



ECO 751: Public Economics (Part 1)

Fall 2007

Gatton College of Business and Economics, 214

11:00-12:15 Tuesday and Thursday

Professor William H. Hoyt

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Office Hours: 9:30-11:00 Monday and Wednesday or by appointment

Course Description

From the University Catalog: *This course examines economic approaches to policy analysis. Included is an analysis of the major concepts of economic analysis and their application to a number of policy problems. Prereq: PA 652 or equivalent and Ph.D. program status or consent of the instructor.*

An advance study of both how government activities influence allocation, relative prices and welfare and what is the proper role of the public sector in resource allocation.

Texts and Readings

The recommended text for this course is Jonathan Gruber, *Public Finance and Public Policy*, 2nd Edition, Worth 2007. While this is considered an undergraduate text it serves as introduction and background for the topics we will cover in the course. We will discuss in more detail a number of the articles cited and briefly discussed in the text. The assigned readings from the text should be read before the lecture. This text will also serve the basis of the second half of the course by Professor Yelowitz.

Journal articles and working papers will serve as the primary source of readings for this section of the course. The list below indicates readings relevant to the course. Only a small subset of the readings on the list will be covered in the class. Many of these readings are obtainable through the internet. If not available on the internet, I will provide the readings to you.

Finally, my lecture notes are another source of reading material. I shall try to have the notes ready prior to lecture, at least by one day, so that you can review them prior to lecture. You will be able to access the lectures directly through the course website (<http://gatton.uky.edu/Faculty/hoytw/751.html>).

Grading and Course Assignments

Your grade is based on my evaluation of your performance on one exam, three assignments, and a project that consists of a short paper and an presentation to the class. The exam will consist primarily of problems and short essays.

Three fairly extensive assignments will be given. One will primarily consist of problems to be solved. I hope that at least one of the other assignments will have an empirical component requiring a short paper.

Each student will be asked to present an article or working paper to the class. This paper can come from the list of readings below as the vast majority of the papers listed there will not be discussed in class. Along with the presentation, the student will be asked to write a paper reviewing the paper he or she presented. More details on the presentation and paper will be forthcoming.

Grading Distribution and Schedule of Assignments

Assignment	Due Date	Points
Assignment 1	September 4 th	20
Assignment 2	September 16 th	20
Assignment 3	October 2 nd	20
Exam	October 4 th	100
Presentations	October 9 th – 16 th	100
Paper	October 23 rd	
Total		260

Outline for ECO 751 (1st 8 weeks)

1. Normative Concepts in Public Economics
 - a. Efficiency
2. Public Goods and Externalities
 - a. The Theory of Public Goods
 - b. Private Provision of Public Goods
 - i. Experimental and Empirical Evidence
 - ii. Preference Revelation Mechanisms
 - c. Public Provision of Private Goods
 - i. Preferences for Redistribution
3. Theory of the Second Best
 - a. Welfare Measures in Theory and Practice
 - b. Optimal Commodity Taxation
 - c. Optimal Income Taxation
 - d. Public Good Provision with Distorting Taxation
4. The Impacts of Taxation: Theory and Evidence
 - a. Taxation and Housing
 - b. Taxation and Labor Supply
 - c. Taxation and Capital Accumulation
 - d. Evidence on Tax Incidence
5. Public Policy in a Federal System
 - a. The Tiebout Hypothesis
 - b. Evidence of the Impacts of Mobile Residents and Resources on Public Policy
 - i. Education
 - ii. Taxation in a Federal System

Readings for 1st 8 Weeks

1. Normative Concepts in Public Economics

- K. J. Arrow. "A Difficulty in the Concept of Social Welfare," *Journal of Political Economy*, 1950.
- F. M. Bator. "Simple Analytics of Welfare Maximization," *American Economic Review*, 1957.
- R.A. Musgrave, "A brief history of fiscal doctrine," in *Handbook of Public Economics, Volume 1*, 1985.
- P. A. Samuelson. "Social Indifference Curves," *The Quarterly Journal of Economics*, 1956.
- J. Gruber, "Why Study Public Finance?" and "Theoretical Tools in Public Finance," Chapters 1 and 2 in *Public Finance and Public Policy*, Worth, 2005.
- W. Hoyt, *Lecture 1: Normative Analysis and Welfare Economics, Lecture 2: Efficiency and the Market, Lecture 3: Social Indifference Curves*

2. Public Goods and Externalities

2.a. The Theory of Public Goods

- E. Lindahl, "Just Taxation--A Positive Solution," in *Classics in the Theory of Public Finance*, (R. A. Musgrave and A. T. Peacock, eds.).
- P. Samuelson. "The Pure Theory of Public Expenditures", *Review of Economics and Statistics*, 1954.
- P. Samuelson, "Diagrammatic Exposition of a Theory of Public Expenditure", *Review of Economics and Statistics*, 1955.
- P. Samuelson, "Aspects of Public Expenditure Theories," *Review of Economics and Statistics*, 1958.
- K. Wicksell, "A New Principle of Just Taxation," in *Classics in the Theory of Public Finance* (R. A. Musgrave and A. T. Peacock, eds.).
- W. H. Oakland, "Theory of public goods," in *Handbook of Public Economics, Volume 2*, 1987.
- J. Gruber, "Public Goods" Chapter 7 in *Public Finance and Public Policy*, Worth, 2007.
- W. Hoyt, *Lecture 4: Market Failure and Government*, pp. 1-12

2.b. Externalities

- *W. Baumol. "On Taxation and the Control of Externalities," *American Economic Review*, 1972.

- K. Chay and M Greenstone, "Air Quality, Infant Mortality, and the Clean Air Act of 1970," *NBER Working Paper*, 2003.
- R. Coase "The Problem of Social Cost" *Journal of Law and Economics*, 1960.
- W. Vickrey, "Pricing in Urban and Suburban Transport", *American Economic Review*, 1963.
- J. Gruber, "Externalities: Problems and Solutions" and "Externalities in Action: Environmental and Health Externalities" Chapters 5 and 6 in *Public Finance and Public Policy*, 2007.
- W. Hoyt, *Lecture 4: Market Failure and Government*, 13-16, *Lecture 5: The Problem of Social Costs: Private and Public Solutions*
- 2.c Private Provision of Public Goods**
- J. Andreoni. Privately Provided Public Goods in a Large Economy: The Limits of Altruism," *Journal of Public Economics*, 1988.
- J. Andreoni, "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving," *Economic Journal*, 1990.
- T. Bergstrom, L. Blume, and H. Varian, "Private Provision of Public Goods", *Journal of Public Economics*, 1986.
- R. W. Boadway, P. Pestieau, and D. E. Wildasin, "Tax-Transfer Policies and the Voluntary Provision of Public Goods," *Journal of Public Economics*, 1989.
- B. Duncan, "Modeling Charitable Contributions of Time and Money", *Journal of Public Economics* 72 (2), 213-242.
- R. D. Roberts, "Financing Public Goods," *Journal of Political Economy*, 1987.
- P. G. Warr, "Pareto Optimal Redistribution and Private Charity," *Journal of Public Economics*, 1982.
- J. Gruber, "Public Goods" Chapter 7 in *Public Finance and Public Policy*, Worth, 2005.
- W. Hoyt, *Lecture 6: Private Provision of Public Goods and Neutrality*

2.c.i Experimental and Empirical Evidence

- J. Andreoni. "An Experimental Test of the Public Goods Crowding Out Hypothesis," *American Economic Review*, 1993.
- G. E. Auten, H. Sieg, and C. T. Clotfelter, "Charitable Giving, Income, and Taxes: Analysis of Panel Data," *American Economic Review*, 2002.

M. Isaac and J. Walker, "Group Size Hypothesis of Public Goods Provision: Experimental Evidence," *Quarterly Journal of Economics*, 1988.

B. Kingma. "An Accurate Measure of the Crowd-Out Effect, Income Effect, and Price Effect for Charitable Contributions," *Journal of Political Economy*, 1989.^{JS}

G. Marwell and R. Ames, "Economists Free Ride --- Does Anyone Else?" *Journal of Public Economics*, 1981.

A. A. Payne. "Does the Government Crowd-Out Private Donations? New Evidence from a Sample of Non-Profit Firms," *Journal of Public Economics*, 1998.

W. Randolph. "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *Journal of Political Economy*, 1995.

D.C. Ribar and M. O. Wilhelm, "Altruistic and Joy-of-Giving Motivations in Charitable Behavior," *Journal of Political Economy*, 2002.

W. Hoyt, *Lecture 7: Empirical Studies of Public Policy and Private Contributions*

2.c.ii. Preference Revelation Mechanisms

T. Groves and J. Ledyard, "Optimal Allocation of Public Goods: A Solution to the Free Rider Problem," *Econometrica*, 1977.

R. Tideman and G. Tullock, "A New and Superior Process for Making Social Choices," *Journal of Political Economy*, 1976.

W. Hoyt, *Lecture 8: Preference Revelation Schemes for Public Goods*

2.d Estimating the Demand for Public Goods

T. Bergstrom and R. Goodman, "Private Demand for Public Goods," *American Economic Review*, 1973.

T.E. Borchering and R.T. Deacon, "The Demand for Services of Nonfederal Governments," *American Economic Review*, 1972.

T. J. Wyckoff. "The Nonexcludable Publicness of Primary and Secondary Public Education," *Journal of Public Economics*, 1984.

W. Hoyt, *Lecture 9: Estimating the Demand for Public Goods*

3. Theory of the Second Best

3.a Welfare Measures in Theory and Practice

E. K. Browning. "On the Marginal Cost of Welfare Taxation," *American Economic Review*, 1987.

- A. J. Auerbach and J. Hines. "Taxation and Economic Efficiency," Chapter 21 in *Handbook of Public Economics, Volume 3* eds. A. Auerbach and M. Feldstein, Elsevier Press, 2002.
- E.K. Browning and W. Johnson, "The Trade-off between Equality and Efficiency," *Journal of Political Economy*, 1984.
- V. Christiansen. "Reflections on the General Theory of the Second Best at its Golden Jubilee," *International Tax and Public Finance*, 2007
- P. Diamond and D. McFadden, "Some Uses of the Expenditure Function in Public Finance," *Journal of Public Economics*, 1974.
- J. Hausman. "Exact Consumer's Surplus and Deadweight Loss," *The American Economic Review*, 1981.
- R. Willig. "Consumer Surplus Without Apology," *The American Economic Review*, 1976.
- P. B. Sorenson. "The Theory of Optimal Taxation: What is the Policy Relevance?" *International Tax and Public Finance*, 2007.
- C. Stuart. "Welfare Cost per Dollar of Additional Tax Revenue in the United States," *American Economic Review*, 1984.
- W. Hoyt, *Lecture 10: Welfare Measures and the Evaluation of Policy and The Dual Approach and its Uses in Public Economics*

3.b Optimal Commodity Taxation

- P. A. Diamond and J. A. Mirrlees, "Optimal Taxation and Public Production I: Production Efficiency," *American Economic Review*, 1971.
- P. A. Diamond and J. A. Mirrlees, "Optimal Taxation and Public Production II: Tax Rules," *American Economic Review*, 1971.
- J. D. Wilson. "On the Optimal Tax Base for Commodity Taxation," *The American Economic Review*, 1989.
- L. Kaplow. "Optimal Taxation with Costly Enforcement and Evasion," *Journal of Public Economics*, 1990.
- J. Slemrod. "Optimal Taxation and Optimal Tax Systems," *Journal of Economic Perspectives*, 1990.
- J. E. Stiglitz, "Pareto efficient and optimal taxation and the new new welfare economics," in *Handbook of Public Economics, Volume 2* eds. A. Auerbach and M. Feldstein, North Holland Press, 1987.
- J. Gruber, "Tax Inefficiencies and their Implications for Optimal Taxation" Chapter 20 in *Public Finance and Public Policy*, 2007.
- W. Hoyt, *Lecture 11: Optimal Commodity Taxation*

3.c Optimal Income Taxation

- P.A. Diamond, "Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates," *American Economic Review*, 1998.
- M E. Feldstein. "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act," *Journal of Political Economy*, 1995.
- J. Gruber and E. Saez, "The Elasticity of Taxable Income: Evidence and Implications," *Journal of Public Economics*, 2002.
- E. Saez. "Using Elasticities to Derive Optimal Income Tax Rates," *Review of Economic Studies*, 2001.
- J. Slemrod and W. Kopczuk, "The Optimal Elasticity of Taxable Income," *Journal of Public Economics*, 2002.
- J. E. Stiglitz. "Self-Selection and Pareto Efficient Taxation," *Journal of Public Economics*, 1982.
- J. E. Stiglitz, "Pareto efficient and optimal taxation and the new new welfare economics" in *Handbook of Public Economics, Volume 1*, 1986.
- H. R. Varian. "Redistributive Taxation as Social Insurance," *Journal of Public Economics*, 1980.
- W. Hoyt, *Lecture 11: Some Basics on the Theory of Optimal Income Taxation*

3.d Public Good Provision with Distorting Taxation

- C. Ballard and D. Fullerton, "Distortionary Taxes and the Provision of Public Goods," *Journal of Economic Perspectives*, 1992, 117-131.¹⁸
- R. Triest. "The Relationship between the Marginal Cost of Public Funds and Marginal Excess Burden," *American Economic Review*, 1990.

3.e Taxation in General Equilibrium

- C. Ballard, J. Shoven, and J. Whalley, "General Equilibrium Computations of the Marginal Welfare Cost of Capital Income Taxation," *American Economic Review*, 1985.
- P. A. Diamond. "Tax Incidence in a Two-Good Model," *Journal of Public Economics*, 1978.
- J. Gravelle and L. Kotlikoff, "The Incidence and Efficiency Costs of Corporate Taxation When Corporate and Noncorporate Firms Produce the Same Good," *Journal of Political Economy*, 1989.
- A. Harberger. "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, 1962.

L. Kotlikoff and L. Summers, "Tax Incidence," in A. J. Auerbach and M. Feldstein, *Handbook of Public Economics I*, North Holland Press, 1985.

C.E. McLure. "General Equilibrium Incidence Analysis," *Journal of Public Economics*, 1975.

P. M. Mieszkowski. "On the Theory of Tax Incidence," *Journal of Political Economy*, 1967.

J. Shoven and J. Whalley. "Applied General Equilibrium Models of Taxation and International Trade: An Introduction and Survey," *Journal of Economics Literature*, 1984.

4. The Impacts of Taxation: Theory and Evidence

4.a Taxation and Housing

D. Bruce and D. Holtz-Eakin. "Apocalypse Now? Fundamental Tax Reform and Residential Housing Values, NBER Working Paper, 1997.

W. Hoyt and S. Rosenthal, "Housing Demand, Capital Gains, and Tax Reform," *Journal of Urban Economics*, 1992.

J. Poterba. "Tax Subsidies to Owner-Occupied Housing: An Asset-Market Approach," *Quarterly Journal of Economics*, 1984.

H. Rosen. "Housing Decisions and the U.S. Income Tax," *Journal of Public Economics*, 1979.

S. Woodward and J. Weicher, "Goring the Wrong Ox: A Defense of the Mortgage Interest Deduction," *National Tax Journal*, 1989.

4.b Taxation and Labor Supply

J. A. Hausman, "Taxes and Labor Supply" in *Handbook of Public Economics, Volume 1*, 1985.

T. MaCurdy, "Work Disincentive Effects of Taxes: A Reexamination of Some Evidence," *The American Economic Review*, 1992.

N. Eissa, J. B. Liebman, "Labor Supply Response to the Earned Income Tax Credit" *Quarterly Journal of Economics*, 1996.

4.c Taxation and Capital Accumulation

M. Boskin, Michael. "Taxation, Savings, and the Rate of Interest," *Journal of Political Economy*, 1978.

M. Feldstein. "The Welfare Cost of Capital Income Taxation," *Journal of Political Economy*, 1978.

W. Gale and J. K. Scholz, "IRAs and Household Saving," *American Economic Review*, 1994.

R. Hall and D. Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, 1967.

K. A. Hassett and R. G. Hubbard, "Tax Policy and Investment," NBER Working Paper, 1996.

J. R. Hines. "Three Sides of Harberger Triangles," NBER Working Paper, 1998.

L. Kotlikoff. "Taxation and Savings: A Neoclassical Perspective," *Journal of Economic Literature*, 1984.

J. Shoven. "The Incidence and Efficiency Effects of Taxes on Income from Capital," *Journal of Political Economy*, 1976.

S. Venti and D. Wise, "Tax Deferred Accounts, Constrained Choice, and the Estimation of Individual Saving," *Review of Economic Studies*, 1986.

4.d Evidence on Tax Incidence

T. Besley and H.S. Rosen. "Sales Taxes and Prices: An Empirical Analysis," *National Tax Journal*, 1999.

J. Gruber and B. Koszegi, "Tax Incidence When Individuals are Time Consistent: The Case of Cigarette Excise Taxes," *Journal of Public Economics*, 2004.

J. W. Harden and W. H. Hoyt, "MSA Location and the Impact of State Taxes on Employment and Population: A Comparison of Border and Interior MSA's," manuscript, 2006.

A. Mitrusi and J. Poterba, "The Distribution of Payroll and Income Tax Burdens, 1979-99," *National Tax Journal*, 2000.

J. Poterba. "Lifetime Incidence and the Distributional Burden of Excise Taxes," *American Economics Review*, 1989.

5. Public Policy in a Federal System

W. E. Oates. "An Essay on Fiscal Federalism," *Journal of Economic Literature*, 1999.

D. L. Rubinfeld, "The economics of the local public sector," in A. J. Auerbach and M. Feldstein, *Handbook of Public Economics I*, 1985.

J. Gruber. "State and Local Government Expenditure," Chapter 10 in *Public Finance and Public Policy*, 2006

5.a The Tiebout Hypothesis

J. Sonstelie and P. Portney, "Profit Maximizing Communities and the Theory of Local Public Expenditures," *Journal of Urban Economics*, 1978.

S. Scotchmer. "Local Public Goods and Clubs," in *Handbook of Public Economics, Volume 4* eds. A. Auerbach and M. Feldstein, 2002.

C. Tiebout. "A Pure Theory of Local Expenditures," *Journal of Political Economy*, 1956.

P. W. Rhode and K. S. Strumpf. "Assessing the importance of Tiebout sorting: Local heterogeneity from 1850 to 1990", *American Economic Review*, 2003.

5.b Limits to the Tiebout Model

J. M. Buchanan and C. J. Goetz. "Efficiency Limits of Fiscal Mobility: An Assessment of the Tiebout Model, *Journal of Economics*, 1972.

D. Epple and A. Zelentiz. "The Implications of Competition among Jurisdictions: Does Tiebout need Politics? *Journal of Political Economy*, 1981.

B. Hamilton. "Zoning and Property Tax in a System of Local Governments," *Urban Studies*, 1975.

B. Hamilton "Capitalization of Intra-jurisdictional Differences in Local Tax Prices," *American Economic Review*, 1976.

W. E. Oates and R. M. Schwab. "Economic Competition among Jurisdictions: Efficiency or Distortion Inducing? *Journal of Public Economics* 1989.

5.c Tests of the Tiebout Hypothesis: The Impacts of Public Goods on Property Values

J. Brueckner. "A Test for Allocative Efficiency in the Local Public Sector," *Journal of Public Economics*, 1982.

W. H. Hoyt and S. S. Rosenthal, "Household Location and Tiebout: Do Families Sort According to Preferences for Locational Amenities?" *Journal of Urban Economics* 1996.

W. E. Oates. "The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis," *Journal of Political Economy*, 1969.

L. Barrow and C. Rouse "Using Market Valuation to Assess Public School Spending", *Journal of Public Economics*, 2003.

D. N. Figlio and M. E. Lucas. What's in a Grade? School Report Cards and the Housing Market. *American Economic Review*, 2004.

L. L. Linden and J. E. Rockoff "There Goes The Neighborhood? Estimates of the Impact of Crime Risk On Property Values From Megan's Laws," NBER Working Paper, 2006.

R. Randall. "House prices and the provision of local public services: Capitalization under school choice programs", *Journal of Urban Economics*, 2005.

M. Urquiola. "Does school choice lead to sorting? Evidence from Tiebout variation", *American Economic Review*, 2005.

5.d *Sorting Among Communities: The Normative Implications*

- C. De Bartolome. "Equilibrium and Inefficiency in a Community Model with Peer-Group Effects," *Journal of Political Economy*, 1991.
- D. Epple, Dennis, R. Filimon, and T. Romer. "Equilibrium among Local Jurisdictions: Toward an Integrated Treatment of Voting and Residential Choice," *Journal of Public Economics*, 1984.
- D. Epple and T. Romer. "Mobility and Redistribution," *Journal of Political Economy*, 1991.
- R. Fernandez and R. Rogerson. "Keeping People Out: Income Distribution, Zoning, and the Quality of Public Education," *International Economic Review*, 1997.
- W. H. Hoyt and K. Lee. "Subsidies as Sorting Devices," *Journal of Urban Economics*, 2001.

5.c *Evidence of the Impacts of Mobile Residents and Resources on Public Policy*

- T. Besley and A. C. Case "Incumbent behavior: Vote-seeking, tax setting, and yardstick competition", *American Economic Review*, 1995.
- R. M. Braid. "The Spatial Effects of Wage or Property Tax Differentials, and Local Government Choice between Tax Instruments," *Journal of Urban Economics*, 2002.
- J. K. Brueckner. "A Tiebout/tax-competition model", *Journal of Public Economics*, 2000.
- J. K. Brueckner and L. A. Saavedra. "Do Local Governments Engage in Strategic Property-Tax Competition?" *National Tax Journal*, 2001.
- A. C. Case, H. S. Rosen, and J. R. Hines. "Budget Spillovers and Fiscal Interdependence: Evidence from the States," *Journal of Public Economics*, 1993.
- S. Calabrese, D. Epple, T. Romer and H. Sieg "Local public good provision: Voting, peer effects, and mobility", *Journal of Public Economics*, 2006.
- M. Greenstone and E. Moretti, "Bidding for Industrial Plants: Does Winning a "Million Dollar Plant" Increase Welfare?" NBER Working Paper , 2003.
- J. Gruber. "Education," Chapter 11 in *Public Finance and Public Policy*, 2006
- T. J. Holmes. "The Effect of State Policies on the Location of Manufacturing: Evidence from State Borders," *Journal of Political Economy*, 1998.
- C. M. Hoxby. "Does competition among public schools benefit students and taxpayers?", *American Economic Review*, 2000.

- W. H. Hoyt. "Property Taxation, Nash Equilibrium, and Market Power," *Journal of Urban Economics*, 1991.
- W. H. Hoyt and J. W. Harden, "MSA Location and the Impact of State Taxes on Employment and Population: A Comparison of Border and Interior MSA's," UK Working Paper, 2006.
- M. Keen and M. Marchand. "Fiscal Competition and the Pattern of Public Spending," *Journal of Public Economics*, 1997.
- S. T. Mark, T. J. McGuire, and L. E. Papke. "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area." *National Tax Journal*, 2000.
- I.W. H. Parry. "How large are the welfare costs of tax competition?" *Journal of Urban Economics*, 2003.
- M. Wasylenko. "Taxation and Economic Development: The State of the Economic Literature." *New England Economic Review, Proceedings of a Symposium on the Effects of State and Local Public Policies on Economic Development*, 1997.
- D. E. Wildasin. "Interjurisdictional Capital Mobility: Fiscal Externality and a Corrective Subsidy," *Journal of Urban Economics*, 1989.
- J. D. Wilson. "A Theory of Interregional Tax Competition," *Journal of Urban Economics*, 1986.
- J. D. Wilson. "Theories of Tax Competition," *National Tax Journal*, 1999.
- J.D. Wilson, "Welfare-improving competition for mobile capital," *Journal of Urban Economics*, 2005.
- G. R. Zodrow and P. Mieszkowski. "Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods," *Journal of Urban Economics*, 1986.
July 28, 2007
