

University of Toronto
Economics 336Y – Public Economics (Taxation)

Practice exercises #1

1. The market demand for and supply of peanuts are given by the functions

$$D(P) = 64P^{-1}$$

$$S(P^s) = 100P^s$$

respectively, where P is the price paid by consumers and

$$P^s = P(1 - \tau)$$

is the price received by producer when the ad valorem tax rate is τ .

Suppose that the tax rate is increased from $\tau_0 = 0.36$ to $\tau_1 = 0.51$. Calculate the fraction of the additional tax burden that is borne by consumers and the fraction that is borne by producers.