

UNIVERSITY OF MISSOURI-COLUMBIA
Department of Economics

ECON 9415-Advanced Public Economics I

Course Description from the Course Catalogue: Tax incidence and optimal taxation in static economies and issues of taxation in dynamic economies. Prerequisite: 8451 (Old 405).

Time and Place: Monday-Wednesday 2:00-3:15pm Middlebush 205

Instructor:

Saku Aura

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Course Webpage: web.missouri.edu/~auras/Public415

Textbook: There is no required textbook for the class. Previous years the required textbook for the course was

Bernard Salanié: “The Economics of Taxation”. MIT Press, 2003

but unfortunately it is out of print at the moment. If you can find Salanie's book it is still strongly recommended (but by no means necessary). The following long review article is a useful substitute for Salenie's book:

Kaplow, Louis “Taxation”, NBER Working Paper no. 12061. Available at <http://papers.nber.org/papers/w12061>

You should read the whole article since it ties in many of the discussions we will have in this class.

The following books might be handy as references:

Myles, Gareth D.: “Public Economics.” Cambridge: Cambridge University Press, 1995. Alternative graduate level textbook, more theory oriented than Salanié’s book.

Slemrod, Joel, and Jon Bakija: “Taxing Ourselves: A Citizen’s Guide to the Great Debate over Tax Reform”, Second Edition. Cambridge, MIT Press, 2000. A good guide to the current US Tax System and the Tax reform discussion discussion.

Grading (corrected to add 100%): The grading on this course is based on the exams (midterm and a final) and problem sets. The relative weights of these for the final grade are:

Final exam	50%
Midterm	30%
Regular Problem sets	10%
One Larger Empirical Problem Set	10%

Exam:

The date and the time of the final exam will be announced later. The midterm is scheduled to be held in class on March 19th. The final exam is comprehensive.

Problem Sets:

I will occasionally assign problem sets based on the material we have learned. While satisfactory completion of the problem sets can have a marginal effect on the grade (20%), the main purpose of the problem sets is to provide practice material for the exams and a to improve your understanding of the material.

Please return an original (handwritten or typed up) problem set solution on the due date. Hold on to a copy of your solutions. You may cooperate with your classmates on the problem sets (work in groups, discuss the solutions), but each student should return their own individual answers to problems (do individual write-ups).

Statement on Academic Dishonesty

Academic integrity is fundamental to the activities and principles of a university. All members of the academic community must be confident that each person's work has been responsibly and honorably acquired, developed, and presented. Any effort to gain an advantage not given to all students is dishonest whether or not the effort is successful. The academic community regards breaches of the academic integrity rules as extremely serious matters. Sanctions for such a breach may include academic sanctions from the instructor, including failing the course for any violation, to disciplinary sanctions ranging from probation to expulsion. When in doubt about plagiarism, paraphrasing, quoting, collaboration, or any other form of cheating, consult the course instructor.

In addition the Economics Department has a Statement on Academic Dishonesty that notes, among other things, that both giving and receiving unauthorized aid on an exam are violations of the University's policy on academic dishonesty. Therefore, anyone caught committing an act of academic dishonesty will receive a failing grade in the class. You should note that, unless otherwise announced, no references may be consulted during an exam.

Statement concerning students with disabilities

If you need accommodations because of a disability, if you have emergency medical information to share with me, or if you need special arrangements in case the building must be evacuated, please inform me immediately. Please see me privately after class, or at my office.

To request academic accommodations (for example, a notetaker), students must also register with the Office of Disability Services, (<http://disabilityservices.missouri.edu>), S5 Memorial Union, 882-4696. It is the campus office responsible for reviewing documentation provided by students requesting academic accommodations, and for accommodations planning in cooperation with students and instructors, as needed and consistent with course requirements. For other MU resources for students with disabilities, click on "Disability Resources" on the MU homepage.

Statement on Intellectual Pluralism

The University community welcomes intellectual diversity and respects student rights. Students who have questions concerning the quality of instruction in this class may address concerns to either the Departmental Chair or Divisional leader or Director of the Office of Students Rights and Responsibilities (<http://osrr.missouri.edu/>). All students will have the opportunity to submit an anonymous evaluation of the instructor(s) at the end of the course.

Lecture Plan

Reading relevant articles from the reading list before the lecture will make the classroom discussion more interesting. The following is a rough guide on how the course will proceed.

Lecture		Date	Topic
1	Wednesday	01/23/08	Tax Incidence and Efficiency Cost (Partial Equilibrium)
2	Monday	01/28/08	Tax Incidence and Efficiency Cost (Partial Equilibrium)
3	Wednesday	01/30/08	Tax Incidence and Efficiency Cost (Partial Equilibrium)
4	Monday	02/04/08	First-Best Allocations: Redistribution, Externalities and Public Goods
5	Wednesday	02/06/08	First-Best Allocations: Redistribution, Externalities and Public Goods
6	Monday	02/11/08	Optimal Commodity Taxation: Tax formulae
7	Wednesday	02/13/08	Optimal Commodity Taxation: Tax formulae
8	Monday	02/18/08	Optimal Commodity Taxation: Efficiency
9	Wednesday	02/20/08	Optimal Income Taxation: 2-type model
10	Monday	02/25/08	Optimal Income Taxation: 2-type model
11	Wednesday	02/27/08	Optimal Income Taxation: Continuum Model
12	Monday	03/03/08	Optimal Income Taxation: Continuum Model
13	Wednesday	03/05/08	Optimal Income Taxation: Tax Formulae
14	Monday	03/10/08	Optimal Income Taxation: Tax Formulae
15	Wednesday	03/12/08	Optimal Income Taxation: Applications
16	Monday	03/17/08	Optimal Income Taxation: Applications
17	Wednesday	03/19/08	Midterm
	Monday	03/24/08	Spring Break
	Wednesday	03/26/08	Spring Break

18	Monday	03/31/08	Income Taxes and Behavioral Responses: Labor Supply
19	Wednesday	04/02/08	Income Taxes and Behavioral Responses: Labor Supply
20	Monday	04/07/08	Income Taxes and Behavioral Responses: Taxable Income
21	Wednesday	04/09/08	Income Taxes and Behavioral Responses: Taxable Income
22	Monday	04/14/08	Taxation of savings and capital: Theory
23	Wednesday	04/16/08	Taxation of savings and capital: Theory
24	Monday	04/21/08	Taxation of savings and capital: Theory
25	Wednesday	04/23/08	Taxation of savings and capital: Theory
26	Monday	04/28/08	Tax incentives to save: Empirics
27	Wednesday	04/30/08	Tax incentives to save: Empirics
28	Monday	05/05/08	Taxation and Risk-Taking
29	Wednesday	05/07/08	Review

Note about timetable: The review class is scheduled because of the zero-probability of managing to go through the whole syllabus following the time-line given. The order of topics should follow closely the order given above, but the actual date of any given lecture is variable. I reserve the right to modify (delete) sections of the reading list during the course in interest of trying to cover the most relevant material.

Reading list

The following is the list of required readings. The starred readings are the most important ones. Most readings are available online, either as working papers, through JSTOR or through MU libraries. The major exceptions to this rule are the older articles from the Journal of Public Economics and some articles from the old versions of the Handbook of Public Economics and the Handbook of Labor Economics that are only available through MU's library in the old-fashioned form. Starred references are given more attention during lectures.

Note: For articles available through JSTOR or otherwise easily found on the web (like NBER Working Papers) the electronic version of this document provides clickable hyperlinks to locate them.

1. Tax Incidence and Efficiency Cost (Partial Equilibrium)

Recommended: Salanié, Chapters 1 and 2.

*Diamond, Peter, and Daniel L. McFadden, "Some Uses of the Expenditure Function in Public Finance," Journal of Public Economics 3 (1974): 3-21.

*Goulder, Lawrence and Roberton C. Williams III: "The Substantial Bias from Ignoring General Equilibrium Effects in Estimating Excess Burden, and a Practical Solution", June 2002. Available

from <http://www.stanford.edu/~goulder/>.

James R. Hines, Jr.: "Three Sides of Harberger Triangles" The Journal of Economic Perspectives, Vol. 13, No. 2. (Spring, 1999), pp. 167-188 . [JSTOR](#)

Hausman, Jerry A., "Exact Consumer's Surplus and Deadweight Loss," American Economic Review, September 1981, pp. 662-676. [JSTOR](#)

2. First-Best Allocations: Redistribution, Externalities and Public Goods

This section provides a quick review of some basic general equilibrium theory and first best allocation. Relevant chapters from a standard textbook such as Varian or Mas-Colell, Winston & Green can be useful.

Recommended: Salanié, Chapter 10.

*Bergstrom, Theodore, Larry Blume and Hal Varian "On the Private Provision of Public Goods," Journal of Public Economics 29 (1986), 25-49.

Optimal Commodity Taxation

Recommended: Salanié, Chapter 3.

*Diamond, Peter, and James Mirrlees, "Optimal Taxation and Public Production I: Production Efficiency," American Economic Review 61 (1971), 8-27. [JSTOR](#)

*Diamond, Peter, and James Mirrlees, "Optimal Taxation and Public Production II: Tax Rules," American Economic Review 61 (1971), 261-278. [JSTOR](#)

Diamond, Peter "A Many-Person Ramsey Tax Rule", Journal of Public Economics, 4, 1975, 335-342.

4. Optimal Income Taxation

Recommended: Salanié, Chapter 4.

Akerlof, George, "The Economics of Tagging as Applied to the Optimal Income Tax," American Economic Review 68 (1978): 8-19. [JSTOR](#)

*Diamond, Peter, "Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates," American Economic Review 88 (March, 1998): 83-95. [JSTOR](#)

*Saez, Emmanuel, "Using Elasticities to Derive Optimal Income Tax Rates," Review of Economic Studies, 68, 2001, 205-229. Available through <http://emlab.berkeley.edu/users/saez/>

Stiglitz, Joseph, "Pareto Efficient and Optimal Taxation and the New New Welfare Economics" in Alan Auerbach and Martin Feldstein, eds., Handbook of Public Economics, Volume 2 (Amsterdam: North Holland, 1987): 991-1041.

Varian, Hal: "Redistributive Taxation as Social Insurance" Journal of Public Economics 14 (1980),

49-68.

5. Optimal Income Taxation: Applications

Recommended: Salanié, Chapter 5.

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

Boadway, Robin; Keen, Michael. "Public Goods, Self-Selection and Optimal Income Taxation", *International Economic Review*. Vol. 34 (3). p 463-78. August 1993. [JSTOR](#)

*Boadway & Pestieau: "Indirect taxation and Redistribution. The scope of the Atkinson-Stiglitz Theorem." Mimeo. Available from Boadway's website:
<http://www.econ.queensu.ca/faculty/boadway/>

Pirttilä, Jukka and Matti Tuomala: 'Publicly provided private goods and redistribution: A general equilibrium analysis', *Scandinavian Journal of Economics* 104, 173-188, (2002). Available through Library Website.

*Saez, Emmanuel: "Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses" *Quarterly Journal of Economics*, 117, 2002, 1039-1073. Available through <http://emlab.berkeley.edu/users/saez/>

6. Income Taxes and Behavioral Responses: Labor Supply

*Blundell, Richard, Alan Duncan, and Costas Meghir, "Estimating Labor Supply Responses Using Tax Reforms," *Econometrica* 66 (July, 1998): 827-862. [JSTOR](#)

Blundell, Richard, and Thomas MaCurdy, "Labor Supply: A Review of Alternative Approaches," in *Handbook of Labor Economics*, Volume 3A, Orley C. Ashenfelter and David Card, eds. (Amsterdam: North Holland, 1999): 1559-1695.

Eissa, Nada and Jeffrey B. Liebman "Labor Supply Response to the Earned Income Tax Credit," *The Quarterly Journal of Economics*, May 1996. [JSTOR](#)

*Eissa, Nada, "Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment," NBER Working Paper No. 5023, 1995. Available from <http://nber.org/papers/W5023>

*Hausman, Jerry A., "Taxes and Labor Supply", in Alan Auerbach and Martin Feldstein, eds., *Handbook of Public Economics* (Amsterdam: North Holland, 1985), 213-265.

*MacCurdy, Thomas, "Work Disincentive Effects of Taxes: A Reexamination of Some Evidence," *American Economic Review* 80:2 (1992): 243-249. [JSTOR](#)

7. Income Taxes and Behavioral Responses: Taxable Income

*Feldstein, Martin, "The Effects of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform," *Journal of Political Economy* 103 (June 1995), 551-571. [JSTOR](#)

Goolsbee, Austan, "Evidence on the High-Income Laffer Curve from Six Decades of Tax Reform," *Brookings Papers on Economic Activity* 2 (1999), 1-47.

*Gruber, Jonathan, and Emmanuel Saez, "The Elasticity of Taxable Income: Evidence and Implications," NBER Working Paper No. 7512, January 2000. Available from <http://nber.org/papers/W7512>

Saez, Emmanuel: "Reported Incomes and Marginal Tax Rates, 1960-2000: Evidence and Policy Implications" NBER Working Paper No. 10273, January 2004. Available from <http://nber.org/papers/W10273>

8. Taxation of Savings and Capital: Theory

Salanié, Chapter 6.

*Angeletos, George-Marios Angeletos, David Laibson, Andrea Repetto, Jeremy Tobacman and Stephen Weinberg: "The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation" *Journal of Economic Perspectives* Vol. 15, No. 3. [JSTOR](#)

*Bernheim, B. Douglas, "Taxation and Saving," NBER Working Paper No. 7061, and forthcoming in *Handbook of Public Economics*, Volume 3, A.J. Auerbach and M. Feldstein, eds., (Amsterdam: Elsevier Science Publishers B.V.), 2000. Available from <http://www-econ.stanford.edu/faculty/workp/swp99007.pdf>

Chamley, Christophe, "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives," *Econometrica*, 54(3), May 1986, 607-622. [JSTOR](#)

*Erosa, A. and M. Gervais (2001): "Optimal Taxation in Infinitely-Lived Agent and Overlapping Generations Models: A Review" *Federal Reserve Bank of Richmond Economic Quarterly* 87(2). Available from <http://www.rich.frb.org/pubs/eq/> .

Laibson, David, "Golden Eggs and Hyperbolic Discounting," *Quarterly Journal of Economics* 112:2 (1997): 443-479. [JSTOR](#)

*Saez, Emmanuel: "Optimal Progressive Capital Income Taxes in the Infinite Horizon Model", July 2002. NBER Working Paper No. 9046. Available from <http://nber.org/papers/W9046>

Lawrence H. Summers: "Capital Taxation and Accumulation in a Life Cycle Growth Model" *The American Economic Review*, Vol. 71, No. 4. (Sep., 1981), pp. 533-544. [JSTOR](#)

9. Tax incentives to save: Empirics

*Engen, Eric M., William G. Gale, and John Karl Scholz, "The Illusory Effects of Saving

Incentives on Saving,” *Journal of Economic Perspectives* 10:4 (1996): 113-137. [JSTOR](#)

*Hubbard, R. Glenn, and Jonathan S. Skinner, “Assessing the Effectiveness of Saving Incentives,” *Journal of Economic Perspectives* 10:4 (1996): 73-90. [JSTOR](#)

*Poterba, James M., Steven F. Venti, and David A. Wise, “How Retirement Saving Programs Increase Saving,” *Journal of Economic Perspectives* 10:4 (1996): 91-112. [JSTOR](#)

10. Taxation and Risk-Taking

Recommended: Salanié, Chapter 2.

Poterba, James M., “Taxation, Risk-Taking, and Household Portfolio Behavior”, mimeo 1998, forthcoming in *Handbook of Public Economics*, Volume 3 (Amsterdam: North Holland). Available as NBER Working Paper No. 8340 from <http://nber.org/papers/W8340>.