Tuesday, September 06, 2011
11:06 AM

# ELASTICITY AND TAX BURDEN (INCIDENCE)

TUTORIAL SESSION

FRI 9 SEPT ✓

FRI 16 SEPT ✓

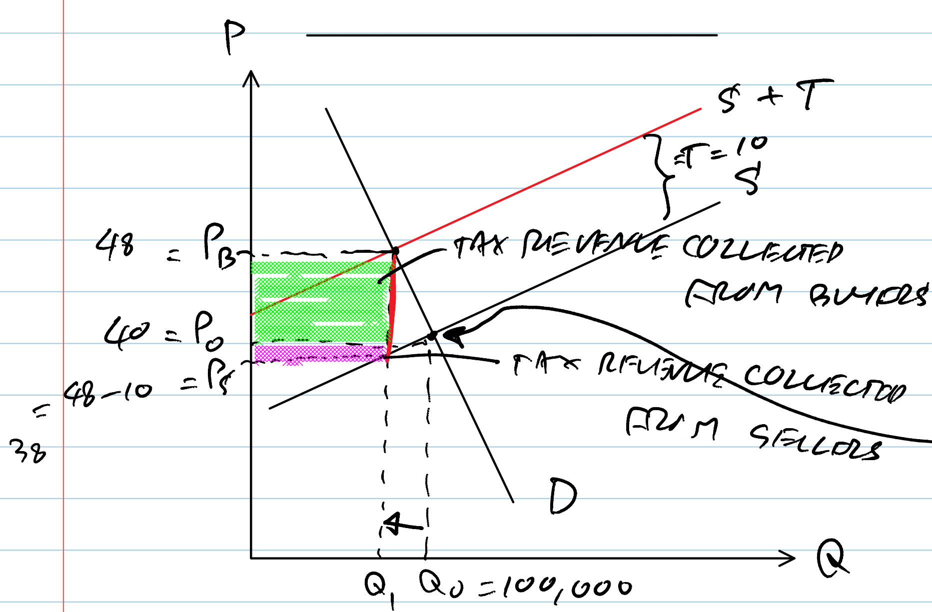
9.30 – 11.30

ROOM: TBA

DEMAND
SUPPLY
ELASTICITY
CS, PS

MR. SEPHAT

## CASE 1 WHEN SUPPLY IS MORE ELASTIC THAN DEMAND




RULE OF THUMB:

THE STEEPER THE CURVE, THE LOWER $E^D$ OR $E^S$

NOTE $E^S > E^D$.

VERIFY THIS:

$E^D = \frac{1}{\text{SLOPE}} \cdot \frac{P_0}{Q_0}$

$E^S = \frac{1}{\text{SLOPE}} \cdot \frac{P_0}{Q_0}$

- Q ↓
- BUYERS PAY HIGHER PRICE
  SELLER GET LESS PRICE

- IMPORTANTLY, BUYERS BEAR MOST OF THE TAX BURDEN. (WHY?)

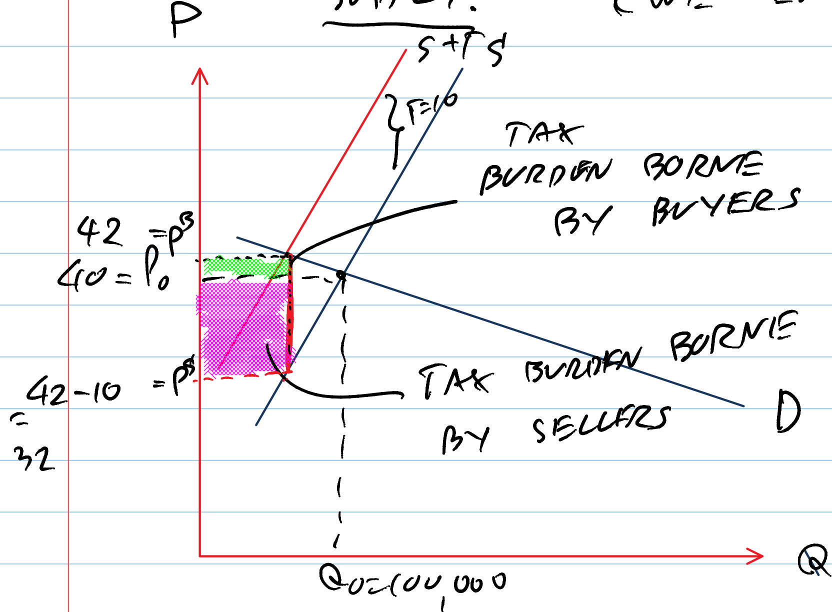
- SO ELASTICITY — NOT WHO OFFICIALLY PAY THE TAX — DETERMINES THE INCIDENCE OF A UNIT TAX

→ STATUTORY INCIDENCE: WHO IS RESPONSIBLE LEGALLY TO DELIVER THE TAX

→ ECONOMIC INCIDENCE: WHO REALLY PAY THE TAX

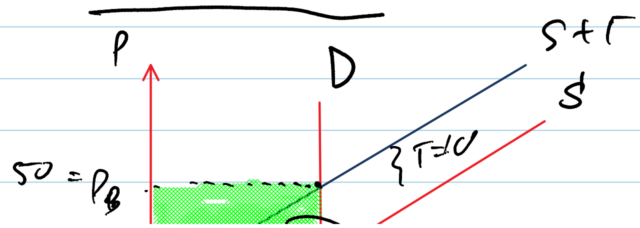
CASE 2 DEMAND IS MORE ELASTIC THAN SUPPLY. (WE EVALUATE AT SAME $P_0$ AND SAME $Q_0$)

AT $P_0, Q_0$: $E^D > E^S$.

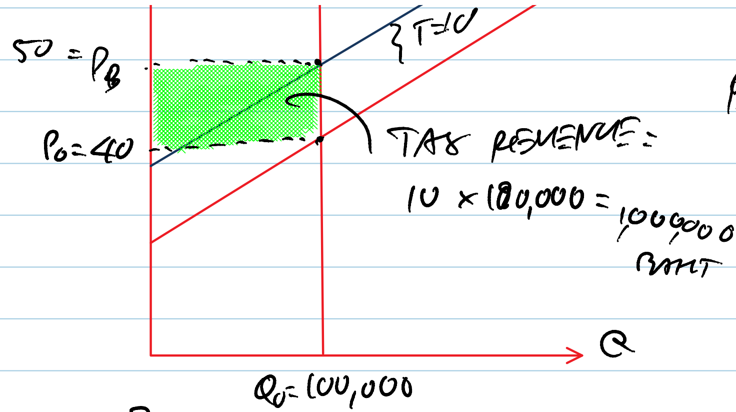



- IN THIS CASE, SELLERS BEARS MOST OF THE BURDEN OF THE TAX

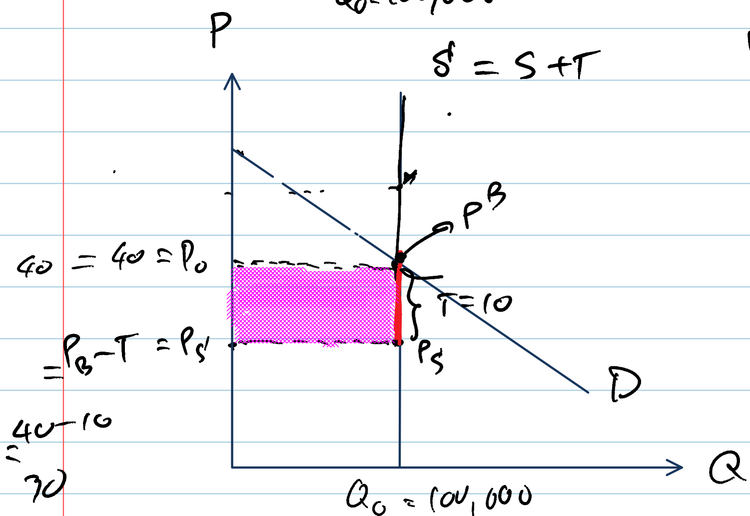
OTHER CASES




WHEN DEMAND IS PERFECTLY INELASTIC, BUYERS BEARS ALL



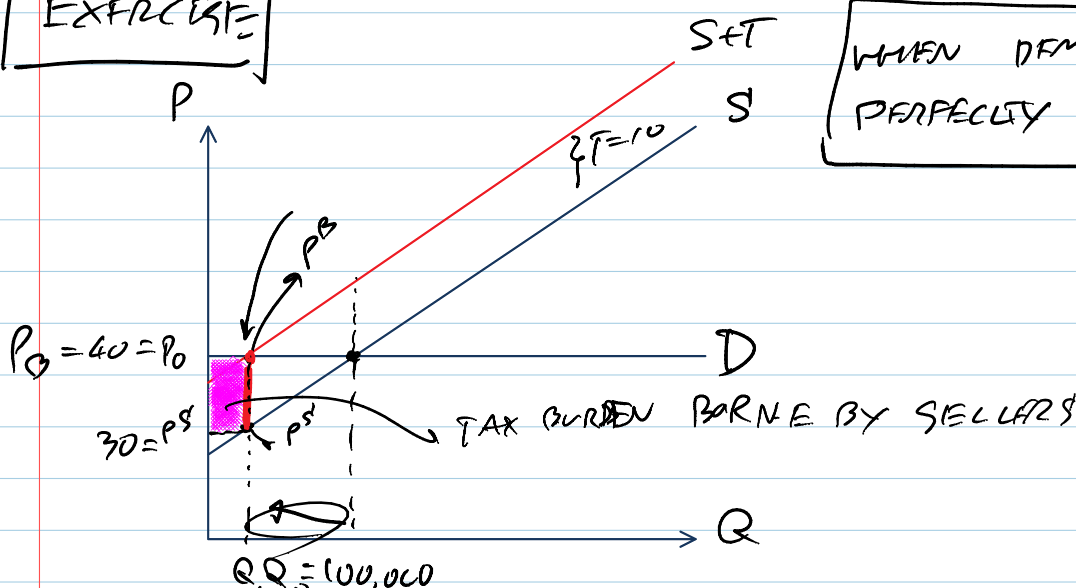

BUYERS BEARS ALL TAX BURDEN.




WHEN SUPPLY IS PERFECTLY INELASTIC

EXERCISE

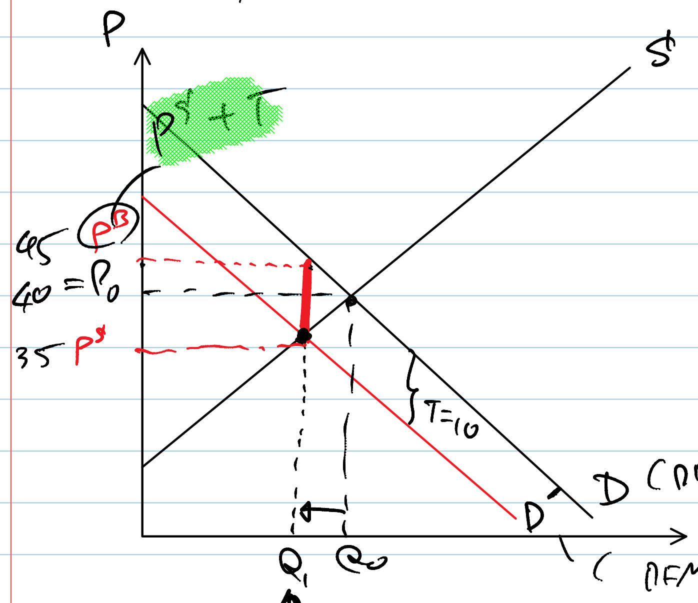
WHEN DEMAND IS PERFECTLY ELASTIC.




IN THIS CASE, SELLERS BEAR ALL TAX BURDEN.

WHAT IF GOVT. IMPOSES A UNIT TAX ON BUYERS?

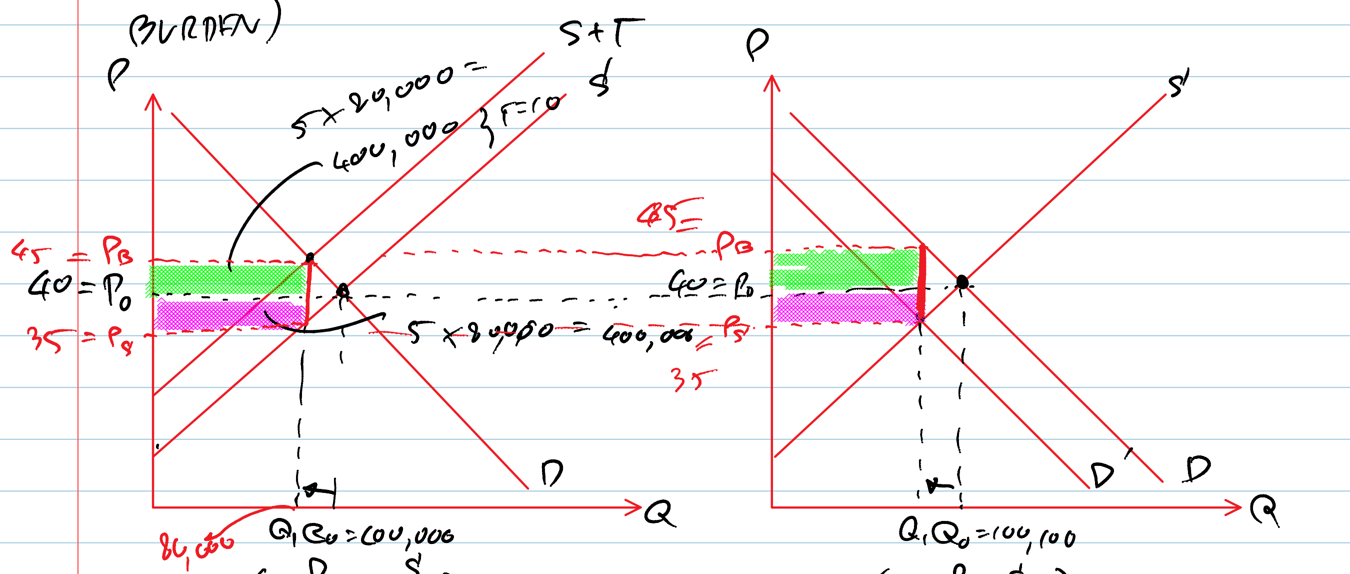
STATUTORY INCIDENCE : ON BUYERS




$\boxed{E^D = E^S}$ AT $P_0, Q_0$

RESULT #1 : Q ↓ FROM $Q_0 \rightarrow Q_1$
(ON Q)

RESULT #2 : BUYERS AND SELLERS " EQUALLY " SHARE THE TAX BURDEN.
(ON TAX BURDEN)



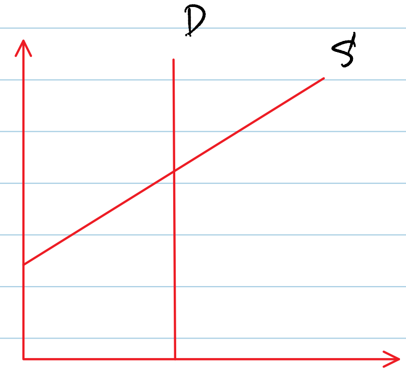

($E^D = E^S$) TAXES ON SELLERS $T = 10$

($E^D = E^S$) TAXES ON BUYERS $T = 10$

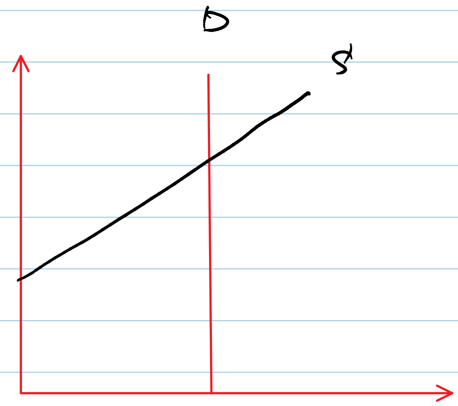
• 'IT DOES NOT MATTER WHO IS LEGALLY RESPONSIBLE TO PAY TAX, EITHER TAX ON SELLERS OR ON BUYERS, THE OUTCOMES

RESPONSIBLE TO PAY TAX, EITHER TAX ON SELLERS ON OR BUYERS, THE OUTCOMES ARE THE SAME !!!

IN OTHER WORDS, THE EFFECT ON P AND Q, AND TAX INCIDENCE ARE THE SAME WHETHER THE TAX IS IMPOSED ON BUYERS OR SELLERS !!!




TAX ON SELLERS




TAX ON BUYERS

D.I.Y.