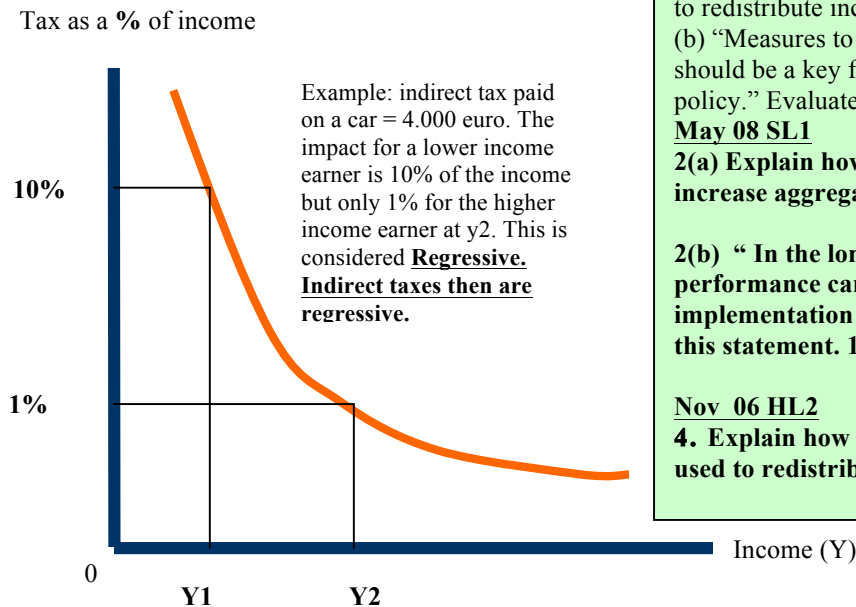


3.6 Taxation: The simple approach

Fig 1: Indirect taxes are regressive.



**Exam Focus:**

M11/3/ECONO/HP1/ENG/TZ2/XX/M

2. (a) Explain **two** policies a government might use to redistribute income. [10 marks]

(b) "Measures to promote greater income equality should be a key feature of government economic policy." Evaluate this proposition. [15 marks]

**May 08 SL1**

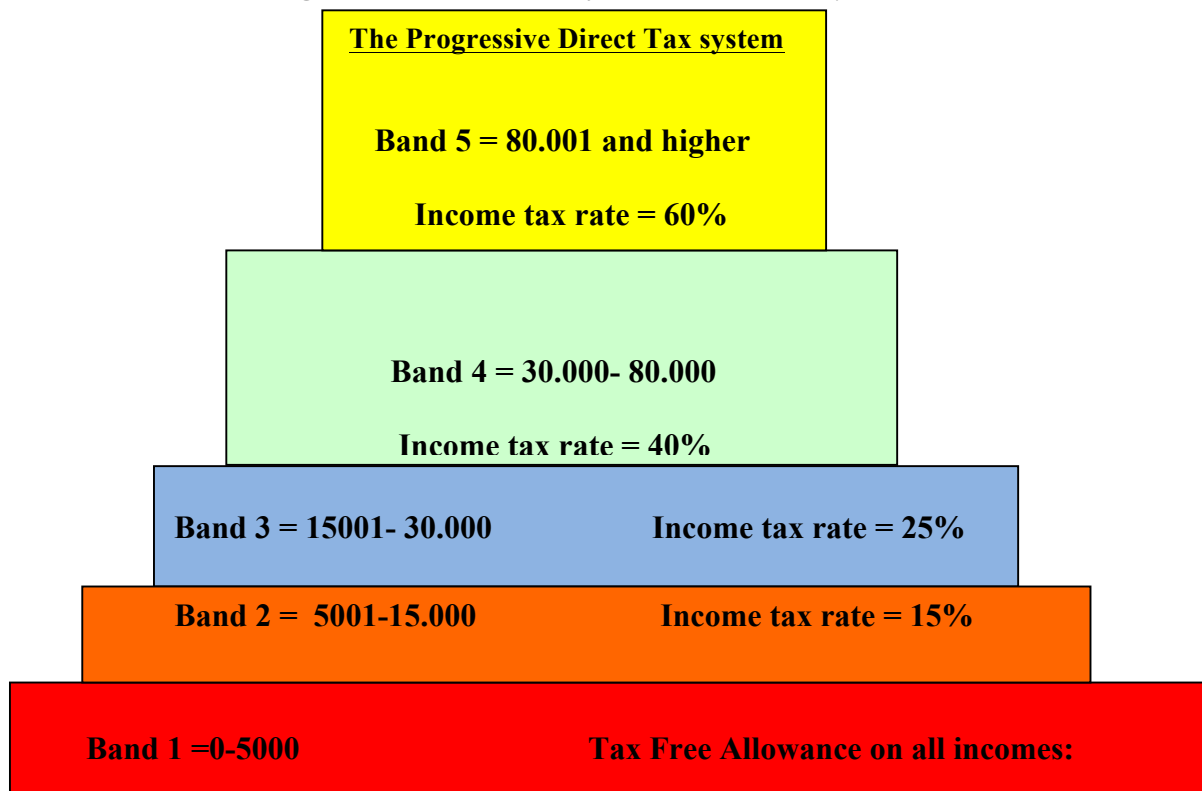
2(a) Explain how fiscal policy could be used to increase aggregate demand. 10 marks

2(b) "In the long run a country's economic performance can only be improved through the implementation of supply side policies." Evaluate this statement. 15 marks.

**Nov 06 HL2**

4. Explain how a progressive tax system may be used to redistribute income.

How is the regressive nature of the indirect system redressed?



Task:

1. Calculate the disposable income for an income of 120.000 euro
2. how much direct income tax is paid on an income of 120000 euro
3. how much direct tax is paid on an income of 45.000 euro
4. calculate the average tax rate on incomes of 45.000 and 120.000

MOVE TEXT BOX FOR....

**ANSWERS**

***Progressive, regressive and proportional taxation ( for direct taxation)***

- Use this diagram to explain different types of taxation for section 3.6
- Use this diagram to show the appropriate type of taxation to promote economic development i.e. a better distribution of income using progressive taxation in section 5.1

**Points to note:**

(1) Government aim to improve distribution should focus on a direct tax system based on the red line (P)

(2) The blue line which is proportional is unfair for lower income earners e.g. if the average rate of tax is 45% then lower income earners are disadvantaged

(3) You should be aware of how taxes are calculated via tax rates and tax bands as these affect the slope of the lines in fig2

(4) If the government does not get its progressive tax system equitable then it runs the risk of more:

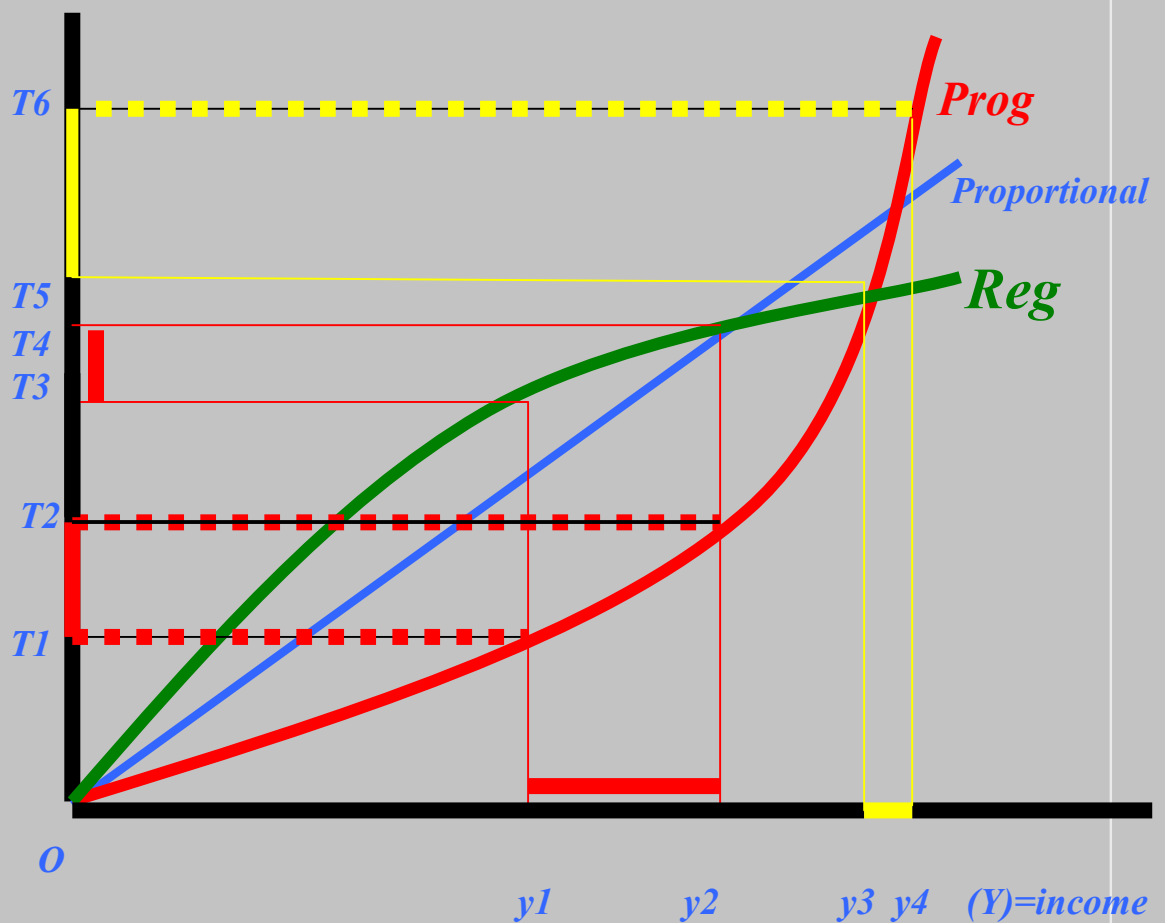
- Black market activity
- 'brain drain'
- capital flight

*Note 1: average rate of tax is total tax paid divided by total income*

*Note 2: fig 2 only relevant for direct taxes as indirect taxes are completely independent of incomes i.e. rate of tax is unrelated to income level.*

***Fig2. Progressive, regressive and proportional taxation ( for direct taxation)***

**Total Tax paid**



**P** = progressive as average rate of tax increases as income Y increases y1 to y2 the tax paid increases from t1 to t2 but for income y3 to y4 the tax rises substantially to t5 to t6.

**R** = average rate of tax decreases as income Y increases. Total tax paid increases from t3 to t4

**Prop** = average rate of tax remains unchanged as Y increases e.g. 45 degree line

*Note: this system is progressive because the income earner who increases income from y1 – y2 (red line segment) pays T1-T2 taxes (red) and not T3-T4 (red) as would be the case in a regressive system.*

Note: answer to task 1 = 70.750