

Econ 131
Spring 2019
Emmanuel Saez

Problem Set 1

DUE DATE: February 27

Student Name:

Student ID:

GSI Name:

- **You must submit your solutions using this template.**
- **Although you may work in groups**, each student must submit individual sets of solutions. You must note the names other students that you worked with. Write their names here:

1. Essay

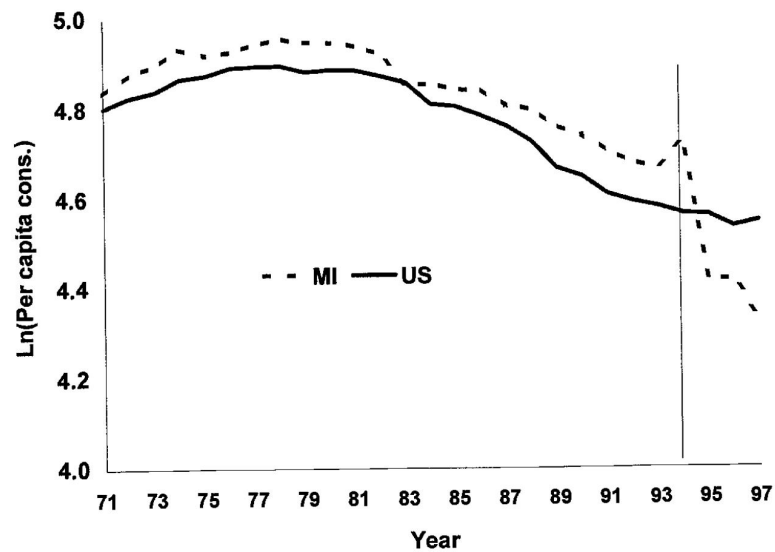
Read the following recent New York Times article about taxing the rich. Write a short essay [the essay has to fit in the page below] explaining whether the Times article accurately reported on changes in inequality and tax progressivity over recent decades (the grade is not based on whether you agree or not with the article but how well you can put the arguments in perspective based on what you learned in class).

NY Times link:

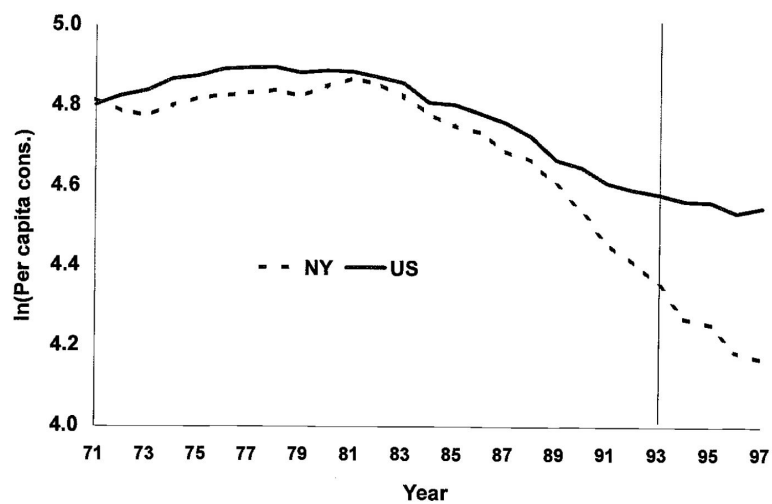
<https://www.nytimes.com/2019/02/03/opinion/democrats-wealth-tax.html>

(d) Suppose two individuals are out of work and receive the same means tested benefit of \$1000/month. One would be able to work while the other is not. Are they both equally deserving of support?

(e) In 1994, Michigan raised taxes on cigarettes sold in Michigan. The graph below shows the evolution of log per capita consumption in Michigan (dashed line) and in the US overall (solid line). Based on what you know about the difference-in-difference methodology learned in class, do you find that this graph provides compelling evidence of an effect of cigarette taxation on consumption? (graph from Evans, Ringel, Stech “Tobacco Taxes and Public Policy to Discourage Smoking” *Tax Policy and the Economy, volume 13*)



- (f) In 1993, New York substantially raised taxes on cigarettes sold to consumers in New York. The graph below shows the evolution of log per capita consumption in New York (dashed line) and in the US overall (solid line). Based on what you know about the difference-in-difference methodology learned in class, do you find that this graph provides compelling evidence of an effect of cigarette taxation on consumption? (graph from Evans, Ringel, Stech “Tobacco Taxes and Public Policy to Discourage Smoking” *Tax Policy and the Economy, volume 13*)



(d) What is the incidence of the tax? Explain the intuition for the key factors that determine the incidence.

(e) Compute and graphically depict deadweight loss due to the tax (The graph doesn't have to be in scale, just make sure you write down the important information)

Now suppose that consumers are inattentive to the tax and demand is given by

$$Q^D = 800 - 100(P + \theta t)$$

where $\theta = 1/2$. Again, suppose that a tax of $t = \$1$ is imposed on each soda that is purchased.

(f) How can we interpret θ ?

(g) What are the new equilibrium price and quantity?

(h) Compute and graphically depict deadweight loss arising due to the tax. How does your answer compare to your answer from part (e)? Explain.