Economics 001
Principles of Microeconomics

Professor Arik Levinson

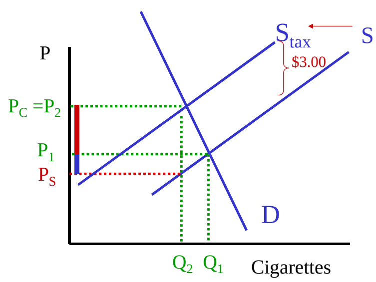
- Lecture 7
  - Tax incidence

Tax incidence

DN: Nominal incidence, or statutory incidence, is borne by those who physically pay the tax. It's what the law says.

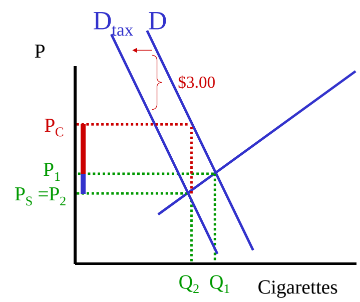
DN: Economic incidence is borne by those who suffer economic loss as a result of the tax.

Example: A $3.00 cigarette tax -- Suppliers bear the nominal incidence



Economic Incidence:
Consumers pay
$P_C - P_1$
Suppliers pay
$P_1 - P_S$

Example: A $3.00 cigarette tax -- Consumers bear the nominal incidence



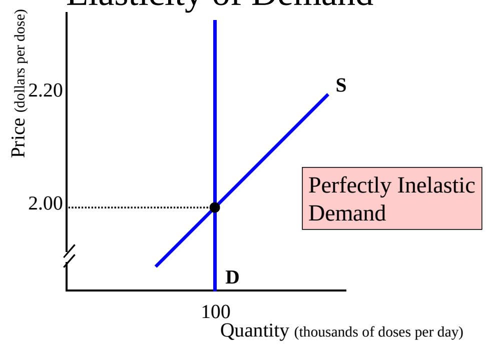
Economic Incidence:
Consumers pay
$P_C - P_1$
Suppliers pay
$P_1 - P_S$

The nominal incidence is irrelevant to the economic incidence.

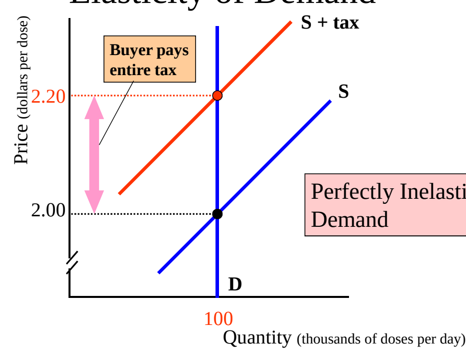
Tax Division and Elasticity of Demand

- Two Extremes
  - Perfectly inelastic demand--buyer pays
    - Example: Insulin
  - Perfectly elastic demand--seller pays
    - Example: Pink marker pens

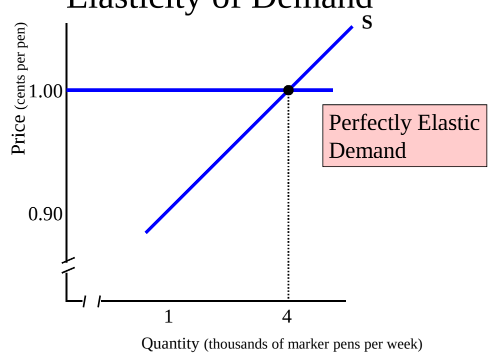
Sales Tax and the Elasticity of Demand



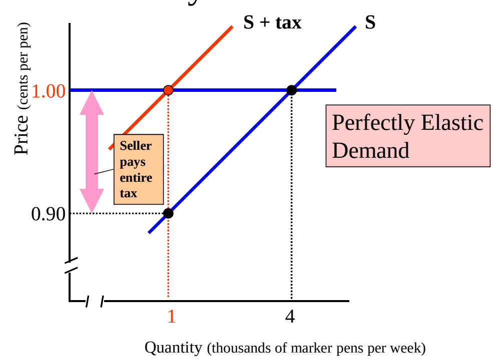
Sales Tax and the Elasticity of Demand



Sales Tax and the Elasticity of Demand



Sales Tax and the Elasticity of Demand



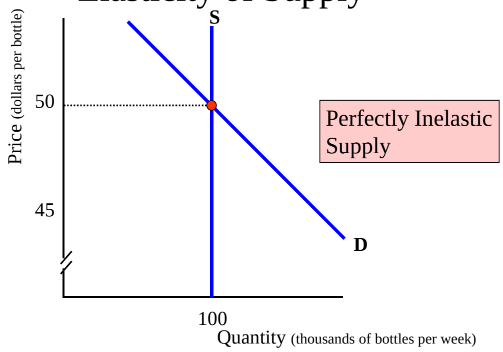
Tax Division and Elasticity of Demand

- The division of the tax depends upon elasticity.
  - The more inelastic the demand, the more the buyer pays.
  - The more elastic the demand, the more the seller pays.

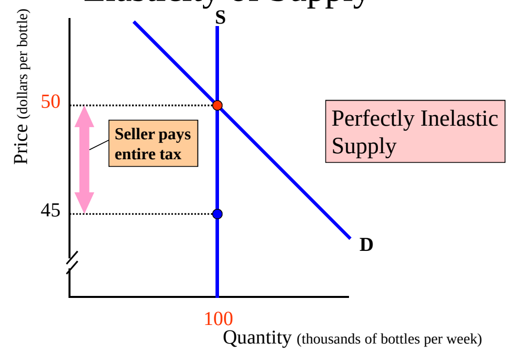
Tax Division and Elasticity of Supply

- Two Extremes
  - Perfectly inelastic supply — seller pays
    - Example: water from a mineral spring
  - Perfectly elastic supply — buyer pays
    - Example: sand used to make silicon used by computer chip makers

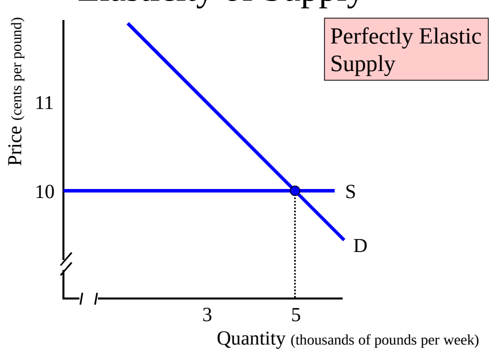
Sales Tax and the Elasticity of Supply



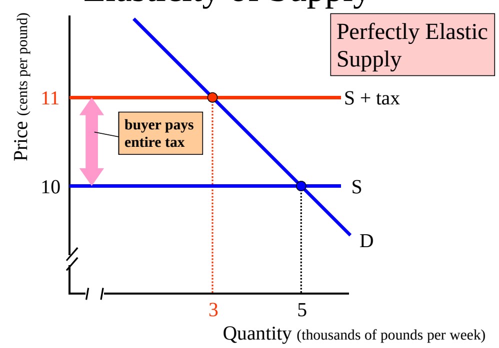
Sales Tax and the Elasticity of Supply



Sales Tax and the Elasticity of Supply



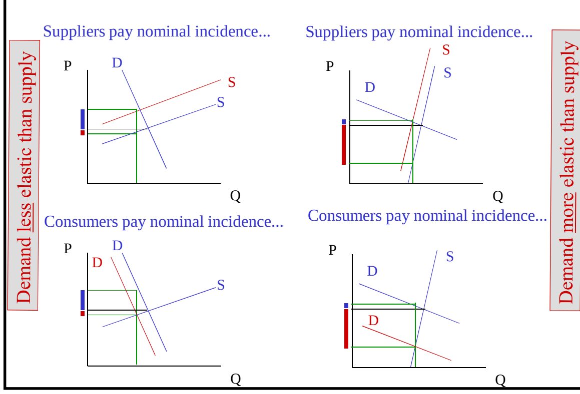
Sales Tax and the Elasticity of Supply



Tax Division and Elasticity of Supply

- The division of the tax depends upon elasticity.
  - The more inelastic the supply, the more the seller pays.
  - The more elastic the supply, the more the buyer pays.

Tax incidence in sum...



Deadweight Loss

DN: Deadweight Loss of a Tax = Social Costs above and beyond Tax revenue

Deadweight Loss