

Public Finance

Peking University HSBC Business School

Fall 2014 / 1st Module

EE&FE

Instructor: Daeyong Lee

Rm. 751 HSBC Building

daeyong@phbs.pku.edu.cn

Class meeting: Lectures are given on M/Th at 13:30~15:20

Classroom: 403

Office hours: M/Th 10:30~11:30 am, or by appointment

Teaching assistant: Jessica Shen, 1301213902@sz.pku.edu.cn

TA office hours: TBA

1. Course Overview

Public finance (also known as public economics) studies the economics of government taxation and redistribution in market economies, in theory and practice. We will analyze the reason for government interventions in a market economy, as well as the impact of alternative government interventions on economic outcomes. Public economics include two primary topics of analysis: government expenditures and taxation. This course covers both topics, with a focus on the impact of government intervention on the relevant agents: households (consumers, workers) and firms. The class will also briefly present different tax systems in different parts of the world, especially focusing on the U.S. tax system. In this course, you will learn how to interpret economic analyses and how to use the tools of microeconomics and empirical analyses to investigate and predict the effects of public expenditures, regulations and government revenue-raising activities. Although not mandatory, this class will provide you with the necessary background for its companion class taught in the second semester: “Economics for Public Issues,” (Spring 2015). This course will more focus on U.S. government expenditure policy, and its companion course, “Economics for Public Issues”, will focus on U.S. government tax policy.

• Prerequisites:

To follow up the class well, you are required to have passed “microeconomics” with at least a “B+”, and “mathematics for economists” with at least a “A” (or, pass the math exam). Students with background in statistics and/or econometrics will find this class more accessible. Basic knowledge of econometric software such as STATA and SAS is strongly recommended.

2. Coursework and Grading

- Homework: 30%
- Midterm: 25%
- Final exam: 30%
- Final team project: 15%
- Class attendance: weight (no absence: 1.0, one absence: 0.99, two absences: 0.98, more than two absences: 0.7) used for the final GPA adjustment.
- FYI, GPAs below 70 are considered as failure of the course by the PKU academic rule.

• Homework:

Students are required to submit 4 reports (hardcopy version) to a TA. Students can write either a summary of published papers or a referee report of working papers. This is an individual task, not a group work. These homeworks will help students keep track of key and recent public economics papers and find their dissertation topics. Published and working papers on the lists are below with due dates and marked with (S) representing the summary and (R) representing the referee report.

► Format guideline:

All text should be double-spaced with Times New Roman 12 point font, one inch margins. Footnotes should be single-spaced. Indent the first word of a new paragraph by one-half inch. Use only one space after the period at the end of a sentence, do not right-adjust the text, and do not add a line of space between paragraphs. Do not cut sentences or paragraphs from original papers and paste them into your summary/referee reports. DO summarize / referee papers in your own word. Do not copy the contents from other students.

1) Summary:

- Summary papers should include a technical and non-technical summary of 1000–1500 words. No more than 5 pages in MS word.
- The summary should identify the main results of the paper, explain their importance, and relate the work to the previous literature.

2) Referee:

- Referee reports should include a technical and non-technical review of 500–1000 words. No more than 3 pages in MS word.
- The referee reports should explain limitation or problems of the papers and suggest how to improve it.

Homework Lists

HW 1: Due Thursday, September 4

HW 2: Due Thursday, September 25

HW 3: Due Monday, October 13

HW 4: Due Monday, November 3

S	Eckerstorfer, Paul and Ronald Wendner. 2013. "Asymmetric and Non-Atmospheric Consumption Externalities, and Efficient Consumption Taxation." <i>Journal of Public Economics</i> , 106(0), 42-56.
R	Hungerman, Daniel M. 2014. "Public Goods, Hidden Income, and Tax Evasion: Some Nonstandard Results from the Warm-Glow Model." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19804.
S	Ward, Courtney J. 2014. "Influenza Vaccination Campaigns: Is an Ounce of Prevention Worth a Pound of Cure?" <i>American Economic Journal: Applied Economics</i> , 6(1), 38-72.
R	Diederich, Johannes and Timo Goeschl. 2013. "To Give or Not to Give: The Price of Contributing and the Provision of Public Goods." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19332.
S	Bhaskar, V. 2011. "Sex Selection and Gender Balance." <i>American Economic Journal: Microeconomics</i> , 3(1), 214-44.
R	Agrawal, Ajay; Iain Cockburn and Laurina Zhang. 2013. "Deals Not Done: Sources of Failure in the Market for Ideas." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19679.
S	Rao, Justin M. and David H. Reiley. 2012. "The Economics of Spam." <i>Journal of Economic Perspectives</i> , 26(3), 87-110.
R	Weitzman, Martin. 2013. "Can Negotiating a Uniform Carbon Price Help to Internalize the Global Warming externality?" <i>National Bureau of Economic Research Working Paper Series</i> , No. 19644.
S	Baicker, Katherine; Amy Finkelstein; Jae Song and Sarah Taubman. 2014. "The Impact of Medicaid on Labor Market Activity and Program Participation: Evidence from the Oregon Health Insurance Experiment." <i>American Economic Review</i> , 104(5), 322-28.
R	Pauly, Mark; Scott Harrington and Adam Leive. 2014. "'Sticker Shock' in Individual Insurance under Health Reform." <i>National Bureau of Economic Research Working Paper Series</i> , No. 20223.
S	Akosa Antwi, Yaa; Asako S. Moriya and Kosali Simon. 2013. "Effects of Federal Policy to Insure Young Adults: Evidence from the 2010 Affordable Care Act's Dependent-Coverage Mandate." <i>American Economic Journal: Economic Policy</i> , 5(4), 1-28.
R	Monheit, Alan C.; Irina Grafova and Rizie Kumar. 2014. "How Does Family Health Care Use Respond to Economic Shocks? Realized and Anticipated Effects." <i>National Bureau of Economic Research Working Paper Series</i> , No. 20348.
S	Wilson, Daniel J. 2012. "Fiscal Spending Jobs Multipliers: Evidence from the 2009 American Recovery and Reinvestment Act." <i>American Economic Journal: Economic Policy</i> , 4(3), 251-82.
R	Shoven, John B. and Sita Nataraj Slavov. 2013. "Recent Changes in the Gains from Delaying Social Security." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19370.
S	Behaghel, Luc and David M. Blau. 2012. "Framing Social Security Reform: Behavioral Responses to Changes in the Full Retirement Age." <i>American Economic Journal: Economic Policy</i> , 4(4), 41-67.
R	Gustman, Alan L.; Thomas L. Steinmeier and Nahid Tabatabai. 2013. "The Social Security Windfall Elimination and Government Pension Offset Provisions for Public Employees in the Health and Retirement Study." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19724.
S	Gustman, Alan L.; Thomas L. Steinmeier and Nahid Tabatabai. 2010. "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the near-Retirement Population." <i>Journal of Economic Perspectives</i> , 24(1), 161-82.

R	Meyer, Bruce D. and Laura R. Wherry. 2012. "Saving Teens: Using a Policy Discontinuity to Estimate the Effects of Medicaid Eligibility." <i>National Bureau of Economic Research Working Paper Series</i> , No. 18309.
S	Watson, Tara. 2014. "Inside the Refrigerator: Immigration Enforcement and Chilling Effects in Medicaid Participation." <i>American Economic Journal: Economic Policy</i> , 6(3), 313-38.
R	Kuziemko, Ilyana; Katherine Meckel and Maya Rossin-Slater. 2013. "Do Insurers Risk-Select against Each Other? Evidence from Medicaid and Implications for Health Reform." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19198.
S	Brown, Jeffrey R. and Amy Finkelstein. 2008. "The Interaction of Public and Private Insurance: Medicaid and the Long-Term Care Insurance Market." <i>American Economic Review</i> , 98(3), 1083-102.
R	Buchmueller, Thomas C.; Sarah Miller and Marko Vujicic. 2014. "How Do Providers Respond to Public Health Insurance Expansions? Evidence from Adult Medicaid Dental Benefits." <i>National Bureau of Economic Research Working Paper Series</i> , No. 20053.
S	Neeraj Kaushal. 2005. "New Immigrants' Location Choices: Magnets without Welfare." <i>Journal of Labor Economics</i> , 23(1), 59-80.
R	Molloy, Raven; Christopher L. Smith and Abigail K. Wozniak. 2014. "Declining Migration within the U.S.: The Role of the Labor Market." <i>National Bureau of Economic Research Working Paper Series</i> , No. 20065.
S	Borjas, George J. 2003. "Welfare Reform, Labor Supply, and Health Insurance in the Immigrant Population." <i>Journal of Health Economics</i> , 22(6), 933-58.
R	Borjas, George J. 2012. "Health Difficulties in the Elderly Immigrant Population."
S	Bitler, Marianne P; Jonah B Gelbach and Hilary W Hoynes. 2005. "Welfare Reform and Health." <i>Journal of Human Resources</i> , 40(2), 309-34.
R	Cadena, Brian C. and Brian K. Kovak. 2013. "Immigrants Equilibrate Local Labor Markets: Evidence from the Great Recession." <i>National Bureau of Economic Research Working Paper Series</i> , No. 19272.
S	Grogger, Jeffrey. 2002. "The Behavioral Effects of Welfare Time Limits." <i>The American Economic Review</i> , 92(2), 385-89.
R	Pavoni, Nicola; Ofer Setty and Giovanni L. Violante. 2013. "Search and Work in Optimal Welfare Programs." <i>National Bureau of Economic Research Working Paper Series</i> , No. 18666.

• Exams:

There will be a midterm (25%) and a final exam (30%). Both exams will include problem solving type questions and short essays. The midterm will be on **Monday, September 29**. The Final will be held on **Monday, November 10 from 3:30 to 5:30pm**. Since **there will be no make-up exam**, please carefully plan your 2014 Fall schedule ahead.

• Team Project:

Students need to make a presentation of their projects at the end of the semester. Each group (max 3 students) chooses one of the topics covered in class and applies it to current Chinese systems, especially focusing on Shenzhen and the Guangdong province. Students should analyze one of the current Chinese government policies and empirically investigate its effect on the Chinese economy, and suggest a new policy to improve the current system. This final team project helps students deepen the understanding of Chinese government policies and economy.

The presentation will be evaluated based on the presentation skill, the level of understanding the topic, how to handle questions during the presentation, and the feasibility of the suggested policy under the current Chinese system. Each group will have 20 minutes for the presentation and 10 minute Q&A time. Each group must submit the final report, original dataset, and programming codes by **5:00pm, November 7 on SZT**.

- **Class Participation:**

Students' final GPAs will be adjusted by their "participation" weight in class, including presence and participation.

- **Rescheduling the Class:**

September 8 (Mid-Autumn Festival holiday) → September 10, same venue and time.

- **Class Policy:**

Students are not allowed to use their laptops or cellphones in the classroom.

3. Course Materials

- **Required Textbook:**

1. Jonathan Gruber, *Public Finance and Public Policy*, 4th ed. Worth Publishers. **[JG]:** *This book is currently available for consultation in the administration office.*
2. Required (*) and optional readings: A list of journal articles is provided below.

- **Recommended References:**

1. Rosen, Harvey and Ted Gayer, *Public Finance*, 9th ed., McGraw-Hill, 2010. **[HR&TG]:** *An older version (ed. 2008) of this book is available at the library.* **Classno:** F817.12/1.v8
2. Handbook of Public Economics, vol.1~5.

4. Class Schedule (tentative)

Part 1: Introduction to Public Finance – JG Ch. 1&2; HR&TG Part I (Ch. 1-3)

- Presentation; Course Overview;
- Introduction to Public Finance and Background

Parts 2: Externalities, Public Goods and Public Choice; Layers of Governments; Social Insurance

- Welfare economics; Market failures: definition, formalization, government role; Externalities: Theory; Private and Public Solutions; Applications: Environmental Damages; – JG Ch. 5&6; HR&TG Ch. 5

- Market Failures: Public goods; Club Goods; Common Property – JG Ch. 7; HR&TG Ch. 4
- Cost Benefit Analysis – JG Ch. 8
- Optimal Fiscal Federalism: State and Local Governments; Decentralization – JG Ch. 10

References

James Adreoni and Theodore Bergstrom, “Do government subsidies increase the private supply of public goods? ,” *Public Choice*, 1996, 295-308

* James Buchanan, “An economic theory of clubs,” *Economica*, 1965, 1-14.

* H. Scott Gordon, “The economic theory of a common property resource,” *Journal of Political Economy*, April 1954, 124-142.

* Theodore Bergstrom, Lawrence Blume and Hal Varian, “On the private provision of public goods”, *Journal of Public Economics*, 1986, 25-49.

* Tiebout, Charles, “A pure theory of local expenditures,” *Journal of Political Economy*, 1956, 416-24.

* Ronald Coase, “The problem of social cost,” *Journal of Law and Economics*, 1960, 1-44.

* William Vickery, “Pricing in urban and suburban transport,” *American Economic Review*, 1963, 452-65.

Part 3: Social Insurance and Redistribution

- Social Insurance and Social Security – JG Ch. 12&13
- Health Insurance – JG Ch. 15&16
- Income Distribution and Welfare Programs – JG Ch. 17

References

Abel, A. B. "Precautionary savings and accidental bequests." *American Economic Review* 75, no. 4 (September 1985): 777-791.

Abel, Andrew B. "The Effects of Investing Social Security Funds, in the Stock market When Fixed Costs Prevent Some Households from Holding Stocks." *American Economic Review* 91, no. 1 (March 2001): 128-48.

Bernheim, D., J. Skinner, and S. Weinberg. "What Accounts for the Variation in Retirement Wealth Among U.S. Households?" *American Economic Review* 91, no. 4 (2001): 832-857.

Brian Knight, “Endogenous Federal grants and crowd-out of State government spending: Theory and evidence from the Federal Highway Aid Program,” *American Economic Review*, March 2002, 71-92.

Diamond, P., and J. Geanakoplos. "Social Security Investment in Equities." *American Economic Review*(2003).

Gruber, J., and M. Lettau. "How Elastic is the Firm's Demand for Health Insurance." July 2004, *Journal of Public Economics*.

James R. Hines, Jr. and Richard Thaler, "Anomalies: The flypaper effect," *Journal of Economic Perspectives*, Fall 1995, 217-226

Hurd, M., and S. Rohwedder. "The Retirement-Consumption Puzzle: Anticipated and Actual Declines in Spending at Retirement." *NBER Working Paper* 9586 (March 2003).

Leora Friedberg, "The labor supply effects of the Social Security earnings test," *The Review of Economics and Statistics*, Volume 82 (1), February 2000, 48-63

* Martin Feldstein, "Social Security, induced retirement, and aggregate capital accumulation," *Journal of Political Economy*, Sep. 1974, 905-26.

* Michael Rothschild and Joseph E. Stiglitz, "Equilibrium in competitive insurance markets," *Quarterly Journal of Economics*, 1976, 629-49.

Part 4: Taxation in Theory and Practice

- Introduction to Taxation: Taxation around the World (Types, Structure); Criteria for Evaluating Tax Systems: Fairness, Efficiency, Administrative Burden – JG Ch. 18
- Tax Incidence: Which side of the market bears the burden of taxes? – JG Ch. 19
- Optimal Taxation: Taxation and Efficiency; Taxation of Consumption and Income in Theory and Practice – JG Ch. 20
- Issues with income taxation: Taxing Labor; How Labor Reacts to Taxes in Theory; Empirical Evidence; Labor Incentive Mechanisms – JG Ch. 21
- Issue with Income Taxation: Taxing Savings; Theory, Evidence; Incentive mechanisms; Application to retirement savings, entrepreneurial activities, innovation – JG Ch. 22
- Impact of Wealth Taxes on Risk-Taking Behavior – JG Ch. 23
- Corporate Taxation – JG Ch. 24. This course or "Economics of Public Issues" course will not cover this topic because "Taxation and Business Strategy" course will cover this in very detail.
- Fundamental Tax Reform – JG Ch. 25
- Final Project Presentation

References

Auerbach, Alan J. "Taxation and corporate financial policy," Chapter 19 in the *Handbook*, Vol. 3.

Auerbach, A., and K. Hassett. "On the Marginal Source of Investment Funds." *Journal of Public Economics* 87, no. 1 (2003): 205–32.

Bernheim, Douglas B. "Taxation and saving," Chapter 18 in the *Handbook*, Vol. 3.

Bricker, J., A. Kennickell, et al. "Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances." (PDF) *Federal Reserve Bulletin* 98, no. 2 (2012): 1–80.

* Chetty, R., A. Looney, et al. "Salience and Taxation: Theory and Evidence." *American Economic Review* 99, no. 4 (2009): 1145–77.

Chetty, R. "Bounds on Elasticities with Optimization Frictions: A Synthesis of Micro and Macro Evidence on Labor Supply." *Econometrica* 80, no. 3 (2012): 969–1018.

Chetty, R., J. Friedman, et al. "Adjustment Costs, Firm Responses, and Micro vs. Macro Labor Supply Elasticities: Evidence from Danish Tax Records." *Quarterly Journal of Economics* 126 (2011): 749–804.

* Diamon, Peter, "A many-person Ramsey tax rule," *Journal of Public Economics*, 1975

* Peter Diamond and James A. Mirrlees, "Optimal taxation and public production, I and II", *American Economic Review*, LXI8-27 and 261-278

Eissa, Nada et al. "Evaluation of four tax reforms in the United States: Labor supply and welfare effects for single mothers," *Journal of Public Economics*, 2008, 795-816.

Fama, E., and K. French. "Financing Decisions: Who Issues Stock?" *Journal of Financial Economics* 76 (2005): 549–82.

Givoly, D., et al. "Taxes & Capital Structure: Evidence from Firms' Responses to the Tax Reform Act of 1986." *Review of Financial Studies* 5 (1992): 331–55.

Graham, J. "A Review of Taxes and Corporate Finance." *Foundations and Trends in Finance* 1, no. 7 (2006): 573–691.

* Gruber, J., and B. Koszegi. "Tax Incidence When Individuals Are Time-Inconsistent: The Case Of Cigarette Excise Taxes." *Journal of Public Economics* 88, no. 9–10 (2004): 1959–87.

Hassett, Kevin and R. Glenn Hubbard, "Tax policy and business investment," Chapter 20 in the *Handbook*, Vol. 3.

Huang J.T., "The personal tax exemptions and married women's birth spacing in the U.S.," *Public Finance Review*, November 2008, 728-47.

Imbens, G., D. Rubin, et al. "Estimating the Effect of Unearned Income on Labor Earnings, Savings, and Consumption: Evidence from a Survey of Lottery Winners." *American Economic Review* 91, no. 4 (2001): 778–94.

Keane, M. "Labor Supply and Taxes: A Survey." *Journal of Economic Literature* 49, no. 4 (2011): 961–1075.

Knittel, M. "Corporate Response to Accelerated Tax Depreciation: Bonus Depreciation for Tax Years 2002-2004." (PDF) U.S. Treasury Office of Tax Analysis Working Paper 98, May 2007.

Korinek, A., and J. Stiglitz. "Dividend Taxation and Intertemporal Arbitrage." *Journal of Public Economics* 93, no. 1–2 (2009): 142–59.

Kumar, A. "Labor Supply, Deadweight Loss, and the Tax Reform Act of 1986: A Nonparametric Evaluation Using Panel Data." *Journal of Public Economics* 92, no. 1–2 (2008): 236–53.

* Mirrlees, James A. "An exploration in the theory of optimum income taxation," *Review of Economic Studies*, 1971, 175-208.

Poterba, J. "Taxation and Corporate Payout Policy." *American Economic Review* 94, no. 2 (2004): 171–5.

* Sandmo, Agnar, "Optimal taxation in the presence of externalities," *The Swedish Journal of Economics*, 1975

* Stiglitz, Joseph E. "Effects of wealth, income and capital gains taxation on risk taking," *Quarterly Journal of Economics*, 1969, 263-83.