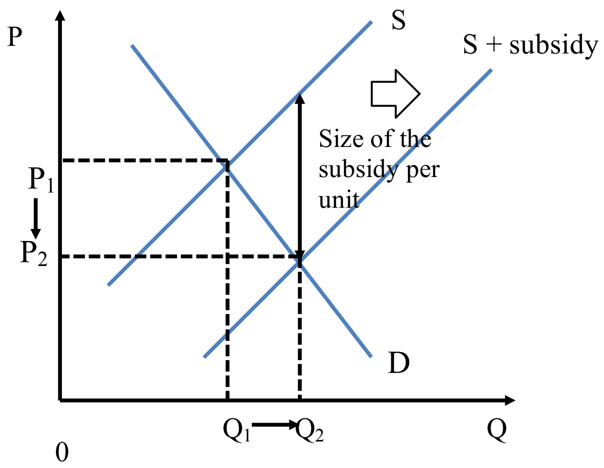
- The purple line shows the tax incidence paid by consumers
- The red line shows the tax incidence paid by producers

Subsidy is an amount of money given to a firm from the government in order to increase output and/or lower market prices per unit.



Why would a government give a subsidy?

⇒ **Affordability (merit goods)** – A subsidy would increase the affordability and output of desirable goods (e.g. merit goods) for (typically low-income) households. Examples include health-care, education-related goods, and eco-friendly goods.

⇒ **Income** – Governments may grant subsidies to farmers to increase their income because of certain features of the agricultural sector.

⇒ **Competitiveness** – A subsidy could make a particular good more competitive abroad and help increase export revenue. It may also limit imports of competing goods.

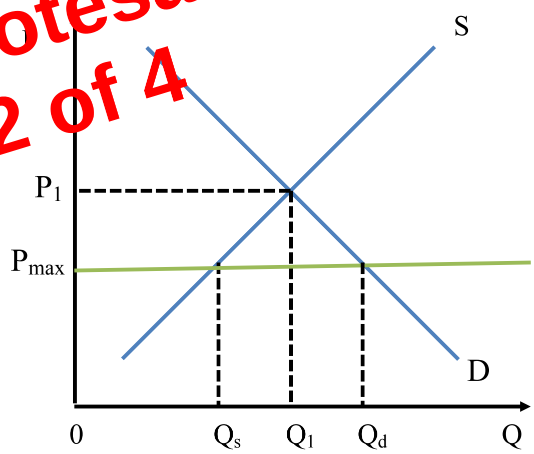
Consequences of a subsidy

⇒ Market prices will decrease
⇒ Equilibrium quantity increases
⇒ Output and consumption of the good therefore increases
⇒ Producers' total revenues increase
⇒ Government revenue decreases while their expenditure increases
⇒ Consumer spending on the good may increase, decrease or stay the same depending on PED

Price controls

Maximum price (price ceiling) – Price control imposed by the government at a price below the market equilibrium.

Examples of price ceilings include food price controls (e.g. corn flour, sugar, oil in Venezuela) and rent controls.



Impact of a price ceiling in market outcomes

⇒ Price falls from P_1 to P_{max}
⇒ Quantity demanded increases from Q_1 to Q_d
⇒ Quantity supplied decreases from Q_1 to Q_s
⇒ This causes a shortage (excess demand) of Q_s - Q_d
⇒ Consumer expenditure (producers' revenue) decreases