



Cost of Taxation




Chapter 7-2



Taxation and Government

- For government to operate, it must tax.
- For the market to work, it needs the government.
- Tax rates depend on what goods and services government provides.



How Much Should Government Tax?

- To answer this, we must know the costs and benefits of taxation.



The Costs of Taxation

- The costs of taxation include:
 - The direct cost of the revenue paid to government
 - The loss of consumer and producer surplus caused by the tax
 - The cost of administering the tax codes.



The Costs of Taxation

- A tax paid by the supplier shifts the supply curve up by the amount of the tax.



The Costs of Taxation

- When government raises taxes, there is a loss of consumer and producer surplus that is **not raised by government weight loss.**



The Costs of Taxation

- Graphically the deadweight loss is shown on a supply-demand curve as the welfare loss triangle.

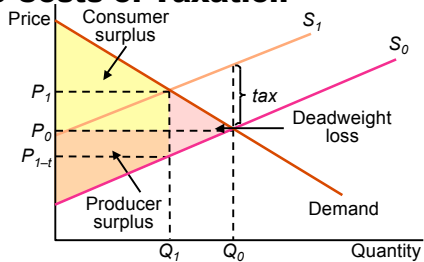


The Costs of Taxation

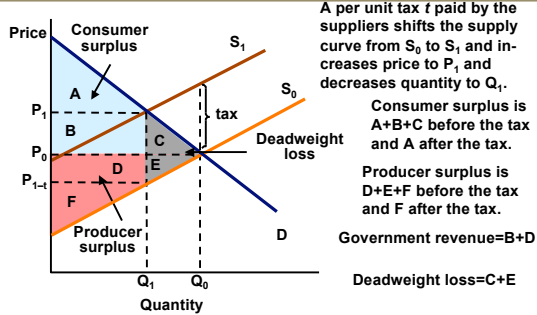
- The **welfare loss triangle** – a geometric representation of the welfare loss in terms of misallocated resources caused by a deviation from a supply-demand equilibrium.



The Costs of Taxation



Costs of Taxation



The Costs of Taxation



- The other costs of taxation are the administrative costs of compliance.
- Resources are used by the government to administer the tax code and by citizens and businesses to comply with it.
