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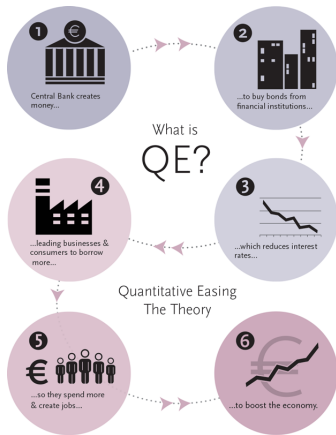
# Taxation

Chapter 80 – April, 2017

# THE REASONS FOR TAXATION

- ▶ pay for government expenditure:
  - ▶ borrowing money (inflationary pressure), or
  - ▶ financing through taxation
- ▶ correct market failure such as externalities: taxing to reduce demand on individual markets (i.e., cigarettes market)
- ▶ manage the economy as a whole: influence macroeconomic variables (i.e., inflation, unemployment, balance of payments)
- ▶ redistribute income: taxing some groups to subsidise others

# QUANTITATIVE EASING



- ▶ Bank of England
- ▶ The Economist
- ▶ Financial Times
- ▶ Financial Times

# TYPES OF TAXES

## CLASSIFICATIONS

There are two ways of classifications of taxes:

- ▶ 2 general classes of taxes:
  1. *direct tax* (i.e., income tax, corporation tax): levied directly on individuals/companies
  2. *indirect tax* (i.e., VAT, excise duties, council tax): levied on goods and services
- ▶ 3 general classes of taxes:
  1. *progressive tax*: as income increases, the proportion paid in tax increases
  2. *proportional tax*: as income increases, the proportion stays the same
  3. *regressive tax*: as income increases, the proportion falls

# THE CANONS OF TAXATION

WEALTH OF NATIONS (ADAM SMITH)

A good tax has four characteristics:

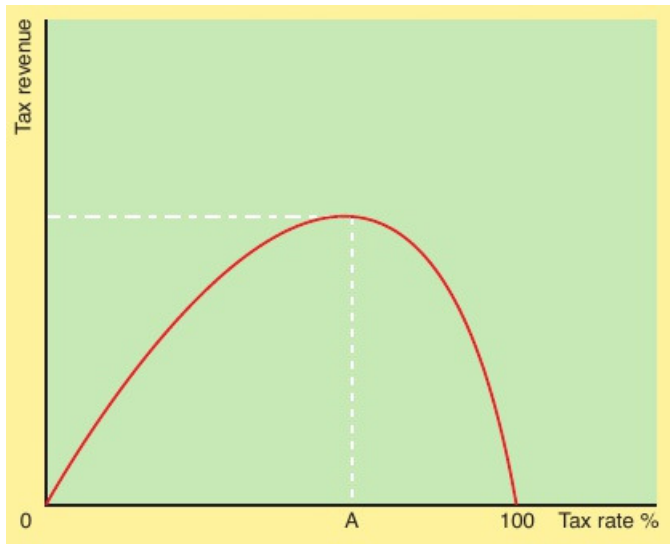
- ▶ *cost of collection* should be low relative to the yield of the tax
- ▶ *timing of collection* and *amount to be paid* should be clear and certain
- ▶ *means of payment* and *timing of payment* should be convenient to the taxpayer
- ▶ taxes should be levied according to the *ability to pay* of individual taxpayer

Economists today add the following characteristics:

- ▶ leads to the least loss of *economic efficiency*
- ▶ compatible with *foreign tax systems*
- ▶ automatically adjusts to *changes in price level* (i.e., high-inflation economy)

# INCENTIVES TO WORK AND TAX REVENUES

## LAFFER CURVE



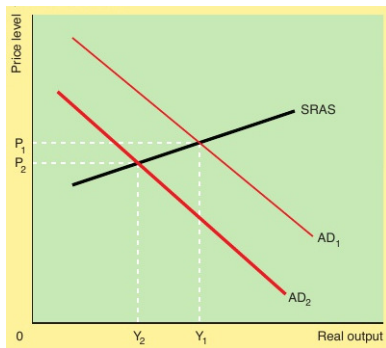
# INCOME DISTRIBUTION

- ▶ If *VAT* ↑ or *excise duties* ↑ then distribution of income may become *less equal*. Reason: *regressive tax*
- ▶ If *top rate of income tax* ↑ then distribution of income is likely to become more *equal*. Reason: *tax will hit top earners*
- ▶ If *corporation tax* ↑ then distribution of income is likely to become more *equal*. Reason: Dividend payments ↓ (revenue of high earners ↓) and tax revenues go to government

# REAL OUTPUT, THE PRICE LEVEL AND EMPLOYMENT

## AGGREGATE DEMAND

- ▶ aggregate demand:



↑ in *income tax* → household disposable income ↓. This will ↓ consumption and prices.

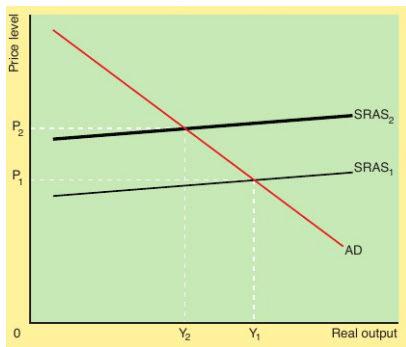
**A rise in income tax rates leads to a fall in the short-run equilibrium price level (see book for long-run effect!).**



# REAL OUTPUT, THE PRICE LEVEL AND EMPLOYMENT

## AGGREGATE SUPPLY

- ▶ aggregate supply:



↑ in *indirect taxes* (i.e., VAT, excise duties, Employers' National Insurance contributions) ↑ costs to firms → prices ↑.

Unemployment rises since real output ↓.

**see book for long run**

# THE TRADE BALANCE

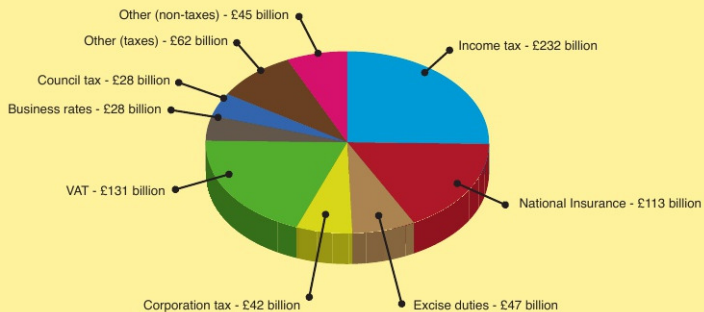
- ▶ ↑ in taxes on households → reduces *disposable income*
  - ▶ ↓ spending on imports → trade balance improves
  - ▶ ↓ consumption → AD ↓
- ▶ ↓ AD → firms need *less capacity* → less investment ↓  
imported capital goods → trade balance improves in **short run**
- ▶ in **long run** trade balance could deteriorate if less investment makes domestic firms less competitive

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# FDI FLOWS

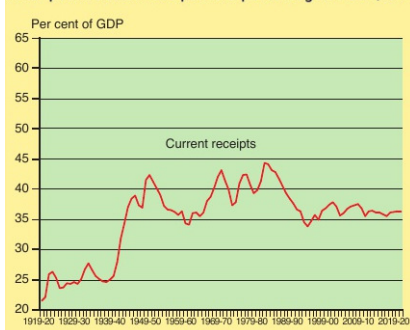
# EXTRACT 1: THE MAIN TAXES IN THE UK

Public sector receipts 2015-16

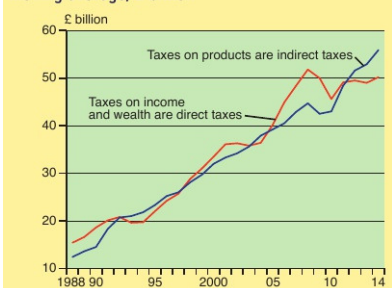


# EXTRACT 1: THE MAIN TAXES IN THE UK

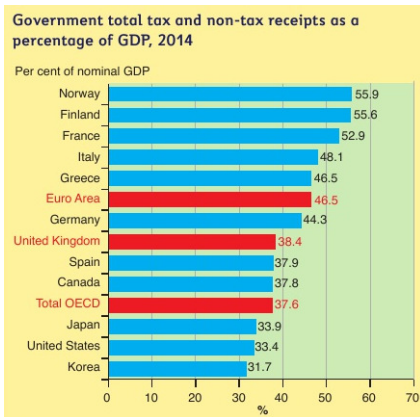
Total public sector receipts as a percentage of GDP, UK



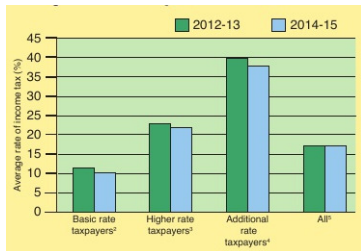
Receipts from direct and indirect taxes, four quarter moving average, £ billion



# EXTRACT 1: THE MAIN TAXES IN THE UK



## EXTRACT 2: FLAT TAX



## EXTRACT 2: FLAT TAX



	<b>Number of taxpayers</b>	<b>Amount of tax paid</b>	<b>Proportion of total tax paid</b>
Basic rate taxpayers	24.1m	54.9bn	33.10%
Higher rate taxpayers	4.5m	64.4bn	38.90%
Additional rate taxpayers	4.5m	46.4bn	28.00%



# KEYTERMS

- ▶ Laffer curve: