

Publieke Economie en publieke financiën

Boek + notities / oplossingen en discussievragen



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Samenvatting publieke economieën en publieke financiën

Samenvatting publieke economieën en publieke financiën.....	1
Chapter one: introduction (blz 2- 15).....	9
Public finance and ideology (blz 3-5).....	9
1 ^e approche: Organic view of government.....	9
2e Approache: Mechanistic view of government (blz 4).....	10
Viewpoint of this book (blz 5)	10
Government at a glance (blz 5-13)	11
The legal framework (blz 6-7).....	11
The size of government (blz 8-9)	13
Expenditures (blz 11).....	15
Revenues (blz 11-12)	16
Chapter 2: Tools of positive analysis (blz 18-31).....	17
The role of theory (blz 18-20).....	17
Eigenschappen Economic Theory (blz 18-20).....	17
Twee soorten goederen	18
Nutsmaximalisatie als goede hypothese (blz 19)	18
Causation vs. correlation (blz 20-21).....	19
Experimental studies (blz 21-24).....	20
Explanation Experimental studies (blz 21-22).....	20
Conduction an Experimental studie (blz 22-23)	20
Pitfalls of Experimental studies (blz 23-24)	21
Observational studies (blz 24-27).....	22
Explanation Observational studies (blz 24)	22
Conduction an Observational Study (blz 25-26).....	22
Pitfalls of Observational Studies (blz 26-27)	23
Quasi-Experimental studies (blz 27-30)	23
Explanation of Quasi-Experimental studies (blz 27-28)	23
Conducting a Quasi-Experimental study (blz 28-30)	24
Pitfalls of Quasi-Experimental studies (blz 30).....	24
Conclusion (blz 31)	25
Welfare Economics (blz 34-41).....	26
Pure Economy exchange (blz34-39) of consumption Economy	26
Production economy (blz39-41)	29
The first fundamental theorem of welfare economics (blz 41-42)	30

Fairness and the second fundamental theorem of welfare economics (blz 42-46).....	30
The superficial understanding of the First Welfare Theorem (blz 42-45)	31
The Second fundamental theorem of Welfare Economics (blz 45-46)	32
Market failure (blz 46-48).....	33
Market power (blz 46-47).....	33
Nonexistence of market (blz 47-48)	33
Overview (blz 48).....	33
Buying into welfare economics (blz 48-49)	34
The underlying outlook is highly individualistic (blz 49)	34
Concerns with results (blz 49)	34
Welfare economics has a great advantage	34
Chapter 4: Public goods (blz 54-68).....	35
Public goods defined (blz 54-56)	35
Characteristics of goods (blz 54)	35
Types of goods (blz 54).....	35
Note worthy aspects of public goods (kantekeningen) blz 55-56).....	35
Examples of public goods	36
Efficient provision of public goods (blz 56-64)	36
The market for private goods.....	36
Deriving the efficiency condition (blz 58-61) --> publiek goed	37
Difference between private goods and public goods (blz 59).....	38
Problems in achieving efficiency (blz 61-62)	38
The free rider problem (blz 63-64)	39
Privatization (blz 64-68).....	40
Public versus private provision (blz 64-65).....	40
Public versus private production (blz 65-68).....	40
Public goods and public choice (blz 68).....	40
Chapter 5: Externalities (blz 73-104)	41
The nature of externalities (blz 74-76).....	41
Example (blz 74)	41
Difference between privately owned and commonly-owned (blz 74).....	41
The characteristics of externalities (blz 74-76)	41
Graphical analysis (blz 76-81).....	42
Implications (blz 77-80)	43
Conclusion (blz 81)	44
Private responses (blz 81-84)	44

Bargaining and the Coase theorem (blz 81-83).....	44
Mergers (blz 83)	46
Social conventions (blz 83-84).....	46
Public responses to externalities: taxes and subsidies (blz 84-87)	46
Taxes (blz 84-85).....	46
Subsidies (blz 85-87).....	47
Subsidies versus taxes	47
Public responses to externalities: Emissions fees and Cap-and-trade programs (blz 87-99)	47
Emission fee (blz 88-91)	48
Cap-and-Trade (blz 91-93).....	50
Emissions fee versus Cap-and-Trade (blz 93-97).....	51
Command-and-Control regulation (blz 97-99).....	53
The US response (blz 99-101).....	53
Progress with incentive-based approaches (blz 100-101)	53
Implications for income distribution (blz 101-103).....	53
Who benefits? (blz 101-102)	53
Who bears the cost? (blz 102).....	53
Positive externalities (blz 103-104)	54
A cautionary note (blz 104)	54
Chapter 6: Political Economy (blz 108-129)	55
Direct democracy (blz 108-117)	55
Unanimity rules (blz 109-110)	55
Majority voting rules (blz 110-114)	56
Logrolling (blz 114-116).....	58
Arrow's impossibility theorem (blz 116-117).....	59
Other examples of direct democracy (zie PP dia 17)	60
Representative democracy (blz 117-126)	60
Elected politicians (blz 118-120)	60
Public employees (blz 120-121)	61
Special interest (blz 121-125).....	61
Other actors (blz 125-126)	62
Explaining government growth (blz 126-129).....	63
Ratio van de overheidsuitgaven ten opzichte van het bruto binnenlands product.....	63
De overheidsgroei controleren (zie PP).....	65
Conclusion (blz 129)	65
Chapter 8: Cost-Benefit Analysis (blz 147-170).....	66

Present value (blz 14-150).....	66
Projecting present dollars into the future (blz 148).....	66
Projecting future dollars into the present (blz 148-149).....	66
Inflation (blz 149-150).....	67
Private sector project evaluation (blz 150-153).....	68
Present value criteria (blz 150-151).....	68
Internal rate of return, IRR (blz 152-153).....	69
Benefits-cost ratio (blz 153).....	69
Discount rate for government projects (blz 154-157).....	70
Rates based on returns in the private sector, weighted average (blz 154-155).....	70
Social discount rate (blz 155-156).....	71
Discounting and the economics of climate change (blz 156).....	71
Government discounting in practice (blz 156-157).....	71
Valuing public benefits and costs (blz 157-163).....	72
Market prices (blz 157-158).....	72
Adjusting market prices (blz 158-159).....	72
Consumer surplus (blz 159-160).....	74
Inferences from economic behavior (blz 160-162).....	74
Valuing intangibles (blz 163).....	75
Games cost-Benefit analysts play (blz 163-164).....	76
The chain-reaction game (blz 163-164).....	76
The labor game (blz 164).....	76
The double-counting game (blz 164).....	76
Distribution considerations (bkz 164-165).....	76
Hicks-Kaldor criterium (blz 146-165).....	76
Overheidsgedrag (blz 165).....	77
Uncertainty (blz 165-166).....	77
Hoe ga je rekeninghouden met onzekerheid? (blz165-166).....	77
Use (and nonuse) by government (blz 169-170).....	79
Chapter 12: Income redistribution: Conceptual Issues (blz 251-268).....	80
Distribution of income (blz 252-256).....	80
Examination of some information on distribution of income (blz 252-253).....	80
Interpreting the distribution data (blz 253-256).....	81
Rationales for income redistribution (blz 256-263).....	82
Simple utilitarianism (blz 256-258).....	82
The implications for income inequality (blz 257-259).....	82

The maximin criterion (blz 259-260)	84
Pareto efficient income redistribution (blz 260-261).....	84
Non-individualistic views (blz 261-262).....	85
Other considerations (blz 262-263).....	85
Expenditure incidence (blz 263-267).....	85
Relative price effects (blz 263-264).....	86
Public goods (blz 264).....	86
Valuing In-Kind transfers (blz 264-267) = overdragen natura of sociale transfers	86
Reasons for In-Kind transfers (blz 267)	88
Paternalism.....	88
Commodity egalitarianism	88
Reduce welfare fraud	88
Political factors	88
Conclusion (blz 268)	88
Chapter 13: Expenditure programs for the poor (blz 270-281)	89
A quick look at welfare spending (blz 270)	89
TANF (blz 271-272).....	89
Income maintenance and work incentives (blz 272-280)	90
The basis trade-offs (blz 272-273).....	90
Analysis of work incentives (blz 273-278)	90
Work requirements (blz 278-279).....	92
The earned income tax credit (blz 280-282)	93
Explanation (blz 280-281).....	93
Empirical evidence: The effect of the earned income tax credit on labor supply (blz 282).....	93
Chapter 14: Taxation and income distribution (blz 296- 321)	94
Tax incidence: general remarks (blz 297-300).....	94
Only people can bear taxes (blz 297-298).....	94
Both sources and uses of income should be considered (blz 298)	94
Incidence depends on how prices are determined (blz 298)	95
Incidence depends on the dispositions of tax revenues (blz 298-299)	95
Tax progressiveness can be measured in several ways (blz 299-300)	95
Partial equilibrium models (blz 301- 313)	96
The incidence of a unit tax (blz 301-305)	96
Ad valorem taxes (blz 305-306).....	98
Taxes on factors (blz 307-309)	98
Commodity taxation without competition (blz 309-311)	99

Profits taxes (blz 311-312).....	100
Tax incidence and capitalization (blz 312-313)	100
General equilibrium models (blz 313-320).....	101
Tax equivalence relations (blz 313-314).....	101
The Harberger model (blz 315-316)	102
Analysis of various taxes (blz 316-318)	103
Some qualifications (blz 318-319)	104
An applied incidence study (blz 319-320)	104
Conclusions (blz 320-321)	105
Chapter 15: Taxation and efficiency (blz 324-341).....	106
Excess burden defined (blz 325-331)	106
In general (blz 325-328).....	106
Questions and answers (blz 328-331)	108
Excess burden measurement with demand curves (blz 332-338)	110
The calculation and representation (blz 332-334)	110
Preexisting distortions (blz 334-335).....	112
The excess burden of subsidy (blz 335-336)	113
The excess burden of income taxation (blz 336-338)	113
Differential taxation of inputs (blz 338-341).....	114
Does efficient taxation matter? (blz 341).....	115
Chapter 16: Efficient and equitable taxation (blz 347-370)	116
Optimal commodity taxation (blz 347-353)	116
Calculation of the optimal commodity taxation (blz 347-348)	116
The Ramsey Rule (blz 348-351)	117
Equity considerations (blz 351-352).....	120
Summary (blz 352).....	120
Application: taxation of the Family (blz 352-353)	120
Optimal user fee (blz 353-356).....	121
General (blz 353-355)	121
The solutions for the government to confront the dilemma (blz 355)	122
Overview (blz 356).....	123
Optimal income taxation (blz 356-358).....	123
Edgeworth's Model (blz 356-357).....	123
Modern studies (blz 357-358)	124
Politics and the time inconsistency problem (blz 358-359)	124
Other criteria for tax design (blz 360-369)	125

Difference between fair and efficient taxes in two different contexts (blz 360)	125
Horizontal equity (blz 360-362)	125
Cost of running the tax system (blz 362-363)	126
Tax evasion (blz 363-369)	126
Overview (blz 369-370)	128
Gastcollege 2018: Lehman Brothers, 10 jaar later door Johan Van Overtveldt.....	129
Overzicht	129
De zwaarste crisis sinds WOII	129
De oorsprong van de crisis met de vier brandhaarden	130
Het gevoerde beleid	133
Werk op de plank	134
Solutions discussion questions of each chapter.....	135
Chapter 1 (blz 14-15)	135
Question 1	135
Question 4	135
Question 5	136
Question 6	136
Chapter 2 (blz 32-33)	136
Question 2	136
Question 6	136
Question 7	137
Question 8	137
Chapter 3 (blz 50-52)	138
Question 4	138
Question 5	138
Question 8	138
Question 13	138
Chapter 4 (blz 69-70)	138
Question 5	138
Question 6	138
Question 8	138
Question 9	138
Question 10	138
Chapter 5 (blz 105-107)	138
Question 3	138
Question 5	139

order to emit carbon. If the cost of purchasing and using abatement equipment is less than the cost of buying a permit, the business will use abatement equipment. In either case (buying a permit or using abatement equipment) costs for the producer increase, decreasing supply and increasing the price of the final good. If the carbon tax and the number of permits issued in the cap and trade system were set appropriately, the outlays for both programs would be the same.

Question 5

In Turkey, many shopping mall owners charge different rental rates on their tenants. The shops of local and relatively unknown brands pay higher rental rates per square meter than international and famous brand shops. Local shop owners protest this differential rental system. What motivates mall owners to use different rates?

This is an example of a private solution to the positive externality problem. Famous and international brands attract shoppers to the mall. Once the customers are in the mall, they shop in other stores as well. The mall owner is subsidizing this positive externality created by brands through charging lower rental rates.

Question 8

Some observers have argued that importing oil makes the United States hostage to the policies of Saudi Arabia and other countries in the Middle East. This complicates US foreign policy.

(a) Explain why an externality is present in this situation.

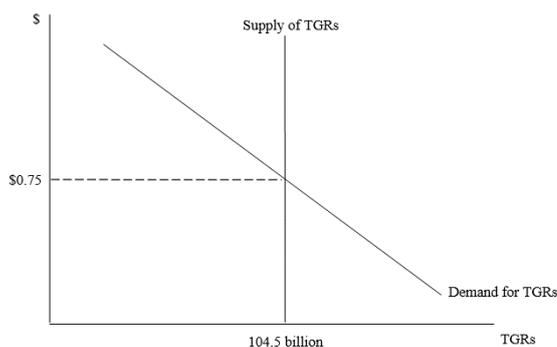
The price of imported oil does not reflect the increased political risk by effectively subsidizing authoritarian regimes like those in Saudi Arabia.

(b) Propose a Pigouvian tax to deal with the externality.

The tax would estimate the marginal damage (e.g., the increased instability in the Middle East, etc.) by importing oil from Saudi Arabia.

(c) How would this change the opportunity cost of buying a gallon of gasoline?

The supply of TGRs is vertical at 104.5 billion if government seeks to reduce consumption of gasoline to 104.5 billion. Consumers must have one TGR in order to buy one gallon of gasoline, plus they must pay the price at the pump. Limiting TGRs effectively limits the demand for gasoline, so the price per gallon will fall, but consumers must have TGRs in order to purchase gasoline. If the market price of one TGR is \$0.75, this means that supply and demand intersect at \$0.75, as shown in the graph. This kind of program curbs consumption without giving government more revenue because consumers are purchasing the TGRs from each other. However, the total amount of TGRs is limited by government. Those consumers seeking to purchase more gasoline than allowed by the initial allocation of TGRs can purchase additional TGRs from other consumers at the market price of \$0.75. By choosing to use a TGR to purchase gasoline, a consumer incurs an opportunity cost equal to \$0.75 since they cannot sell the TGR once it has been used.



Question 13

The Kyoto Protocol has tried to create an international framework where greenhouse gas emissions are limited through a cap-and-trade system. So far, it has experienced very limited success. The actual greenhouse emissions of many countries are considered to be much higher than efficient levels. Explore the challenges experienced during the drafting and implementation of the protocol. What would the Coase Theorem predict about the emission levels? Why weren't these predictions realized? Suppose that marginal costs of emissions are very uncertain. In this case, would you suggest emission fees or cap-and-trade?

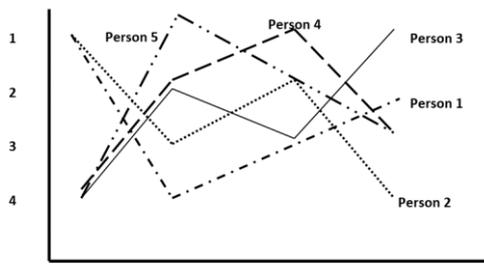
Determining the emission allowances of individual countries was a very difficult task. Specific sectors and countries were given exemptions, and transition periods were put into place for developing countries, all of which involved high levels of income transfer between countries. Furthermore, political and economic reasons prevented countries from reaching a consensus. The Coase Theorem in its simplest form would predict a consensus on an efficient level of emissions. However, the transaction costs of reaching an agreement prevented the agreement and an efficient level of emissions from being reached.

This is another application of Figures 5.11 and 5.12. Suppose that MB and MC are correctly estimated. Both the cap-and-trade and emission fees methods would work efficiently. However, if the correct marginal benefit of abatement is MBL but the system is implemented with the MBN estimate, then the cap-and-trade system would yield a more than efficient level of abatement. The emission fee system would yield a less than efficient level of abatement. If the marginal benefits of abatement estimated are less than the true level, the opposite is true. Ultimately, the choice depends on the risk preferences of society in relation to climate change.

Chapter 6 (blz 130-131)

Question 1

a) Below, the preferences for each person.



b) C wins in every pair wise vote. Thus, there is a stable majority outcome, despite the fact that persons 1, 2, and 3 have double-peaked preferences. This demonstrates that although multi-peaked preferences *may* lead to voting inconsistencies, this is not necessarily the case.

Question 5

When the policy changed to allow and encourage female voting, female voters became the majority, so it is sensible that the median voter is now a woman. Given this, the median voter theorem suggests that politicians should shift their positions to more closely align with the views of women.

Question 7

If barriers to entry are due to rent-seeking behavior, the incomes of pharmacists would increase. A decrease in supply would also increase the prices of the services provided by pharmacies. There are two types of deadweight loss: first, the typical deadweight loss due to a less than efficient amount of service provision in the market (supply shifts left). The second type of efficiency loss is caused by the pharmacists' use of real resources on lobbying.

Question 9

- With the demand curve of $Q=100-10P$ and a perfectly elastic supply curve at $P=2$, the milk is sold at a price of \$2, and a quantity of 80 units is sold.
- The marginal revenue curve associated with the inverse demand curve $P=10-(1/10)Q$ is $MR=10-(1/5)Q$, while the marginal cost curve is $MC=2$. The cartel would ideally produce a quantity where $MR=MC$, or $10-(1/5)Q=2$, or $Q=40$. The price associated with a cartel quantity of 40 units is $P=10-(1/10)*40$, or $P=6$.
- The rent associated with the cartel is the product of the marginal profit per unit and the number of units produced. The marginal profit per unit of milk is \$4 (= \$6 price - \$2 marginal cost), while 40 units are produced. Thus, the rents equal \$160.
- The most the cartel would be willing to contribute to politicians is the full economic rent of \$160. The cartel situation, the quantity of milk produced is too low from society's point of view. The deadweight loss triangle is computed using the difference between the cartel output and competitive output as the "base" of the triangle, and the difference between the cartel price and competitive price as the "height." Thus, the triangle is equal to $(1/2)*(80-40)*(\$6-\$2)=\$40$.
- As Figure 6.5 in the textbook shows, the deadweight loss could now go as high as the sum of the conventional deadweight loss and the rents, or \$160 rents + \$80 DWL = \$240. This is because, as noted in the text, "rent-seeking can use up resources – lobbyists spend their time influencing legislators, consultants testify before regulatory panels, and advertisers conduct public relations campaigns. Such resources, which could have been used to produce new goods and services, are instead consumed in a struggle over the distribution of existing goods and services. Hence, the rents do not represent a mere lump-sum transfer; it is a measure of real resources used up to maintain a position of market power."

Chapter 8 (blz 171-172)

Question 5

- Bill is willing to pay 25 cents to save 5 minutes, so he values time at 5 cents per minute. The subway saves him 10 minutes per trip, or 50 cents. The value of 10 trips per year is \$5. The cost of each trip is 40 cents, or \$4 per year. The annual net benefit to Bill is therefore \$1. The present value of the benefits = $\$5/.25 = \20 ; the present value of the costs is $\$4/.25 = \16 .
- Total benefits = $\$20 \times 55,000 = \$1,100,000$.
Total costs = $\$16 \times 55,000 = \$880,000$.
Net benefits = \$220,000.
- Costs = $\$1.25 \times 55,000 = \$68,750$.
Benefits = $(\$62,500/1.25) + (\$62,500/1.25^2) = \$90,000$.
Net benefit = \$21,250.
- The subway project has a higher present value. If a dollar to the "poor" is valued the same as a dollar to the "middle class," choose the subway project.
- Let λ = distributional weight. Set $220,000 = -68,750 + \lambda \left[\left(\frac{62,500}{1.25} \right) + \left(\frac{62,500}{1.25^2} \right) \right] \Rightarrow \lambda = 3.21$
This distribution weight means that \$1 of income to a poor person must be viewed as more important than \$3.21 to the middle class for the legal services to be done.

Question 6

\$100 billion invested for 100 years at 5 percent per year would generate over \$13 trillion, a little more than twice the \$700 billion in damage caused by the climate change. There might be other considerations offered when evaluating this proposal, but the critic is correct from a financial standpoint.

Question 7

This presents the typical fixed cost, marginal cost difference. If the expected damage of existing nuclear power stations exceeds the expected benefits, then the power stations should be shut down. The expenditure made on the construction of existing plants should not be taken into account. It is possible that the cost benefit analysis might recommend the continuance of existing power plants but not recommend any new construction of nuclear generators because for new power plants, the construction costs need to be taken into account.

Question 8

Presumably, those settled in Jubail would have been working in other cities if the city had not been expanded and industrial facilities had not been created there. Only a small portion would have been unemployed. Therefore there is little or no job creation, only job replacement.

Chapter 12 (blz 268-269)

Question 1

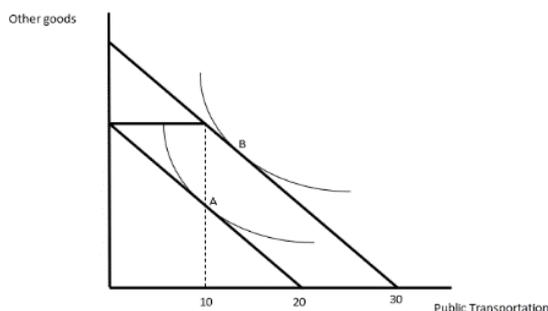
“I don’t care how rich the very rich are. I care if they became rich in an unethical way, or if they use their riches in a particularly vulgar or revolting way ... I wouldn’t mind if they lost (their wealth) or had it taxed away. But I don’t mind if they keep it either... But I do find poverty of the very poor unlovely... that condition deserves, in my opinion, our most intensive care. I believe that the present focus on inequality of income diverts national attention from it” (Stein, 1996, p. A14). Do you agree with this statement? Is it consistent with utilitarianism?

Utilitarianism suggests that social welfare is a function of individuals’ utilities. Whether the rich are vulgar is irrelevant, so this part of the statement is inconsistent with utilitarianism. On the other hand, Stein’s assertion that inequality *per se* is unimportant is consistent with utilitarianism.

Question 3

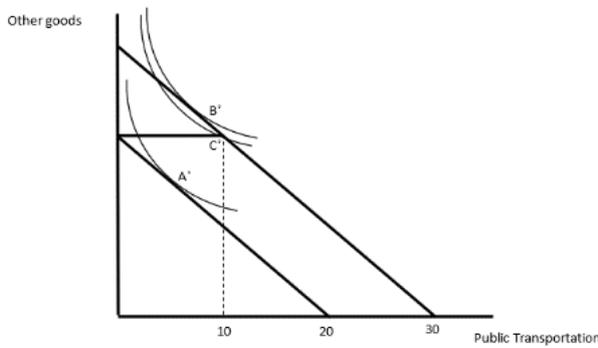
President Vladimir Putin of Russia proposed replacing in-kind subsidies such as free public transportation and rent-free apartments for government workers with cash subsidies of between \$20 and \$120 per month. The proposal led to widespread complaints among Russian citizens that the cash subsidies were not large enough. One reportedly asked: “What is a perk worth?” (Chivers, 2004)? Use an indifference curve analysis to show how to convert an in-kind subsidy into a cash subsidy that leaves people equally well off.

Suppose the government is initially providing an in-kind benefit of 10 units of free public transportation, worth \$2 each, so the cost of the subsidy is \$20. Without the subsidy, income is \$40. With no subsidy, the consumer maximizes utility at point A, and with an in-kind benefit of 10 units of free public transportation, the consumer maximizes utility at point B. A cash subsidy equal to \$20 would allow the consumer to reach point B as well, so the government could convert an in-kind subsidy valued at \$20 to a cash subsidy of \$20 and leave people equally well off.



Another possibility is that the utility-maximizing point for a cash subsidy differs from the utility-maximizing point for an in-kind subsidy, as illustrated in the next graph.

In this case, an in-kind subsidy, costing \$20, would allow the consumer to move from point A' to point C', while a cash subsidy of \$20 would make the consumer better off at point B'. In order to make the consumer equally well off, the cash subsidy should be a little less than \$20.



Question 5

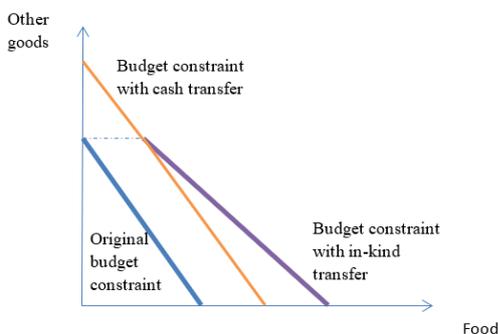
Razin and Wahba (2011) studied the interaction of immigration and welfare policies in EU countries and found that the more generous the welfare policies, the lower the skill composition of immigrants. Why might this occur, and what are the likely consequences?

If the welfare benefits are generous, low income (which usually also means low skilled) workers migrate to the country more than do high income workers. This happens because low income workers are net beneficiaries of welfare policies while high income workers are net payers towards welfare policies. If generous welfare policies attract low skilled immigrants, local voters may become less supportive of the welfare policies and may push for change.

Question 8

A government program in Mexico randomly assigned villages to receive boxes of food and equivalently-valued cash transfers. Cunha at al. (2011) found that food prices declined in the villages where food boxes were distributed but not in the villages where the equivalently-valued cash was given. Adjust figure 12.3 accordingly and compare cash and in-kin transfers.

This figure shows how transfer programs affect budget constraints. The utility of the beneficiaries of in-kind transfers is higher than that of the beneficiaries of cash transfers.

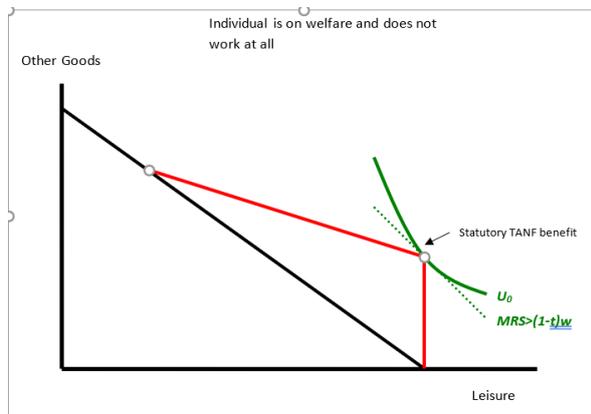


Chapter 13 (blz 293-294)

Question 6

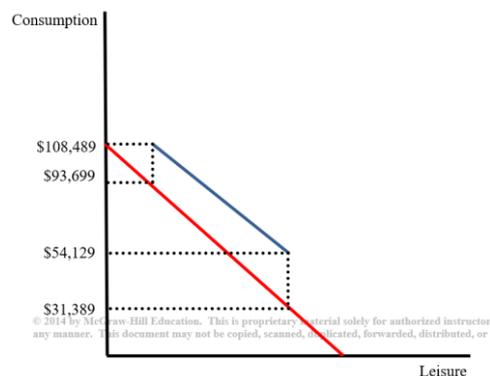
For an individual who is not working while on welfare, in this case the highest indifference curve touches the budget constraint on the right vertical axis. Note that the marginal rate of substitution

(MRS) does not necessarily equal the after-tax wage rate at the time endowment – rather, it is possible that the person would want to consume more leisure than the time endowment but is obviously constrained from doing so.



Question 10

In the graph below, the budget constraint between consumption of \$31,389 and \$93,699 is higher than the original budget constraint (in red). The increase in consumption possibilities at \$93,699 will decrease the incentive to work to receive the 93,700th dollar. However, there may be an incentive for a person who is earning \$31,388 to work for the additional dollar that would make him or her eligible for the subsidy (depending on the value of the health benefits provided on incomes less than those for which the subsidy is paid).



Chapter 14 (blz 321-322)

Question 4

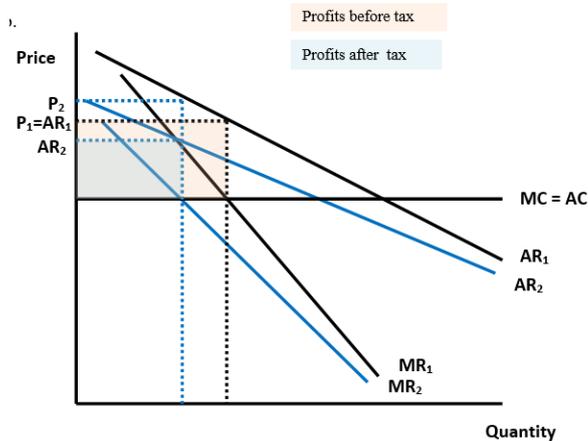
In an editorial entitled “ Truth and Les About Medicare”, the New York Times (august 19, 1012, P. SR10) discussed the financing of the Affordable care Act of 2010 and stated:” And a further chunk (of revenue) will come from fees or taxes on drug makers, device maker and insurers- fees that they can surely afford since expanded coverage for the uninsured will increase their markets and their revenues.”

a) Consider a firm that has a monopoly on the production of a particular medical device. A tax of 10 percent is levied on the sales of the firm. What is the editorial implicitly assuming about the incidence of this tax?

The assumption is that firms will pay the full tax form its profits rather than passing some of the cost to consumer.

b) Assume that the firm has standard linear average revenue and marginal revenue curves and produces with constant and positive marginal cost. Show the firm’s profits and the price paid

by consumers of medical devices before and after the tax is imposed. (Hint: A 10 percent tax pivots both the AR and MR curves. Pivot the curves appropriately and find the intersection of the after MR curve with the marginal cost curve).



c) If you did part B correctly, you have shown that the editorial writer did not understand how the think about the incidence of a tax. Explain briefly the error.

With the tax, profits for the companies do decline, but the price paid by the consumer before the tax is P_1 while it is P_2 after the tax, with the difference between the two the amount of the tax that the consumer pays.

Question 7

A report by the Australian government (Australia’s Future Tax System, 2009) recommended changes to income tax rates. These tables present simplified versions of tax rates under the current and recommended systems. Using equation 14.2, assess whether this tax change increases or decreases progressiveness. In your calculations use the income levels of \$30 000 and \$100 000.

Current system		Recommended system	
Income Bracket	Marginal tax rate	Income Bracket	Marginal tax rate
0 – 6 000	0%	0 – 25 000	0%
6 001 – 37 000	15%	25 001 – 180 000	35%
37 001 – 80 000	30%	180 001 +	45%
80 001 – 180 000	37%		
180 001 +	45%		

Tax paid on an income of \$30,000 in the current system: $24,000 \times 0.15 = 3,600$.

Tax paid on an income of \$100,000 in the current system: $(31,000 \times 0.15) + (43,000 \times 0.3) + (20,000 \times 0.37) = 24,950$.

Tax paid on an income of \$30,000 in the proposed system: $5,000 \times 0.35 = 1,750$

Tax paid on an income of \$100,000 in the proposed system: $75,000 \times 0.35 = 26,250$

When we plug these numbers into Equation 14.2, we get elasticity values of 2.54 and 6 in the current and proposed tax systems, respectively. The recommended system increases the progressiveness of taxation.

Question 9

In 2011, the Turkish government increased taxes on the sale of new luxury cars (once with larger than 2.0-liter engines) from 84 percent to 130 percent. Show the expected effects of this increase on new luxury car prices and used luxury car prices. Would anybody be happy about this tax increase? Explicitly state your assumptions about elasticities.

Since luxury cars are “luxuries”, they tend to have elastic demand. Thus, we would expect the price of these cars *not* to increase significantly; instead, we would expect the tax burden to be carried by suppliers. On the other hand, since luxury cars are imported, we might reasonably consider the supply of these cars to be more elastic than the demand. If that is the case, we would expect the prices to increase significantly. Both answers are reasonable so long as the correct assumptions are made about the elasticities. If elasticity of supply is considered to be bigger than demand, we would expect a significant increase in the price of used cars. This would make some people happy, especially if they were considering selling their cars.

Question 12

In 1999, the Japanese government reduced the income tax rate for top earners from 50 percent to 37 percent (Yamada, 2011). Most labor economists believe that labor supply of male workers is very inelastic. How would the decrease in the income tax rate affect after-tax earnings of male workers and cost structures of firms (as demanders of labor)? It's also believed that female labor supply is more elastic than male labor supply. Compare the effects on this tax reform on male labor markets and female labor markets. (Assume that workers' only income source is their labor).

As can be seen from the below figures, the income tax burden is completely carried by male workers. A decrease in the tax rate increases their after-tax wage rates by the same amount. The amount that corporations pay is not affected by the tax changes. However, for female workers, the tax burden is shared between female workers and their employers. The after-tax wage of female workers will increase but by less than that of their male colleagues. The costs to employers of female workers will decrease.

Chapter 15 (blz 342-343)

Question 1

Which of the following is likely to impose a large excess burden?

a) A tax on land

The supply of land is fixed, or perfectly inelastic, so there is no excess burden because the lower price that sellers receive does not cause quantity supplied to fall.

b) A tax of 24 percent on the use of cellular phones (This is the approximate sum of federal and state tax rates in California, New York and Florida.)

The use of cell phones is probably fairly price-elastic, which implies that the excess burden could be large.

c) A subsidy for investment in high-tech companies

It is possible that companies could identify themselves as high-tech in order to receive the subsidy. Thus, the supply is quite elastic, and there will be substantial excess burden.

d) A tax on soda bought in a cup or glass but not bought in a bottle or can. (Such tax exists in Chicago)

Consumers and sellers will likely agree to avoid cups and glasses in order to avoid the tax. A tax that is easily avoided does not have much of an impact, except to create some inconvenience, and does not raise revenue.

e) A 10-cent tax on deck of card that contains no more than 54 cards. (Such tax exists in Alabama).

Card companies can easily increase or decrease the number of cards in a pack, avoiding the tax and reducing the excess burden.

f) A tax on blueberries. (such a tax exists in Maine).

There are many good substitutes for blueberries. Therefore, their demand is quite elastic, and a tax on them will have a substantial excess burden, relative to the size of revenues collected.

Question 6

Most advanced countries in the world provide some kind of benefits to individuals with children, often in the form of tax credits. These benefits make up 4 percent of the average wage rate among OECD countries (OECD Family Database, 2012). One economist argued that keeping the child tax credit “might be good for social purposes, but there’s no economic case for it” (Ip, 2006). Explain what this economist meant using the concept excess burden.

Presumably, the demand price elasticity of having children is small. As a result, taxes on children would not create too much excess burden. Following this argument, child tax credit does not create too many incentives or disincentives to work. Assuming there are no other positive externalities, subsidizing having children does not make economic sense because of the excess burden created to finance it.

Question 7

Former Secretary of Labor Robert Reich has advocated for a cap-and-trade program for greenhouses gases. Under Reich’s proposal, the government would auction off the permits and distribute the revenues in a lump sum fashion to every adult citizen (Reich, 2008). What are the implications of this plan for excess burden? If you were interested in reducing excess burden, how would you distribute the revenues?

The cap and trade program would likely cause the cost of producing many consumer goods to increase. By changing prices in this way, the program may induce an excess burden. However, if the program succeeds in addressing a significant externality, the distortion in status-quo prices may actually succeed in bringing consumption closer to the efficient level. As to the cap and trade revenues, distributing the revenues via a lump sum transfer would have no impact on excess burden. If one wants to reduce excess burden, the revenues should be redistributed via reduction in marginal tax rates, for instance, in the payroll and income taxes.

Chapter 16 (blz 370-371)

→ **Geen verbetering van gekregen op Blackboard**

Question 1

According to estimates by Goolsbee and Petrin (2004), the elasticity of demand for basic cable services is -0.51 and the elasticity of demand for direct broadcast satellites is -7.40. Suppose that a community wants to raise a given amount of revenue by taxing cable service and the use of direct broadcast satellites. If the community’s goal is to raise the money as efficiently as possible, what should be the ratio of the cable tax to the satellite tax? Discuss briefly the assumption behind your calculation.

Wanneer we de winst van belastingen willen verhogen, moeten we rekening gaan houden met de taksurden dat de belastingen veroorzaken. We kunnen de winsten van de belastingen verhogen door deze taksurden zo klein mogelijk te houden. Om dit te gaan berekenen gaan we gebruik maken van de Ramsey rule, omdat ze hier spreken van vraag elasticiteiten kunnen we de inverse elasticiteit regel gaan gebruiken die zegt dat $\frac{t_x}{t_y} = \frac{\eta_y}{\eta_x}$ met t het belastingtarief op een van de producten en η de vraag elasticiteit. Dus dit wil zeggen dat $\frac{t_x}{t_y} = \frac{\eta_y}{\eta_x} \Rightarrow \frac{-0.51}{-7.40} = \frac{t_x}{t_y} = 0.0689$

Question 2

In 2002, the US federal government levied a tax of 3 percent on that part of a car's price exceeding \$40 000. (for example, the tax liability on a \$50 000 car would be $0.03 \times (\$50\,000 - \$40\,000)$, or \$300). Discuss the efficiency equity and administrability of this 'luxury car tax'.

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Question 7

Many diseases, such as malaria and tuberculosis, disproportionately affect low-income countries. Because profit potentials are lower for the drugs and vaccines for these 'neglected' diseases, pharmaceutical companies are reluctant to undertake the high R&D costs of developing them. On the other hand, many international organizations, like UNICEF and the Bill & Melinda Gates Foundation, would be willing to buy the drugs and vaccines and donate them to countries in need. However, pharmaceutical companies are still not investing. Discuss the root of the problem, using the concept of the "time inconsistency of optimal policy". Try to find solutions to the problem.

Definition time inconsistency of optimal policy: When the government can't implement an optimal tax policy because the policy is inconsistent with the government's incentives over time, and taxpayers realize this fact.

Je moet ervoor zorgen dat de overheid geloofwaardige beloftes maakt en geen enkele uitweg heeft om af te stappen van zijn plannen. Dit wil dus zeggen in dit geval dat de internationale organisaties die deze drugs willen kopen ervoor moeten zorgen dat ze dit op een geloofwaardige manier kunnen overbrengen tot de farmaceutische sector en dat ze niet van hun belofte tot afkoop afstappen. Dit kan zijn door regels in te voeren waardoor ze niet kunnen afwijken van de gemaakte beloftes tot afkoop. Wanneer dit kan gerealiseerd worden, gaan de farmaceutische bedrijven investeren in de vaccins en medicijnen.