

Income Elasticity and Market Intervention

I. Income Elasticity

A. Definition

$$\epsilon_I = \frac{Y}{Q} \frac{dQ}{dY}$$

B. Change in Prices

Income Elasticity	Good is...	
$\epsilon_I > 1$	Luxury	Normal
$1 > \epsilon_I > 0$	Necessity	
$0 > \epsilon_I$	Inferior	

II. Market Intervention

Let demand be $Q = 8 - 2P$ and supply be $Q = P$

A. Tax

- i. Tax on Supplier
 - Replace P as $P - t$ in supply
- ii. Tax on Consumer
 - Replace P as $P + t$ in demand

B. Subsidy

- Just the reverse situation of tax. In other words, a subsidy of S is identical to a tax of $-S$.