

Economics 512  
First Exam Study Questions  
Fall 2013  
(Subject to revision)

Most of these questions can be answered in a paragraph or two. Some questions may be answered more easily using a graph or graphs.

1. Show the short-run impact of a \$2 per unit excise tax imposed on firms in a competitive industry. (Assume the industry is in equilibrium before the tax was imposed.)  
How would the long-run results differ?  
What is the impact on efficiency of the tax?
2. Give a brief rationale for the following provisions of the individual income tax laws:
  - a. exemptions.
  - b. deductions for charitable contributions to colleges.
  - c. deductions for large medical expenses.
  - d. deductions for property taxes paid to local governments.
3. If we had a truly comprehensive individual income tax (based on the Haig-Simons approach), there would be no reason to have a corporate income tax or estate and gift taxes. Explain and evaluate this statement. For use on next exam.
4. ~~Explain how inflation can create problems in regard to the taxation of the income, especially in regard to the income from capital (e. g., interest, dividends, and capital gains). How might these problems be dealt with?~~
5. How does the ability-to-pay philosophy of taxation differ from the benefit principle? What problems are encountered in implementing both these tax philosophies?
6. If the same amount of revenue is raised, a selective tax on a small number of goods is likely to have a greater excess burden as compared to a lower rate tax on a broader range of goods (with similar demand curves). Agree or disagree and explain.
7. ~~Briefly review the possible impacts of income taxation on work effort. Summarize the results of empirical studies of the question.~~
8. Briefly explain why the private market might fail to allocate resources efficiently in the following cases:
  - a. Contributions to a charity to fight cancer.
  - b. Inoculation against contagious diseases.

9. ~~Small countries that are allied with the United States tend to spend a smaller share of their national income for national defense as compared with the United States. Provide a plausible explanation for this situation.~~
10. When someone travels on business in the U. S., the traveler can usually deduct the hotel expenses, but can deduct only half the cost of meal expenses. Does this tax policy make sense from a Haig-Simons perspective? Explain.
11. Two students have identical high school records and test scores. After college, one student becomes an accountant and the other a social worker. The social worker will likely pay less in income taxes than the accountant. Will this violate the principle of horizontal equity? Explain. (Hint: Your answer depends on the choice of the measure that is used in deciding whether people are the same or different for tax purposes.) Will this create an inefficiency or excess burden?
12. Assume the government plans to offer a transportation subsidy through the tax system for the costs of commuting to work. What would be the implications of making these expenditures deductible for tax purposes compared to offering a 25 percent tax credit for the expenses?
13. If the government moved to a Haig-Simons definition of income, would employers be more or less likely to offer employer provided benefits such as health insurance?
14. Why can some taxes that appear to be regressive in terms of current income be thought of as progressive from a lifetime (or permanent) income standpoint?
15. Luxury goods often have much higher elasticities of demand than more basic staples such as rice and potatoes. If taxes are to be imposed on these goods, from the standpoint of optimal taxation, what might be the relative rates on the two types of goods? What might be the problem of this approach?
16. ~~The impact of a proportional income tax on work effort is theoretically ambiguous. Explain.~~  
~~How might the different responses to increased taxes impact the excess burden of the tax?~~
17. Provide an argument for making child care costs tax-deductible for working families. Should the tax subsidy be also provided for non-working families for purposes of horizontal equity?
18. ~~The impact of a proportional income tax on the return on savings is theoretically ambiguous. Explain.~~  
~~Show the potential excess burden from such a tax.~~
19. ~~Optimal tax theory provides a detailed guideline for real world tax policy.~~  
~~Agree and disagree and explain.~~

20. Why are fixed limits on pollution emissions for each firm likely to be an inefficient means of reducing pollution compared to a Pigouvian tax?
21. Would the sales of pollution rights or certificates be an efficient means of allocating a given amount of pollution? Explain.
22. What are the essential differences between pure public goods and pure private goods?

Compare the conditions necessary for efficiency for a pure public good with a private good.

23. Why are most taxes likely to cause losses in efficiency? Show.
24. Review some of the important explanations or rationales for and against progressivity in taxation. Which of these are positive and normative arguments?