Tax and Subsidy Incidence Equivalence Theories:
Experimental Evidence from Competitive Markets

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June 2001

Abstract

A basic tenet in elementary microeconomics is tax incidence equivalence. This tenet holds that the burden of a unit tax on buyers and sellers is independent of who actually pays the tax. Recently, the empirical validity of tax incidence equivalence has been brought into question. In this paper, using competitive laboratory markets, I test both tax incidence equivalence and an analogous theorem I refer to as subsidy incidence equivalence. For sufficiently large markets, the results show very strong support for both theories. In smaller markets in which competitive forces are weaker and relative bargaining strengths may play a role, the evidence for tax incidence equivalence is weaker as minor price discrepancies may persist between markets.

keywords: tax incidence equivalence, subsidy, competitive markets, experimental economics

*I thank Ted Bergstrom and Avia Spivak for comments. I also thank my research assistants, Inna Agroskin, Gil Attia, Michal Livne, Iris Mini, Lilach Sudak, Tsafi Vana and Liat Winner, as well as Noam Green for programming the software for the transaction graphs. Financial support from Ben-Gurion University is gratefully acknowledged. The incidence of any remaining shortcomings must be fully borne by me.