

The Rich Can't Pay for Obama Care
ECON 1a extra credit opportunity, Spring 2010

This extra credit assignment is worth up to one full percentage point on your final course grade. As a reminder, total extra credit including Provocative Lectures is capped at 1.5%.

This assignment is based on an article in the Wall St. Journal of Mar. 30, 2010 by Alan Reynolds entitled "The Rich Can't Pay for Obama Care." If you can't find the article on-line (because the WSJ charges for access to its articles) you can get one by sending an email request to your instructor.

The arguments Reynolds makes are an example of "supply-side" economics which emphasizes the incentives put in place by increases or decreases in tax rates. Reynolds argues that the rate increases on the "rich" that are proposed by Obama will produce far less than proportionate tax revenue increases.

The assignment is to write a paper analyzing Reynolds' arguments. The paper should be roughly 1,000 to 2,000 words in length and be free of spelling or grammar errors. The point of the paper is not so much to express agreement or disagreement with Reynolds (though you may do so) as to analyze his arguments. The paper should include the following

- Definitions of "tax rate" and "tax revenue."
- A summary of the four kinds of tax rate increases proposed by Obama.
- The historical record of the effects of tax rate increases and decreases in terms of revenues generated.
- Some of the ways taxpayers will dodge the Obama tax increases. Although Reynolds lists only legal means of reducing taxable income, might some people also resort to illegal means?
- Verbal and algebraic definitions of the term "elasticity of taxable income" (ETI). This elasticity is the ratio of the percentage decrease in taxable income to the percentage increase in tax rates. (Note: the denominator is a percent of a percent. Thus if some tax rate is raised from 20% to 30%, the percentage increase in that rate is $(30-20)/20 \times 100\% = 50\%$.)
item Provide sample calculations pertaining to a group of high-income people who currently report \$10 billion in taxable income and are subject to a 35% average tax rate. Now assume the tax rate is increased to 40%. Calculate the increase or decrease in tax revenue resulting from this rate increase under these assumptions
 - Perfectly elastic ETI.
 - $ETI=0.5$
 - $ETI=1.0$
 - $ETI=1.2$
 - Very high ETI (verbal answer)

- Summarize Reynolds' conclusion about the likelihood that the Obama health care plan can be paid for by taxing "the rich." Add your own comments and conclusions if you like.
- Although Reynolds does not mention this, tax rate increases cause "collateral damage." Even though a rate increase might leave tax revenues unchanged, this does not mean society as a whole is no better off or worse off. Thinking about the steps that people take to avoid taxes, comment on the productive activity that is lost to society.

Type your paper and submit a printed copy to me in class. Be sure to check spelling and grammar. I believe there is a Writing Center somewhere in Clark Hall that can help you. The deadline for papers is Wed. May 12.