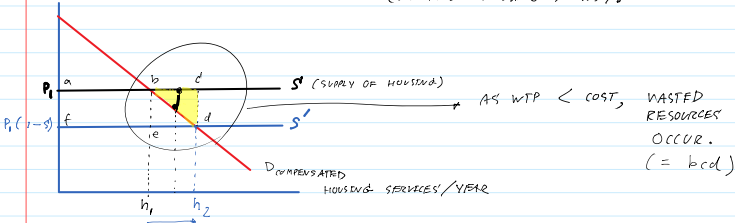


EXCESS BURDEN OF SUBSIDY

CONSIDER HOUSING SUBSIDY.



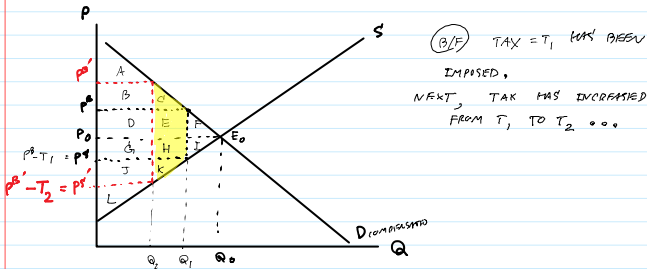
O/F SUBSIDY: $P = P_1, Q = h_1$

A/F SUBSIDY: $P = P_1(1-s), Q = h_2$

- COSTS OF HOUSING SUBSIDY =
- BENEFITS OF HOUSING SUBSIDY =

AS COSTS > BENEFIT BY AREA bcd, bcd IS AN EXCESS BURDEN OF HOUSING SUBSIDY

EXCESS BURDEN W/ A PRE-EXISTING TAX

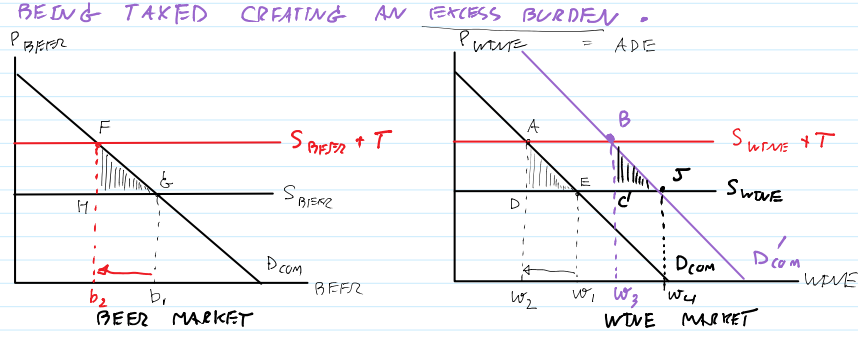


	w/ T ₁	w/ T ₂	
CS	A + b + c'	A	- b - c' (MORE LOSS ON CS WHEN T ₂ INTRODUCED)
PS	J + k + l	L	- J - k (MORE LOSS ON PS AS WELL)
GOVT.	D + E + H + G	B + D + G + J	+ B + J - E - H
TD	A + b + c' + D + E + H + G + J + k + l	A + L + B + D + G + J + J	- C - E - H - K

= $\frac{1}{2} \cdot (Q_1 - Q_2) \cdot (T_1 + T_2)$

NEXT: PREEXISTING DISTORTIONS & THEORY OF SECOND BEST

CONSIDER BEER AND WINE. CONSUMERS VIEW THE TWO GOODS AS SUBSTITUTES. SUPPOSE THAT WINE IS CURRENTLY BEING TAKEN CREATING AN EXCESS BURDEN.



NOW, GOVT. DECIDES TO IMPOSE TAX ON BEER. Q: WHAT IS THE EXCESS BURDEN OF THE BEER TAX?

IN BEER MARKET, THERE IS AN EXCESS BURDEN =

AS BEER BECOMES MORE EXPENSIVE, SOME CONSUMERS JUMP TO CONSUMER WINE AND SO DEMAND FOR WINE INCREASES. (RIGHTWARD SHIFT OF DEMAND CURVE FOR WINE) WINE CONSUMPTION IS NOW AT w₃.

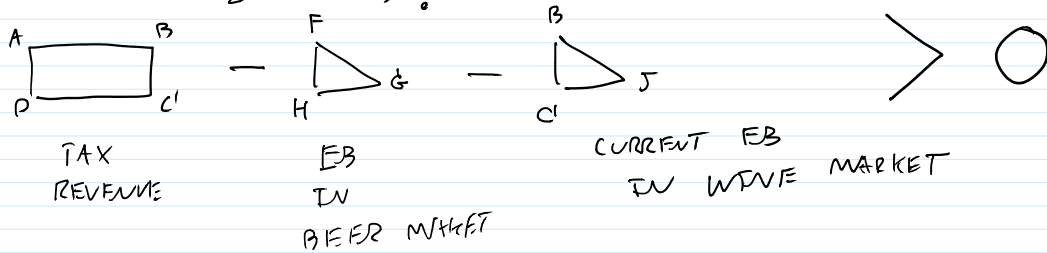
(RIGHTWARD SHIFT OF DEMAND CURVE FOR WINE)

WINE CONSUMPTION IS NOW AT w_3 .



= TAX REVENUE FROM WINE DUE TO THE FACT THAT BEER TAX MAKES WINE CONSUMPTION INCREASE FROM w_2 TO w_3 !

• IF



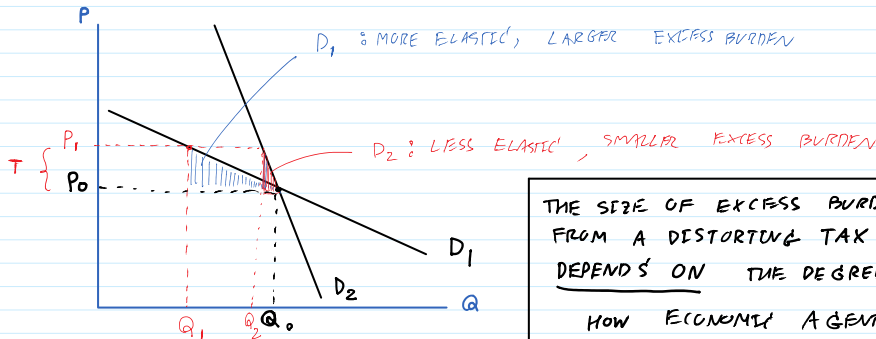
SOCIETY MAY BENEFIT FROM BEER TAX IMPOSITION IN THIS CASE WHERE WE HAVE PRIOR EXISTING DISTORTIONS IN WINE MARKET

↳ WINE BEING TAXED ALREADY AT THE FIRST PLACE

THEORY OF SECOND BEST

PRINCIPLE OF SECOND BEST : THE FACT THAT A TAX DISTORTS AN ECONOMIC DECISION DOES NOT ALWAYS IMPLY THAT SUCH A TAX IMPOSES EXCESS BURDEN. IF THERE ARE PREVIOUSLY EXISTING DISTORTIONS, SUCH A TAX MAY ACTUALLY IMPROVE EFFICIENCY.

EXCESS BURDEN & PRICE ELASTICITY OF DEMAND



THE SIZE OF EXCESS BURDEN FROM A DISTORTING TAX DEPENDS ON THE DEGREE OF HOW ECONOMIC AGENTS ARE RESPONSIVE TO IT.