

Public Finance (Econ 431)
Spring 2012
Macalester College

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Office Hours: Monday 9:00-11:00 AM, Tuesday 1:45-3:00 PM, and by appointment
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Course Description and Objectives:

This course examines the economics of government policy. It relies on theoretical and empirical research to explore how government affects the allocation of resources and the distribution of income and to characterize optimal government policy. First, we consider the conditions under which the desire for efficiency or equity might justify government intervention in markets. In particular, we analyze optimal government responses to the presence of public goods and externalities, focusing on pollution control and education policy. We then consider what various approaches to social welfare imply for optimal income redistribution. Second, we examine the optimal provision of services and programs such as welfare assistance, health care, and social security, and the effects of these programs on labor supply, savings and investment, income distribution, and government revenue. Last, we analyze the distributional burdens of taxation, optimal commodity and income taxation, and current debates in tax research and policy.

Texts (Required):

Rosen, Harvey S. and Ted Gayer *Public Finance*, 9th edition (Boston: Irwin/McGraw Hill, 2010)

ISBN: 978-0-07-351135-1.

Slemrod, Joel and Jon Bakija. *Taxing Ourselves: A Citizen's Guide to the Debate over Taxes*, 4th edition (Cambridge: The MIT Press). **ISBN:** 978-0262693639.

Additional readings will be available on the course homepage or through one of two websites:

JSTOR: <http://www.jstor.org/cgi-bin/jstor/listjournal>

NBER: <http://papers.nber.org/>

Course Policies and Tips for Success:

The class itinerary is included in this syllabus. Please note exam dates and assignment due dates now. You may **reschedule an exam only** if you have a conflicting religious holiday. You must make arrangements to reschedule at least one week before the scheduled exam time.

The only excuses for a **missed exam** are verifiable medical emergencies or absences for those students who represent the College in college-sponsored activities as specified in Macalester's [*Class Attendance and Absences Policy*](#). In the event of an excused missed exam, a weighted average of the other exam grade and the research paper grade will serve as the grade of the missed exam. I do not accept late assignments or those handed in electronically (article summaries may be handed in electronically). All assignments are due at the beginning of the class period.

A substantial amount of course content will be presented only in class. I urge you to work together on your homework, but each of you must write up your own assignment. Homeworks are generally long, so starting them early and working on a section each day is a good idea. Read actively and write down questions. Visit me often to make sure that you are clear on ideas presented in class. Check your email regularly for class updates.

Prerequisites:

Economics 361, 371, and 381.

Academic Honesty:

Cheating on exams, copying another’s homework solutions, or failure to acknowledge the contributions of others’ work to your own are serious offenses. Cheating or failure to properly reference sources will result in a grade of **F** for the exam or assignment and **may result in a failing grade for the course**. All cheating and plagiarism will be reported to the Dean of Academic Programs. For additional information on academic honesty, please consult the MAX Center Academic Honesty sheet handed out in class and the *Student Handbook*. If you remain in doubt about what constitutes cheating or plagiarism, you must consult with me.

Grading:

Homework (6 total)	10%
Journal Article Summaries	10%
Research Paper and Presentations	35%
Exam 1: Take Home	20%
Exam 2: In Class	25%

Homework:

There will be six homework assignments designed to help you to prepare for the exams. They will consist of problem solving and short essays, and will count for 10% of the final grade.

Journal Article Summaries:

A written summary of 12 of 16 readings indicated by an (*) will be due via email at the beginning of the class period in which the reading is to be discussed. You choose which 12 to summarize. The summaries will be graded on a pass/fail basis, and 10% of the final grade is based on them. Exams will draw on material from these summaries. Guidelines will be handed out separately.

Papers and Presentation:

Each student will complete a research paper on an economic issue that is relevant to public finance. This project is to be done in five stages. The five stages, percentages of final grade allocated to each stage (for a total of 35%) are below. If you would like to propose an alternative format (so as to better complement work on an honors thesis or other previous, current or future work, for example) please talk with me before handing in your project proposal.

	<u>% of Grade</u>
1. Project Proposal (2 pages)	} 10%
2. Literature Review (4-6 pages)	
3. Theoretical Model (3-5 pages)	
4. Step IV: Varies by Project Type (3-5 pages)	
5. Final Paper (14-18 pages)	20%
6. Presentations (3, each 8-10 minutes)	5%

All written submissions should be double-spaced and of 12 point Times New Roman font, have one-inch margins, and include references. All sources must be properly cited. Please include page numbers. Please print papers double-sided, preferably on recycled paper, or single-sided on used paper. The page maximum is not negotiable; the limit INCLUDING references, tables, graphs and figures, is 18 pages. **Papers that do not conform to these specifications will receive zero points. For the final paper, each spelling error after the fifth error will result in one drop of a grade (from B to B-, for example).** A simple way to find typos and errors is to read your paper aloud. Due to problems with software compatibility and server reliability, I do not accept electronic versions.

Paper Guidelines

A. Three types of papers are acceptable:

- (1) A paper that uses economics to analyze the efficiency or equity of an existing federal, state, or local expenditure program or tax policy, and proposes one substantial way in which the policy could be improved.
- (2) A paper that makes an empirical contribution to the literature. This would be a paper that is like the paper you wrote for econometrics, but is on a public finance topic and has a better-developed theory section.
- (3) A paper that makes a theoretical contribution to the literature. For this paper you would replicate and extend an existing theoretical (mathematical) economic model that can be used to shed light on a specific public finance policy.

B. Each project will involve the following stages:

I. Project Proposal (2 pages)

This proposal should be written in complete paragraphs, not in an outline.

- (1) Explain the policy that you would like to analyze, state the question that you would like to answer, or exposit the hypothesis that you would like to test.
- (2) Use relevant statistics to provide motivation for the study.
- (3) Present your research strategy.
- (4) If you are doing paper option 2, describe your data sources.
- (5) Include a bibliography.

II. Literature Review (4-6 pages)

- (1) Summarize the papers that relate directly to your research, and explain exactly how each paper relates to your policy, hypothesis, or question.
- (2) Identify the gaps in the literature that your research fills, or how your research challenges previous results.

III. Theoretical Model (3-5 pages)

There are four reasonable levels of possible effort and complexity for this section (A through D):

(A) Option A is the very minimal effort on this section. It entails a graphical depiction of a theoretical model whose implications are relevant for the policy you analyze, match those of your hypothesis, or whose ambiguous results you hope to illuminate.

(B) Option B is an average effort that entails writing down and explaining the main equations from a theoretical model that someone else has used, and explain how you will use the model to analyze your policy or motivate your empirical work. You should type all equations.

(C) This better than average effort entails full derivation of a model that you would like to use. It would be based on someone else's model, but you would walk through all of the steps to derive it. You may hand in a hand-written derivation if you would like. Your final paper, though, would have the main equations typed, and an explanation of their derivation in words.

(D) This much better than average effort entails modifying an existing model to make it your own, and deriving its testable implications. Very rarely, you would start from scratch (using microeconomic or other suitable theory) and derive a fully new approach to a problem. In this case, I would expect more from the theory section and little from the empirical or policy reform section. You may hand in a hand-written derivation if you would like. Your final paper, though, would have the main equations typed, and an explanation of their derivation in words.

Under some circumstances, I am willing to entertain the idea of not using any math in the paper. Sometimes the best ideas are expressed most appropriately using only words. Please visit me if you would like to not use a mathematical model.

IV. Policy Critique, Summary Statistics or Model Extension (3-5 pages)

Paper type (1): If you are analyzing an existing policy, critique the policy using well-defined criteria that flow from your theory section and are supported (or refuted) by empirical evidence.

OR

Paper type (2): If your contribution to the literature is empirical:

- (a) Describe the data that you would use to test your hypothesis or answer your question. Describe the “ideal” data, and the existing data that comes as close to the ideal as possible.
- (b) Calculate summary statistics using the “closest to ideal” data. These should include means and standard deviations of your variables of interest and preliminary analysis of the relationships among your variables (e.g. using scatter plots or correlation coefficients).

OR

Paper type (3): If your contribution is theoretical:

- (a) Hand in a preliminary derivation of your extension to a theoretical model.
- (b) Provide intuitive explanation for the results of your model.

V. Final Paper (14-18 pages including references, tables, and figures)

Your final paper should include the following sections. While the Introduction and References need not be titled or numbered, all other sections should have their own headings and be numbered with roman numerals. The headings should be specific to your topic.

Introduction (1-2 pages)

- (1) Your first paragraph should use relevant statistics to motivate your topic and draw in the reader. It should end with a brief statement of your question or hypothesis.
- (2) Your second paragraph should provide further clarification of your question if necessary.
- (3) Your third paragraph should briefly explain the method that you use to answer your question and the results of your analysis. Be very brief here.
- (4) The last paragraph of the introduction should tell the reader what each of the subsequent sections of the paper contains.

I. Theory (3-5 pages)

II. Policy Critique, Empirical Evidence or Extension to Theoretical Model (3-5 pages)

This includes final results that move beyond what you did for step IV above.

III. Conclusion (1-2 pages)

- (1) Briefly summarize the results of your analysis.
- (2) Explain how your research contributes to the literature on your topic.
- (3) List any caveats to your conclusions.
- (4) Describe directions for future research.

References: A list of sources directly cited in the text of your paper. You may single-space these.

Examples of policy areas (there are many more):

Social security reform
Health care reform
Optimal degree of progressivity in the income tax system
Taxes versus permits for greenhouse gas reduction
Optimal obesity policy
Subsidies in agriculture
Corporate tax reform
Policies to contain urban sprawl
Sin taxes
Policies for the reduction of gasoline consumption
Sex education policies
Value added taxation
Estate tax
Welfare to work
Charter schools
Education vouchers
Teacher quality and student outcomes
Policies for the education of women in developing countries
Consumption (“flat”) tax
Funding of sports stadiums
Equalization of funding across school districts
“No Child Left Behind”
Optimal ethanol subsidy (or tax)

Some empirical and theoretical paper topics from previous semesters:

How did welfare reform affect caseloads?
What is the effect of open space (parks, etc.) on home values?
Do state tax policies affect the rate of growth of state GDP?
How do labor market forces affect children’s health outcomes in developing countries?
Have hospital mergers reduced costs?
What is the optimal policy for the control of nonpoint source water pollution in the Great Lakes?
What are the social benefits of government provided child care?
Does the provision of public housing change neighborhood composition?
How does federal tax policy affect entrepreneurship?
How do cigarette taxes affect demand?
Do charter schools in the Twin Cities perform better than public schools?

For more paper ideas, browse the following journals and websites and talk with me:

Journal of Public Economics, National Tax Journal, International Tax and Public Finance, Journal of Economic Perspectives, American Economic Review, Journal of Political Economy, Journal of Urban Economics, Journal of Environmental Economics and Management

The Tax Policy Center: <http://www.taxpolicycenter.org/>

Brookings Institution: <http://www.brookings.edu>

Congressional Budget Office: <http://www.cbo.gov>

National Bureau of Economic Research: <http://www.nber.org>

Tentative Course Schedule and Readings (Subject to Change)

		<u>Due</u>
Introduction and Tools from Microeconomics		
23-Jan	Rosen and Gayer, Chaps. 1, 2	
25-Jan	Microeconomics Review (Sent via email)	
27-Jan	Rosen and Gayer, Chap. 3	Meet/email to discuss paper idea
Public Goods and Externalities		
30-Jan	Rosen and Gayer, Chap. 4 and Samuelson solution handout	
1-Feb	Rosen and Gayer, Chap. 5	HW 1
3-Feb	*Fullerton, Don and Sarah West, "Can Taxes on Cars and on Gasoline Mimic an Unavailable Tax on Emissions?" <i>Journal of Environmental Economics and Management</i> 42 (January 2002): 135-157. (Course Homepage)	
Education		
6-Feb	Rosen and Gayer, Chap. 7	Proposal
8-Feb	*Hanushek, Eric, "Publicly Provided Education," NBER Working Paper No. 8799 (February 2002) also in <i>Handbook of Public Economics</i> 4. (NBER)	
10-Feb	*Card, David and Alan B. Krueger, "Does School Quality Matter? Returns to Education and the Characteristics of Public Schools in the United States," <i>Journal of Political Economy</i> , 100 (February 1992): 1-40. (JSTOR)	
Education, Presentations		
13-Feb	*West, Kristine Lamm, "Complementarity of Incentive Pay and Decentralized Decision Making: Evidence from Minnesota's Q-Comp Program for Teachers," Working Paper (Course Homepage)	
15-Feb	Presentations: Refined Proposal and Literature Review	HW 2
17-Feb	Presentations: Refined Proposal and Literature Review	
Income Redistribution		
20-Feb	Rosen and Gayer, Chap. 12	
22-Feb	*Rawls, John, "Some Reasons for the Maximin Criterion," <i>American Economic Review</i> 64 (May 1974): 141-146. (JSTOR)	
24-Feb	*Thurow, Lester, "The Income Distribution as a Pure Public Good," <i>Quarterly Journal of Economics</i> (May 1971): 327-336. (JSTOR)	Literature Review
Exam, Expenditure Programs for the Poor		
27-Feb	Exam Review, Exam 1 (take home)	HW3
29-Feb	Exam 1 Due	
2-Mar	Rosen and Gayer, Chap. 13	

Expenditure Programs for the Poor		<u>Due</u>
5-Mar	"Hours of Work," from Kaufman, Bruce E. and Julie Hotchkiss, <i>The Economics of Labor Markets</i> (Fort Worth: Dryden Press, 1999). (Handout)	
7-Mar	*Goodman-Bacon, Andrew, '05. "Welfare Caseloads and the 2001 Recession," (Course Homepage)	
9-Mar	*Bitler, Marianne and Hilary Hoynes, "The State of the Social Safety Net in the Post-Welfare Reform Era," Brookings Papers on Economic Activity, Fall 2010. (Course Homepage)	Theory
Spring Break: March 12-16		
Tax Incidence		
19-Mar	Rosen and Gayer, Chap. 14	
21-Mar	*West, Sarah, "Equity Implications of Vehicle Emissions Taxes," <i>Journal of Transport Economics and Policy</i> , 39 (1), (January 2005): 1-24 (Course Homepage) .	
23-Mar	*Sallee, James '02, "The Surprising Incidence of Tax Credits for the Toyota Prius," <i>American Economic Journal: Economic Policy</i> (Course Homepage) .	HW4
Tax Incidence, Presentations		
26-Mar	The Harberger Model. Notes will be handed out in class.	
28-Mar	Presentations: Refined Theory and Step IV	
30-Mar	Presentations: Refined Theory and Step IV	
Taxation: Equity and Efficiency		
2-Apr	Rosen and Gayer, Chap. 15 (Measuring Excess Burden)	Step IV
4-Apr	Rosen and Gayer, Chap. 16 (Ramsey Rule for Optimal Commodity Taxation)	
6-Apr	Rosen and Gayer, Chap. 16 (Optimal Income Taxation)	
Optimal Income Taxation, U.S. Income Taxation		
9-Apr	*Stern, Nicholas, "The Theory of Optimal Commodity and Income Taxation: An Introduction," in <i>The Theory of Taxation for Developing Countries</i> , Newbery and Stern, eds. (New York: Oxford University Press, 1987). Focus on pp. 35-43.	HW5
11-Apr	The U.S. Income Tax System: Rosen and Gayer, Chapter 17 and *Slemrod and Bakija, Chaps. 1 and 2.	
13-Apr	*The Income Tax and Fairness: Slemrod and Bakija, Chap. 3	

Due

Income Taxation: Evidence and Reform

16-Apr *Honors defense day. Attend one defense and summarize by April 23 to receive credit for one article summary.

18-Apr The Income Tax and Efficiency: Rosen and Gayer Chap. 18, and *Slemrod and Bakija Chap. 4

20-Apr Tax Reform: Rosen and Gayer Chap. 21, and *Slemrod and Bakija Chaps. 6 and 7

**Optional
Draft**

Exam, Presentations

23-Apr Summary, Review

HW6

25-Apr **Exam 2: In Class**

27-Apr Presentations: Final

Presentations, Final Paper

30-Apr Presentations: Final

2-May Final Paper Due by 4 PM

**Final
Paper**