Subject: Public finance
Course code: ECON4009
Topic: Shifting and Incidence of Tax
M.A. Economics (2nd Semester)

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What is tax incidence?

- Tax incidence is the study of the effects of tax policies on prices and the distribution of utilities/welfare.
- What happens to market prices when a tax is introduced or changed?
- Examples:
  - what happens when impose $1 per pack tax on cigarettes? Introduce an earnings subsidy (EITC)? provide a subsidy for food (food stamps)?
  - effect on price : distributional effects on smokers, profits of producers, shareholders, farmers,...
- This is positive analysis: typically the first step in policy evaluation; it is an input to later thinking about what policy maximizes social welfare.
- Empirical analysis is a big part of this literature because theory is itself largely inconclusive about magnitudes, although informative about signs and comparative statics.

What is tax incidence? (cont...)

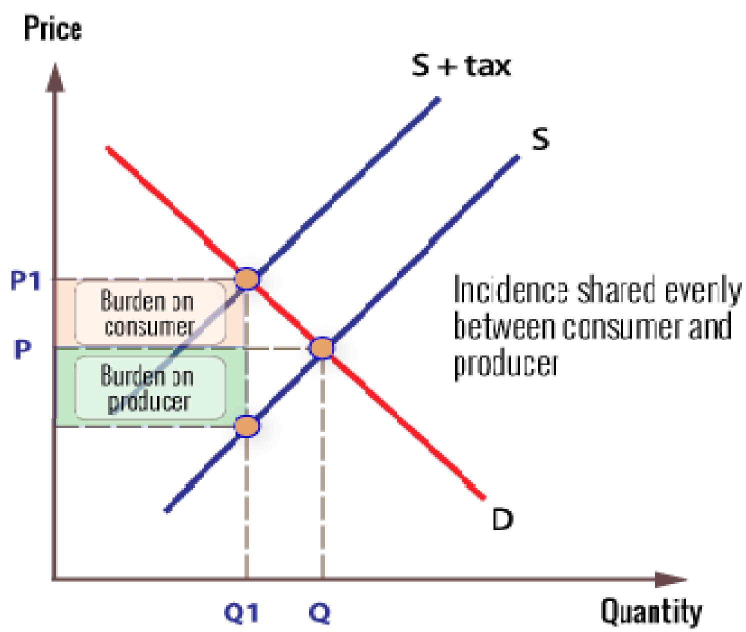
- Tax incidence is not an accounting exercise but an analytical characterization of changes in economic equilibria when taxes are changed.
- Key point: Taxes can be shifted: taxes affect directly the prices of goods, which affect quantities because of behavioural responses, which affect indirectly the price of other goods.
- If prices are constant economic incidence would be the same as legislative incidence.
- Knowing incidence is incredibly important for policy analysis.

What is tax incidence? (cont...)

- Ideally, we want to know the effect of a tax change on utility levels of all agents in the economy.
- Realistically, we usually look at impacts on prices or income, rather than utility.
- Useful simplification is to aggregate economic agents into a few groups.
    - Gas tax: producers vs. consumers
    - EITC: suppliers vs. demanders of labour, recipients vs. non-recipients
    - Income tax: rich vs. poor
    - Property tax: region or country
    - Social security: across generations

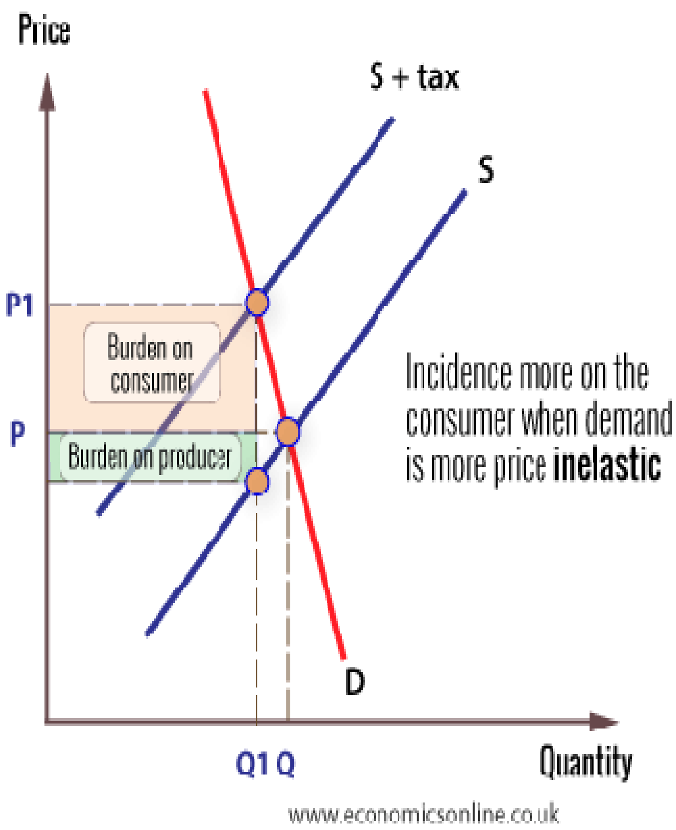
Incidence of Tax

- The incidence of a tax refers to the extent to which an individual or organisation suffers from the imposition of a tax – it may fall on the consumer, the producer, or both.
- The incidence is also called the ‘burden’ of taxation.

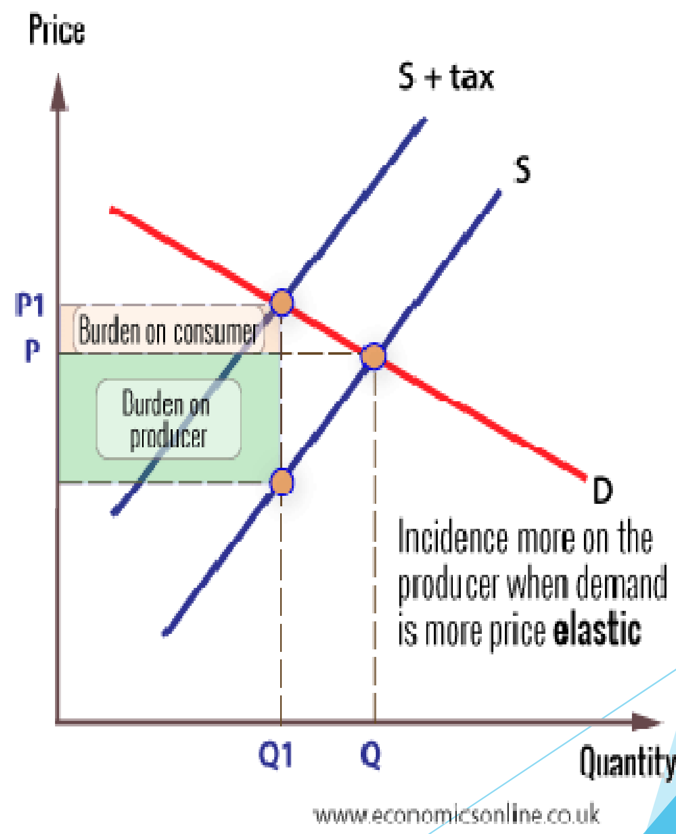


Impact of Incidence of Tax

Incidence more on the consumer



Incidence more on the producer



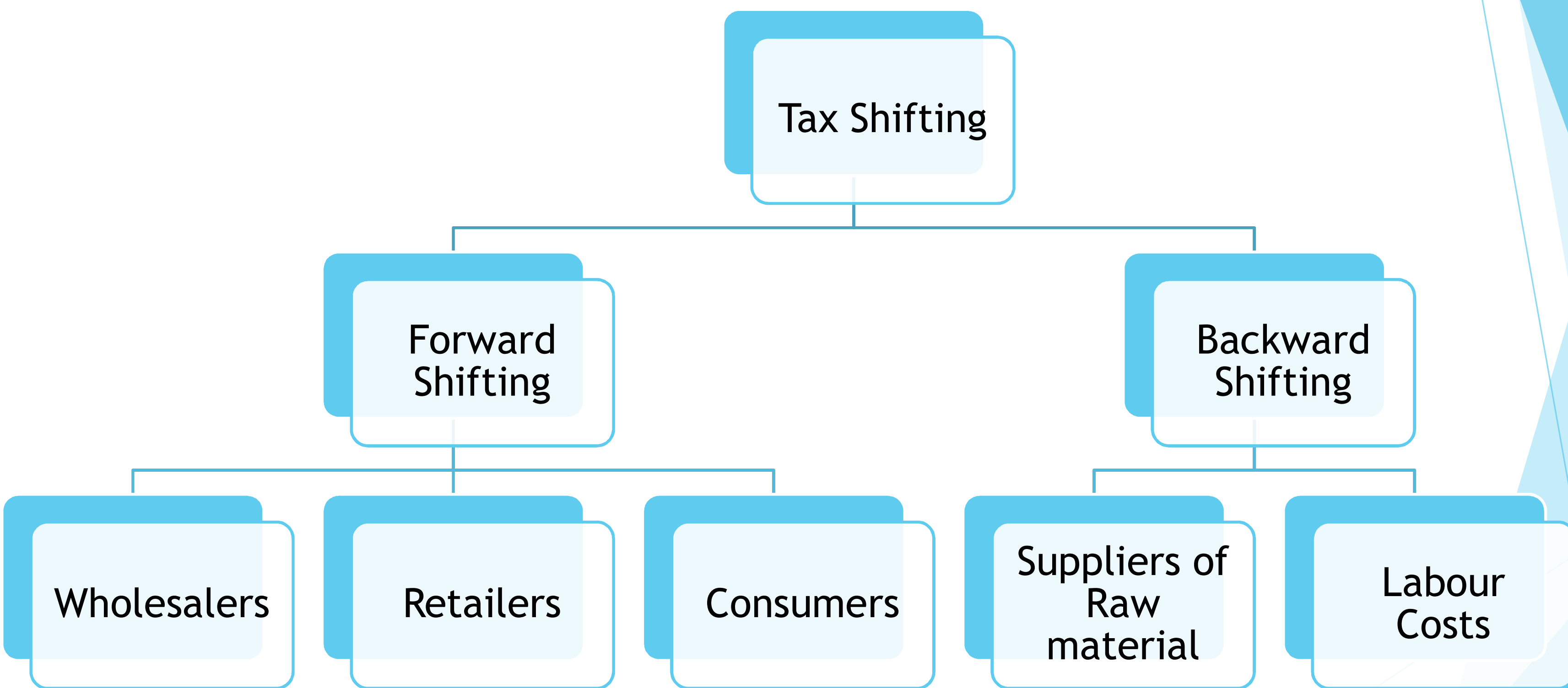
Shifting of Taxation

- The term shifting refers to the transfer of some or all of the burden of the tax from the one on whom tax is imposed to another person.
- **Shifting of Tax:** The process of transfer of a tax, while its impact lies on the person who pays it at first instance. Or, shifting is a process through which a taxpayer escapes the burden of a tax.
- There are two types of Shifting of taxation-
  - Single point shifting
  - Multi point Shifting

Process of Tax Shifting

- Shifting through prices
- Shifting at many points
- Shifting through tax-capitalisation
- Shifting of tax:
  - Forward shifting- Tax shifted from the seller to the purchaser.
  - Backward shifting- Backward shifting is that shifting in which the tax is shifted from purchaser to the seller.

Process of Tax Shifting



Thank You