Figure 20.1 Deadweight Loss of a Tax

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(a) Inelastic demand

(b) Elastic demand

Figure 20.2 Deadweight Loss Rises with Elasticities
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Figure 20.3 Marginal Deadweight Loss Rises with Tax Rate
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Figure 20.4 Preexisting Distortions Matter
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Figure 20.5 (a, b)  Low Rates Imposed on a Broad Base Are Desirable

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<table>
<thead>
<tr>
<th>Tax rate below $10,000</th>
<th>Tax rate above $10,000</th>
<th>Hours of labor supply</th>
<th>Deadweight loss from taxation</th>
<th>Hours of labor supply</th>
<th>Deadweight loss from taxation</th>
<th>Total deadweight loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>No tax</td>
<td>0</td>
<td>0</td>
<td>1,000 ($H_1$)</td>
<td>0</td>
<td>1,000 ($H_1$)</td>
<td>0</td>
</tr>
<tr>
<td>Proportional tax</td>
<td>20%</td>
<td>20%</td>
<td>894 ($H_2$)</td>
<td>$115.71 (area BAC)</td>
<td>894 ($H_2$)</td>
<td>$347.13 (BAC + EDF)</td>
</tr>
<tr>
<td>Progressive tax</td>
<td>0%</td>
<td>60%</td>
<td>1,000 ($H_1$)</td>
<td>0</td>
<td>837 ($H_3$)</td>
<td>$566.75 (EDF + GEFI)</td>
</tr>
</tbody>
</table>

Figure 20.5 (c) Low Rates Imposed on a Broad Base Are Desirable
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Figure 20.6 (a) Efficiency Consequences of Subsidies and Taxes in Pakistan
Figure 20.6 (b) Efficiency Consequences of Subsidies and Taxes in Pakistan
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Figure 20.6 (c) Efficiency Consequences of Subsidies and Taxes in Pakistan
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<table>
<thead>
<tr>
<th>Good</th>
<th>Subsidy</th>
<th>Price elasticity</th>
<th>Policy change</th>
<th>Welfare gain</th>
<th>Include distributional concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wheat</td>
<td>40%</td>
<td>−0.64</td>
<td>Reduce subsidy</td>
<td>Small</td>
<td>Don’t reduce subsidy</td>
</tr>
<tr>
<td>Rice</td>
<td>40%</td>
<td>−2.08</td>
<td>Reduce subsidy</td>
<td>Large</td>
<td>Reduce subsidy</td>
</tr>
<tr>
<td>Oil/fat</td>
<td>−5%</td>
<td>−2.33</td>
<td>Reduce tax</td>
<td>Large</td>
<td>Reduce tax further</td>
</tr>
</tbody>
</table>

Deaton (1997).
\[ \lambda = \frac{MU}{MR_{Poor}} = \frac{MU}{MR_{Rich}} \]
Figure 20.9 (a) Simulations of Optimal Nonlinear Income Tax Rates
<table>
<thead>
<tr>
<th>Income groups</th>
<th>$0–$10K</th>
<th>$10K–$32K</th>
<th>$32K–$75K</th>
<th>$75K and above</th>
<th>Guaranteed income level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marginal tax rates</td>
<td>68%</td>
<td>66%</td>
<td>56%</td>
<td>49%</td>
<td>$11,000</td>
</tr>
<tr>
<td>Average tax rates</td>
<td>−161%</td>
<td>12%</td>
<td>40%</td>
<td>47%</td>
<td></td>
</tr>
</tbody>
</table>
Figure 20.10 Tax-Benefit Linkages

(a) Effect of taxes only

(b) Effect of taxes plus benefits
Figure 20.11  Taxation with No Deadweight Loss Due to Linkages

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