

Lesson 18: Sales and Income Taxes

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1. Lesson 18: Sales and Income Taxes

4. Chapter: Lesson 18: Sales and Income Taxes

1. Lesson 18: Sales and Income Taxes Questions

4.1.1. *Does economics conclude that government spending is bad?

Author: Robert Murphy

*Does economics conclude that government spending is bad?

- No, economics simply points out that resources will be directed to different projects when the government spends money.
The goods and services produced because of government spending come at the expense of other goods and services that now will never exist. Economics per se can't say that one pattern of output is better or worse than the other, but it reminds us that there is a tradeoff, an opportunity cost to the government's actions.

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4.1.2. How do we know that government spending diverts resources from the ...

Author: Robert Murphy

How do we know that government spending diverts resources from the private sector? Does it matter how the government obtained its funds?

- We know government spending diverts resources, because we can see that actual resources are consumed (or at least devoted to a specific end) when the government spends money. Those resources can't physically be used for private projects (at least in most cases). At this level of analysis, it doesn't matter how the government obtained its funds; its spending necessarily commits resources to particular projects and thereby makes them unavailable for entrepreneurs in the private sector.

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4.1.3. **If the government builds a library, do we know that the private s...

Author: Robert Murphy

**If the government builds a library, do we know that the private sector wouldn't have built a library instead?

- This is a subtle question. Generally speaking, we can say that the government directs resources in different ways from how the private sector would; otherwise, there would be no point to government programs. However, it doesn't follow that entire categories of government services (such as old-age pensions or "free" libraries) exist in a vacuum left by the private sector. If the government didn't build any libraries—and especially if it lowered taxes accordingly by the amount it currently spends on libraries—then charitable groups would probably develop an alternative in the voluntary market sector. The market-produced "free" libraries would probably be much more modest in terms of the physical structures, especially in urban areas with high real estate prices, but it's likely that they would be more useful to their actual customers. At the very least, they would provide more useful services per dollar spent.

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4.1.4. If the government raises a modest amount of money through taxation,...

Author: Robert Murphy

If the government raises a modest amount of money through taxation, do we know that the tax burden is light?

- Not necessarily, as the example of a 200% income tax shows.

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4.1.5. As long as people continue working, does the income tax have little...

Author: Robert Murphy

As long as people continue working, does the income tax have little effect on the economy?

- Not necessarily, as the example of a worker considering a job in New York City shows

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4.1.6. Discuss the difference in economic efficiency between Disney spendi...

Author: Robert Murphy

Discuss the difference in economic efficiency between Disney spending \$10 million to improve Disneyland and the government spending \$10 million to build a bomber.

- Disney is guided by profit and loss. Its executives are only spending the money because they think consumers will value the improvements more than the expense, meaning that resources will be tend to be efficiently used. In contrast, the government has no idea how much extra value the public gets from an additional bomber, and therefore has no guidance on whether it is spending tax dollars wisely.

Sample Partial Credit Answer

The government gets no feedback on its spending.

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4.1.7. Explain why political authorities in an interventionist economy can...

Author: Robert Murphy

Explain why political authorities in an interventionist economy cannot objectively measure how much their citizens benefit from their expenditures.

- Most government services are paid out of general revenues, which are taken involuntarily from the citizens. Then, the services are often provided with a low or zero price. The citizens' desires for resources to go into one area versus another are thus virtually ignored.
Sample Partial Credit Answer
The government doesn't have real competition, so the public has to take whatever it gives them.

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4.1.8. Sometimes the government spends money to build something (e.g., a l...

Author: Robert Murphy

Sometimes the government spends money to build something (e.g., a library) because entrepreneurs won't do it themselves.

Does this prove that the government spending is a good thing?

- No, because we aren't seeing the opportunity cost of the project. The resources going into the library would otherwise have produced different goods and services that the consumers valued more (since the private sector wouldn't have built the library on its own). If the library were a gift from Martians, it would be valuable, but it isn't worth the potential goods and services that now will never be produced.
Sample Partial Credit Answer
No, because people in the private sector could've built something else.

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4.1.9. Identify the three typical methods by which governments raise money.

Author: Robert Murphy

Identify the three typical methods by which governments raise money.

- Taxation, borrowing, and inflation.

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4.1.10. Explain why high sales tax rates fuel black market economies.

Author: Robert Murphy

Explain why high sales tax rates fuel black market economies.

- The high sales tax rate gives an incentive for sellers and buyers to keep transactions "off the books" or "under the table."

By hiding sales, the participants don't have to report the transaction and therefore don't pay the tax.

This allows both buyer and seller to walk away with more money than if they had complied with the tax code.

Sample Partial Credit Answer

People hide their transactions to escape the tax.

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4.1.11. Suppose that there are two income tax brackets.
Income up to \$100,0...

Author: Robert Murphy

Suppose that there are two income tax brackets.

Income up to \$100,000 is taxed at 10 percent, while income higher than that is taxed at 20 percent.

Mary originally earns \$99,000, but then gets a raise and now earns \$101,000.

How much total tax does Mary owe the government in each scenario? Has the raise pushed Mary into a higher tax bracket?

If so, is she worse off (assuming she only cares about her takehome salary)?

- Originally Mary pays $10\% \times \$99,000 = \$9,900$ in tax.
After her raise, she pays $(10\% \times \$100,000) + (20\% \times \$1,000) = \$10,000 + \$200 = \$10,200$ in tax.
Yes, the raise pushed her into the higher tax bracket.
No, Mary isn't worse off, because originally her take-home salary was $\$99,000 - \$9,900 = \$89,100$, but after her raise it's $\$101,000 - \$10,200 = \$90,800$

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