CHAPTER OUTLINE:

I. Controls on Prices
   A. Definition of price ceiling: a legal maximum on the price at which a good can be sold.
   B. Definition of price floor: a legal minimum on the price at which a good can be sold.
   C. How Price Ceilings Affect Market Outcomes
      1. There are two possible outcomes if a price ceiling is put into place in a market.
         a. If the price ceiling is higher than or equal to the equilibrium price, it is not binding and has no effect on the price or quantity sold.
         b. If the price ceiling is lower than the equilibrium price, the ceiling is a binding constraint and a shortage is created.
      2. A binding price ceiling leads to undesirable rationing mechanisms.

D. How Price Floors Affect Market Outcomes
1. There are two possible outcomes if a price floor is put into place in a market.
   a. If the price floor is lower than or equal to the equilibrium price, it is not binding and has no effect on the price or quantity sold.
   b. If the price floor is higher than the equilibrium price, the floor is a binding constraint and a surplus is created.

2. A binding price floor leads to undesirable rationing mechanisms.

II. Taxes

A. Definition of tax incidence: the manner in which the burden of a tax is shared among participants in a market.

B. How Taxes on Buyers Affect Market Outcomes

1. Step 1: If the government requires the buyer to pay a certain dollar amount for each unit of a good purchased, this will cause a decrease in demand.

2. Step 2: The demand curve will shift down by the amount of the tax.

3. Step 3: The quantity of the good sold will decline. Buyers pay more for the good (including the tax) and sellers receive less.

4. Implications:
   a. Taxes discourage market activity.
   b. Buyers and sellers share the burden of a tax.
C. How Taxes on Sellers Affect Market Outcomes

1. Step 1: If the government requires the seller to pay a certain dollar amount for each unit of a good purchased, this will cause a decrease in supply.

2. Step 2: The supply curve will shift up by the amount of the tax.

3. Step 3: The quantity of the good sold will decline. Buyers pay more for the good and sellers receive less (because of the tax).

4. Taxes on buyers and taxes on sellers are equivalent.
D. Elasticity and Tax Incidence

1. When supply is elastic and demand is inelastic, the largest share of the tax burden falls on buyers.

2. When supply is inelastic and demand is elastic, the largest share of the tax burden falls on sellers.

3. In general, a tax burden falls more heavily on the side of the market that is less elastic.