



Lent 2017 examination

EC426

Public Economics

2016/7 syllabus only – not for resit candidates

Instructions to candidates

This paper contains **8** questions. ALL candidates should answer **four** short questions and **one** long question.

Each short question has a weight of 15% of the overall mark and the long question a weight of 40% of the overall mark. In multipart questions, answer all parts.

Time Allowed **Reading Time:** *None*
 Writing Time: *2 hours*

You are supplied with: *No additional materials*

You may also use: *No additional materials*

Calculators: *Calculators are not allowed in this examination*

Short questions: Answer FOUR questions (each question carries 15 marks)

1. "Wealth taxation produces only a small amount of tax revenue and therefore must be ineffective as a redistributive tool." Discuss.
2. Outline a pivotal mechanism for the provision of public goods. Under what circumstances could such a mechanism be used as the basis of practical policy?
3. Should luxuries be taxed more heavily than necessities?
4. Claim: "The classic no-distortion-at-the-top result implies that governments are currently taxing top-income earners too much." True or false? Explain.
5. Outline the Gruber-Saez simulated instrument approach to estimating the elasticity of taxable income. Does the instrument introduced in this approach resolve the potential bias from trending inequality? Discuss.
6. Claim: "The optimal marginal tax rate on income can never be above 100%." True or false? Explain.

Long questions: Answer ONE question (each question carries 40 marks)

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- (a) Does greater income mobility imply greater equality of opportunity? (12 marks)
- (b) Can the objective of greater mobility be reconciled with standard social-welfare functions? (13 marks)
- (c) To what extent can policies that promote economic mobility be used as a substitute for policies that are targeted at income redistribution? (15marks)

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Starting from a progressive income tax schedule with marginal tax rates τ_1, τ_2 and a bracket threshold at the income level z^* , the government implements a reform that moves the threshold to a higher level.

- (a) Illustrate the reform in a budget set diagram and explain how different income groups are affected. (10 marks)
- (b) Devise an empirical strategy using this reform to estimate both the substitution effect and the income effect on labour supply. What are the assumptions of your approach? (15 marks)
- (c) The government has asked you to evaluate the merits of the reform. Outline the key considerations of such an evaluation, and how they will depend on the empirical study discussed above. Are there empirical results that would lead you to the unambiguous conclusion that the reform was either good or bad? Discuss (15 marks)