

EFFECT OF TAXATION

FIRST, THERE ARE 2 MAIN TYPES OF TAXES:

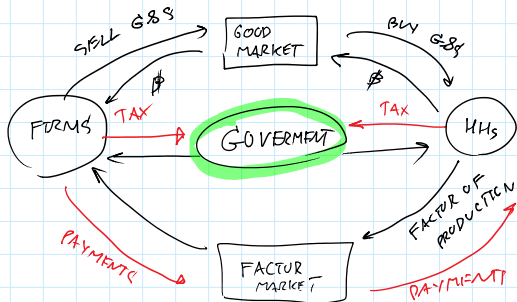
① UNIT TAX: TAX CHARGED PER UNIT OF GOOD

EX: CIGARETTE TAX, MINE TAX, WINDOW TAX, ETC.

(PERCENTAGE TAX)

② AD VALOREM TAX: TAX CHARGED AS % OF VALUE OF A GOOD

EX: VALUED-ADDED TAX (VAT)



CIRCULAR FLOW

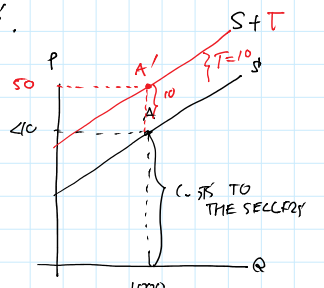
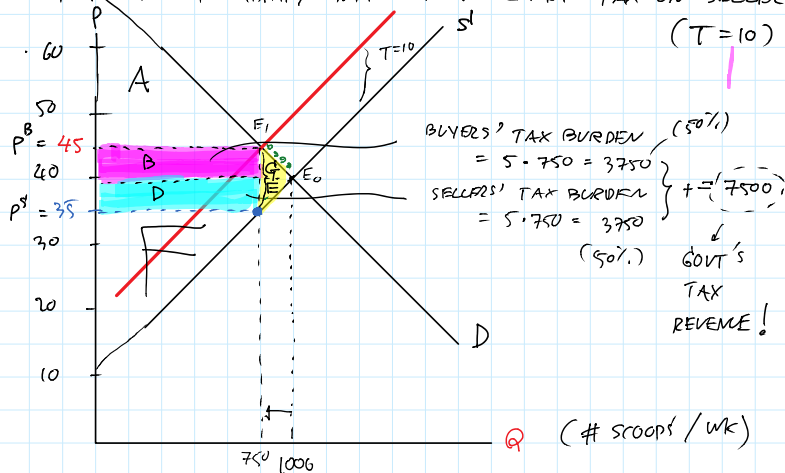
EFFECT OF A UNIT TAX ON BUYERS AND ON SELLERS

"STATUTORY INCIDENCE"

CASE 1 A UNIT TAX IMPOSED ON SELLERS (SELLERS ARE LEGALLY RESPONSIBLE TO PUT MONEY INTO TAX BOX)

CONSIDER ICECREAM MARKET WHICH IS ASSUMED TO BE "PERFECTLY COMPETITIVE"

SUPPOSE GOVT. IMPOSES 10 PAINT/UNIT OF ICECREAM TAX ON SELLERS.



- 10 PAINT UNIT TAX SHIFTS THE SUPPLY CURVE "VERTICALLY UPWARD" BY THE SIZE OF TAX.
 - W/ UNIT TAX = 10, TO INDUCE THE SELLERS TO PRODUCE $Q = 1000$, NOW THE SELLERS REQUEST TO GET AT LEAST 50 PAINT/SCOOP! (WHY?)
- B/C' 10 PAINT UNIT TAX INCREASES THE SELLERS' COST.

RESULT #1 TAXES REDUCE MARKET QUANTITY (= MRT BECOMES LESS ACTIVE)

RESULT #2 BUYERS PAY A HIGHER PRICE.

LAST WEEK: BUYERS PAY 40 PAINT/SCOOP
 THIS WEEK: " " 45 PAINT/SCOOP

SELLERS GET A LOWER PRICE.

LAST WEEK: SELLERS RECEIVE 40 PAINT/SCOOP
 THIS WEEK: " " 35 PAINT/SCOOP

$P^B =$ PRICE THAT BUYERS PAY = 45

$P^S =$ PRICE THAT SELLERS ACTUALLY RECEIVE = 35

$P^B - P^S = 45 - 35 = 10$ WHICH IS EQUAL TO "T"

IN SHORT, $P^B - P^S = T$.

RESULT #3 IN THIS CASE, BUYERS AND SELLERS "EQUALLY" SHARE
(ON TAX BURDENS) THE TAX BURDEN

TAX REVENUE = 7500

- 3750 FROM BUYERS' POCKET
- 3750 FROM SELLERS' POCKET

RESULT #4
(WHO GAIN/
WHO LOSE)

| | FREE MKT = | UNDER TAX = | | |
|------|-------------------|----------------|-------------------|--------------|
| CS | B/F TAX A+B+C' | A/F TAX A | Δ -B-C' | ☹️ WORSE OFF |
| PS | D+E+F | F | -D-E | ☹️ WORSE OFF |
| GOVT | - | B+D | +B+D | 😊 |
| TS | A+B+C' + D+E+F | A+F+B+D → | -C-E | ↓ DWL |

- BUYERS ARE WORSE OFF.
- SELLERS ARE WORSE OFF.
- GOVT GETS TAX REVENUE.
- SOCIETY AS A WHOLE, TS REDUCES AND SO DWL OCCURS.

RESULT #5

SHAPES OF DEMAND CURVE AND SUPPLY CURVE WILL DETERMINE HOW TAX BURDENS ARE SHARED AMONG

