

Practical Session XI

Taxation

Questions and Problems

1. Your roommate and you had identical high school grade point averages and SAT scores (scholastic aptitude test). In many respects, one would expect that you would be equally successful. But because you chose economics as a major and your roommate chose geology, you will be paying a larger amount of tax in the future than your roommate will because your income will be higher. Is this attribute of the tax code vertically equitable? Is it horizontally equitable?

2. The government of Utopia plans to offer a transportation tax credit in which families receive a share of their expenditures on transportation to and from work or school as a reduction in their tax bill. Utopia is considering two forms of this tax credit, one that is fully refundable and one in which the tax credit is limited to the amount of taxes the family pays. Which form of the tax credit is more progressive? Explain.

3. The demand for rutabagas is $Q = 2,000 - 100P$ and the supply of rutabagas is $Q = -100 + 200P$. Who bears the statutory incidence of a \$2 per unit tax on the sale of rutabagas? Who bears the economic incidence of this tax?

4. The city of Malaise is considering a 10% tax on the revenues of all hotels/motels inside the city limits. Although not completely different from hotels and motels in the nearby suburbs, the ones in Malaise have a distinct advantage in their proximity to the interesting sights and convention centers. So individuals will pay some premium to stay in Malaise rather than to stay nearby. Furthermore, all land is used equally well by hotels/motels and other forms of business; any Malaise land not taken by a hotel/motel is readily absorbed by other forms of business. Mayor Maladroit calls you in to advise him on the incidence of such a tax. He is particularly concerned with who will bear this tax in the short run (one month) and the long run (five years).

a) What is the incidence of the tax in the short run? Answer intuitively, and use a diagram if possible.

b) What is the long-run incidence? Once again, use a diagram if possible. c. How would your analysis in b change if hotels/motels in the suburbs were perfect substitutes for those in Malaise? What would happen to tax revenues?

5. To finance a new health insurance program, the government of Millonia imposes a new \$2 per hour payroll tax to be paid by employers.

a) What do you expect to happen to wages and the size of the workforce?

b) How will this answer change in markets where labor is inelastically demanded.

6. The government of Washlovia wants to impose a tax on clothes dryers. In East Washlovia the demand elasticity for clothes dryers is -2.4 while in West Washlovia the demand elasticity is -1.7 . Where will the tax inefficiency be greater? Explain.