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**College of Administrative and Financial Sciences**

**Assignment-2**

**Deadline: 05/11/2020 @ 23:59**

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| Course Name: Macroeconomics | Student’s Name: |
| Course Code: ECON201 | Student’s ID Number: |
| Semester: I | CRN: |
| Academic Year: 1441/1442 H | |

**For Instructor’s Use only**

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| --- | --- |
| Instructor’s Name: | |
| Students’ Grade: / **5** | Level of Marks: High/Middle/Low |

**Instructions – PLEASE READ THEM CAREFULLY**

* The Assignment must be submitted on Blackboard (**WORD format only**) via allocated folder.
* Assignments submitted through email will not be accepted.
* Students are advised to make their work clear and well presented, marks may be reduced for poor presentation. This includes filling your information on the cover page.
* Students must mention question number clearly in their answer.
* Late submission will NOT be accepted.
* Avoid plagiarism, the work should be in your own words, copying from students or other resources without proper referencing will result in ZERO marks. No exceptions.
* All answered must be typed using **Times New Roman (size 12, double-spaced)** font. No pictures containing text will be accepted and will be considered plagiarism).
* Submissions without this cover page will NOT be accepted.

**Assignment 2-Case Study-Chapters: 7, 8, 9 & 12 :** - **[5 Marks]**

**Case Study**

When taxes induce people to change their behavior—such as inducing Jane to buy less pizza—the taxes cause deadweight losses and make the allocation of resources less efficient. As we have already seen, much government revenue comes from the individual income tax in many countries. In a case study in Chapter 8, we discussed how this tax discourages people from working as hard as they otherwise might. Another inefficiency caused by this tax is that it discourages people from saving.

Consider a person 25 years’ old who is considering saving $1,000. If he puts this money in a savings account that earns 8 percent and leaves it there, he would have $21,720 when he retires at age 65. Yet if the government taxes one-fourth of his interest income each year, the effective interest rate is only 6 percent. After 40 years of earning 6 percent, the $1,000 grows to only $10,290, less than half of what it would have been without taxation. Thus, because interest income is taxed, saving is much less attractive.

Some economists advocate eliminating the current tax system’s disincentive toward saving by changing the basis of taxation. Rather than taxing the amount of income that people earn, the government could tax the amount that people spend.

Under this proposal, all income that is saved would not be taxed until the saving is later spent. This alternative system, called a *consumption tax,* would not distort people’s saving decisions.

Various provisions of the current tax code already make the tax system a bit like a consumption tax. Taxpayers can put a limited amount of their saving into special accounts—such as Individual Retirement Accounts and 401(k) plans—that escape taxation until the money is withdrawn at retirement. For people who do most of their saving through these retirement accounts, their tax bill is, in effect, based on their consumption rather than their income.

European countries tend to rely more on consumption taxes than does the United States. Most of them raise a significant amount of government revenue through a value-added tax, or a VAT. A VAT is like the retail sales tax that many U.S. states use, but rather than collecting all of the tax at the retail level when the consumer buys the final good, the government collects the tax in stages as the good is being produced (that is, as value is added by firms along the chain of production). Various U.S. policymakers have proposed that the tax code move further in direction of taxing consumption rather than income. In 2005, economist Alan Greenspan, then Chairman of the Federal Reserve, offered this advice to a presidential commission on tax reform: “As you know, many economists believe that a consumption tax would be best from the perspective of promoting economic growth—particularly if one were designing a tax system from scratch—because a consumption tax is likely to encourage saving and capital formation. However, getting from the current tax system to a consumption tax raises a challenging set of transition issues.”

**Q1: What should be taxed - Personal Income or Personal Consumption and why? Provide your opinion based on the case given below. (200 words) [2.5 Marks]**

**Q2: How may it affect Saudi Economy if an income tax is imposed in KSA? (200 words) [2.5 Marks]**