Public Finance  

1. Exercise 12 on page 688: A researcher found that when the capital gains tax rate declined, the average bequest size fell as well. How does the tax treatment of capital gains in the United States explain this relationship?

2. A city is considering building a bridge to link its two parts, which are separated by a river. The demand curve for crossings of the bridge in a year has a choke price of $6 (this is the price at which demand is zero) and 8 million crossings at a price of zero. The bridge costs 200 million to build, and there are maintenance costs of 5 million a year. The cost of building the bridge would be financed by borrowing at an interest rate of 7% over the lifetime of the bridge (60 years). The loan would be repaid by charging higher property taxes.

   a. Should the bridge be built?

   b. What determines whether you should use a multiplier in your answer to (a)?

3. Exercise 15 on page 574: The city of Malaise is considering a 10% tax on the revenues of all hotels/motels inside the city limits. Although not completely different from hotels and motels in the nearby suburbs, the ones in Malaise have a distinct advantage in their proximity to interesting sights and convention centers. So individuals will pay some premium to stay in Malaise rather than to stay nearby.

   Furthermore, all land is used equally well by hotels/motels and other forms of business; any Malaise land not taken by a hotel/motel is readily absorbed by other forms of business.

   Mayor Maladroit calls you in to advise him on the incidence of such a tax. He is particularly interested in who will bear this tax in the short run (one month) and in the long run (five years).

   a. What is the incidence of the tax in the short run? Answer intuitively, and use a diagram if possible.

   b. What is the long-run incidence? Once again, use a diagram if possible.

   c. How would your analysis in (b) change if hotels/motels in the suburbs were perfect substitutes for those in Malaise? What would happen to tax revenues?

4. Exercise 12 on page 607: Gruber and Krueger (1991) found that mandated increases in the costs of workers’ compensation benefits in the 1970s and 1980s led to substantial wage offsets for workers. Some of the wage reductions they found were even larger than the total cost to firms of providing the additional benefits. What does this suggest about the deadweight loss from the implicit “benefit tax” involved in imposing these mandatory benefits?