

Economics 5300 : Public Economics I  
Midterm Exam : October 16 1996

time = 1 hour

Do all 3 questions. All count equally.

1. Discuss ( as precisely as possible ) the policy choice of a “Rawlsian” decision maker ( i.e. one wishing to maximize the well-being of the worst-off person in the society ), if the only fiscal instruments are a proportional sales tax, and a head tax ( which may be negative ).

2. Discuss the effect of an interest income tax on the savings of a person whose utility function could be written

$$U(C_Y, C_O) = C_O - e^{-aC_Y}$$

where  $C_Y$  is the person’s consumption when young,  $C_O$  her consumption when old and  $a$  is a positive parameter, if she has a fixed income, which is earned when she is young.

3. Would introduction of an old-age pension, funded by a tax on workers’ earnings, be a good idea in the long run? Explain briefly.