Chapter 6: Supply, Demand, and Government Policies
Principles of Economics, 8th Edition
N. Gregory Mankiw
Page 1

1. Introduction:
- *a.* *This is an interesting chapter with important insights.*
- *b.* *Most of the examples of government interference in markets in this book--as well as other microeconomics books--reduce social welfare.*
  - *i.* *They are often motivated by the desire to benefit a group with a narrow focus at the expense of a potentially much larger group with a more dispersed focus.*
- c. Economists have two roles:
  - i. Scientists and
  - ii. Policy makers.
- d. This chapter offers our first look at policy.

2. Controls on Prices
- *a.* *Buyers always want a lower price, while sellers want a higher price.*
- b. Price ceiling is a legal maximum on the price at which a good can be sold. P. 112.
  - i. Rent controls.
- c. Price floor is a legal minimum on the price at which a good can be sold. P. 112.
  - i. Agricultural price supports
  - ii. Minimum wages.
- d. How Price Ceilings Affect Market Outcomes
  - i. **Figure 1: A Market with a Price Ceiling. P. 113**
  - ii. While there can be non-binding price ceilings, we are interested in the situations in which they are binding.
  - iii. The outcome of a binding price ceiling is usually inefficient and unfair.
    - (1) Some mechanism for rationing will naturally develop.
    - (2) One method is the sellers' personal biases.
    - (3) Only the people who get it benefit.
    - (4) A general result: When the government imposes a binding price ceiling on a competitive market, a shortage of the good arises and sellers must ration the scarce goods among the large number of potential buyers.
    - (5) A competitive market is both efficient and impersonal using the price to ration the good.
- **e.** **Case Study: Lines at the Gas Pump, P. 114**
  - i. *By causing people to want to have a full tank all the time, the price controls can cause a shortage when one does not actually exist.*
  - ii. **Figure 2: The Market for Gasoline with a Price Ceiling. P. 114.**
- f. **Case Study: Rent Control in the Short Run and Long Run, P. 115**

i. **Figure 3: Rent Control in the Short Run and in the Long Run. P. 116.**
ii. The effects are worse in the long run as both the supply and demand curves become more elastic.
iii. Ask the Experts: 95% disagree with rent controls on positive effects of rent controls on affordable rental housing.

g. How Price Floors Affect Market Outcomes
   i. A binding price floor causes a surplus.
   ii. **Figure 4: A Market with a Price Floor. P. 117.**
h. **Case Study: The Minimum Wage, P. 118.**
   i. They are not likely to benefit those for whom they are aimed.
   ii. The effects are particular bad for the most unattractive workers when there is a municipal minimum wage because of the effect on the quantity of workers supplied by nearby areas.
   iii. **Figure 5: How the Minimum Wage Affects the Labor Market. P. 118**
   iv. **Ask the Experts: A $15 minimum wage will reduce employment of low wage workers:**
      (1) **29% disagree**
      (2) **34% agree and**
      (3) **37% are uncertain**
i. Evaluating price controls
   i. They re-enforce that markets are usually a good way to organize economic activity.
   ii. The poor are best served by something like an earned income credit.

3. Taxes
   a. Tax incidence is the study of who bears the burden of taxation. P. 121.
      i. This should be interesting material.
         (1) Who pays the corporate income tax?
         (2) Who pays the gross receipts tax (on sellers) in New Mexico?
   a. How Taxes on Sellers Affect Market Outcomes
      i. **Figure 6: A Tax on Sellers. P. 122.**
      i. *Comparing Figures 6 and 7 demonstrate that taxes on producers or buyers produce the same results.*
      ii. Two general lessons:
         (1) Taxes discourage market activity.
         (2) Buyers and sellers share the burden of the tax.
   b. How Taxes on Buyers Affect Market Outcomes
      i. **Figure 7: A Tax on Buyers. P. 123.**
   a. **Case Study: Can Congress Distribute the Burden of a Payroll Tax? P. 124.**

i. *Economists argue that the whole tax comes from the compensation available for workers, so they in effect pay it.*
ii. **Figure 8: A Payroll Tax. P. 125.**

b. Elasticity and tax incidence
i. A tax burden falls more heavily on the side of the market that is less elastic.
ii. **Figure 9: How the Burden of a Tax Is Divided. P. 126.**
iii. **Case Study: Who Pays the Luxury Tax?, P. 126.**
(1) May fall on the workers who produce the products.

4. Conclusion

5. Summary