

Tutorial Questions

December 16, 2010

1. What implications do the principles of optimal taxation have for each of the following:
 - a. The government must finance a temporary recapitalization of banks. How should this be financed?
 - b. Evidence shows females are more responsive to marginal tax rates than males.
 - c. Demand for luxury goods is elastic, while demand for gambling (e.g., the “lotto”) and addictive goods is not.
 - d. People with high IQs earn higher incomes.
 - e. Many high income earners work not for cash, but because they like their work.
2. In the budget, the government raised *average* tax rates and *marginal* tax rates. What are the implications for labour supply?
3. If the government charged everyone a lump-sum fee of 1000 euros for bank recapitalization, but at the same time, reduced marginal tax rates on labour, what would be the implications for labour supply?
4. Examine the Ramsey model for the case where the production function is

$$y = Ak$$

In particular,

- a. Is there a steady state? Explain why.
- b. Give a condition that ensures positive consumption growth in equilibrium
- c. Does the model exhibit conditional convergence? Explain why.
- d. What is the equilibrium interest/rental rate?
- e. What effect would a tax on capital have on the model?

5. Suppose we have the usual production function combined with the assumption that

$$A = k^{1-\alpha}$$

Explain the intuition for this (recall that $0 < \alpha < 1$): how would we rationalize this? how the dynamics would change relative to the standard model.

6. Consider the Ramsey model for a small open economy in a globalized world. If the economy was below steady state and opened up to trade, what would happen? If the model had labour supply, what would be the implications for the real wage?