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.

Textbook: Richard Tresch, Public Finance: A Normative Theory (hereafter, Tresch)

Two other frequently cited reference texts are:

A.B. Atkinson and J. Stiglitz, Lectures on Public Economics (hereafter, Atkinson, Stiglitz)

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 tend not to be discussed in my text. We will consider a selection of them when appropriate, approximately in the order listed below.

I. The First-Best Theory of the Public Sector

A. Background and Overview-- Issues and Methods

Tresch, Chs. 1-4 (especially Chs. 2 and 3)
Also: Atkinson, Stiglitz, Ch. 11
J. Buchanan, "The Constitution of Economic Policy," AER, June, 1987 (This is Buchanan's Nobel lecture, which summarizes the very different view of public sector economics held by him and his followers of the Public Choice school).
B. The Social Welfare Function

1. Arrow's Impossibility Theorem and Majority Voting Difficulties

   A. Feldman, Welfare Economics and Social Choice Theory, Chs 9, 10; 11(optional).
   Also: R. Boadway and D. Wildasin, Public Sector Economics, Ch. 6, pp. 138-154; Ch. 10, pp. 269-277.

2. Properties of the Social Welfare Function (optional--for reference only--on the ordinal property of the social welfare function, addressing an issue I left muddled in my text).


C. Public Expenditure Theory

1. Externalities and Public Goods

   Tresch, Chs. 5-8.

2. Decreasing Cost Production

   Tresch, Chs. 9,10.

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

1. Underlying Theory

   Review Tresch, Ch. 2, pp. 37-42; Ch. 4, pp. 81-85.
   Tresch, Ch. 12, pp. 252-253.
   Also: Atkinson, Stiglitz, Ch. 11, pp. 333-343.

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

   a. Overview

b. Pareto-optimal redistribution

Tresch, Ch. 12, pp. 253-260. (See, also, 3 comments on Orr empirical study referenced in Tresch, in AER, December 1978.

R. Boadway and D. Wildasin, Public Sector Economics, pp. 66-69, 113-118.


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. Toward Application--Horizontal and Vertical Equity

Tresch, Ch. 13, pp. 261-274.

Atkinson, Stiglitz, Ch. 11, pp. 350-356.

H. Young, "Distributive Justice in Taxation," Journal of Economic Theory, April, 1988, along with his empirical companion piece:


S. Sheffrin, "What Does the Public Believe About Tax Fairness?" National Tax Journal, September 1993, pp. 301-303

E. Fiscal Federalism

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

   Tresch, Chs. 29, 30 (primarily Ch. 30).
   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, Ch. 29.

   For reference: Two sophisticated, current generation models of the location decision. Very difficult, but worth careful study if you become interested in these types of models.


   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, Ch. 31, pp. 601-606, 614-642.


F. Postscript on First-best Theory

How useful is first-best theory? Not very, according to Peter Hammonds. See:


I think Hammonds' viewpoint is too limited. If you agree with Hammonds, though, Richard Arnott took you down some of Hammonds' preferred second-best roadways last term.
II. Selected Topics (in approximate order of presentation)

A. The Social Welfare Function in Empirical Analysis

1. Social Welfare and Income

   A. Atkinson, *The Economics of Inequality*, 2nd ed., section 3.4,
   pp. 53-59.


2. Social Welfare and Consumer Expenditures


   An interesting application related to poverty suggesting that poverty is less of a problem than we are led to believe is D. Slesnick, "Gaining Ground: Poverty in the Postwar United States," *Journal of Political Economy*, February, 1993. See, also, the related articles by Jorgenson and Triest in the *Journal of Economic Perspectives*, Winter 1998, pp. 79-114.

   Note cautions to Jorgenson/Slesnick registered by:

   Another related paper of interest:

3. Process Equity: Social Mobility

B. Policy Issues in the Control of Pollution

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


Interest in free-riding experimentation continues. See:


1. On the Coase Theorem and Externalities


D. Tax Reform

1. Overview


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

Treasury I, Ch. 9.

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 current issues surrounding tax reform in Washington.

3. Integrating the Corporation and Personal Income Taxes


4. Simplicity, Compliance Costs, and Tax Evasion

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


c. What determines investment demand?


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. The relationship of tax policy to long-run economic growth

B. Bosworth, Tax Incentives and Economic Growth, Ch. 2.


See, also, the Auerback and Kotlikoff OLG model referenced above in E-3.
6. Taxation and investment in human capital


F. Transfer Payments

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.)


2. Cash vs. In-kind Transfers


Also, for reference only:

3. Workfare

Two good overview articles: D. Friedlander, et. al., "Evaluating Government Training Programs for the Economically Disadvantaged," *Journal of Economic Literature*, December 1997; and


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

   a. The Harberger model

      *Tresch, Ch. 17.*


b. The sources and uses approach

J. Whalley, "Regression or Progression: the Taxing Question of Incidence," *Canadian Journal of Economics*, November 1984. (A "must read" on this issue)

J. Pechman, *Who Paid the Taxes, 1966-85?* (everyone cites this study, but see comments by E. Browning and Pechman's reply in *AER*, December 1986).


c. Summary and overview


2. Expenditure Incidence

Tresch, Ch. 18, pp. 419-422.


3. Incidence Measures in the Lorenz Tradition

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*.

3 articles by Aronson and Lambert on measuring horizontal and vertical inequities:


H. Modelling State and Local Governments

1. Overview


2. Demand-Oriented Models With Government Utility Functions


   R. Ehrenberg, *The Demand for State and Local Government Employees*, especially Ch. 2.


3. Models Incorporating Production (Other than the median voter model)


4. The Role of the Political Process--Voters and Bureaucrats


I. The Empirical Analysis of Grants-in-Aid

1. Overview

   E. Gramlich surveys the empirical literature in Ch. 12 of W. Oates (ed.), *The Political Economy of Fiscal Federalism*.

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


J. Estimating the Demand for Public Goods

1. The Median Voter Model

- D. Rubinfeld, "The Economics of the Local Public Sector,"

  a. Tiebout bias, to which researchers now routinely pay attention


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):

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: