

"Formal and Effective Incidence"

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Introductory: — We have discussed what is meant by incidence of a tax. What it is? We have seen or described "incidence" as money burden and "incidence of tax" as the final resting point of a tax.

Today, Let us discuss what is Formal and Effective incidence? Mrs. Hicks uses the terms,
Formal and Effective incidence of a tax.

Mrs. Hicks distinguished between formal and effective incidence. According to her, formal incidence measures "the proportion of people's incomes which goes not to provide incomes to those who furnish them with goods and services, but is paid over of governing bodies to finance collective satisfaction." In this sense, formal incidence refers to money burden of a

tax or its money incidence. Formal incidence, meaning who is legally obliged to pay the tax. According to Mrs. Hicks, formal incidence of direct taxes rests with those who initially pay them while that of indirect taxes is borne by the buyers of the commodity.

Effective incidence, on the other hand, refers to the broader effects of a tax. Effective incidence, meaning who actually bears the economic burden of the tax. It will include all the advantages and disadvantages which an economy derives from a tax system. Mrs. Hicks defines effective incidence as follows: "In order to discover the full economic consequences of a tax we have to draw and compare two pictures — one of the economic set up (tax distribution of consumers' wants and income, and allocation of factors) as it is with the tax in operation; the other of a similar economic

set up, but without the tax. It is convenient
to call the difference between these two
pictures the effective incidence of the tax."

To Sum up: The formal incidence and
effective incidence of a tax will often
be different owing to the potential
for the tax burden to be passed on
through the operation of the Price
mechanism.



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