

Practice Questions

Question 1: A city charges residents a fee for collecting household waste based on the volume of bins used. How does this differ from a tax?

- a) It does not differ — any compulsory payment to the state is a tax by definition
 - b) It is a fee because there is a direct correspondence between the payment and the service received
 - c) It is a tax because it is paid to a public authority and is legally binding
 - d) It is a social contribution because it funds a public service consumed by all citizens
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Question 2: A tax system has very low administrative costs but is widely seen as unfair and poorly understood by citizens. Which two desirable characteristics does it fail on?

- a) Efficiency and flexibility
 - b) Equity and transparency
 - c) Financial effectiveness and flexibility
 - d) Low administrative costs and financial effectiveness
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Question 3: A good is taxed and a new equilibrium is reached. The government collects €10 million in revenue, but the total welfare loss to consumers and producers is €13 million. What does the €3 million difference represent?

- a) The administrative cost of collecting the tax
 - b) The excess burden — the welfare loss not captured by anyone, caused by transactions that no longer take place
 - c) The income effect of the tax on consumer purchasing power
 - d) The producer surplus transferred to the government through the tax
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Question 4: Why does a lump sum tax produce no substitution effect, while a tax on labour income does?

- a) Because a lump sum tax reduces income more than a labour tax, leaving no room for substitution
 - b) Because a lump sum tax does not change the relative price of work versus leisure, so it cannot alter the choice between them
 - c) Because a lump sum tax is only paid once, so it does not affect ongoing decisions
 - d) Because a lump sum tax applies uniformly to all goods and therefore the substitution effects cancel out
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Question 5: A factory pollutes a nearby river. A Pigouvian tax equal to the marginal external damage is imposed on its output. What is the expected outcome?

- a) The factory shuts down because the tax makes production unprofitable
 - b) The tax raises revenue but has no effect on the factory's output decision
 - c) The factory reduces output to the socially efficient level, and the market outcome improves
 - d) The tax creates a deadweight loss equal to the external damage it aims to correct
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Question 6: Road tolls are often justified as an application of a particular tax equity principle. Which one, and why?

- a) Vertical equity, because higher-income drivers use roads more intensively
 - b) Horizontal equity, because all drivers using the same road pay the same amount
 - c) The benefits principle, because the payment is linked to the use of a specific public service
 - d) The ability to pay principle, because toll amounts are set based on vehicle value as a proxy for income
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Question 7: A per-unit tax is imposed on a good with perfectly elastic supply. Who bears the full economic burden?

- a) Producers, because they are legally required to remit the tax
 - b) The burden is shared equally between consumers and producers
 - c) Consumers, because perfectly elastic supply means producers cannot absorb any of the tax
 - d) Neither, because a perfectly elastic supply eliminates the excess burden entirely
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Question 8: A taxpayer's income rises from €30,000 to €50,000 and their average tax rate increases from 22% to 27%. What type of tax does this describe?

- a) Regressive, because the marginal rate exceeds the average rate
 - b) Proportional, because the taxpayer pays more in absolute terms
 - c) Progressive, because the average tax rate rises as income increases
 - d) Progressive, because the marginal rate equals the average rate at the new income level
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Question 9: From an efficiency standpoint, it makes sense to tax inelastic goods heavily. From an equity standpoint, the same policy may be undesirable. What best explains this conflict?

- a) Inelastic goods generate too much excess burden, making them inefficient to tax
 - b) Heavily taxing inelastic goods violates horizontal equity by treating similar taxpayers differently
 - c) Inelastic goods are often necessities consumed more by lower-income households, so taxing them heavily is regressive
 - d) The Laffer curve implies that taxing inelastic goods too heavily will reduce total revenue
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Question 10: A single taxpayer has a taxable income of €30,000 and a marginal rate of 34.9%. Their average rate is approximately 20.6%. What explains the gap between the two rates?

- a) The conjugal quotient reduces the effective rate below the statutory marginal rate
 - b) Tax deductions reduce the tax liability, closing the gap between marginal and average rates
 - c) In a progressive system, lower income brackets are taxed at lower rates, so the average rate is pulled below the top marginal rate
 - d) The marginal rate applies only to non-labour income, while the average rate covers all income types
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