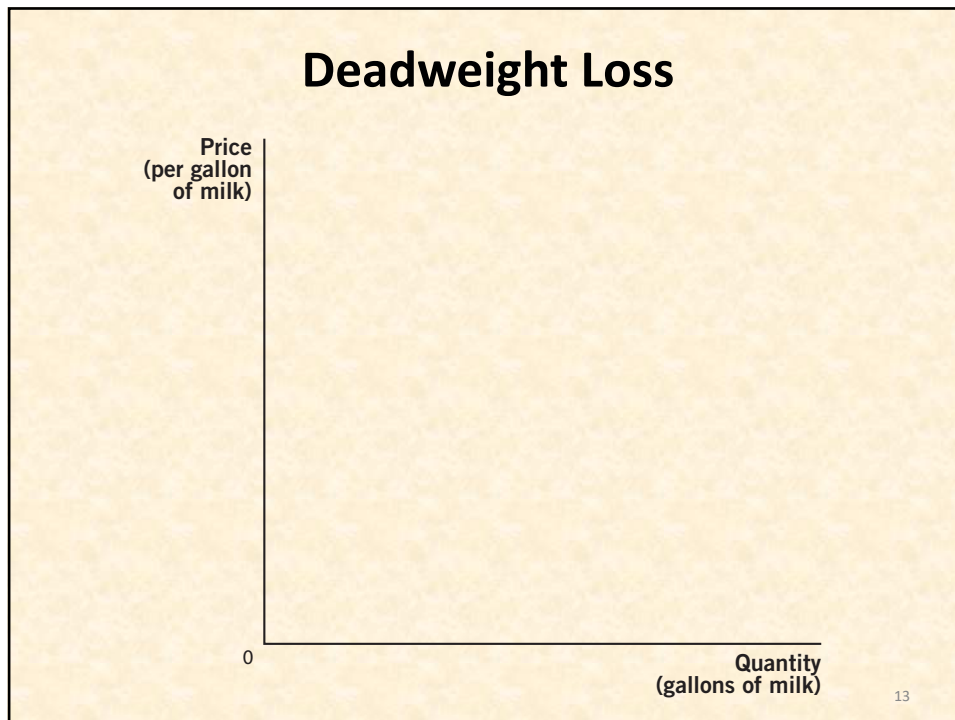
- Tax levied on consumers:
 - Some of the burden is passed to producers since the market price
- Tax levied on a business:
 - The firm will attempt to _____ prices to pass some of the burden to consumers.
- Incidence (who actually pays the tax):
 - Whether the tax is levied on the producer or consumer, the end

11

Deadweight Loss

- We have shown that a tax hurts both buyers and sellers.
 - Buyers pay a _____ price, and sellers receive a _____ price.
- What did we miss?
- Deadweight loss:
 - The _____ in economic activity caused by market distortions.

12

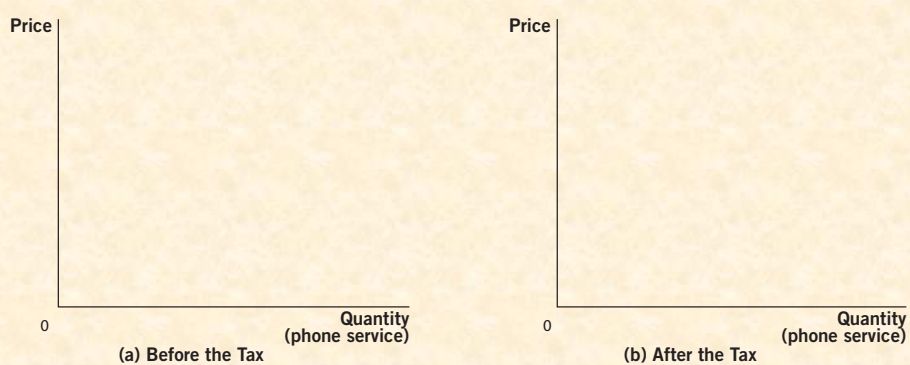


Tax and Deadweight Loss with Inelastic Demand

- Tax incidence is the _____ no matter who the tax is levied on
 - Elasticity of demand and supply can change tax incidence, though
- Why would the government want to tax a good with very inelastic demand?
 - No _____ (ensures steady tax _____)
 - Amount of purchases will not _____ (or not change at all if _____)
 - This means little or no _____

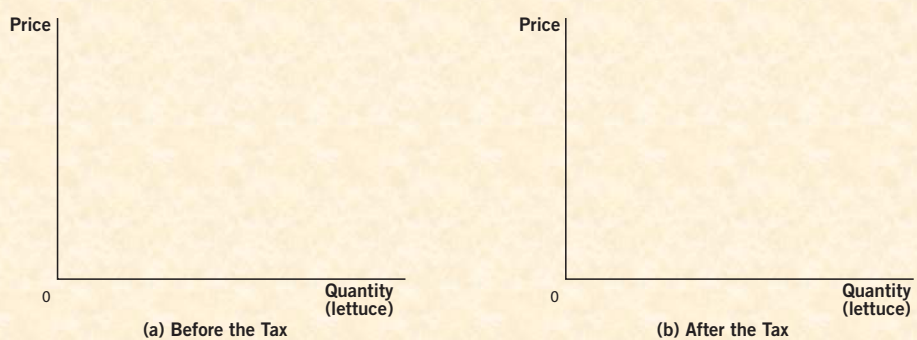
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Tax and Deadweight Loss with Perfectly Inelastic Demand



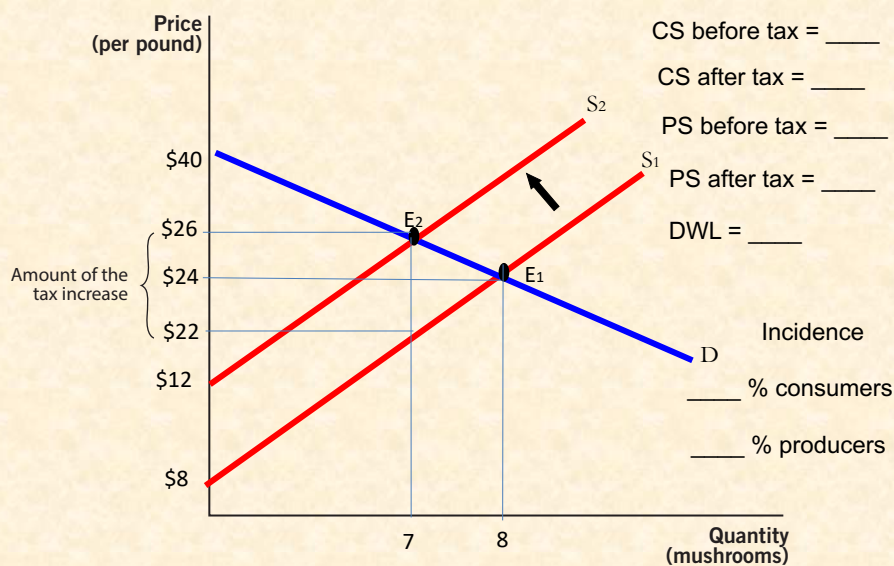
15

Tax and Deadweight Loss with Perfectly Elastic Demand

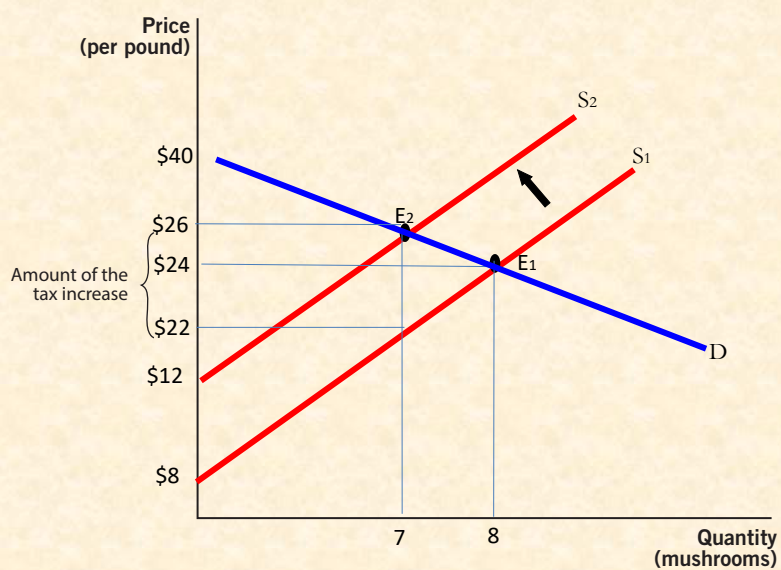


16

Review Question



17



18

- **Consumer Surplus**
 - Before tax:
 - After tax:
- **Producer Surplus**
 - Before tax:
 - After tax:
- **Tax Revenue**
- **DWL**
- **Incidence**
- Market price rises by (from \$ to \$).
 - Consumers pay \$ of the \$ (%)
- Amount producers keep falls by \$ (from \$ to \$)
 - Producers pay \$ of the \$ (%)

19