University of California, Davis
Department of Economics
ECONOMICS 131

Spring 2010 L. Jay Helms

Problem Set #8: Taxing Consumption & Wealth

1. Consumption Taxation and Saving

To focus on saving incentives, assume that a consumption tax leaves lifetime earnings patterns unaffected.

a. In present consumption-future consumption space show (i) the budget set and (ii) the utility-maximizing point for a person earning A dollars in the first (present) period and B dollars in the second (future) period in the absence of taxation.

b. Show, on the same graph, (i) the budget set and (ii) the utility-maximizing point for the same person in the presence of a consumption tax at rate *t*.

c. Identify on your graph and explain verbally (i) the income effect and (ii) the substitution effect of the consumption tax.

2. The Estate and Gift Taxes

Since 1976 the gift and estate taxes in the United States have been integrated, and are officially referred to as the "unified transfer tax." Explain what we mean by "integrated"; that is, explain the link between the gift tax and the estate tax.

3. Property Tax Reform

Suppose that in the city of Elko political favoritism has resulted in properties north of Main Street being assessed at only 75% of what identical properties south of Main Street are assessed, although the city provides the same public services to all of its residents. This year, however, a newly elected city council is proposing a tax reform policy under which all properties would be assessed at their full value.

a. Provide an argument *against* this tax reform policy.

b. Now provide an argument *in favor of* the tax reform policy.