Unit 6 scenario

identify and describe the goals of each tax—that is, what does the hope to achieve by imposing the taxes? identify the beneficiaries of the street improvements

explain the likely outcome on equilibrium prices and quantity for the local businesses if the entertainment tax is imposed

describe how much of each tax will be paid by businesses and how much will be paid by consumers. (e. g., how much of the tax will be passed on to the consumer)

comment on the effectiveness of each tax in terms of achieving the citys goals

Your explanation not in full. Please, check again.

Option 1

When an indirect tax is imposed on the visitors, the city wishes to impose the burden on the visitors. The beneficiaries of street improvement will be the shopowners, government , society and visitors. We need to consider what is the effect on consumers, producers, government and the society at large. In our case, when an entertainment tax is imposed on the visitors, the following questions have to be answered:

1. What will happen to the price that the visitors pay?

2. What will happen to the amount received by the producer?

3. How much tax will the government receive?

4. What will happen to the size of the market and so employment?

If we take a normal demand and supply curve and then assume that the city imposes an entertainment tax on the visitors, we get the diagram as follows:

S1+5% tax

S1

X

W

Y

D

The market is in equilibrium with Qe being supplied and demanded at a price Pe. After a tax of XY(entertainment tax), the supply curve shifts upward from S1 to S1 + 5% tax. The producers would like to hike the price to P2, where the whole tax burden is borne by the visitors. But will the visitors be willing to pay for the increase in price because of tax. So the demand and supply do not match, at point P2, there is an excess supply. Hence, the price has to come down to P1, where Q1 will be both demanded and supplied.

It is evident that, the price of the product for the consumer increases from Pe to P1, which is their share of tax and is about half of the tax of XY. Producers now get C per unit, after paying tax PeC per unit. The revenue for the producers falls from OPeWQe to OCYQ1. The government will receive a tax revenue equal to CP1XY and the market size falls from Qe to Q1. This may have an implication on the employment in the society as firms may employ less number of people and the visitors will also think about alternate places of entertainment due to the increase in prices. However, the tax burden on the consumers and producers will vary depending upon the price elasticity of the entertainment service.

Option 2

On the other hand, if the option of charging a special tax on the shop owners based on the shop size, then, the smaller shops will be at the advantageous side. Smaller shop owners will pay less taxes and so their ratio of profit to investment will be high. If the owners with bigger shops want to share the tax burden with the consumers, then the price of products from the big shops will be higher than that from smaller shops. It will create opportunities for unfair trade practices. This might discourage entrepreneurial activity and even encourage shop owners to search for better places with favorable tax climates. Hence, the option 1 of imposing indirect tax will be a better option.

Reference:

Blink Jocelyn, Dorton Ian, 2007, Economics, Oxford University press, Oxford.