PUBLIC ECONOMICS LECTURES

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Harvard University

This is the first of two courses in the graduate public economic sequence at Harvard. This one-semester course covers basic issues in the optimal design of tax and social insurance policies, with emphasis on combining theoretical models with empirical evidence. Topics include efficiency costs and incidence of taxation, income taxation, transfer and welfare programs, public goods and externalities, optimal social insurance (excluding social security), and welfare analysis in behavioral models.

The course consists of 24 lectures, each lasting 1.5 hours. The slides and reading list are divided into seven parts:

Part 1: Introduction

Part 2: Tax Incidence [3 lectures]

Part 3: Efficiency Cost of Taxation [3 lectures]

Part 4: Optimal Taxation [5 lectures]

Part 5: Income Taxation and Labor Supply [4 lectures]

Part 6: Social Insurance [5 lectures]

Part 7: Public Goods and Externalities [4 lectures]

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PUBLIC ECONOMICS READING LIST
Harvard University, Fall 2009

***Bold** indicates required reading; * indicates recommended reading*

Part 2: Tax Incidence

A. Partial Equilibrium Incidence

A. Atkinson and J. Stiglitz. *Lectures on Public Economics*, New York: McGraw Hill, 1980. Chapter 6.

R. Chetty, A. Looney, and K. Kroft. "Salience and Taxation: Theory and Evidence," *American Economic Review* 99(4): 1145-1177, 2009. Section V.C.

L. Kotlikoff and L. Summers. "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, 1043-1092. Required reading: Sections 0, 1, 2, 3.1, and 4.4.

J. Poterba. "Lifetime Incidence and the Distributional Burden of Excise Taxes," *American Economic Review*, 79(2), May 1989, 325-330.

B. Salanie. *The Economics of Taxation*, Cambridge: MIT Press, 2003, Chapter 1.

B. Partial Equilibrium: Empirical Applications

J. Adda and F. Cornaglia. "Taxes, Cigarette Consumption and Smoking Intensity," *American Economic Review*, 96(4): 1013—1028, 2006.

T. Besley and H. Rosen. "Sales Taxes and Prices: An Empirical Analysis," *National Tax Journal* 52, (1999).

J. Doyle and K. Samphantharak. "$2.00 Gas! Studying the Effects of a Gas Tax Moratorium," *Journal of Public Economics,* April 2008.

W. Evans, J. Ringel, and D. Stech. "Tobacco Taxes and Public Policy to Discourage Smoking," in *Tax Policy and the Economy*, vol. 13, ed. J. Poterba, MIT Press: Cambridge, 1999.

J. Gruber and B. Koszegi. "Tax Incidence when Individuals are Time-Inconsistent: The Case of Cigarette Excise Taxes," *Journal of Public Economics* (2004), 88(9-10), 1959-1987.

* J. Hastings and E. Washington. "The First of the Month Effect: New Evidence for the Optimal Timing of Food Stamp Benefits," NBER Working Paper No. 14578, 2008.

R. Kerschbamer and G. Kirchsteiger, 2000. "Theoretically robust but empirically invalid? An experimental investigation into tax equivalence," *Economic Theory*, 16: 719-734.

J. Poterba. "Lifetime Incidence and the Distributional Burden of Excise Taxes," *American Economic Review* 79 (May 1989), 325-330.

* J. Rothstein. "The Unintended Consequences of Encouraging Work: Tax Incidence and the EITC," Princeton Univ. Working Paper, 2008.

C. General Equilibrium Incidence

A. Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," NBER Working Paper No. 11686, October 2005.

C. Davidson and L. Martin, "General Equilibrium Incidence Under Imperfect Competition: A Quantity-Setting Supergame Analysis," *Journal of Political Economy*, 93(6), December 1985, 1212-1223.

P. Diamond. "Tax Incidence in a Two-Good Model," *Journal of Public Economics*, 9(3), June 1978, 283-299.

D. Feenberg, A. Mitrusi, and J. Poterba. "Distributional Effects of Adopting a National Retail Sales Tax," in J. Poterba, ed., *Tax Policy and the Economy*, Volume 11, 49-89, Cambridge, MA: MIT Press, 1997.

A. Harberger. "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, 1962, 215-240.

L. Kotlikoff and L. Summers. "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, Sections 2.2.1-2.2.3 and 2.3.

C. McClure. "General Equilibrium Incidence Analysis," *Journal of Public Economics*, 4(2), February 1975, 125-162.

J. Pechman. *Who Paid the Taxes, 1967-85*, Washington, D.C.: The Brookings Institution, 1986, Chapters 1, 3.

N. Stern. "The Effects of Taxation, Price Controls, and Government Intervention in Oligopoly and Monopolistic Competition," *Journal of Public Economics*, 32(2), March 1987, 133-158.

D. Open Economy Applications

D. Bradford, "Factor Prices May Be Constant but Factor Returns are Not," *Economic Letters*, volume 1, 1978, 199-203.

* M. Feldstein and C. Horioka, "Domestic Savings and International Capital Flows," *Economic Journal*, 90(358), June 1980, 314-329.

M. Feldstein and P. Krugman, "International Trade Effects of Value Added Taxation," in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy*, Chicago: University of Chicago Press, 1990, 263-278.

L. Kotlikoff and L. Summers, "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, 1043-1092, Section 3.1.

E. Capitalization and the Asset Price Approach

D. Cutler, "Tax Reform and the Stock Market: An Asset Price Approach," *American Economic Review*, 78(5), December 1988, 1107-1117.

* J. Friedman, "The Incidence of the Medicare Prescription Drug Benefit: Using Asset Prices to Assess Its Impact on Drug Makers," Harvard KSG Working Paper, 2009.

J. Gyourko and J. Tracy, "The Importance of Local Fiscal Conditions in Analyzing Local Labor Markets," *Journal of Political Economy*, 97(5), October 1989, 1208-1231.

J. Gyourko and J. Tracy, "The Structure of Local Public Finance and the Quality of Life," *Journal of Political Economy*, 99(4), August 1991, 774-806.

* L. Linden and J. Rockoff, "There Goes the Neighborhood? Estimates of the Impact of Crime Risk on Property Values from Megan's Laws," *American Economic Review* 98(3): 1103-1127, 2008.

D. Lyon, "The Effect of the Investment Tax Credit on the Value of the Firm," *Journal of Public Economics*, 38(2), March 1989, 227-247.

J. Poterba, "Tax Subsidies to Owner-Occupied Housing: An Asset Market Approach," *Quarterly Journal of Economics*, 99(4), November 1984, 729-752.

J. Roback, "Wages, Rents, and the Quality of Life," *Journal of Political Economy*, 1982, 1257-1276.

K. Rosen, "The Impact of Proposition 13 on House Prices in Northern California: A Test of the Interjurisdictional Capitalization Hypothesis," *Journal of Political Economy*, 90(1), February 1982, 191-200.

L. Summers, "The Asset Price Approach to the Analysis of Capital Income Taxation," *Proceedings of the National Tax Association*, 1983, 112-120.

* L. Summers, "Taxation and Corporate Investment: A q-Theory Approach," *Brookings Papers on Economic Activity*, 1981:1, 67-127.

F. Mandated Benefits

* D. Acemoglu and J. Angrist, "Consequences of Employment Protection? The Case of the Americans with Disabilities Act,'' *Journal of Political Economy* 109(5) 915-957, 2001

D. Cutler, and B. Madrian, "Labor Market Implications of Rising Health Insurance Costs," *RAND Journal of Economics*, Autumn 1998, 509-530.

J. Gruber, "The Incidence of Mandated Maternity Benefits," *American Economic Review*, 84(3), June 1994, 622-641.

J. Gruber and A. Krueger "The Incidence of Mandated Workers Compensation," in D. Bradford, ed., *Tax Policy and the Economy*, Volume 5, 111-143, Cambridge, MA: MIT Press, 1991.

J. Gruber, "The Incidence of Payroll Taxation: Evidence from Chile," Journal of Labor Economics 15, 1997, S73-S91.

C. Ruhm, "The Economic Consequences Of Parental Leave Mandates: Lessons From Europe," *Quarterly Journal of Economics* 113(1): 285-317, 1998.

L. Summers, "Some Simple Economics of Mandated Benefits," *American Economic Review*, 79(2), May 1989, 177-183.

Part 3: Efficiency Cost of Taxation

A. Theory

A. Auerbach, "The Theory of Excess Burden and Optimal Taxation," in A. Auerbach and M. Feldstein, *Handbook of Public Economics*, Volume 1, 61-127. Amsterdam: North Holland,

1985. Sections 1, 2, 3.1, and 4.

A. Auerbach, J. Hines , "Taxation and Economic Efficiency," in A. Auerbach and M. Feldstein, *Handbook of Public Economics*, Volume 3, Chapter 21, Amsterdam: North Holland, 2002.

C. Ballard, D. Fullerton, J. Shoven, and J. Whalley, *A General Equilibrium Model for Tax Policy Evaluation*, Chicago: University of Chicago Press, 1985, Chapters 2, 3.

* C. Ballard, J. Shoven, and J. Whalley, "General Equilibrium Computations of the Marginal Welfare Cost of Taxes in the United States," *American Economic Review*, March 1985, 128-138. E. Browning, "On the marginal welfare cost of taxation," *American Economic Review* 77: 11–23, 1987.

D. Bernheim and A. Rangel, 2009. "Beyond Revealed Preference: Choice-Theoretic Foundations for Behavioral Welfare Economics," *Quarterly Journal of Economics*, 124(1): pages 51-104.

E. Browning, "The Non-Tax Wedge," *Journal of Public Economics*, 53, 1994, 419-434.

R. Chetty, "Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods," *Annual Review of Economics* 1: 451-488, 2009. Sections 2 and 6.

R. Chetty, A. Looney, and K. Kroft. "Salience and Taxation: Theory and Evidence," *American Economic Review* 99(4): 1145-1177, 2009. Section V.C.

Chipman, John S. and James C. Moore. "Compensating Variation, Consumer's Surplus and Welfare," *American Economic Review*, 70(5), 1980, 933-49.

D. Corlett and E. Hauge, "Complementarity and the Excess Burden of Taxation," *Review of Economic Studies* 21(1): 21-30, 1953

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* A. Harberger, "The Measurement of Waste," *American Economic Review*, 54(3), 1964, 58-76.

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J. Slemrod, "Optimal Taxation and Optimal Tax Systems," *Journal of Economic Perspectives*, 4(1), Winter 1990, 157-178.

B. Applications

D. Albouy, "The Unequal Geographic Burden of Federal Taxation," NBER Working Paper 13995, 2008.

* R. Chetty. "Is the Taxable Income Elasticity Sufficient to Calculate Deadweight Loss? The Implications of Evasion and Avoidance," *American Economic Journal: Economic Policy*: 1(2):

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K. Gallagher and E. Muehlegger, 2008. “Giving Green to Get Green: Incentives and Consumer Adoption of Hybrid Vehicle Technology,” Harvard KSG Working Paper.

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* L. Goulder and R. Williams. "The Substantial Bias from Ignoring General Equilibrium Effects in Estimating Excess Burden, and a Practical Solution," *Journal of Political Economy*, 2003, 111:898-927.

* J. Marion and E. Muehlegger. “Measuring Illegal Activity and the Effects of Regulatory Innovation: Tax Evasion and the Dyeing of Untaxed Diesel,” *Journal of Political Economy* 116:4, p.633-666, August 2008.

* J. Poterba, “Taxation and Housing: Old Questions, New Answers,” *American Economic Review* 82(2): 237-242, May 1992.

Part 4: Optimal Taxation

A. Optimal Commodity Taxation

E. Ahmad and N. Stern, “The Theory of Reform and Indian Indirect Taxes,” *Journal of Public Economics*, 25(3), December 1984, 259-298.

A. Atkinson and J. Stiglitz, *Lectures on Public Economics*, New York: McGraw Hill, 1980. Chapter 12-1,12-2, and 12-5.

A. Auerbach, “The Theory of Excess Burden and Optimal Taxation,” in A. Auerbach and M. Feldstein, Handbook of Public Economics, 1985, Volume 1, 61-127, Section 5.

A. Auerbach and J. Hines, “Taxation and Economic Efficiency,” in A. Auerbach and M. Feldstein, 2002, Handbook of Public Economics, Volume 3, 61-125.

T. Besley and I. Jewitt, “Uniform Taxation and Consumer Preferences,” *Journal of Public Economics*, September 1995, 58, 73-84.

R. Burgess and N. Stern, “Taxation and Development,” *Journal of Economic Literature*, 31(2), 1993, 762-830.

* P. Diamond, “A Many-Person Ramsey Tax Rule,” *Journal of Public Economics*, 4, 1975, 335-342.

* P. Diamond and J. Mirrlees, “Optimal Taxation and Public Production,” *American Economic Review*, 61, 1971, 8-27 and 261-278.

* T. O’Donoghue, and M. Rabin, 2006. “Optimal Sin Taxes,” *Journal of Public Economics* 90:

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A. Sandmo, “Optimal Taxation: An Introduction to the Literature,” *Journal of Public Economics*, 6(1-2), July-Aug 1976, 37-54.

B. Optimal Income Taxation

I. The Mirrlees Model

Atkinson, A.B., Stiglitz, J.E., “The design of tax structure: Direct versus indirect taxation,” *Journal of Public Economics* 6, 1976, 55-75.

* M. Brewer, E. Saez, and A. Shephard “Means Testing and Tax Rates on Earnings,” IFS Working Paper, *The Mirrlees Review: Reforming the Tax System for the 21st Century,* Oxford University Press, 2009.

R. Chetty, “Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods,” *Annual Review of Economics* 1: 451-488, 2009. Section 4.

* P. Diamond, “Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates,” *American Economic Review*, 88, March 1998, 83-95.

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G. Laroque, 2005 “Indirect taxation is superfluous under separability and taste homogeneity: A simple proof,” *Economic Letters*, 87, 141-144.

N. G. Mankiw and M. Weinzierl “The Optimal Taxation of Height: A Case Study of Utilitarian Income Redistribution” AEJ: Economic Policy forthcoming, 2009.

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J. Mirrlees, “An Exploration in the Theory of Optimal Income Taxation,” *Review of Economic Studies*, 38, 1971, 175-208.

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E. Saez, “Using Elasticities to Derive Optimal Income Tax Rates,” *Review of Economics Studies*, 68, 2001, 205-229, Sections 1-3 and 5.

B. Salanie, *The Economics of Taxation,* Cambridge: MIT Press, 2003, Chapter 4.

J. Stiglitz, “Pareto Efficient and Optimal Taxation and the New New Welfare Economics,” in A. Auerbach and M. Feldstein, Volume 2, 991-1041.

II. Optimal Transfer Programs

G. Akerlof, “The Economics of Tagging as Applied to the Optimal Income Tax,” *American*

***Economic Review*, 68(1), March 1978, 8-19.**

A.B. Atkinson, "Income Maintenance and Social Insurance," in A. Auerbach and M. Feldstein, eds., *Handbook of Public Economics Volume 2* (Amsterdam: North Holland, 1987), 779-908.

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* T. Besley and S. Coate, "Workfare versus Welfare: Incentives Arguments for Work Requirements in Poverty-Alleviation Programs," *American Economic Review*, 82(1), March 1992, 249-261.

S. Coate, "Altruism, the Samaritan's Dilemma, and Government Transfer Policy," *American Economic Review,* 85(1), March 1995, 46-57.

S. Coate, S. Johnson, and R. Zeckhauser, "Pecuniary Redistribution through In-Kind Programs," *Journal of Public Economics,* 55(1), September 1994, 19-40.

D. Lee and E. Saez "Optimal Minimum Wage in Competitive Labor Markets," NBER Working Paper No. 14320, September 2008.

A. Nichols and R. Zeckhauser, "Targeting Transfers Through Restrictions on Recipients," *American Economic Review*, 72(2), May 1982, 372-377.

E. Saez, "Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses," *Quarterly Journal of Economics* 117 (2002), 1039-1073.

* B. Salanie, *The Economics of Taxation*, Cambridge: MIT Press, 2003, Chapter 8.

* H. Varian, "Redistributive Taxation as Social Insurance," *Journal of Public Economics*, 14 (1980), 49-68.

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III. Capital Taxation and Dynamic Models

A. Auerbach, L. Kotlikoff, and J. Skinner "The Efficiency Gains from Dynamic Tax Reform," *International Economic Review*, 24, 1987.

C. Chamley, "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives," *Econometrica*, 54 (1986), 607-622.

E. Farhi and I. Werning, "Inequality, Social Discounting and Estate Taxation" *Journal of Political Economy* 115: 365-402, 2007.

* M. Feldstein, "The Welfare Cost of Capital Income Taxation," *Journal of Political Economy* 86 (1978), 329-52.

M. Golosov and A. Tsyvinski, "Designing Optimal Disability Insurance: A Case for Asset Testing," Journal of Political Economy, (2006) 114 (2).

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Part 5: Income Taxation and Labor Supply

A. Labor Supply Elasticity Estimation: Methodological Issues

* R. Blundell and T. Macurdy, " Labor supply: a review of alternative approaches," in the *Handbook of Labor Economics*, Vol. 3A, O. Ashenfelter and D. Card, eds., 1999, pp. 1559-1695.

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B. Non-linear Budget Set Methods and Bunching

S. Borenstein, "To What Electricity Price Do Consumers Respond? Residential Demand Elasticity Under Increasing-Block Pricing," UC-Berkeley Working Paper, 2009.

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D. Intertemporal Labor Supply

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E. Elasticity of Taxable Income

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