Microeconomics

3. Government Intervention

Indirect Taxes

- **Indirect tax:** a tax imposed by a government on spending
- Two different types:
  - Specific tax (fixed amount)
    - e.g. £8 tax per bottle of whisky
  - Ad valorem tax (percentage)
    - e.g. VAT - 20%

REASONS FOR IMPOSING INDIRECT TAXES

- ↓ consumption of demerit goods
- ↑ government revenue
- Govt may impose tariffs on imported goods

CONSEQUENCES OF TAX ON STAKEHOLDERS

Consumers

- Price ↑
- ↓ consumption of demerit goods ∴ ↑ health
- **Consumer surplus ↓**

Producers

- Revenues ↓ ∴ may lay off workers → unemp.
- Profits ↓ ∴ lack of funds for R&D
- **Producer surplus ↓**

Governments

- Tax revenue ↑
- Govt expenditure on H+E ↑
- Budget deficit ↓
- Firm could absorb tax and not pass on higher price/burden to consumer
- **Welfare loss ↑**

Subsidies

- **Subsidy:** a grant given by the government to decrease producers' costs of production
- e.g. EU gives £35 subsidy per tonne to Euro wheat farmers (common agricultural policy)

REASONS FOR GRANTING SUBSIDIES

- ↑ price competitiveness of producers
  - ∴ ↑ export revenue + ↓ import expenditure
- Protect/create jobs in certain industries
- ↓ price + ∴ ↑ consumption of merit goods
  - e.g. fresh fruit, gym memberships

CONSEQUENCES OF SUBSIDY ON STAKEHOLDERS

Consumers

- Price ↓
- **Consumer surplus ↑**
- May have to pay for subsidy indirectly by tax

Producers

- Revenues ↑ ∴ may hire workers → ↑ empl.
- Profits ↑ ∴ more funds for R&D
- **Producer surplus ↑**

Governments

- ↑ health + productivity if merit goods are subsidised
- ↑ political happiness from producers
- Firm could absorb subsidy and not pass on lower price to consumer
- Opportunity cost of spending on subsidy
  - Govt expenditure on H+E ↓