EC865-01, Fall 2010
Public Finance I: Taxation (TTW 1:30-2:45)
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COURSE DESCRIPTION

This is a course in public economics at the Ph.D. level, with its emphasis on taxation (finance) side. EC866 deals with expenditure side of public economics. The covered materials include the theories of optimal commodity taxation, optimal income taxation, and tax reform. We study multiple complementary approaches and tools. There are tax design and tax reform problems. A tax design problem analyzes the optimal taxes on a white sheet of paper, while tax reform problem investigates the effects of a small tax policy change starting from an arbitrary tax system. The optimal commodity taxation (introduced by Ramsey 1927, and Diamond & Mirrlees 1971) is a tax design problem based on linear taxes, and we often use duality theory in first year Micro I. The optimal income taxation (introduced by Mirrlees 1971) is a mechanism design problem with nonlinear income tax system. Dynamic taxation involves multiple issues: intertemporal resource allocation (should we impose a tax on capital income?), commitment issues (time inconsistency), and risk-sharing (uncertain future and social security). We also use two types of models: an infinite horizen model by Ramsey (1928), and an overlapping generation (OLG) model by Diamond (1965). The former is more standard in macroeconomics, while in public economics, it is perhaps more important to discuss how to share tax burdens among different generations, described by the OLG model. My lectures are theoretical.

RECOMMENDED BOOKS

covered in this class. Narayana Kocharkota surveys new dynamic public economics (*New Dynamic Public Economics* MIT Press 2010), which deals with Mirrleesian optimal nonlinear income taxation in dynamic setting. This book assumes that commitment is always feasible, but provides a unified framework to analyze various issues. It appears that this literature is heading towards computations, but it is one of the most recent developments in public economics.

**GRADE AND COURSE REQUIREMENTS**

Tentatively, I would say that your grade will be based on your performance on a final exam and in-class presentation of a paper. I ask you to present one possibly challenging paper in class, and you should provide a report on the paper. The exam will count for 60% of your course grade. The remaining 40% will be based on your presentation. In completing your writing assignment (in particular), please refer University’s academic integrity policy: [http://www.bc.edu/offices/stserv/academic/resources/policy/#integrity](http://www.bc.edu/offices/stserv/academic/resources/policy/#integrity)

**Tentative Schedule**

1. organization matters, production economy

2. the theory of secondbest (Ramsey 1927)
   1. duality theory
   2. tax reform with lump sum transfers (Hatta 1977)
   3. tax reform without lump sum transfers (Corlett-Hague 1953, Hatta 1986)
   4. optimal commodity taxation (Diamond-Mirrlees 1971)
   5. production efficiency, pure profit etc.

3. the optimal income tax theory (Mirrlees 1971)
   1. a continuum model (Mirrlees 1971, 1976, 1986)
   2. nonlinear commodity taxes (Atkinson and Stiglitz 1976) mixed taxation (Konishi 1995)
   3. a finite model (Weymark 1986)

4. OLG model (Diamond, Myles)
   1. OLG model without production (Samuelson 1958)
   2. OLG model with production (Diamond 1965)
   3. steady-state
   4. optimal tax in the steady state (Ihori 1981)
   5. intertemporal burden sharing (Ordover-Phelps 1979)

5. intertemporal Ramsey taxation
   1. commitment with flexible taxes (Chamley, 1986)
   2. commitment and tax reform (Judd 1985)
   3. no commitment (Kydland-Prescott 1977)

6. social insurance (Diamond-Mirrlees 1978)

7. new dynamic public economics
   1. commitment (Kocherlakota 2010)
   2. survey (Golosov, Tsvinski, Werning 2005)

8. old dynamic public economics?
   1. without commitment (Brett-Weymark 2008)
   2. OLG and population dynamics (Brett 2008)

References


taxes in an overlapping generations model, Mt. Allison WP

[4] Brett, C., and J.A. Weymark, 2008, Strategic nonlinear income tax com-
petition with perfect labor mobility, Vanderbilt WP

and savings without commitment, Vanderbilt WP

with infinite lives, EM 54, 607-622

of taxation, RES 21, 21-30

1126-1150

duction: 1. production efficiency, 2. tax rules, AER 61, 8-27, 261-78

variable retirement, JPubE 10, 295-336

nance: a user’s guide, in NBER Macroeconomic Annual 2006


uniformity, JPubE 29, 99-112

growth model, AER 68, 389-396

Economics Letters 8, 89-93

[16] Judd, K., 1985, Short-run analysis of fiscal policy in a simple perfect foresight
model, JPE 93, 298-319


