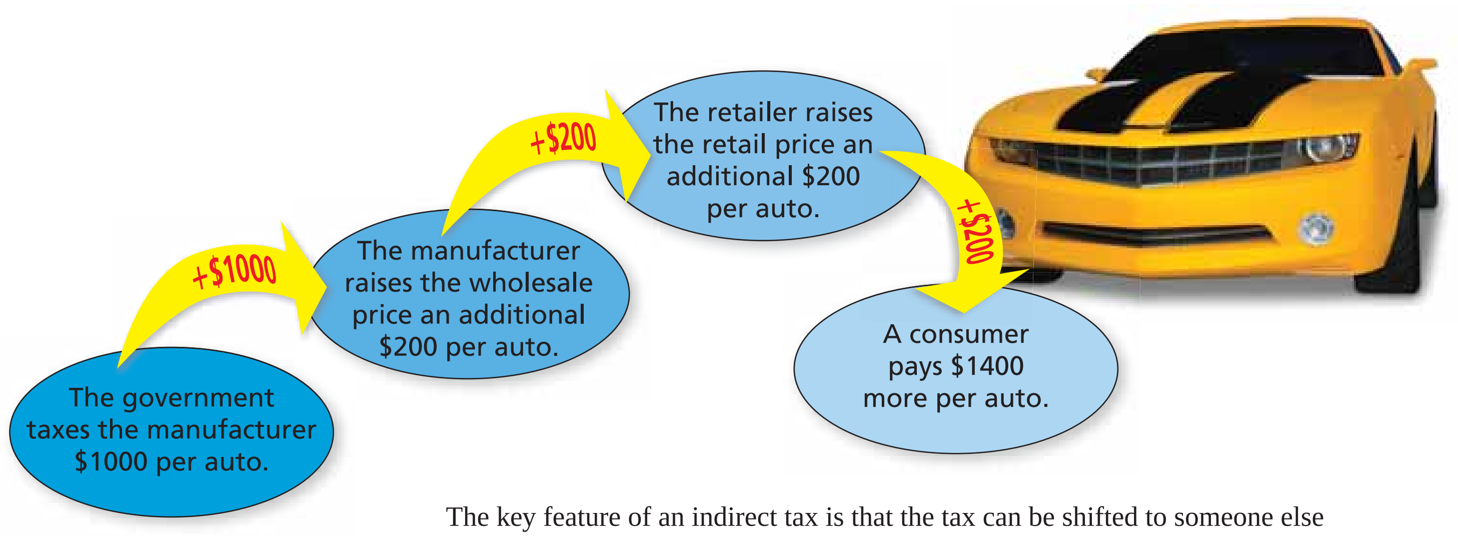
Analyzing Indirect Taxes

An **indirect tax** is a tax that increases the price of a product. Consumers actually pay the tax by paying more for the product.

The diagram illustrates an example. The *direct tax* is on an automobile manufacturer. However, the person who ultimately pays the tax is the consumer.



The key feature of an indirect tax is that the tax can be shifted to someone else who is farther along in the manufacturing chain.

EXAMPLE 5 Analyzing an Indirect Tax

A store in the United States imports fireworks from China and pays $250, plus an import duty of 2.4%. Is the tax regressive, flat, or progressive? Draw a diagram showing a chain of events that could occur.

SOLUTION

Here is one possible diagram.

The point is that, regardless of who the tax is levied at *directly*, usually the consumer ends up *indirectly* paying the tax. Excise taxes and sales taxes are generally considered to be regressive.

✓ Checkpoint

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Suppose the federal government levies a $1 per gallon excise tax on diesel fuel. Draw a diagram showing a chain of events that could occur.