

Arnaud Dellis
Spring 2005

Tentative Syllabus for Economics 651 Theory of Public Finance - Revenue

Course Outline

This is the second semester of a two-semester course in Public Economics. This course focuses on the revenue side of the public sector budget. The prerequisite for the course is graduate microeconomic theory. The course contains four parts. The first one covers the public economy of taxation, and explores both its positive and normative aspects. The second part goes over fiscal federalism; that is, the allocation of fiscal instruments and transfers between the different levels of government. The third part introduces the political constraint. The last part relaxes the assumption of rationality. A reading list for each topic is provided below. Note however that it is intended to serve as a reference since not all sections will be covered this semester.

The course will be organized as follows. During the first part of the semester I will be lecturing, mainly on part I and on some topics from parts II-IV. The second part of the semester will consist of presentations by students.

Grading

Your grade will be based on a class presentation and a final exam. Each student enrolled in the class has to choose one paper from the reading list part II-IV, and present it in class. The presentation format will be similar to a seminar, so a full lecture will be devoted to one presentation. A list of presentations as well as the order of presentations will be established by the beginning of February. The presentation will determine 40% of your grade. Your grade will also be based on a final exam which will be held on May 9th, 2005 from 2.15 pm to 4.15 pm. The final exam will determine 60% of your grade.

Texts and Reading

I have ordered five books for the course. They are:

Auerbach, A. and M. Feldstein, 2002. Handbook of Public Economics: Volume 3. North Holland, Amsterdam. **(A & F)**

Myles, G., 1995. Public Economics. Cambridge University Press, Cambridge. **(M)**

Salanie, B., 2003. The Economics of Taxation. MIT Press, Cambridge, MA. **(S)**

Slemrod, J. and J. Bakija, 2004. *Taxing Ourselves. A Citizen's Guide to the Debate over Taxes*. 3rd edition. MIT Press, Cambridge, MA. (S & B)

Tresch, R., 2002. *Public Finance: A Normative Theory*. 2nd edition. Academic Press, London. (T)

M is a graduate textbook covering the field of Public Economics. It covers all the material discussed in part I. It is the reference graduate textbook in the field. **S** is a graduate textbook, focused on the public economy of taxation. It is a fine new textbook. **M** and **S** will serve as the main textbooks for the first part of the class. **A & F** is the third volume of the handbook of public economics. It is focused on the theory of taxation and on the political economy applications to public economics. Students who plan to make research in the field should acquire it. **T** is the textbook used in the first-semester course. Finally **S & B** is an optional reading for this class. It provides an overview of the US tax system as well as a discussion of the main issues in taxation. People who are not familiar with the tax system should read it.

The reading list below also contains journal articles and working papers. The articles marked (B) are background papers that layout the basics of a topic. The articles marked (E) are empirical papers. Finally the articles marked (S) are survey papers that provide a summary of the literature on a specific topic.

Reading List

Introduction: The Size of Government

(E) Husted, T. and L. Kenny, 1997. The effect of the expansion of the voting franchise on the size of government. *Journal of Political Economy* 105, 54-82.

Meltzer, A. and S. Richard, 1981. A rational theory of the size of government. *Journal of Political Economy* 89, 914-927.

Mueller, D., 2003. *Public Choice III*. Cambridge University Press, Cambridge, Chapter 21.

Part I: The Public Economy of Taxation

1. Effects of Taxation

S – Ch. 1-2;

(S) Auerbach, A. and J. Hines, 2002. Taxation and economic efficiency. In: *Handbook of Public Economics: vol. 3*, A. Auerbach and M. Feldstein (eds), North-Holland, Amsterdam.

1.1. Tax Incidence

(S) Fullerton, D. and G. Metcalf, 2002. Tax incidence. In: *Handbook of Public Economics: vol. 4*, A. Auerbach and M. Feldstein (eds), North-Holland, Amsterdam.

Harberger, A.C., 1962. The incidence of the corporation income tax. *Journal of Political Economy* 70(3), 215-240.

Hines, J.R. Jr., 1999. Three sides of Harberger triangles. *Journal of Economic Perspectives* 13(2), 167-188.

1.2. Labor Supply

M – Ch. 5

(E) Gruber, J. and E. Saez, 2002. The elasticity of taxable income: evidence and implications. *Journal of Public Economics* 84, 1-32.

Hausman, J., 1981. Exact consumers surplus and deadweight loss. *American Economic Review* 81, 622-676.

1.3. Savings

(S) Bernheim, D., 2002. Taxation of saving. In: *Handbook of Public Economics: vol. 3*, A. Auerbach and M. Feldstein (eds), North-Holland, Amsterdam.

Summers, L., 1981. Capital taxation and accumulation in a life cycle model. *American Economic Review* 71, 533-544.

1.4. Risk-bearing and Portfolio Choice

M – Ch. 7

(S) Poterba, J., 2002. Taxation, risk taking and household portfolio behaviour. In: *Handbook of Public Economics: vol. 3*, A. Auerbach and M. Feldstein (eds), North-Holland, Amsterdam.

2. Optimal Taxation

Mirrlees, J.A., 1986. The theory of optimal taxation. In: *Handbook of Mathematical Economics: Volume III*, K.J. Arrow and M.D. Intriligator (eds), Elsevier, 1197-1249.

(B) Slemrod, J., 1990. Optimal taxation and optimal tax systems. *Journal of Economic Perspectives* 4(1), 157-178.

2.1. Indirect Taxation

S – Ch. 3; M – Ch. 4;

Diamond, P.A. and J.A. Mirrlees, 1971. Optimal taxation and public production. I: Production efficiency. *American Economic Review* 61, 8-27 and 261-278.

Ramsey, F., 1927. A contribution to the theory of taxation. *Economic Journal* 37, 47-61.

2.2. Direct Taxation

S – Ch. 4; M – Ch. 5

Diamond, P., 1998. Optimal income taxation: An example with a U-shaped pattern of optimal marginal tax rates. *American Economic Review* 88, 83-95.

Kremer, M., 2004. Should taxes be independent of age?. *Quarterly Journal of Economics*, forthcoming.

Mirrlees, J.A., 1971. An exploration in the theory of optimum income taxation. *Review of Economic Studies* 38(2), 175-208.

Saez, E., 2001. Using elasticities to derive optimal income tax rates. *Review of Economic Studies* 68, 205-229.

Sheshinski, E., 1972. The optimal linear income tax. *Review of Economic Studies* 39, 297-302.

2.3. Direct vs. Indirect Taxation

S – Ch. 5; M – Ch. 5

Atkinson, A. and J. Stiglitz, 1976. The design of tax structure: direct versus indirect taxation. *Journal of Public Economics* 6, 55-75.

Boadway, R., M. Marchand and P. Pestieau, 1994. Towards a theory of the direct-indirect tax mix. *Journal of Public Economics* 55, 71-88.

2.4. Capital Income Taxation

S – Ch. 6;

Saez, E., 2002. *Optimal Progressive Capital Income Taxes in the Infinite Horizon Model*. NBER WP 9046.

3. Deficit and Debt

M – Ch. 15

Barro, R., 1974. Are governments bonds net wealth. *Journal of Political Economy* 82, 1095-1117.

Diamond, P., 1965. National debt in a neoclassical growth model. *American Economic Review* 55, 1125-1150.

4. Social Security

M – Ch. 14;

Cremer, H., J-M. Lozachmeur and P. Pestieau, 2004. Social security and variable retirement schemes. An optimal income taxation approach. *Journal of Public Economics* 88, 2259-2281.

Diamond, P., 1977. A framework for social security analysis. *Journal of Public Economics* 8, 275-298.

Diamond, P., 2003. *Taxation, Incomplete Markets, and Social Security*. MIT Press, Cambridge, MA.

Diamond, P. and J.A. Mirrlees, 1978. A model of social insurance with variable retirement. *Journal of Public Economics* 10, 295-336.

Samuelson, P., 1975. Optimum social security in a life-cycle growth model. *International Economic Review* 16(3), 539-544.

Sheshinski, E. and Y. Weiss, 1981. Uncertainty and optimal social security systems. *Quarterly Journal of Economics* 96(2), 189-206.

Van Groezen, B., T. Leers and L. Meijdam, 2003. Social security and endogenous fertility: pensions and child allowances as Siamese twins. *Journal of Public Economics* 87, 233-51.

5. Family Taxation

Cigno, A. and A. Pettini, 2002. Taxing family size and subsidizing child-specific commodities?. *Journal of Public Economics* 84, 75-90.

Cremer, H., A. Dellis and P. Pestieau, 2003. Family size and optimal income taxation. *Journal of Population Economics* 16, 37-54.

Fleurbaey, M. and F. Maniquet, 2004. *Optimal Fiscal Benefits when Children are not Held Responsible for the Wealth of their Parents*. Mimeo.

Part II: Fiscal Federalism

1. The Economic Theory of Federalism

Bewley, T., 1981. A critique of Tiebout's Theory. *Econometrica* 49(3), 713-740.

Epple, D. and A. Zelenitz, 1981. The implications of competition among jurisdictions: Does Tiebout need politics? *Journal of Political Economy* 89(6), 1197-1217.

(E) Faguet, J-P., 2004. Does decentralization increase government responsiveness to local needs? Evidence from Bolivia. *Journal of Public Economics* 88, 867-893.

Gordon, R.H., 1983. An optimal taxation approach to fiscal federalism. *Quarterly Journal of Economics* 98, 567-586.

(B) Musgrave, R., 1999. Fiscal federalism. In: *Public Finance and Public Choice. Two contrasting Visions of the State*, J.M. Buchanan and R.A. Musgrave (eds), MIT Press, Cambridge, MA, 155-175.

(S) Oates, W., 1999. An essay on fiscal federalism. *Journal of Economic Literature* 37, 1120-1149.

(E) Strumpf, K. S. and F. Oberholzer-Gee, 2002. Endogenous policy decentralization: Testing the central tenet of Economic federalism. *Journal of Political Economy* 110(1), 1-36.

Tiebout, C., 1956. A pure theory of local expenditures. *Journal of Political Economy* 64(5), 416-424.

Wildasin, D.E., 1991. Income redistribution in a common labor market. *American Economic Review* 81(4), 757-774.

2. Intergovernmental Transfers

Boadway, R., K. Cuff and M. Marchand, 2003. Equalization and the decentralization of revenue-raising in a federation. *Journal of Public Economic Theory* 5(2), 201-228.

Boadway, R. and F. Flatters, 1982. Efficiency and equalization payments in a federal system of government: a synthesis and extension of recent results. *Canadian Journal of Economics* 15(4), 613-633.

Lockwood, B., 1999. Inter-regional insurance. *Journal of Public Economics* 72, 1-37.

Smart, M., 1998. Taxation and deadweight loss in system of intergovernmental transfers. *Canadian Journal of Economics* 31(1), 189-206.

3. Commodity Taxation

Kanbur, R. and M. Keen, 1993. Jeux sans frontieres: Tax competition and tax coordination when countries differ in size. *American Economic Review* 83(4), 877-892.

4. Capital Income Taxation

Edwards, J. and M. Keen, 1996. Tax competition and Leviathan. *European Economic Review* 40, 113-134.

(E-S) Hines, J.R., 1999. Lessons from behavioral responses to international taxation. *National Tax Journal* 52, 305-322.

Keen, M. and M. Marchand, 1997. Fiscal competition and the pattern of public spending. *Journal of Public Economics* 66, 33-53.

(S) Wilson, J.D., 1999. Theories of tax competition. *National Tax Journal* 52, 269-304.

(S) Wilson, J.D. and D.E. Wildasin, 2004. Capital tax competition: bane or boon. *Journal of Public Economics* 88, 1065-1091.

Part III: Political Economy of Taxation

Hettich, W. and S. Winer, 1997. The political economy of taxation. In: *Perspectives on Public Choice: a handbook*. D. Mueller (ed.), Cambridge University Press, Cambridge, 481-505.

1. Voting and Taxation

Austen-Smith, D., 2003. Majority preference for subsidies over redistribution. *Journal of Public Economics* 87, 1617-1640.

Gradstein, M., 1999. Optimal taxation and fiscal constitution. *Journal of Public Economics* 72, 471-485.

Roemer, J., 1999. The democratic political economy of progressive income taxation. *Econometrica* 67(1), 1-19.

2. Electoral Systems and Taxation

Austen-Smith, D., 2000. Redistributing income under proportional representation. *Journal of Political Economy* 108(6), 1235-1269.

Lizzeri, A. and N. Persico, 2001. The provision of public goods under alternative electoral incentives. *American Economic Review* 91(1), 225-239.

(E) Milesi-Ferretti, G.M., R. Perotti and M. Rostagno, 2002. Electoral systems and public spending. *Quarterly Journal of Economics*, 609-657.

Persson, T. and G. Tabellini, 1999. The size and scope of government: comparative politics with rational politicians. *European Economic Review* 43, 699-735.

3. The Political Economy of Debt and Deficit

Aghion, Ph. and P. Bolton, 1990. Government domestic debt and the risk of default: a political-economic model of the strategic role of debt. In: *Public Debt Management: Theory and History*, Dornbusch, R. and M. Draghi (eds), Cambridge University Press, Cambridge, 315-345.

Alesina, A. and A. Drazen, 1991. Why are stabilizations delayed? *American Economic Review* 81(5), 1170-1188.

(B) Alesina, A. and R. Perotti, 1996. *Budget Deficits and Budget Institutions*. NBER WP 5556.

Alesina, A. and G. Tabellini, 1990. A positive theory of fiscal deficits and government debt. *Review of Economic Studies* 57, 403-414.

Lizzeri, A., 1999. Budget deficits and redistributive politics. *Review of Economic Studies* 66, 909-928.

(E) Perotti, R. and Y. Kontopoulos, 2002. Fragmented fiscal policy. *Journal of Public Economics* 86, 191-222.

Persson, T. and L.E. Svensson, 1989. Why a stubborn conservative would run a deficit: Policy with time-inconsistent preferences. *Quarterly Journal of Economics* 104(2), 325-345.

(E) Poterba, J.M., 1994. State responses to fiscal crises: The effects of budgetary institutions and politics. *Journal of Political Economy* 102(4), 799-821.

4. Political Accountability

(E) Besley, T. and A. Case, 1995. Incumbent behavior: Vote-seeking, tax-setting, and yardstick competition. *American Economic Review* 85(1), 25-45.

Besley, T. and M. Smart, 2004. *Fiscal Restraints and Voter Welfare*. Mimeo.

Sand-Zantman, W., 2004. Economic integration and political accountability. *European Economic Review* 48, 1001-1025.

Part IV: Behavioral Public Finance

Gruber, J. and B. Koszegi, 2004. Tax incidence when individuals are time-inconsistent: The case of cigarette excise taxes. *Journal of Public Economics* 88, 1959-1987.

Hines, J.R. and R.H. Thaler, 1995. The Flypaper effect. *Journal of Economic Perspectives* 9(4), 217-226.

(B) McCaffery, E.J. and J. Slemrod, 2004. *Toward an Agenda for Behavioral Public Finance*. USC CLEO Research Paper No. C04-22.

O'Donoghue, T. and M. Rabin, 2003. Studying optimal paternalism, illustrated by a model of sin taxes. *American Economic Review Papers and Proceedings* 93(2), 186-1991.

O'Donoghue, T. and M. Rabin, 2004. *Optimal Sin Taxes*. Mimeo.

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