

Group Exercise #2

Name:

1) An article in the September 1, 2000 issue of the *Denver Post* had the headline “It’s official: Tax for kids on city ballot.” The article stated:

“Denver Mayor Wellington Web signed a bill Wednesday that puts a referendum on the November ballot for .2 percent sales tax increase . . . The money raised by the tax, which is estimated to be as much as \$30 million in the first year, is earmarked for early childhood education, youth health care programs and before- and after-school activities.”

Sales taxes are levied on the purchase of physical goods in a retail setting, but not on services. Everyone, rich and poor, pays the same sales tax rate on the goods they purchase. Consider the likely consumption bundles (in terms of goods and services) of the rich and poor.

- a) Who is likely to spend a larger fraction of their income on things that will be subject to sales tax, the rich or the poor? Why?
 - b) Is the sales tax progressive, regressive or income neutral? (hint: make sure you take into account your answer to part a)
 - c) Without considering who gets the money once it is raised, would this tax increase cause inequality to increase, decrease or stay the same? Why?
 - d) Do you think a sales tax increase is a sensible way to raise revenue to fund programs for the poor?
- 2) Below is a graph of charitable contributions by household income from the 7/24/00 issue of *Time*.
- a) Should contributions to charity be excluded from measures of income when calculating income inequality statistics? Why or why not? (Be explicit about your reasoning. It is more important than whether you answer yes or no.)
 - b) If charitable contributions are subtracted from income, will the statistics show more or less inequality? Why?

