

Effects of Taxation

Effects of Taxation on Production

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- The effects of taxation cover all the changes in the economy, resulting from the imposition of tax system. Imposing of taxation has certain inputs on the production, consumption investment, employment and similar other patterns. Its presence distorts these patterns and such distortions may be called effects of taxation.

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- According to Dalton, taxation effect can be studied by grouping it in the following categories.
 - (1) Effects of taxation on production;
 - (2) Effect of taxation on distribution;
 - (3) Other effects of taxation

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(i) Ability to Work and Save

- Imposition of taxes reduces disposable income, more bitterly of the poor section, their purchasing power and ability to acquire necessities, comforts and luxuries. This reduces their consumption and therefore the ability to work and save.
- But some taxes like the tax on liquor, opium and similar taxes may not interfere with the tax payer's ability to work.

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- Similarly, with the reduction of income due to the tax- imposition, decreases the saving of the rich but it does not have significant effect on the saving of the poor as the poor has very low marginal propensity to save.
- Investment is a function of saving potential and the resources for investment are curtailed to the some extent with the increase in taxation.

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(ii) Willingness to Work, Save and Invest

- The effects of taxation on people's willingness to work, save and invest are partly due to monetary burden of the tax and partly due to the psychological state of the tax payers.
- for example direct tax has adverse effects on incentive to work save and invest but in case of indirect tax, it has negligible effect on that.

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- Willingness to work, save and invest is also affected by the psychology of tax-payer.
- Net effect will depend upon their elasticity of demand for income i.e. the intensity by desire of tax-payer to obtain a given income; (elastic, inelastic or unit elastic).
- Elastic demand will reduce the willingness to work, save and invest

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(iii) Effects of Taxation on Allocation of Resource

- Taxation may be used as an instrument of fiscal policy for the diversion of resources between different industries and region.
- A tax imposed as a particular type of industries will raise the price of the goods produced and it will bring down the demand of that particular product which will have adverse effect as the particular unit of the industry. And divert the resources towards other sector.