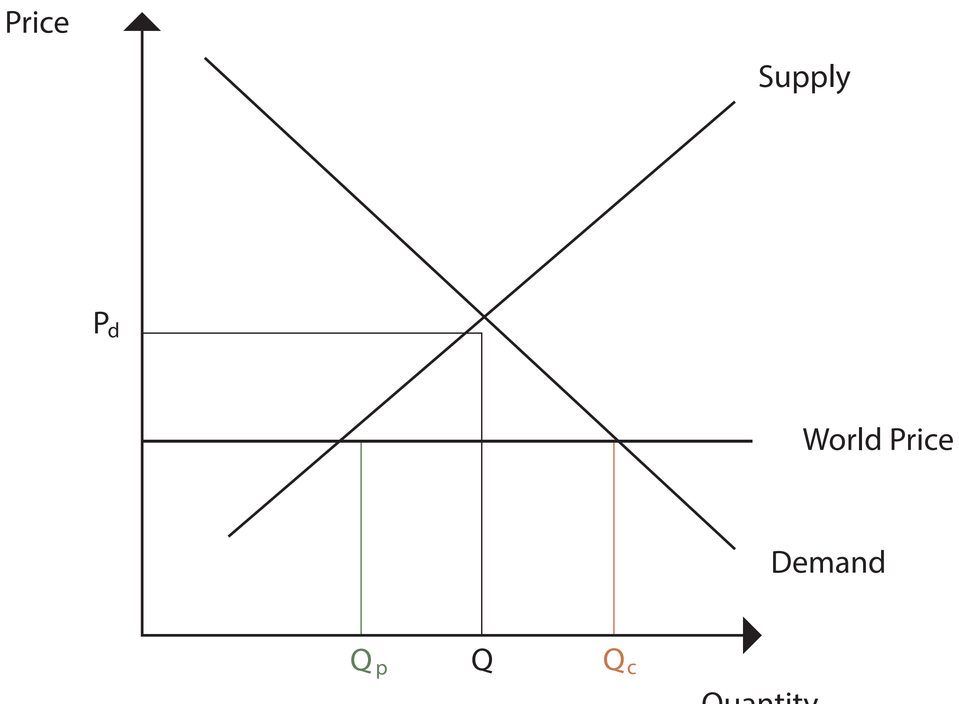
Handout A: Graphing and Analyzing the Effects of Taxes

Directions: Review the examples and complete the questions throughout the text.

A tariff (or tax) is added to imported goods as it is administratively easy to tax goods as the ship is being unloaded. During the first century after the United States was founded, manufactured goods were generally imported as they were cheaper to produce in England or France than in the United States.

Furniture was an imported manufactured good. The price of others' furniture (the World Price) will be less than the American manufactured price (Pd).

Furniture in America



Without Trade

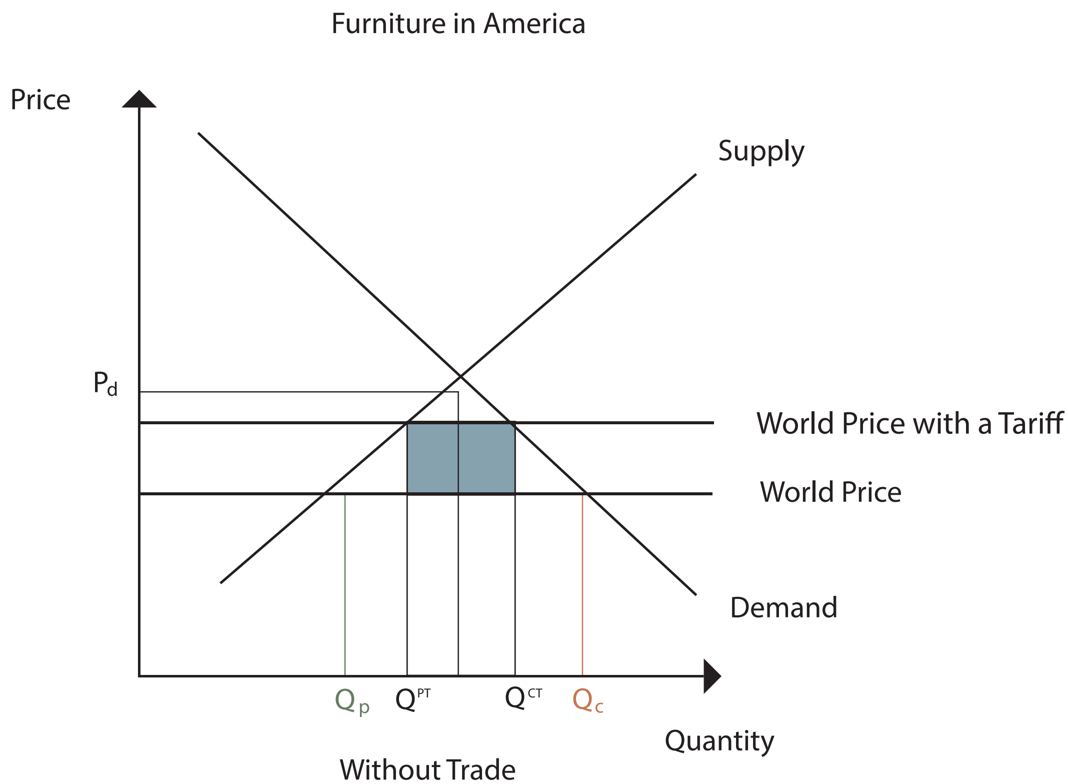
Looking at the above graph, Pd is the price of American manufactured furniture or domestic price for domestic furniture. Since the World Price is less than the domestic price, the Quantity consumed (Qc) will be greater than without imports. But American furniture manufactures will have a hard time competing at the World Price and thus American production of furniture decreases to QP. The difference between quantity consumed (Qc) and American production (QP) would be American imports.

Who is better off and who is worse off from trading?

The buyers of furniture would be better off as the price of furniture has decreased and people can afford to buy more furniture.

The American manufacturers of furniture are worse off because they find it harder to compete with foreign producers of furniture and therefore they supply the market with less American-made furniture.

If the United States added a tariff then the price of the good is increased.



Since the tariff only affects imported goods then the tax only increases the world price. Some people will chose not to pay the higher price and therefore the quantity consumed decreases to (QCT) the Quantity consumed after the tariff. American manufactures can better compete with these higher prices on imports and therefore they increase production to (QPT). Imports are going to decrease from (QC – QP) to (QCT – QPT).

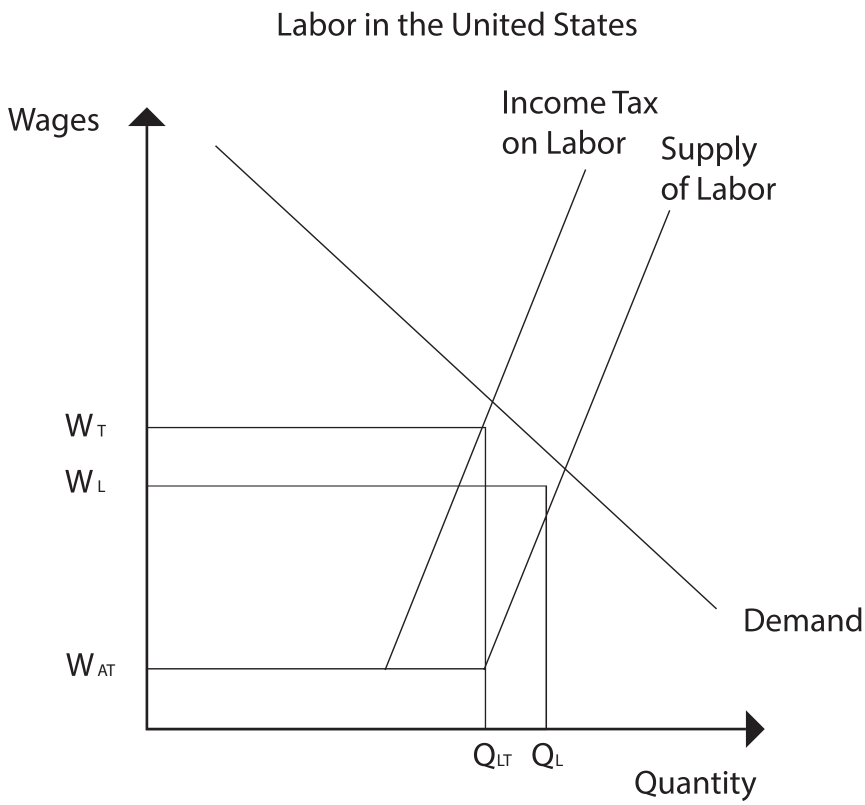
Who is better off and who is worse off from the addition of this tariff?

The American consumer of furniture is worse off as they pay a higher price. The foreign producers of furniture are worse off as they have to pay taxes on their exports to America and therefore they sell less.

The American producers of furniture are better off as they can compete more easily on price with foreign competitors. The government will also be better off as they will collect taxes. The tax revenue will be the blue box. However, because of the tax and the reduction of imports the government will collect less revenue than expected as the tax "base" was reduced. (QPT – QCT) is less than (QC – QP).

After the passage of the Sixteenth Amendment and Introduction of the Income Tax.

When the United States implemented an income tax, it was mostly a tax on one's labor. Since you have to work to earn money to live the supply and demand curves are slightly different.



Demand for labor roughly remains the same negatively-sloped line as before. However, since you have to work to earn money the supply of labor is more vertical. People will not reduce their hours much even when highly taxed because they need that income to pay their bills.

From the above graph, the amount of hours worked is largest when income or labor is not taxed (QL). As we have seen above, when a tax is added the costs are increased from WL to WT. However, what the employee actually takes home is much less, the wage after taxes (WAT). Thus you have two things happening, one is increased business costs measured from WL to WT, and the other is less take home pay measured from WL to WAT.

Who is better off and who is worse off from the addition of the tax?

The government is better off as they collect the tax revenue from WT – WAT multiplied by QLT.

The laborers are worse off as they take home less pay, now WAT instead of WL. The employers are worse off as they have to pay higher wages in the form of additional taxes and they receive less work, QL – QLT.

