

ECON0024: Economic Policy Analysis

2022 Reforming the Tax System

Tutorial Sheet

Example Short Question (Section A)

- 1) Box / ‘The new tax-credit policy raises questions about how best to motivate people to work, sustain the incomes of households with poor job opportunities and shield children from the burden of growing up in relatively impoverished households. There would be high costs for a policy whose central elements are to lower support for children and greatly reduce the marginal returns from work..’ *Martin Wolf, The Financial Times.*]
- (i) What are the key components of an earned income tax credit system? Why are they typically directed to working age adults with children?
 - (ii) Using examples from real tax credits systems, explain how such policies attempt to balance the dual objectives of work incentives with redistribution?

Example Long Question (Section B)

- 2) Consider the following quote : *J. Slemrod, W. Kopczuk, Journal of Public Economics*. ‘Most models have focused on the elasticity of labor supply, in the belief that the relative price of leisure and goods is the most important margin affected by taxes. Empirical evidence suggests that, at least for hours worked, the aggregate (compensated) labor supply elasticity is quite small. However, increasing leisure is by no means the only possible margin of response to higher marginal tax rates. there is a growing body of evidence, that, at least for high-income individuals, the elasticity of taxable income to the marginal tax rate is substantial.’
- a) Examine the quote and in doing so describe the optimal design approach to the tax rate on top earners? Make sure you define the taxable income elasticity and explain how knowledge of it can useful in finding the revenue maximising income tax rates at the top of the income distribution.
 - b) Explain how society’s preference for equality can enter the design of tax rates.
 - c) Suppose it is known that the labour supply elasticity is higher for women with primary school age children. What would be the arguments for and against setting a lower earnings tax rate for such individuals?