Econ 131

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Assignment 6
Due at the beginning of Class, May 31, 2017

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Students are encouraged to work on assignments in small groups of no more than four students. Assignments *must be written up separately* and *must* include the names of the other group members. Assignments should be handed in at the beginning of class on the due date. Late assignments will not be accepted under any circumstances.

1. School Finance Equalization

Consider the town of Lexington, which is choosing between spending on education and spending on all other private goods. Suppose the town has a total of $2 million to spend.

(a) Now suppose that the state government tells Lexington that any funds allocated toward education above the amount of $750,000 will be taken by the state government. Draw Lexington's budget constraint under this scenario.

(b) Suppose Lexington was spending $200,000 on education before the policy. What is the tax price of educational spending after the policy? How much will Lexington spend on education? How much will it spend on all other goods?

(c) Suppose instead that the state government decides to take away only $0.60 for every $1 Lexington allocates to education above $750,000. Draw Lexington's budget constraint under this scenario.

(d) Suppose Lexington was spending $1,000,000 on education before the policy (when there was no interference by the state government). What is the tax price of educational spending after the policy?

(e) Again suppose Lexington was spending $1,000,000 on education before the policy. Will the *income* effect of the policy cause Lexington to spend more or less on education? Will it cause Lexington to spend more or less on all other goods? Explain.

(f) Again suppose Lexington was spending $1,000,000 on education before the policy. Will the *substitution* effect of the policy cause Lexington to spend more or less on education? Will it cause Lexington to spend more or less on all other goods? Explain.

(g) Again suppose Lexington was spending $1,000,000 on education before the policy. At Lexington's new optimal point with the policy (wherever it is), will it spend more or less on education than before the policy in (c) was put into place? Will it spend more or less on all other goods?

(h) Now consider school finance equalization programs more generally. Suppose that after a school finance equalization program there is greater equality in test scores (and other student outcomes) across districts (recipient districts and those that are taxed to provide funds). Why might this not be sufficient evidence to conclude that the program was a success? Explain (2-3 sentences)

2. Estate Taxation

After considering the material from class and the readings, what position would *you* take on repealing the estate tax in the US? Please summarize what you see as the key arguments in favor and against repeal and then explain how you weighed these arguments in coming to your decision (200-300 words).