"Tax Shifting : Determinant factors"

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Factors involved in Tax Shifting :—

Tax shifting is not always possible. Whether or not the money burden of a particular tax imposed upon any commodity can be wholly, partially or not at all shifted to the buyers depends upon numerous factors. These factors can be conveniently grouped under two broad headings : a) Factors which affect the determination of price of the taxed commodity, i.e. demand and supply and b) Factors which relate to the nature of production, its impact and public policy.

Tax shifting is regarded as part of the problem of price determination and as such are dependent upon the forces of demand and supply.

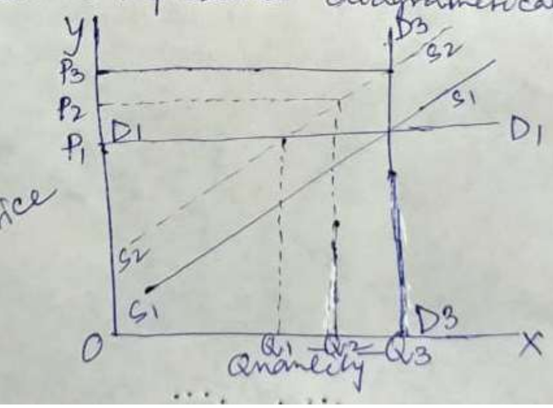
Elasticity of demand :—

The incidence of a tax on a

Commodity is generally determined by the elasticity of demand. Other things being equal the more elastic the demand for the object of taxation, the more will be the incidence of the tax upon the seller, i.e. Shifting is not Possible. On the other hand, more inelastic the demand for the object of taxation, the more will be the incidence of the tax upon the buyer, i.e. Shifting is Possible.

Elasticity of Supply:-

The Incidence of a tax on a Commodity is generally determined by the relative elasticity of Supply. Other things being equal, the more elastic the Supply of the object of taxation, the more will be the incidence of the tax upon the buyers, i.e tax Shifting is Possible. Take for instance, the case of a tax on tea. If the seller of tea adds the tax to the price when the demand for tea is elastic, Consumers will buy a smaller quantity, the demand falls off and Sellers cannot shift the burden of the tax to the consumers. Again, if the demand for tea is inelastic, higher prices will be paid by the buyers and the incidence of the tax will be entirely on the buyer. On the other hand if the supply is elastic, the supply will fall off, as a result of the increased cost of production because of the tax, and the buyers will be able to resists the rise on price. In short a struggle goes on between sellers and buyers. The sellers try to put the incidence on the buyer by reducing supply, the buyers try to put it on the sellers by reducing demand. The relative ability of the sellers and the buyers to hold their ground determines the incidence of the tax. These affects can be represented diagrametically as follows.



In the diagram S_1S_1 represents Supply before the tax. After the tax, Supply Shifts to S_2S_2. Now if the demand is Perfectly elastic represented by D_1D_1, their will be no change in Price OP_1. And if the demand is perfectly inelastic represented by D_3D_3, Price will increase by the full amount of the Shift in Supply (from OP_1 to OP_3) and their will be no change in the quantity OQ_3. If the demand is D_2D_2 the price will increase from OP_1 to OP_2, but less than if the demand were completely inelastic, and the quantity will be free from OQ_3 to OQ_2, but less if the demand were perfectly elastic. It will be obvious that when the Supply Curve becomes horizontal, i.e., when it becomes infinitely inelastic the tax is Shifted wholly to the buyer. Likwise, when the demand Curve is infinitely elastic, the incidence of the tax is wholly on the Seller.

The demand for Luxaries is generally elastic and the demand for necessary are inelastic. The demand for a

Commodity is made elastic by the present of Substitutes. Suppose only one Commodity in a group of Substitutes is taxed, others remaining Untaxed. in this case if the Consumer Can discover an Untaxed Supply of the Commodity or a Satisfactory untaxed Substitute, the entire burden of the tax will fall on the Producer or Seller of the taxed Commodity.

On the Supply Side, the laws of returns will also exert their influence. The taxing of a Commodity tends to check its demand which, in its turn, will check Production. Now if the industry is Subject to the law of increasing returns, the reduced Production will be obtained at a higher cost and, in the Case of the law of diminishing returns, at a lower Cost. In the former Case, the price will be higher than in the later with a Corresponding burden on the Consumer.

Other factors which govern the Course of Shifting of a taxed Commodity are whether Competition Prevailing in the market is Perfect, and whether labour and Capital are freely mobile. Only incase of free and unfettered Competition Can the tax be passed on to the Consumer, otherwise it will go to the Producer. If labour and Capital are freely mobile, it will add to the ability of the Producer to shift the burden on to the Consumer. If, on the other hand, large fixed Capital is locked up in the industry, the Position of the Producer is Correspondingly Weakened, and the Probability is that the tax burden will be borne by him. He Cannot withdraw his Capital. He must Continue in the field even when he is losing for a time.

We may Conclude in the words of Dalton as follows:— "The direct money burden of a tax imposed on any object is divided between the buyers and the Sellers in the Proportion of the elasticity of Supply of the object taxed to the elasticity of demand for it. When the elasticity of Supply is equal to the elasticity of demand, the burden is equally divided, and the Price of the object taxed rises by half the amount of the tax."

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