

A long-exposure photograph of a train at night. The train is moving from the right towards the left, leaving a bright, glowing trail of light that stretches across the frame. The overhead power lines and their supporting poles are also visible, creating a series of parallel lines that recede into the distance. The sky is a deep, dark blue, and the ground is mostly dark, with some greenery visible on the left side. The overall effect is one of motion and light in a dark environment.

2.7 Role of government in microeconomics (Indirect taxes)

Objectives

Government intervention in markets

- Indirect taxes

Government intervention in markets—consequences for markets and stakeholders



Indirect taxes

An **indirect tax** is one imposed on expenditure.

An **indirect tax** is placed on the selling price of a product. It raises the firm's costs and shifts the supply curve to the left

There are two types of indirect tax

- a specific tax (per unit tax)
- an ad valorem tax (percentage tax)

Specific tax - cigarettes, alcohol, air passenger duty, electronic road pricing, and highway tolls.

Ad valorem tax - stamp duty, sales tax (VAT), tariffs

Indirect taxes

Value Added Tax or Goods & Services Tax

Cigarette tax

Air passenger tax

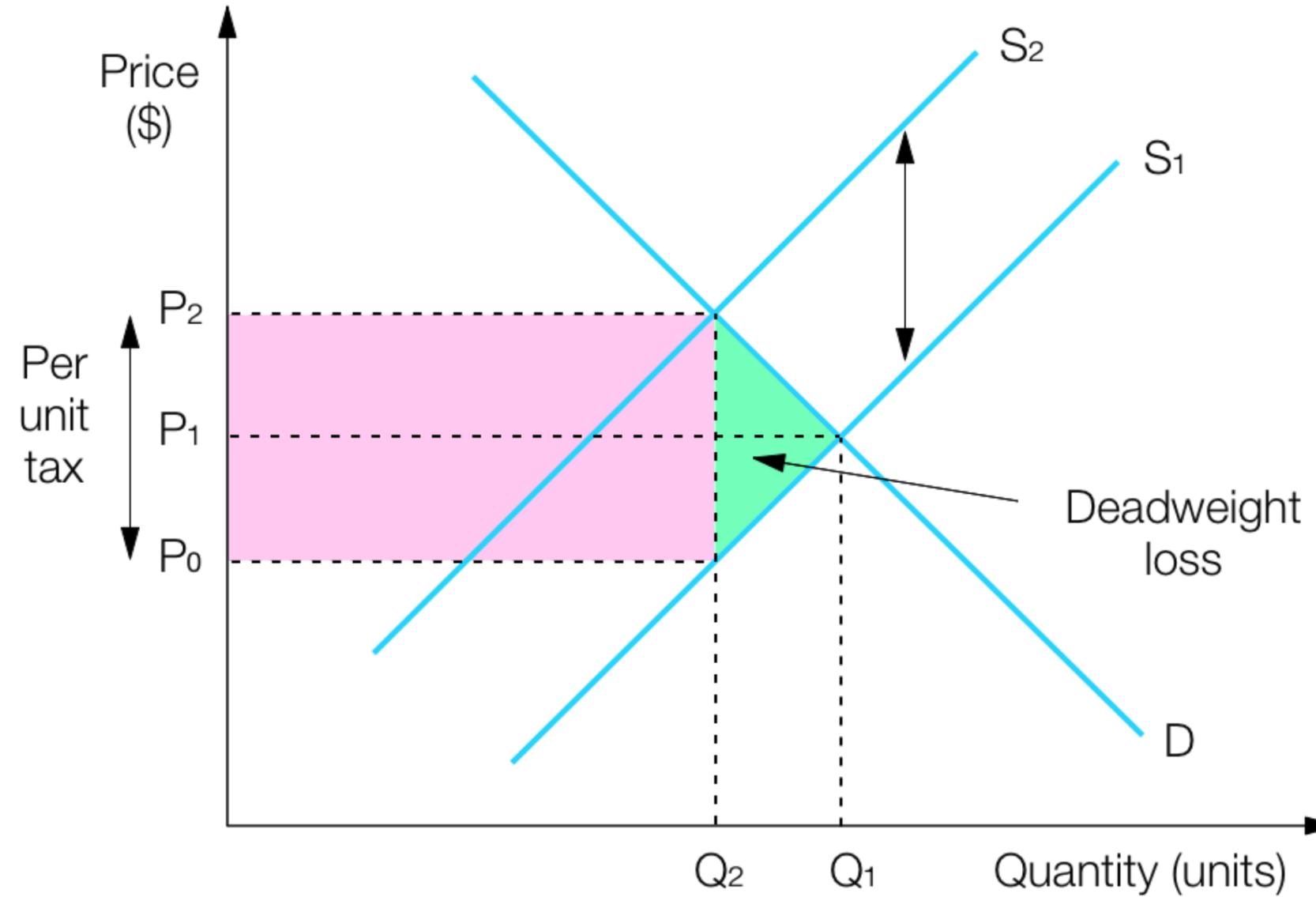
Sugar tax

Petrol tax

Fast food tax

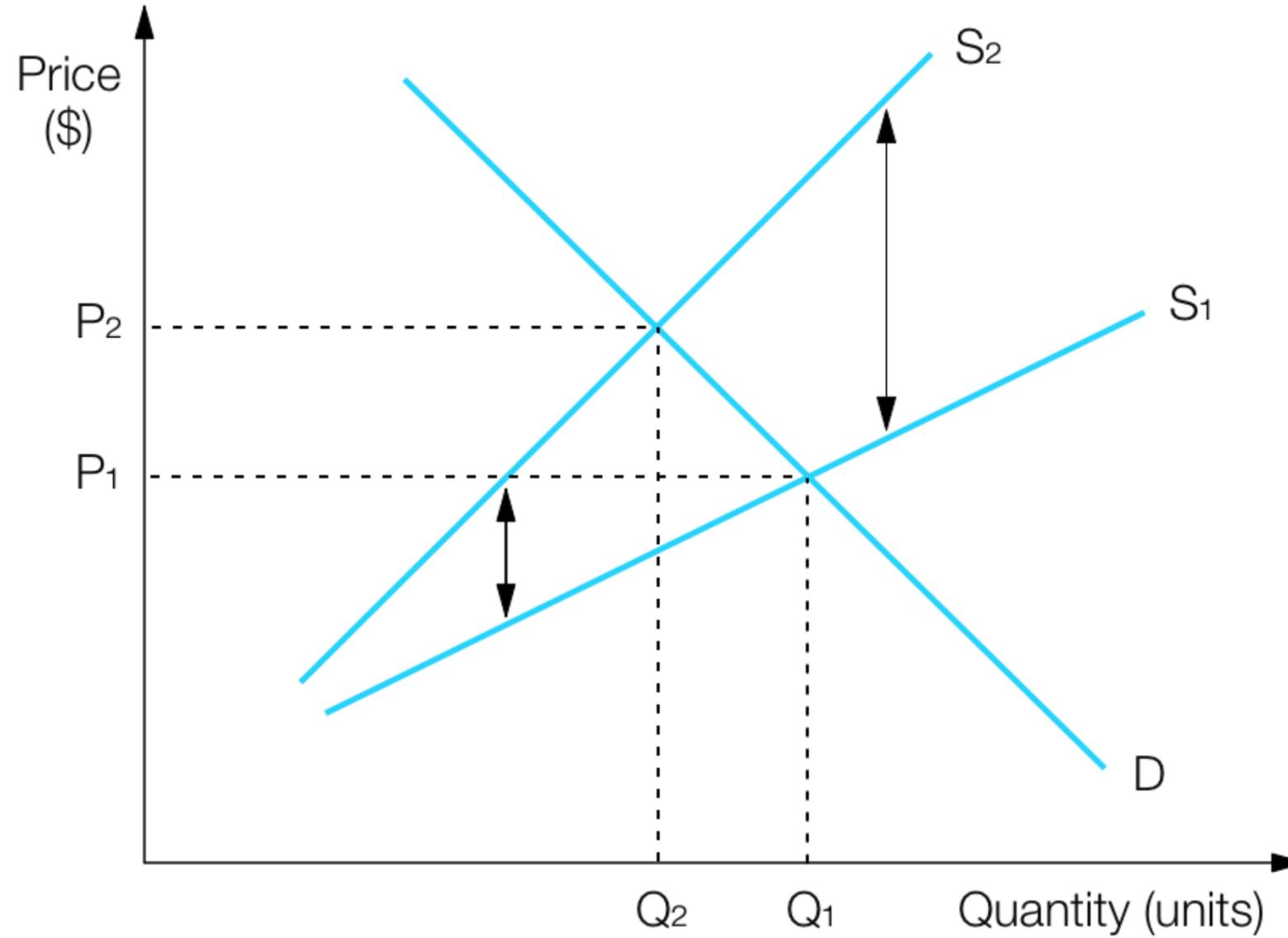
Alcohol tax

Indirect taxes



A specific tax (per unit tax)

Indirect taxes



An ad valorem tax (percentage tax)

Disadvantages of indirect taxes

Consumers lose out as they must pay higher prices

Producers also lose out as their costs of production increase

The imposition of an indirect tax creates a deadweight loss (combined loss of consumer and producer surplus)

Indirect taxes

The share of the tax burden will not always be equal between producers and consumers.

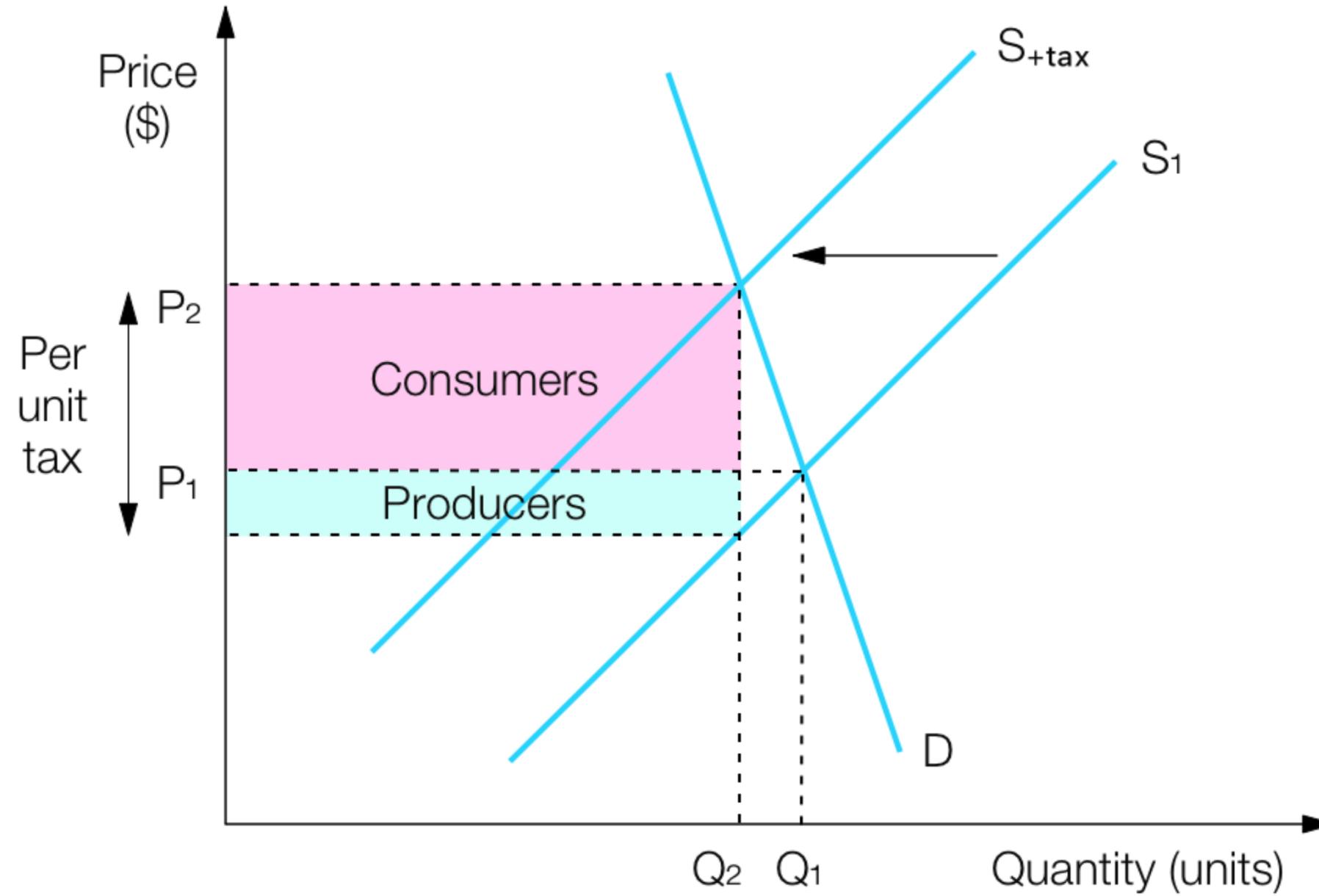
It is dependant on the relative values of PED (**price elasticity of demand**) and PES (**price elasticity of supply**) for the product.

If the PED is low (lack of substitutes) then a higher proportion of tax falls on the consumer.

If the PED is high (many substitutes) then a higher proportion of tax falls on the producer.

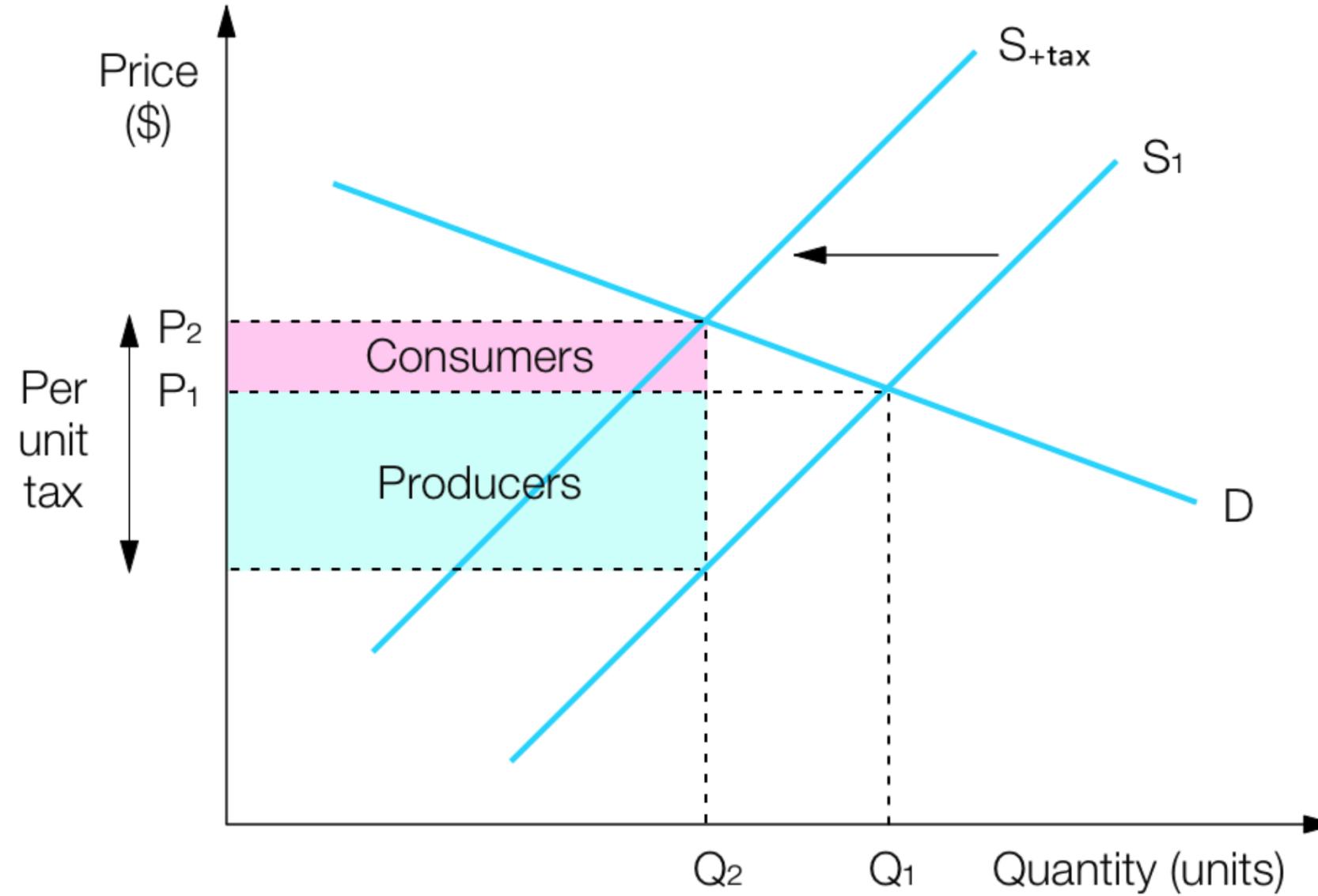
Governments place tax on products that have relatively inelastic demand e.g. cigarettes, alcohol.

Indirect taxes



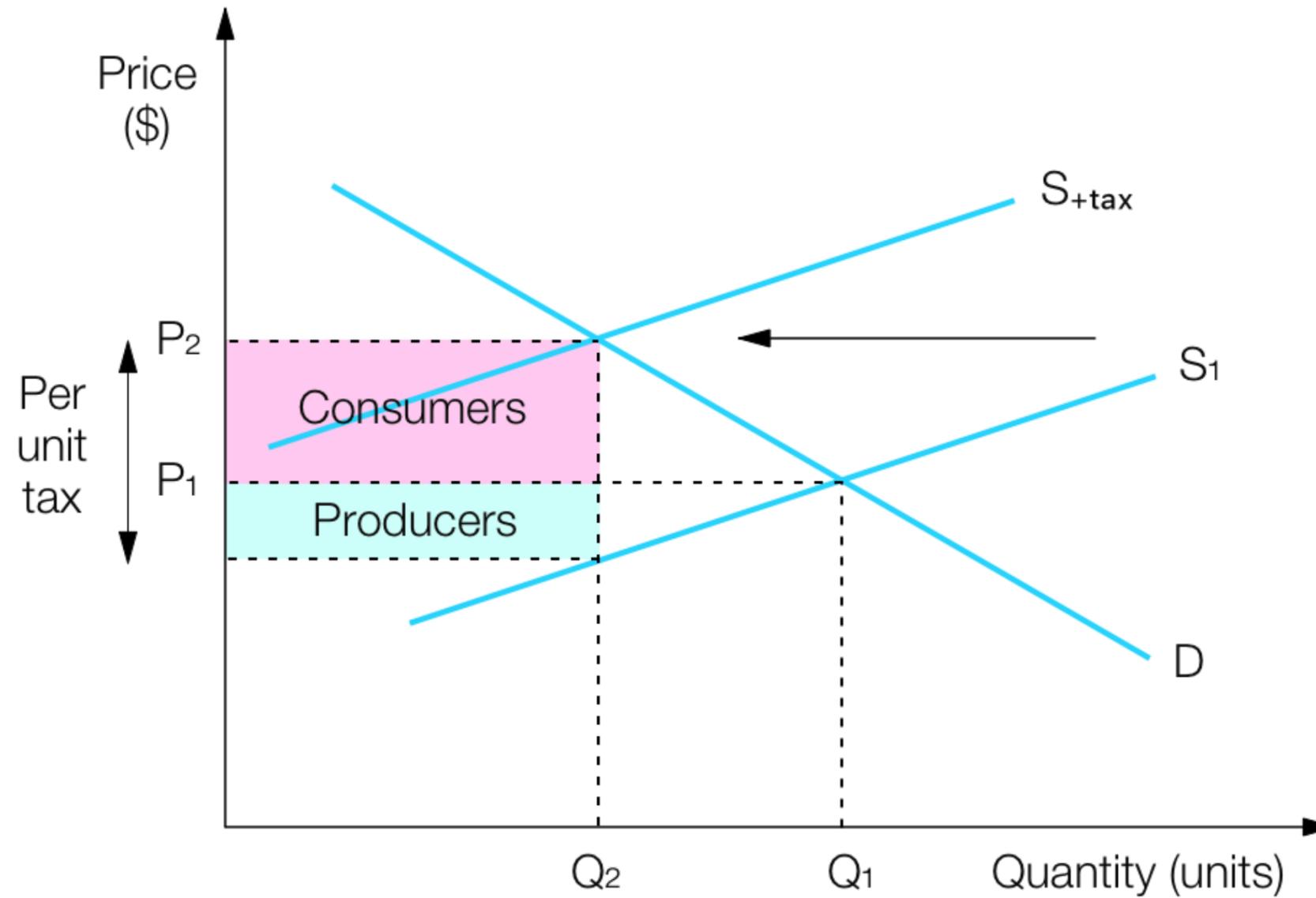
Tax incidence and price inelastic demand

Indirect taxes



Tax incidence and price elastic demand

Indirect taxes



Tax incidence and price elastic supply

Indirect taxes

Paper 1 style questions

Explain one type of government intervention that could be used to correct market failure and earn government revenue [10 marks]

Explain two reasons why a government might impose indirect taxes [10 marks]

Explain why a government has to consider the PED of a product before implementing an indirect tax [10 marks]

Using real-world examples, discuss the consequences of an indirect tax on stakeholders [15 marks]

Indirect taxes



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Indirect taxes



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Indirect taxes

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5 JUNE 2025, NEELAM PATIL



Indirect taxes

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