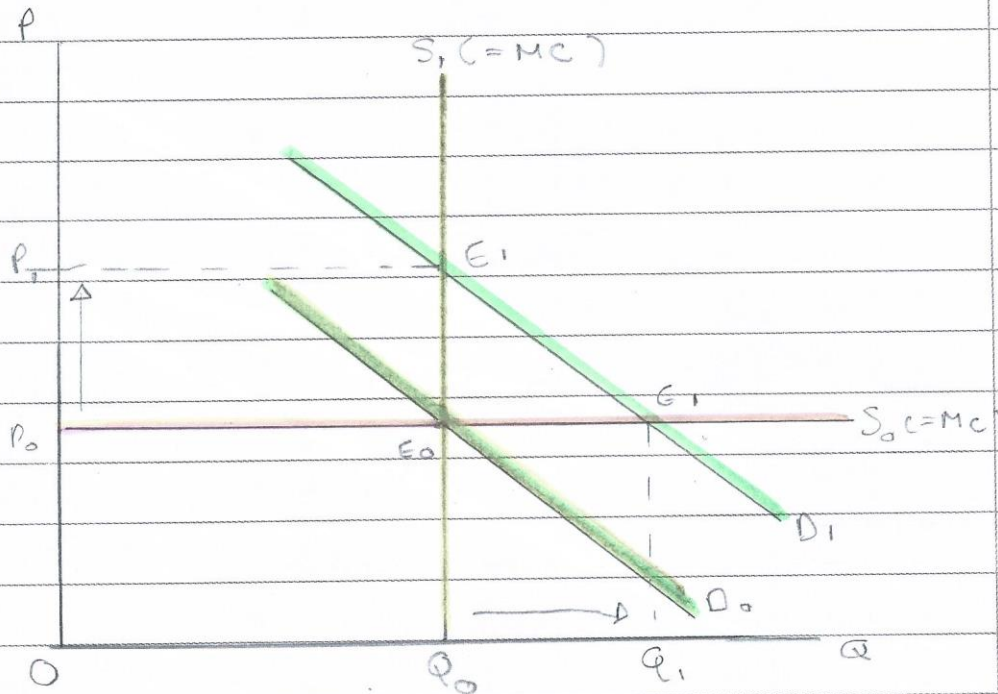




SU 7 :

- 1) Use a dig. to explain potential benefits of a govt. housing subsidy for poor buyers if ^{housing} supply is
(i) inelastic & (ii) elastic. (10) OCT 2012 Q6(b)

Q BANK



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THE IMPACT OF A HOUSING SUBSIDY

- o if S is perfectly inelastic (vertical) - S_{IR} case
 - purchasing power \uparrow
 - D curve shift (D_0 to D_1)
 - P of houses \uparrow (P_0 to P_1)
 - Benefit of subsidy shifted to existing homeowners (capital gains)
- o If S is perfectly elastic (horizontal) - S_{ER} case
 - D curve shift (D_0 to D_1)
 - $Q_{supplied} \uparrow$ (Q_0 to Q_1)
 - price unaffected
 - no shifting of benefit - new owners get the benefit of subsidy.

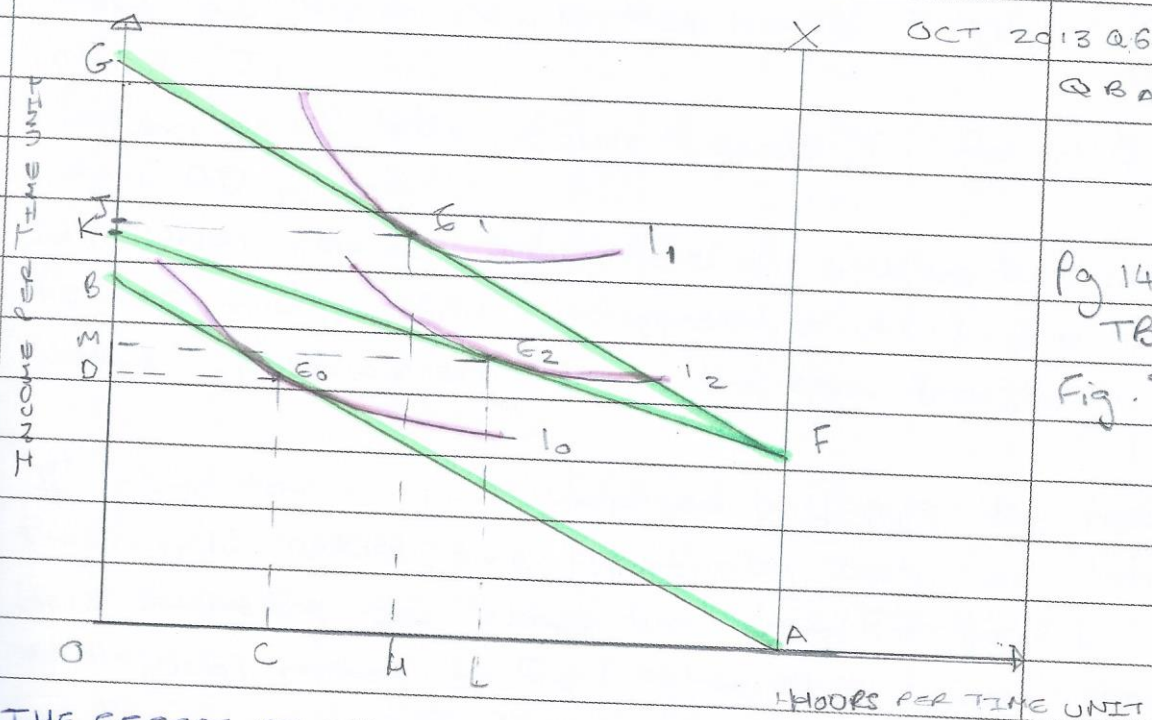


2) Explain with the use of a dig. what the effect of a cash transfer is on work effort. How does the funding of 1 cash transfer using a personal income tax, impact on work effort? (14)

MAY 2013 Q6 (a)

OCT 2013 Q6 (a)

Q BANK



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Fig. 85

THE EFFECT OF AN INCOME TRANSFER ON WORK EFFORT

- OA hours are available to the worker to allocate between work & leisure: time endowment
- Vertical line AX signifies that time endowment is fixed at all income levels.
- Line AB shows his combined budget & time constraint, where sacrificing leisure would allow him to earn a bigger wage income & ∴ to ↑ his consumption of goods.
- Initially equilibrium @ E0 on price line AB, given his indifference curve (I0) btwn goods (income) & leisure, sacrificing CA hours of leisure i.o.t. consume OD of goods.
- OD is value of goods which can be purchased with ↑ revenue earned by working AC hours & thus, assuming no saving, is equal to total income earned.

P.T.O



- If govt provides income transfer irrespective of its effect on individual work effort, the budget constraint shifts parallel to the right (FG).
- Now at E_1 on new budget line & higher indifference curve I_1 .
- Consumption of both leisure & goods \uparrow (OC to OH) & (OD to OJ).
- Individual now at higher level of welfare but works fewer hours (AH as opposed to AC). due to income effect arising from the cash transfer.
- If income tax is now imposed to finance the cash transfer, this would reduce the opportunity cost of leisure, thus swivelling the budget line from FG to FK.
- Individual moves to E_2 (where FK is tangent to indifference curve I_2). & work effort is further reduced to AL.
- Even lower than AH.

The combined effect of \uparrow cash transfer & taxation to fin

it is thus to reduce work incentives in 2 ways:

- neg. (income) effect CH of the cash transfer
- neg net (income & substitution) effect HL of \uparrow income tax.

3) A housing subsidy will always benefit poor people, do you agree? Explain your answer with \uparrow aid of a diagram (15)

Q BANK