

End-of-chapter Questions

Chapter 19: Tax Incidence - Applications

The first seven questions refer to the 2-good (X and Y), 2-factor (capital and labor) model in the beginning of the chapter, with fixed supplies of capital and labor.

1. As the economy moves along the production possibilities frontier from good X to good Y, what happens to the price ratios of the goods and factors, P_X/P_Y and P_K/P_L , and the capital–labor ratio K/L , in each industry? Explain.
2. Why are the only interesting tax incidence issues in this model associated with specific taxes?
3. Why can all general taxes be designed to have the same incidence? Name four general taxes that have the same incidence and explain why they do.
4. What does it mean to say that good Y is relatively capital intensive, and why is it important for the analysis of tax incidence that the two goods do not have the same relative capital (or labor) intensity?
5. Why does the price ratio P_K/P_L fall as a result of the tax on capital in Y? Why does the return to capital used in X fall?
6. Harberger studied the effects of a tax on income from capital in good Y, which he called the corporate sector. He assumed that Y was relatively capital intensive. What factors determine whether capital or labor bears the burden of this tax? Explain why the factors that you name matter in determining the tax burden?
7. Comment on the following statement: Congress tried to place a burden only on income from capital in the corporate sector with a corporation income tax but it cannot succeed in doing this. If corporate capital bears a burden from the tax, then all capital bears the same burden whether it is used in the corporate or unincorporated sector.
8. Why, in a world of variable factor supplies, is it likely that the burden of a tax on income from capital might be shifted partly or completely to labor in the long run?

9. Harberger's model presented in the first part of the chapter assumed identical individuals. If individuals are not identical, discuss ways in which the burden of taxation could be affected in the short run; in the long run.
10. Why do immobile factors of production tend to bear the burden of taxation when the mobile factors are taxed?
11. Suppose the supply of capital to a locality or nation is perfectly elastic. In this case, who bears the burden of a tax on the income from capital paid by the firms in the locality or nation? Why? Who bears the burden of a tax on the income from capital levied on the locality's or nation's citizens? Why?
12. Why might oligopolists be able to escape the burden of a tax levied on them, such as a tax on their accounting profits?
13. What is the standard sources and uses approach to the analysis of the incidence of the five major U.S. taxes, as pioneered by Joseph Pechman and Bernard Okner: federal and state personal income taxes; the payroll tax that finances the Social Security system; federal and state corporation income taxes; states' general sales taxes; and local property taxes?
14. Why is John Whalley skeptical about the sources and uses approach to tax incidence? What alternative assumptions to those used by Pechman and Okner might you use to make the U.S. tax system far more progressive than Pechman and Okner found it to be?
15.
 - a. What kinds of assumptions are employed in the sources and uses approach to tax incidence?
 - b. What kinds of assumptions are employed in the general equilibrium modeling approach to tax incidence?
 - c. Which do you think is the better modeling approach for analyzing tax incidence? Explain.
 - d. What does each approach typically conclude about the incidence of the overall U.S. tax system?
16. Compare and contrast the annual and lifetime approaches to tax incidence within the sources and uses modeling framework. In particular, how do the sources and uses of income differ, and how sensitive are the two approaches to different assumptions about the incidence of the various U.S. taxes?