Course Requirements: Final examination (50%) and a short paper on one of the topics from Part II of the syllabus (50%). I encourage you to present your paper to the class, although the presentation is optional and I will only grade your paper, not your presentation. The paper is due on the day of the last class meeting.


Two other frequently cited reference texts are:


The syllabus contains two parts. Part I covers the theoretical foundations of classical, first-best public sector analysis. Part II offers readings on a number of topics of recent professional interest. The topics in Part II are mostly empirical and are not always discussed in my text. We will consider a selection of them, approximately in the order listed below.

I. The First-Best Theory of the Public Sector

A. Background and Overview—Issues and Methods

   Tresch, Chs. 1-3.
   Also: Atkinson, Stiglitz, Ch. 11

B. The Social Welfare Function

   1. Arrow's Impossibility Theorem and Majority Voting Difficulties
       Tresch, Ch. 3.
       Also for reference:
       R. Boadway and D. Wildasin, *Public Sector Economics*, Ch. 6, pp. 138-154; Ch. 10, pp. 269-277.
       U. Segal, "Let's Agree That All Dictatorships are Equally Bad," *Journal of Political Economy*, June, 2000. (Segal's attempt to rescue a simple weighted social welfare function, which I find convincing and important.)
C. Public Expenditure Theory

1. Externalities and Public Goods

   Tresch, Chs. 5-8.

2. Decreasing Cost Production

   Tresch, Ch. 9.

D. First-best Tax Theory--Equity in Taxation

1. Underlying Theory

   Tresch, Ch. 10.
   Also: Atkinson, Stiglitz, Ch. 11, pp. 333-343.

2. The Public Choice Perspective--Self-interested Redistribution

   a. Overview


   b. Pareto-optimal redistribution

      Tresch, Ch. 10.
      Also, for variations:

   c. Public insurance

      L. Friedman, Microeconomic Policy Analysis, Ch. 6.
      R. Boadway and D. Wildasin, Public Sector Economics, Ch. 14 on Social Insurance.

   d. Voting for transfers to oneself

3. Towards Application--Horizontal and Vertical Equity

Tresch, Ch. 11.
Also:
Atkinson, Stiglitz, Ch. 11, pp. 350-356.
R. Musgrave, "Horizontal Equity, Once More," National Tax
S. Sheffrin, "What Does the Public Believe About Tax Fairness?"
National Tax Journal, September 1993, pp. 301-303
L. Kaplow, "On the Divergence Between "Ideal" and Conventional
taxing labor income in the Haig-Simons tradition.)
E. Plug, B. van Praag, J. Hartog, "If We Knew Ability, How
Would We Tax Individuals?", Journal of Public Economics, May, 1999. (Does this give
one hope that lump-sum taxation is practicable?)

E. Fiscal Federalism

1. The Sorting of Functions: Which Governments Do What?

Tresch (original text), Chs. 29, 30 (primarily Ch. 30).
D. Rubinfeld, "The Economics of the Local Public Sector," Ch. 11
D. Wildasin, "Theoretical Analysis of Local Public Economics,
Ch. 29. in E. Mills (ed.), Handbook of Regional and Urban Economics, Vol. 2 (especially
sections 2,3,4).

2. The Sorting of People: Jurisdiction Formation and Mobility With Public
Goods Supply

Tresch (original text), Ch. 29.
D. Rubinfeld, "The Economics of the Local Public Sector," in
and R. Inman (eds.). The Economics of Public Services. (Difficult going, but a classic,
worth some effort. Reproduced in abridged form in Atkinson,Stiglitz, Ch. 17. The
original is clearer).
T. Bewley, "A Critique of Tiebout's Theory of Local Public
B. Hohaus, et.al., "Too Much Conformity? A Hotelling Model of
Public Goods Supply," Economic Letters, 44/3, 1994 (Follows the Pauly model in my
text).

For reference: Two sophisticated, current generation models of the
location decision, and an empirical study based on location theory. Very difficult, but
worth careful study if you become interested in these types of models.
D. Epple, et. al., "Existence of Voting and Housing Equilibrium In
a System of Communities With Property Taxes," Regional Science and Urban Economics,
November 1993.
J. Henderson, "Community Choice of Revenue Instruments,"
D. Epple, H. Sieg, "Estimating Equilibrium Models of Local
Additional wrinkles, for reference:

Finally, the following three papers use a modelling approach that incorporates a broad spectrum of the federalism literature. The first considers efficiency, the second adds equity, and the third is an empirical exercise that supports the approach:

a. The distribution function and mobility

W. Johnson, "Income Redistribution in a Federal System," *AER*, June, 1988, along with his empirical study:
D. Epple, T. Romer, "Mobility and Redistribution," *Journal of Political Economy*, August, 1991. (An earlier related paper using the same type of model that explores the problem of establishing an equilibrium with public goods is:
3. The Role of Grants-in-Aid in a Federalist System

   Tresch (original text), Ch. 31, pp. 601-606, 614-642.
   J. Alm, "The Optimal Structure of Intergovernmental Grants," Public Finance Quarterly, October, 1983, or

4. Centralized vs. decentralized governments

   J. Wilson, "Theories of Tax Competition," National Tax Journal, June, 1999. (An excellent survey and starting point on this topic, which relates specifically to potential problems with local taxation)

F. Postscript on First-best Theory

   How useful is first-best theory? Not very, according to Peter Hammonds. See:
   P. Hammonds, "Theoretical Progress in Public Economics: A Provocative Assessment," Oxford Economic Papers, January, 1990 (Special Issue on Public Economics--incidentally, OEP runs occasional special issues on a variety of topics and fields).
   I think Hammonds' viewpoint is too limited. If you agree with Hammonds, though, Richard Arnott will take you down some of Hammonds' preferred second-best roadways next term.
II. Selected Topics (in approximate order of presentation)

A. The Social Welfare Function in Empirical Analysis
   Tresch, Ch. 4.

   A related paper of interest on consumption and social welfare that I did not reference in the text is:

B. Policy Issues in the Control of Pollution
   Tresch, Ch. 8

   Other studies of interest not referenced in Ch. 8, by topic:

1. Current U.S. Policy


2. Direct Controls, Taxes, and Marketable Permits


3. On the Benefits of Reducing Pollution

   Another instance of how little we know about environmental damage relates to the current concern about global warming. See the Symposium on "Global Climate Change" in the Journal of Economic Perspectives, Fall 1993, particularly the articles by W. Nordhaus and J. Poterba.
C. The Free Rider Problem

Tresch, Ch. 6.

Free riding behavior has been the subject of much experimental testing, often with economics students as subjects. Two well-known original experiments are: P. Bohm, "Estimating Demand for Public Goods: An Experiment," *European Economic Review*, Vol. 3, No. 2, 1972 (something of a classic); and F. Schneider and W. Pommerhene, "Free Riding and Collective Action: An Experiment in Public Microeconomics," *Quarterly Journal of Economics*, November, 1981. An interesting recent study not referenced in Ch. 6 is:


1. On the Coase Theorem and Externalities


D. Tax Reform

1. Overview


2. Tax Income or Expenditures?: Equity and Administrative Issues


Articles by Goode, Bradford, and Graetz in J. Pechman (ed.), What Should Be Taxed: Income or Expenditures?

Economists remain divided on the issue of taxing income or consumption. See the National Tax Association Symposium on "New Directions in Tax Policy," National Tax Journal, September, 1993, especially the articles by T. Barthold, C. McLure, and J. Sabelhaus for some of the issues surrounding tax reform that have been influential in Washington.

3. Integrating the Corporation and Personal Income Taxes


4. Simplicity, Compliance Costs, and Tax Evasion

Tresch, Ch. 15 (The sections on Tax Evasion and Tax Amnesties)

Also, for further analysis:

J. Andreoni, "Tax Compliance", Journal of Economic Literature, June 1998 (A good overview of the issues and literature.)


E. Income Taxes and Economic Behavior

1. Taxation, labor supply, saving, and investment--overview

A. Auerbach, J. Slemrod, "The Economic Effects of the Tax Reform Act of 1986," Journal of Economic Literature, June 1997. (A discussion of TRA86 is perhaps dated, but the article offers a good overview of the issues in this section, along with a superb bibliography of the best related journal articles. And TRA86 was the biggest federal tax reform ever enacted.)

2. Taxation and labor supply

Atkinson, Stiglitz, Ch. 2.


3. Taxation and saving

Atkinson, Stiglitz, Ch. 3.

For interesting analyses in the life-cycle tradition, see:

Also, for reference: A. Auerbach, L. Kotlikoff, *Dynamic Fiscal Policy*, a monograph published in 1987 that applies their OLG model to all kinds of public expenditure and tax policies.


A. Imrohoroglu, et. al., "The Effect of Tax Favored Retirement Accounts on Capital Accumulation," *AER*, September 1998. (One of the latest in a large literature on IRA's and saving, with a good beginning summary of the results to date.)

4. Taxation and investment

Atkinson, Stiglitz, Ch. 5.

a. Taxation and the cost of capital

b. Inflation, tax rules, and the cost of capital


R. Chirinko, S. Fazzari, A. Meyer, "How Responsive is Business Capital Formation to its User Cost? An Exploration With Micro Data," Journal of Public Economics, October, 1999 (The answer is "not much"--recommended by Fabio Schiantarelli as the latest word.)
A. Goolsbee, "Investment Tax Incentives, Prices, and the Supply of Capital Goods," Quarterly Journal of Economics, February 1998 (Suggests that much of investment tax breaks are captured by capital goods suppliers in the form of higher prices, which he thinks explains the low investment response to tax policy.)

d. On measuring effective tax rates:


5. Taxation and investment in human capital

F. **Transfer Payments**

Tresch, Ch. 19.

Interesting articles not referenced in Ch. 19, by topic:

1. Universal vs. Means-tested Transfers


   J. Creedy, "Comparing Tax and Transfer Systems: Poverty, Inequality, and Target Efficiency," *Economica*, 1996 Supplement. (Tough analytics, but the approach is clear enough and the basic premise is interesting in comparing the two types of transfer schemes.)

   N. Rowe, F. Woolley, "The Efficiency Case for Universality," *Canadian Journal of Economics*, May, 1999 (when only needs are the concern, such as for eyeglasses.)


2. Cash vs. In-kind Transfers


   Also, for reference only:


3. Workfare


4. The Earned Income Tax Credit


5. The Incentive Effects of the U.S. Welfare System on Labor Supply, Family Structure, and Other Issues


G. The Incidence of Taxes and Government Expenditures Under First-Best Assumptions

1. Tax Incidence

*Tresch*, Chs. 16, 17.

a. The Harberger model

*Tresch*, Ch. 16.

Also:


b. The sources and uses approach

*Tresch*, Ch. 17

Also:


c. Summary and overview


2. Expenditure Incidence

Tresch, Ch. 17.

3. Incidence Measures in the Lorenz Tradition

Tresch, Ch. 17.
Also:
D. Kiefer, "Distributional Tax Progressivity Indexes," *National Tax Journal*, December, 1984. Also, an empirical companion piece:
A. Atkinson, "Horizontal Equity and the Distribution of the Tax System," in H. Aaron, M. Boskin (eds.), *The Economics of Taxation*.
Some recent articles following Aronson and Lambert:
U. Ebert, P. Moyes, "Consistent Income Tax Structures When Households are Heterogeneous," *Journal of Economic Theory*, January, 2000. (Very heavy going--only if you are very interested in this approach.)
H. The Empirical Analysis of Grants-in-Aid

1. Overview


2. The Flypaper Effect

C. Holsley, "Price and Income Distortions Under Separate Spending and Taxing Decisions," Journal of Public Economics, January 1993. (Boring and estimates not very believable, but the only empirical study on the flypaper effect that I found which recognizes that citizens have to pay taxes to support grant programs, a point made in Ron Fisher's article on the flypaper effect.)

3. Project Grants With Negotiable Matching Rates

M. McGuire, Ch. 5 in R. Inman (ed.), Financing the New Fiscal Federalism (Also, McGuire's Ch. 4, in P. Mieszkowski and W. Oakland (eds.), Fiscal Federalism and Grants-in-Aid).
H. Chernick, Ch. 7 in Mieszkowski and Oakland.

4. The Budget Constraint With Closed-ended Matching Grants


5. Grants and the granting government

I. Estimating the Demand for Public Goods

1. The Median Voter Model

   D. Rubinfeld, "The Economics of the Local Public Sector,"
   T. Borcherding and R. Deacon, "The Demand for the Services of
   T. Bergstrom and R. Goodman, "Private Demands for Public
   E. Gramlich and D. Rubinfeld, "Micro Estimates of Public
   Spending Demand Functions and Tests of the Tiebout and Median Voter Hypotheses,"
   W. Oates, "On the Measurement of Congestion in the Provision of

   a. Tiebout bias, to which researchers now routinely pay attention
   G. Goldstein, M. Pauly, "Tiebout Bias on the Demand for
   D. Wildasin, "Demand Estimation for Public Goods,"
   Review of Economic Studies, August, 1989, pp. 354-362 (good discussion of other
   issues, too, in estimating the demand for local public goods).

2. Capitalization and the Hedonic Price Technique

   D. Rubinfeld, "The Economics of the Local Public Sector,"
   A.M. Freeman,III, The Benefits of Environmental Improvement,
   Ch. 4, pp. 78-83, Ch. 6, Appendix.

   a. Econometric issues and difficulties (for reference only):
   J. Follain and E. Jiminez, "Estimating the Demand for
   Housing Characteristics: A Survey and Critique," Regional Science and Urban
   T. Bartik, "The Estimation of Demand Parameters in
   Smith, Huang, "Can Markets Value Air Quality? A Meta
   1995. (Contains a huge bibliography of hedonic price studies, which it surveys).
3. Survey Techniques

See, also, the update which corrects for Tiebout bias:

An interesting empirical paper that uses the survey technique to try to separate insurance and charity motives for transfers is: