

End-of-chapter Questions

Chapter 17: Taxes, Transfer, and Private Information

1. What is the distinction between tax avoidance and tax evasion? Give an example of each.
2.
 - a. Why do individuals have an incentive to evade taxes?
 - b. How does that incentive depend on the taxpayer's private information, and what form does this private information take?
3. What is the optimal strategy for determining how much income tax to try to evade? What assumptions about people's objectives lie behind the optimal strategy?
4. In the model of tax evasion presented in the chapter, what are the relative advantages and disadvantages of trying to reduce tax evasion by raising the fine on undeclared income versus auditing more tax returns?
5. In the model of tax evasion presented in the chapter, does raising the income tax rate necessarily increase or decrease tax evasion? Explain.
6.
 - a. What is the rationale behind tax amnesties?
 - b. What are their advantages and disadvantages?
 - c. Are they always effective in achieving their goals?
7. How would you answer the following question: 'Should the government attempt to reduce tax evasion?'
8. The public choice theory of pareto optimal redistributions says that in-kind aid should be decentralized and subsidized. Does this recommendation necessarily hold if people have private information about themselves? Explain.
9. In the Blackorby/Donaldson model with two goods presented in the text, what rule must be satisfied for the economy to be on its first-best utility possibilities frontier? Explain why that rule must hold.
10. In the Blackorby/Donaldson model with two goods presented in the text:
 - a. What are the self-selection constraints and what purpose do they serve?

- b. Why do the self-selection constraints rule out some points on the first-best utility possibilities frontier?
11. Suppose the government can tax and transfer lump sum. Under Atkinson's three assumptions about applying social welfare functions described in Chapter 5, what should the government do to achieve the optimal distribution of income? Why might the existence of private information undermine the government's attempt to achieve the optimal distribution of income?