

Economics 680a: Public Finance I

Hanming Fang
Syllabus and Reading List

Fall 2004

Tuesday, Thursday 10:30-11:50pm
Room 108, 28 Hillhouse Avenue

In Public Finance I (680A) we plan to cover the following topics in the field of public economics: (1). Public Goods; (2) Economic Analysis of Public Policy: Affirmative Actions, Welfare Reform and Social Security Reform; (3) Economics of Taxation.

The selected readings for the course will consist of classical papers and recent developments in each literature. The lectures will mostly cover important classical papers. Student will be expected to make two or more presentations of recent studies. Skills in presenting and articulating one's ideas are very important for professional success in economics. We will expect active participation from everyone, not just the presenter. Each student is required to write a critical referee report on the papers he/she presents in class.

Students will also be expected to write a short research paper. Empirical papers, which can also be submitted for the econometrics paper requirement, are encouraged. There will also be a short oral final examination for the course.

In the reading list below, papers with * will be discussed in lectures; and those with ♦ are recommended for student presentations.

0. YOUNG ECONOMIST'S GUIDE TO THE PROFESSION

- Hamermesh, Daniel S., "The Young Economist's Guide to Professional Etiquette," *Journal of Economic Perspectives*, Vol 6, no 1, Winter 1992, 169--179.
- Thomson, William. *A Guide for the Young Economist*. MIT Press, 2001.

1. PUBLIC GOODS

1.1 NEOCLASSICAL THEORY

- Anthony Atkinson and Joseph Stiglitz (1980). *Lectures on Public Economics*, Lecture 16.
- Jean-Jacques Laffont (1988): *Fundamentals of Public Economics*. Chapter 2.
- (*) Paul A. Samuelson (1954): "The Pure Theory of Public Expenditure", *Review of Economics and Statistics*, Vol. 36, 387-389.
- Samuelson, Paul A., "Diagrammatic Exposition of a Theory of Public Expenditures," *Review of Economics and Statistics*, 1955, 350--356.
- Samuelson, Paul A., "Pure Theory of Public Expenditure and Taxation," in Margolis and Guitton, eds., *Public Economics*, Macmillian, 1969, 492--517.
- (*) Lindahl, E., "Just Taxation --- A Positive Solution," in Musgrave and Peacock, ed., *Classics in the Theory of Public Finance*, Macmillian, 1958, 168--176.
- Foley, Duncan, "Lindahl's Solution and the Core of an Economy with Public Goods," *Econometrica*, 1970, 38, pp. 66--72.

1.2. STATIC MODELS OF PRIVATE PROVISION OF PUBLIC GOODS

- (*) Theodore Bergstrom, Lawrence Blume and Hal Varian (1986), "On the Private Provision of Public Goods", *Journal of Public Economics*, 29(1), February, pp. 25-49.
- Theodore Bergstrom, Lawrence Blume and Hal Varian (1992), "Uniqueness of Nash Equilibrium in Private Provision of Public Goods: An Improved Proof", *Journal of Public Economics*, 49(3), December, pp. 391-92.
- Douglas Bernheim (1986), "On the Voluntary and Involuntary Provision of Public Goods", *American Economic Review*, Vol 76, pp789-793.
- (♦) James Andreoni (1998), "Toward a Theory of Charitable Fund-Raising", *Journal of Political Economy*, 106(6), December, pp. 1186-1213.
- (♦) Andreoni, James, "Giving with Impure Altruism: Applications to Charity and Ricardian Equivalence," *Journal of Political Economy*, December, 1989, 1447--1458.
- Andreoni, James, "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving," *Economic Journal*, 100, 1990.
- Romano, Richard and Huseyim Yildirim, "Why Charities Announce Donations: A Positive Perspective." *Journal of Public Economics*, v 81, 2001, 423—448.
- (♦) John Morgan (2000), "Financing Public Goods by means of Lotteries", *Review of Economic Studies*, October, pp.761-784.

1.3. DYNAMIC VOLUNTARY PROVISION OF PUBLIC GOODS

- (*) Varian, Hal R., "Sequential Provision of Public Goods," *Journal of Public Economics*, 1994, 53, 165--86.
- (*) Anat Admati and Motty Perry (1991), "Joint Projects without Commitment", *Review of Economic Studies*, 58, pp 259-276.
- Leslie Marx and Steven Matthews (2000), "Dynamic Voluntary Provision of Public Goods", *Review of Economic Studies*, April 2000, p.327-358.

1.4 EXPERIMENTAL AND ECONOMETRIC STUDIES.

Experimental Studies

- (♦) J. Andreoni. An Experimental Test of the Public Goods Crowding-Out Hypothesis. *American Economic Review* 83 (5), 1317-27, 1993.
- Ledyard, John O., "Public Goods: A Survey of Experimental Research" in J.H. Kagel and A.E. Roth, eds., *Handbook of Experimental Economics*, Princeton, 1995.
- Marwell, G. and Ruth Ames, "Economists Free Ride --- Does Anyone Else?" *Journal of Public Economics*, 1981, 295--310.
- Isaac, Mark and James Walker, "Group Size Hypothesis of Public Goods Provision: Experimental Evidence," *Quarterly Journal of Economics*, 1988.
- (♦) Andreoni, James, "An Experimental Test of the Public Goods Crowding Out Hypothesis," *American Economic Review*, December 1993.
- (♦) Andreoni, James, "Cooperation in Public Goods Experiments: Kindness or Confusion?," *American Economic Review*, September 1995, 85, 891--904.
- (♦) John Morgan and Martin Sefton (2000). Funding Public Goods with Lotteries: An Experiment, *Review of Economic Studies*, October.
- (♦) Palfrey, Thomas R. and Jeffrey E. Prisbrey, "Anomalous Behavior in Public Goods Experiments: How Much and Why?," *American Economic Review*, v. 87(5), 829--846.
- Palfrey, Thomas R. and Jeffrey E. Prisbrey, "Altruism, Reputation and Noise in Linear Public Goods Experiments," *Journal of Public Economics*, v. 61, 1997, March 1996, 409--427.

Econometric Studies

- Clotfelter, Charles T., "The Impact of Tax Reform on Charitable Giving: A 1989 Perspective," in J. Slemrod, ed., *Do Taxes Matter? The Impact of the Tax Reform Act of 1986*, MIT Press, 1990.
- (♦) Randolph, William, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *Journal of Political Economy*, August 1995, 103, 709--738.
- Kingma, Bruce, "An Accurate Measure of the Crowd-out Effect, Income Effect, and Price Effect for Charitable Contributions," *Journal of Political Economy*, October 1989.
- Payne, Abigail, , "Does the Government Crowd-Out Private Donations? New Evidence from a Sample of Non-Profit Firms," *Journal of Public Economics*, v.69 (3), 1998, 323--345.
- Andreoni, J. and Abigail Payne, "Government Grants to Private Charities: Do They Crowd Out Giving or Fundraising?" working paper, 2001.
- Berry, Steven T. and Joel Waldfogel, "Public Radio in the United States: Does it Correct Market Failure or Cannibalize Commercial Stations?," *Journal of Public Economics*, v.71, February 1999, 189--211.

1.5 PREFERENCE REVELATION AND IMPLEMENTATION.

- Laffont, Chapter 5, "Incomplete Information in Public Economics."
- (*) Groves T. and J. Ledyard, "Optimal Allocation of Public Goods: A Solution to the Free Rider Problem," *Econometrica*, 45, 1977, 783--810.
- (♦) Chen, Yan and Charles Plott, "The Groves-Ledyard Mechanism: An Experimental Study of Institutional Design," *Journal of Public Economics*, v.59(3), 1997, 335-364.

- (♦) Chen, Yan and Fang-Fang Tang, "Learning and Incentive-Compatible Mechanisms for Public Goods Provision: An Experimental Study," *Journal of Political Economy*, June 1998, v. 106 (3), 633--662.
- Varian, Hal R., "A Solution to the Problem of Externalities and Public Goods When Agents are Well Informed," *American Economic Review*, December 1994, 84, 1278-1293.
- (*) George J. Mailath and Andrew Postlewaite (1990), "Asymmetric Information Bargaining Problems with Many Agents", *Review of Economic Studies*, 57(3), July, pp. 351-67.
- Rafael Rob (1989), "Pollution Claim Settlements under Private Information", *Journal of Economic Theory*, 47, 307-333.

1.6 LOCAL PUBLIC GOODS

Theoretical Issues: The Tiebout Hypothesis

- (*) Cornes and Sandler. *The Theory of Externalities, Public Goods and Club Goods*, 1997. Chapters 11 and 12, On Club Goods.
- (*) Tiebout, C., "A Pure Theory of Local Public Expenditures," *Journal of Political Economy*, 1956, 416--424.
- Stiglitz, Joseph E., "The Theory of Local Public Goods Twenty-five Years After Tiebout: A Perspective," in G.R. Zodrow, ed., *Local Provision of Public Services: The Tiebout Hypothesis After 25 Years*, Academic Press (New York), 1983.
- (*) Bewely, T., "A Critique of Tiebout's Theory of Local Public Expenditures," *Econometrica*, 1982, 713--737.
- Scotchmer, Suzanne, "Public Goods and the Invisible Hand", in Quigley and Smolensky, eds., *Modern Public Finance*, Harvard Univ:Boston, 1994.
- Scotchmer, Suzanne and Myrna H. Wooders, "Competitive Equilibrium and the Core in Club Economies with Anonymous Crowding," *Journal of Public Economics*, 1987, 34, 59--73.
- (*) Epple, Dennis and Allen Zelenitz, "The Implications of Competition Among Jurisdictions: Does Tiebout Need Politics?" *Journal of Political Economy*, 1981, 1197--121.
- Oates, Wallace E., and Robert M. Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?" *Journal of Public Economics*, v 25, 1988, 333--354.
- (♦) Nechyba, Tom, "Local Property and State Income Taxes: The Role of Interjurisdictional Competition and Collusion," *Journal of Political Economy*, v.105, 1997, 351--384.

Empirical Issues of local public finance and education

- Bergstrom, T. C. and R. Goodman, "Private Demands for Public Goods," *American Economic Review*, 1973.
- Bergstrom, T. C., D. Rubinfeld, and P. Shapiro, "Micro-based Estimates of Demand Functions for Local Public School Expenditures," *Econometrica*, Vol. 50, September 1982, 1185--1205.
- Oates, W.E. (1969): "The Effects of Property Taxes and Local Public Spending on Property Value: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis, *Journal of Political Economy*.
- Gramlich, E and Rubinfeld (1982): "Micro Estimates of Public Spending Demand Functions and Tests of the Tiebout and Median-Voter Hypothesis," *Journal of Political Economy*, 536-560.
- Gyourko, Joseph and Joseph Tracy (1991): "The Structure of Local Public Finance and the Quality of Life", August, *Journal of Political Economy*, 774-806.

- Bergstrom, Roberts, Rubinfeld, and Shapiro, "A Test for Efficiency in the Supply of Public Education," *Journal of Public Economics*, 1988, Vol. 35, 289--307.
- (♦) Epple, Dennis, and Holger Sieg, "Estimating Equilibrium Models of Local Jurisdictions," *Journal of Political Economy*, 1999, 107(4), 645-681.
- Levinson, Arik, "NIMBY Taxes Matter: The Case of Hazardous Waste Disposal Taxes," *Journal of Public Economics*, 1999, 74.
- Hines, James and Thaler, Richard, "Anomalies: The Flypaper Effect," *Journal of Economic Perspectives*, Fall 1995, 9, 217--227.
- (♦) Hoxby, Caroline M. "Does Competition Among Schools Benefit Students or Taxpayers?" *American Economic Review*, December 2000, 1209-1238.
- (♦) Epple, D. and R.E. Romano, "Competition Between Private and Public Schools, Vouchers, and Peer-Group Effects," *American Economic Review*, v.88 (1), March 1998, 33--62.
- Epple, D. and R.E. Romano, "Ends Against the Middle: Determining Public Service Provision When There Are Private Alternatives," *Journal of Public Economics*, v.62(3), November 1996, 297--325.

2. PUBLIC POLICIES:

2.1 DISCRIMINATION AND AFFIRMATIVE ACTIONS

TASTE BASED DISCRIMINATION:

- (*) Gary S. Becker (1957), *The Economics of Discrimination*, Chicago: University of Chicago Press.

STATISTICAL DISCRIMINATION.

- (*) Kenneth Arrow (1973), "The Theory of Discrimination", in O. Ashenfelter and A. Rees ed., *Discrimination in Labor Markets*, Princeton, NJ: Princeton University Press, 3-33.
- (*) Stephen Coate and Glenn C. Loury (1993), "Will Affirmative Action Policies Eliminate Negative Stereotypes?", *American Economic Review*, December, Vol 83, 1220-40.
- (♦) Glen Loury (1992). "Incentive Effects of Affirmative Action". *Annals of American Academic Political and Social Science*, Vol 523: 19-29.
- (♦) Andrea Moro and Peter Norman (2000), "Affirmative Action in a Competitive Economy", Forthcoming, *Journal of Public Economics*.

LOOKING FOR EVIDENCE OF DISCRIMINATION

- (*) Gary Becker: "The Evidence Against Banks Doesn't Prove Bias", *Business Week*, April 19, 1993.
- Ian Ayres (2001), *Pervasive Prejudice? Unconventional Evidence of Race and Gender Discrimination*, Chicago: University of Chicago Press
- Gary Becker: "Nobel Lecture: The Economic Way of Looking at Behavior", *Journal of Political Economy*, 101(3), June 1993, pages 385-409.
- (♦) Ian Ayres and Joel Waldfogel, "A Market Test for Race Discrimination in Bail Setting", *Stanford Law Review*, May 1994: 987-1046.
- (♦) Symposia on Discrimination in Product, Credit and Labor Markets, *Journal of Economic Perspectives*, Spring 1998, including the following articles and comments by Kenneth Arrow, James Heckman and Glenn Loury.
- (♦) Ian Ayres and Peter Siegelman (1995), "Race and Gender Discrimination in Negotiation for the Purchase of a New Car", *American Economic Review*.

- (♦) Penny Goldberg: “Dealer Price Discrimination in New Car Purchases: Evidence from the Consumer Expenditure Survey”, *Journal of Political Economy*, June 1996, pp. 622-54.
- James Heckman and Peter Siegelman, “The Urban Institute Audit Studies: Their Methods and Findings”, in *Clear and Convincing Evidence: Measurement of Discrimination in America*, edited by Michael Fix and Raymond J. Struyk, Washington: Urban Institute Press, 1993.

EMPIRICAL STUDIES.

- Audra J. Bowlus and Zvi Eckstein (2001), “Discrimination and Skill Differences in an Equilibrium Search Model,” *Forthcoming, International Economic Review*.
- (*) John Knowles, Nicola Persico and Petra Todd, “Racial Bias in Motor-Vehicle Searches: Theory and Evidence,” *Journal of Political Economy*, February 2001.
- (*) Shamena Anwar and Hanming Fang (2004). “An Alternative Test of Racial Prejudice in Motor Vehicle Searches: Theory and Evidence.”
- James Heckman and John Donohue: “Continuous vs. Episodic Change: The Impact of Affirmative Action and Civil Rights Policy On The Economic Status of Blacks”, *Journal of Economic Literature*, Vol. 29, No. 4, December, 1991, pp. 1603-1643.

2.2 WELFARE REFORM

- Moffitt, Robert, “Incentive Effects of the U.S. Welfare System: A Review,” *Journal of Economic Literature*, March 1992, 1--61.
- (*) Besley, Tim and Stephen Coate, “Workfare versus Welfare: Incentive Arguments for Work Requirements in Poverty Alleviation Programs,” *American Economic Review*, 1992, 249--61. 62, 187—221
- (*) Moffitt, Robert, “An Economic Model of Welfare Stigma,” *American Economic Review*, 73, 1983, 1023--1035.
- (♦) Hoynes, Hillary Williamson, “Welfare Transfers in Two-Parent Families: Labor Supply and Welfare Participation Under AFDC-UP,” *Econometrica*, 64(2), March 1996, 295-332.
- Scholz, John Karl, “The Earned Income Tax Credit: Participation, Compliance, and Anti-Poverty Effectiveness,” *National Tax Journal*, March 1994, 59--81.
- (♦) Bertrand, Luttmer and Mullainthan, “Network Effects and Welfare Culture,” *Quarterly Journal of Economics*, August 2000, 1019—1056.
- (♦) Jeff Grogger and Charles Michalopoulos (2003), “Welfare Dynamics under Term Limits”, *Journal of Political Economy*, 530-54.
- (♦) Jeff Grogger (2004), “Time Limits and Welfare Use”, *Journal of Human Resources*, 39, No. 2, 405-24.
- Michael P. Keane and Robert Moffitt (1998), “A Structural Model of Multiple Welfare Program Participation and Labor Supply”, *International Economic Review*, 39(3), August, pp. 553-89.
- (*) Michael P. Keane (1995), “A New Idea for Welfare Reform”, *Federal Reserve Bank of Minneapolis Quarterly Review*, 19(2), Spring, pp. 2-28.
- (♦) Keane, M. and K. Wolpin (2001). Estimating Welfare Effects Consistent with Forward Looking Behavior, Part I: Lessons from a Simulation Exercise. *Forthcoming, Journal of Human Resources*.
- (♦) Keane, M. and K. Wolpin (2001). Estimating Welfare Effects Consistent with Forward Looking Behavior, Part II: Empirical Results. *Forthcoming, Journal of Human Resources*.
- Hanming Fang and Dan Silverman (2001), On the Compassion of Time-Limited Welfare, *forthcoming, Journal of Public Economics*.

- (♦) Bruce Meyer and Dan T. Rosenbaum (2001), Welfare, the Earned Income Tax Credit, And the Labor Supply of Single Mothers. *Quarterly Journal of Economics*, August.
- (*) Hanming Fang and Michael P. Keane (2004). "Assessing the Impact of Welfare Reform on Single Mothers." *Brookings Papers on Economic Activity*, 2004 (1), 1-116.

2.3 SOCIAL SECURITY REFORMS

The Role of Social Security

- (*) Samuelson, P.A. (1958) ``[An Exact Consumption Loan Model without the Social Contrivance of Money](#)'' *Journal of Political Economy* 66 467-482.
- (*) Diamond, P. (1965) ``[National Debt in a Neoclassical Growth Model](#)'' *American Economic Review* 32-4 289-298.
- Barro, Robert, "Are Government Bonds Net Wealth?," *Journal of Political Economy*, 1974
- Auerbach, A. and L. Kotlikoff (1987) [Dynamic Fiscal Policy](#) Cambridge University Press.

The Effects of Social Security

- (♦) Crawford, V. and Lilien, D. (1981) ``Social Security and the Retirement Decision'' *Quarterly Journal of Economics* 3 505-534
- Peter Diamond (1977): "A Framework for Social Security Analysis". *Journal of Public Economics*, Vol. 8, No. 3, December 1977: 275-298.
- Andrew Abel: "The Effects of Investing Social Security Funds in the Stock Market When Fixed Costs Prevent Some Households from Holding Stocks," *American Economic Review*, 91, 1 (March 2001), 128-148.
- John Geanakoplos, Olivia Mitchell and Stephen Zeldes: "Would a Privatized Social Security System Really Pay a Higher Rate of Return?," *Framing the Social Security Debate. Values, Economics, and Politics*, R.D. Arnold, M. Graetz and A. Munnell, eds., National Academy of Social Insurance, 1998, pp. 137-157.
- Butler, M. (1999) ``[Anticipation Effects of Looming Public Pension Reforms](#)'' *Carnegie-Rochester Conference Series on Public Policy* 50 119-160.
- Stock, J. and D.A. Wise (1990) ``[Pensions, The Option Value of Work, and Retirement](#)'' *Econometrica* 58-5 1151-1180.
- (♦) Zeldes, S., et al, "Precautionary Saving and Social Insurance," *JPE*, Vol 103, No2, April 1995, 360-399.
- Bernheim, Doug, "Rethinking Saving Incentives," in Auerbach, ed. *Fiscal Polity: Lessons from Economic Research* (Cambridge: MIT Press, 1997) 259-313.
- (♦) Venti and Wise, "Have IRAs Increased U.S. Saving? Evidence from Consumer Expenditure Surveys," *QJE* 105 (1990). 661-698

Privatizing Social Security

- Bohn, H. (1999) ``[Should the Social Security Trust Fund Hold Equities? An Intergenerational Welfare Analysis](#)'' *Review of Economic Dynamics* 2-3 666-697.
- (♦) Geanakoplos, J. Mithcell, O. and S. Zeldes (1999) ``[Social Security Money's Worth](#)'' manuscript, Yale University.
- (♦) Geanakoplos, J. Mithcell, O. and S. Zeldes (1999) ``[Would a Privatized Social Security System Really Pay a Higher Rate of Return ?](#)'' manuscript, Yale University.
- Cooley, T. and J. Soares (1999) ``[Privatizing Social Security](#)'' *Review of Economic Dynamics* 2-3 731-755.

3. ECONOMICS OF TAXATION

- (*) Bernard Salanie: *The Economics of Taxation*, MIT Press, 2003.

3.1 TAX INCIDENCE

- Kotlikoff and Summers, "Tax Incidence," ch 16 of Handbook.
- C. Ballard et al., General Equilibrium Computations of the Marginal Welfare Cost of Taxes in the United States., *American Economic Review*, March 1985, 128-138.
- (♦) Feldstein, M., "The Surprising Incidence of a Tax on Pure Rent: A New Answer to an Old Question, *JPE*, 85, 1977
- Feldstein, M., "Tax Incidence in a Growing Economy with Variable Factor Supply," *QJE*, Nov. 1974
- (♦) Diamond, P., "Incidence of an Interest Income Tax," *JET* 2, 1970, 211-214

3.2 Optimal Commodity Taxation and Excess Burden

- Auerbach, A., "The Theory of Excess Burden and Optimal Taxation" Handbook of Public Economics, Chapter 2
- (♦) Feldstein, M., "The Welfare Cost of Capital Income Taxation," *JPE*, 86, 1978
- Chamley, C., "Efficient Tax Reform in a Dynamic Model of General Equilibrium," *Quarterly Journal of Economics* 100 (May 1985), 335-356.
- Judd, K., Optimal Taxation and Spending in General Competitive Growth Models, *Journal of Public Economics*. January 1999; 71(1): 1-26
- (♦) Saez, Emmanuel. "The Desirability of Commodity Taxation under non-Linear Income taxation and Heterogeneous Tastes," *Journal of Public Economics* 83, 2002, 217-230.
- (♦) Coate, S., "Altruism, the Samaritan's Dilemma, and Government Transfer Policy." *American Economic Review* 85(1) March 1995. 46-57

3.3 Optimal Income taxation

- (*) Dixit, A. and Sandmo, A. "Some Simplified Formulae for Optimal Income Taxation," *Scandinavian Journal of Economics*, 1977
- (*) Mirrlees, James. "An exploration in the Theory of Optimum Income Taxation," *Review of Economic Studies*, April 1971
- (♦) Saez, Emmanuel. "Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses" *Quarterly Journal of Economics*, 117, 2002, 1039-1073
- (♦) Saez, Emmanuel. "Using Elasticities to Derive Optimal Income Tax Rates" *Review of Economic Studies*, 68, 2001, 205-229