5. Government Intervention

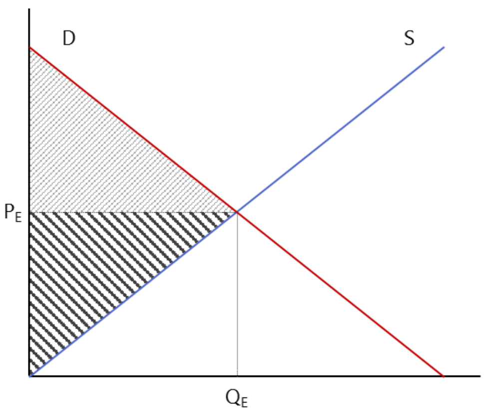
ECON1101 • KC Notes

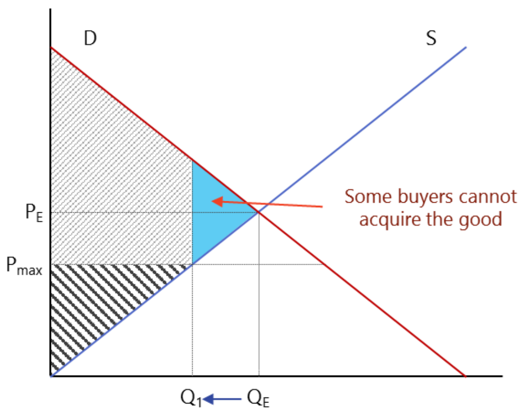
: Consumer surplus   : Producer surplus   : Dead weight loss   : Government revenue

- **Deadweight loss** (DWL): loss in economic surplus as market is prevented from reaching equilibrium price

5.1 Price Ceiling

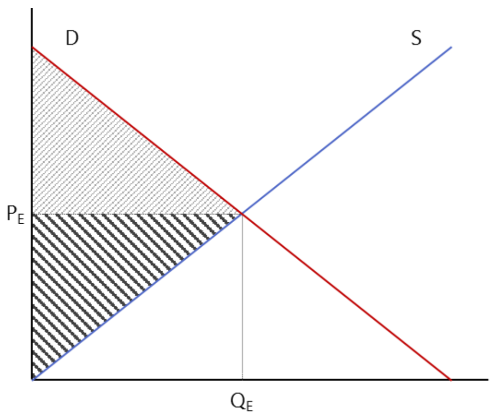
- **Price Ceiling**: Max allowable price imposed by government
  - Winners: Consumers with high willingness to pay (rationing rule 4.3). Consumers with lower reservation price lose out (the top half of the DWL)
  - Losers: Producers

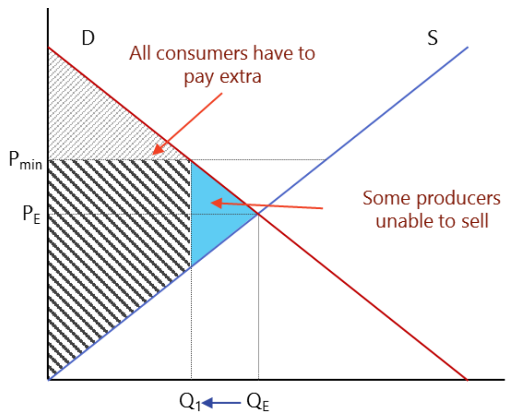




5.2 Price Floor

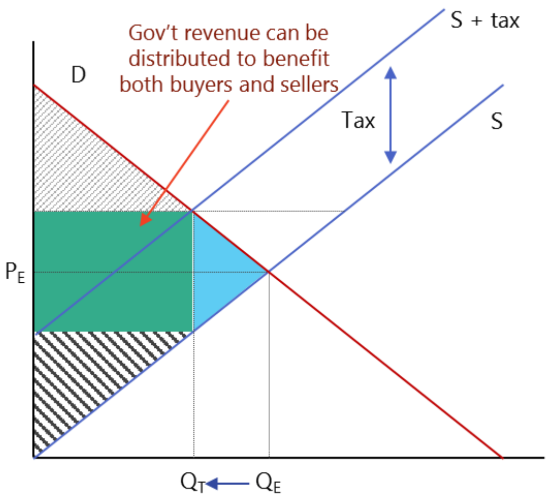
- **Price Floor**: Min allowable price imposed by government
  - Winners: Producers who can sell the good
  - Losers: Producers and consumers who no longer are able to buy/sell the good, and consumers who can pay must pay extra

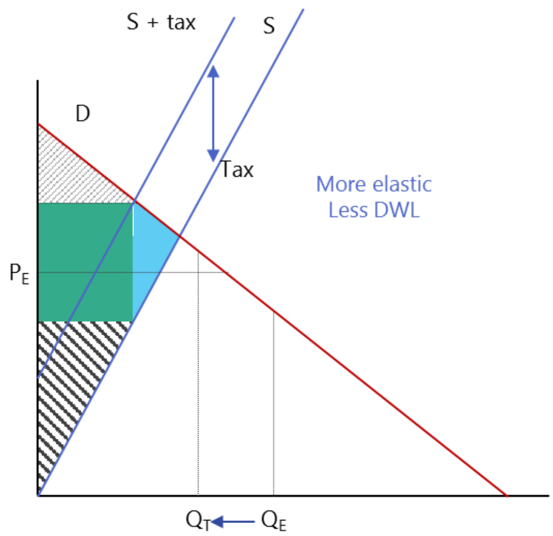




5.3 Taxation

- **<u>Taxation</u>**: Tax levied on producers
  - Supply simply shifts up by the amount taxed – line is now MC + tax
  - Total tax revenue = tax $\times$ quantity produced
- Taxation is more efficient if supply is **more inelastic** (compare the sizes of the DWL)





5.4 Subsidy

- **<u>Subsidy</u>**: payment to producers
  - DWL generated from the government subsidy cost