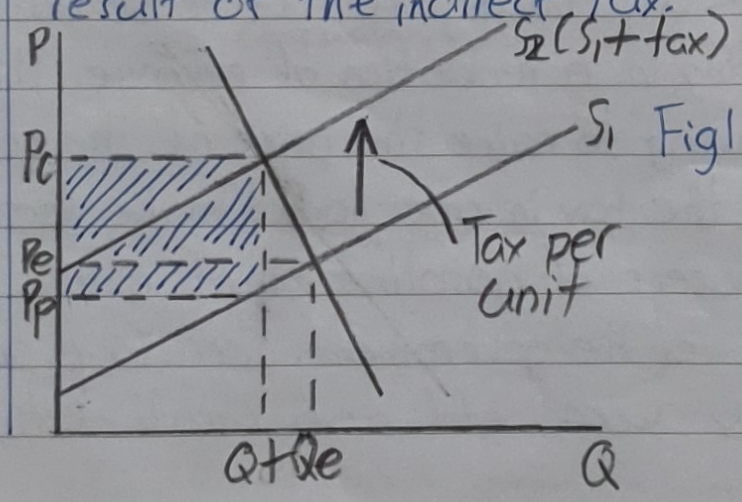
Econ 15 Mark Test

Question= Discuss the consequences of the introduction of an indirect tax on gasoline (petrol) for consumers, producers and government

Plan=
Intro= Define indirect tax
~~P1=~~
Diagram= Effect of indirect tax
P1= Focus on Consumer (Worse off, higher price)
P2= Focus on producer (worse off, less revenue)
P3= Government (Better off, tax revenue, less pollution
P4= Conclusion (Overall beneficial to society.

A indirect tax refers to the governments taxation of goods and services. Such a tax is utilised by the government to obtain tax revenue and to in many cases, reduce the production and consumption of a demerit good. However, when an indirect tax is imposed on a good or service, this has varying effects on different stakeholders such as consumers, producers and the government, some obtaining benefit, some being disadvantaged ~~due~~ as a result of the indirect tax.



The imposition of an indirect tax on petrol has a relatively damaging effect on consumers. In the case of petrol, consumers will have to pay a higher price for petrol due to the indirect tax, as it is illustrated on Fig1 by the increase in price from Pe to Pc (price paid by consumers) as a result of the indirect tax causing a shift in supply from S_1 to S_2 (S_1 + tax). This makes consumers worse off as not only do consumers have to pay a higher price for petrol ($Pe < Pc$) but as petrol has no direct substitutes, causing the good to have an inelastic demand as consumers have little substitutes to change to. Subsequently, consumers are thus more likely to endure the higher price. This also causing a reduction of consumers disporable income. Therefore, consumers are negatively effected by the imposition of an indirect tax.

Furthermore, producers are also negatively effected by the indirect tax. The negative effect on producers is visualized in Fig 1 as a loss of revenue as a result of the tax as the price recieved by producers decreases from Pe to Pp, paired with a decrease of quantity supplied as $Qe < Qt$ causing $Pp \times Qt$ to be less than $Pe \times Qe$, resulting in a reduction of revenue. This is due to producers having to raise the price of the good by the amount of the tax in order to not make loss as due to the tax producers of gasoline must give a portion of the revenue to the government. Therefore, producers are additionally worse off as a result of the tax.

Finally, government gain great benefit from the imposition of an indirect tax on petrol. Firstly, government earns tax revenue illustrated in Figure 1 as the area of $P_c - P_p \times Q_t$, this being revenue governments can use to invest into the economy such as the provision of merit goods. In addition, the reduction of petrol supply ($Q_t < Q_e$) and the slight reduction of petrol consumption ($Q_t < Q_e$) are two greatly beneficial factors to both government and society as due to the reduction of quantity supplied and demanded, there will be a subsequent decrease in pollution which is a negative consumption externality caused by the consumption and use of petrol. This reduction of pollution due to less petrol is greatly beneficial to society and government, however due to the inelasticity of petrols demand, one would likely not observe a significant decrease in demand following the imposition of the indirect tax. Therefore, both government and society benefit from the indirect tax as it earns tax revenue and potentially slightly reduces pollution.

In conclusion, the imposition of an indirect tax on petrol is generally not beneficial across stakeholders as both consumers and producers are negatively affected. However, due to indirect taxation providing both tax revenue for government to invest into merit goods and simultaneously reducing pollution ever so slightly indicating a slight positive environmental impact. Therefore, an indirect tax on petrol is deemed to be advantageous.