

ECON 445
Spring 2007
Professor Paul Rothstein

PUBLIC FINANCE

This is a course in *the economics of the public sector*. We study the economic rationale for government activity, which provides a foundation for the economic analysis of public policy. We also study particular spending and tax policies and examine the insights and limitations of the *economic* analysis of these policies.

The economic perspective on markets and governments is that they are both institutions for allocating resources. They are arguably much more than that. Economics is distinctive in focusing on this particular aspect, but it is an important aspect, and placing both institutions in one simple framework ensures that the analysis is at least internally consistent. When we do branch beyond very narrow economic criteria, we will try not to hold the two institutions to different standards, ignore the weaknesses of one or the strengths of the other, apply inconsistent principles, or do any of the other things that make for lively cable television.

This class fulfills the requirement of the Economics major that a student take two classes with a prerequisite of Economics 401 or 402. This means that this course is a “capstone” for the major – an opportunity to synthesize what you have learned so far and take it to the next level. We will review, extend, and use the full box of analytical tools that are presented in the prerequisite classes. Expect a worthwhile challenge.

Prerequisites

Economics 103B, 104B, 401; Math 131.

Note: Calculus and price theory will be used in about one-third of the course. We will review basic material and develop some extensions in the first couple of weeks.

Textbook and Course Reader

Jonathan Gruber, **Public Finance and Public Policy**, 2nd edition.

Purchase the **Course Reader** from the Department of Economics (205 Eliot Hall)

The course reader will come in two parts.

Contacting Me

Office: Eliot 321D

Email: rstein@wustl.edu

Phone (and voice mail): 935-4352

Office Hours: Monday and Wednesday, 2:30-4:00pm, in my office.

I will need to cancel office hours from time to time because of travel and Departmental commitments. Please watch the “Updates” section of the course website for this information. Individual appointments will replace office hours as necessary.

Website

This syllabus, course updates, assignments, and other useful information, are available at the course website:

<http://rstein.wustl.edu/UPF07.htm>

Requirements

There will be four homework sets, each worth 5% of the grade (for a total of 20%). A paper worth 15% of your grade will be assigned and due in the first half of the course. A late midterm worth 25% of the grade will be given in class.

The final exam is worth 40% of the grade and will take place May 8, 1:00-3:00pm, during finals week.

Class participation will count in borderline situations, at my discretion.

A Few Rules

- Please arrive on time and consider how your behavior affects the people around you.
- There are no extra credit opportunities, no extra papers, no exam retakes, and no distributed lecture notes apart from the material in the course reader.
- The exams will be based on the problem sets and lectures, including journal articles I assign and discuss in lecture. If you miss a lecture you should get the notes from a colleague (but see the next bullet point).
- All questions on any subject are fair game at office hours.
- I encourage you to bring the course reader to each lecture. Part I of the course reader has old notes of mine for material in the first half of the course. I will not follow these notes exactly, but you will be able to focus less on writing and more on what I am saying if you have this material in front of you.

Lecture	Date	Topics and Reading Assignments
1	16-Jan	Introduction; Mathematics
2	18-Jan <i>Primary</i>	The Mathematics of Optimization Nicholson, <u>The Mathematics of Optimization</u> , course reader
3	23-Jan <i>Primary</i> <i>Review for Lecture</i>	Empirical Tools of Public Finance Chapter 3 (textbook), "Empirical Tools of Public Finance" Dale and Krueger (2002), <u>Estimating the Payoff to Attending a More Selective College</u> , course reader
Review of Microeconomic Theory: Welfare Properties of Market Equilibria in the Standard Economic Model		
4	25-Jan <i>Primary</i> <i>Review for Lecture</i>	Microeconomic Theory Silberberg, "Section 15.2: The Pareto Conditions," course reader Chapter 2 (textbook), "Theoretical Tools of Public Finance," first half
5	30-Jan <i>Primary</i> <i>Review for Lecture</i>	Microeconomic Theory Silberberg, "Section 15.3: The Classical 'Theorems' of Welfare Economics," course reader Chapter 2 (textbook), "Theoretical Tools of Public Finance," second half
Welfare Problems with Market Equilibria when there are Externalities; Remedies		
6	1-Feb <i>Primary</i>	Theory Chapter 5 (textbook), "Externalities: Problems and Solutions"
7	6-Feb <i>Primary</i> <i>Primary</i>	Applications Barthold (1994), <u>Issues in the Design of Environmental Excise Taxes</u> , course reader Chapter 6 (textbook), "Externalities in Action"
8	8-Feb <i>Primary</i> <i>Review for Lecture</i>	Applications Joskow (1998), <u>The Market for Sulfur Dioxide Emissions</u> , course reader Miguel and Kremer (2004), <u>Worms: Identifying Impacts on Education and Health in the Presence of Treatment Externalities</u> , course reader

Welfare Problems with Market Equilibria when there are Public Goods;

Remedies

- | | | |
|---|---|---|
| 9 | 13-Feb
<i>Primary</i>
<i>Primary</i>
<i>Review for Lecture</i> | Theory
Silberberg, "Section 15.6: Public Goods," course reader
Chapter 7 (textbook), "Public Goods"
Samuelson (1955), <u>A Diagrammatic Exposition of a Theory of Public Expenditure</u> , course reader |
| 10 | 15-Feb
<i>Primary</i>
<i>Primary</i> | The Nature of Public Policy and the Role of Economic Analysis
Chapter 9 (textbook), "Political Economy"
Stiglitz (1998), <u>The Private Uses of Public Interests: Incentives and Institutions</u> , course reader |
| Social Insurance: The New (and Expensive) Function of Central Government | | |
| 11 | 20-Feb
<i>Primary</i> | Social Insurance
Chapter 12 (textbook), "Social Insurance: The New Function of Government" |
| 12 | 22-Feb
<i>Primary</i>
<i>Primary</i>

<i>Review for Lecture</i> | Social Security
Chapter 13 (textbook), "Social Security"
Excerpt on the Diamond-Orszag plan to rescue social security (OASDI), course reader
Statistics on social security benefits and retirement, course reader |
| 13 | 27-Feb
<i>Primary</i> | Unemployment Insurance
Chapter 14 (textbook), "Unemployment Insurance, Disability Insurance, and Worker's Compensation" |
| 14 | 1-Mar
<i>Primary</i> | Health Insurance
Chapter 15 (textbook), "Health Insurance I: Health Economics and Private Health Insurance" |
| 15 | 6-Mar
<i>Primary</i>

<i>Primary</i> | Health Insurance
Chapter 16 (textbook), "Health Insurance II: Medicare, Medicaid, and Health Care Reform"
Feldstein (2005), <u>Rethinking Social Insurance</u> , first half only, course reader |
| Programs to Assist the Poor | | |
| 16 | 8-Mar | Income Distribution and Welfare Programs
Chapter 17 (textbook), "Income Distribution and Welfare Programs" |

Central Concepts in the Analysis of Taxation		
17	20-Mar <i>Primary</i> <i>Review for Lecture</i> <i>Review for Lecture</i> <i>Review for Lecture</i> <i>Review for Lecture</i>	Taxation: Overview and Vocabulary Chapter 18 (textbook), "Taxation in the United States and Around the World" Figure, Federal Government, course reader Figure, State and Local Government, course reader Table: Government Sector, 2004, OECD countries, course reader Table: Taxation, 2002, OECD countries, course reader
18	22-Mar <i>Primary</i> <i>Primary</i> <i>Review for Lecture</i>	Incidence and Fairness Chapter 19 (textbook), "The Equity Implications of Taxation: Tax Incidence" Tables from CBO, <u>Historical Effective Federal Tax Rates: 1979-2004</u> , course reader Piketty and Saez (2003), <u>Income Inequality in the United States, 1919-1998</u> , course reader, especially Figures 1, 2, 5, 8, 9.
19	27-Mar <i>Primary</i> <i>Primary</i>	How Much Do People Know About the Tax System, and What Do They Think is Fair? <u>National Survey of Americans' Views on Taxes</u> , course reader, especially Questions 4a, 4b, 7a, 7b, 8, 10, 16, 20, 21, 22, 29, 36 Slemrod (2006), <u>The Role of Misconceptions in Support for Regressive Tax Reform</u> , course reader
Exam	29-Mar	Exam
	The Theory of Optimal Taxation	
20	3-Apr <i>Primary</i> <i>Review for Lecture</i>	Optimal Taxation Chapter 20 (textbook), "Tax Inefficiencies and Their Implications for Optimal Taxation" Table 4 from Jorgenson and Yun, course reader

Key Features of US Taxes on Income, Wealth and Consumption; Effects on Individual Choice and Welfare; Effects on the Economy

- 21 5-Apr **Individual Income Tax**
Primary 2006 Form 1040 and Tax Rate Schedule, course reader.
Vocabulary: exemptions, standard deduction, itemized deductions, tax credits, refundable tax credits, AGI, AMT, Taxable Income.
Primary Holtz-Eakin (2005), The Individual Alternative Minimum Tax, especially Figures 2 and 4 and Table 1; course reader
Review for Lecture Statistical Abstract of the United States, Table 473, course reader
- 22 10-Apr **Taxes on Labor Supply**
Primary Chapter 21 (textbook), "Taxes on Labor Supply"
- 23 12-Apr **Taxes on Savings**
Primary Chapter 22 (textbook), "Taxes on Savings"
- 24 17-Apr **Taxes on Risk Taking and Wealth**
Primary Chapter 23 (textbook), "Taxes on Risk Taking and Wealth"
- 25 19-Apr **Consumption Taxes and Fundamental Tax Reform**
Primary Chapter 25 (textbook), "Fundamental Tax Reform"
Review for Lecture Chapter 7, "What are the Alternatives," Taxing Ourselves, course reader

The Challenge of Ensuring Compliance: Avoidance, Evasion, and the Capacity of the IRS to Audit and Enforce the Tax Code

- 26 24-Apr **Tax Avoidance and Evasion**
Primary Chapter 19, "Gimme Shelter," Perfectly Legal, course reader
Review for Lecture Tax Year 2001 Federal Tax Gap, course reader
Review for Lecture Form 1040, Schedule C; course reader
Review for Lecture IRS-2005-37 (Son of Boss), course reader
Review for Lecture NY Times (04-22-06), course reader
Review for Lecture NY Times (03-28-06), course reader
Review for Lecture IRS Notice 2000-44, course reader
- 27 26-Apr **Auditing and Enforcement**
Primary Rossotti (2002), Report to the IRS Oversight Board, excerpts, course reader
Primary Statistical Abstract of the United States, Tables 471 and 472, course reader
Primary Spreadsheet on examination coverage, course reader
Review for Lecture IRS 2005 Databook, Table 10, course reader
Review for Lecture IRS 2005 Databook, Table 18, course reader