

MSc Public Economics (EC426)

2016-17

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Lectures: Mondays 14:00-16:00, 32L.G.15

Classes: Mondays 16:00-17:00, TBA

Office hours: Cowell: Thursdays 12:00-13:00
Kleven: Tuesdays 16:00-17:00
Spinnewijn: (Beginning Lent Term) Tuesdays 16:00-17:00

Websites: <http://econ.lse.ac.uk/courses/ec426>; <http://darp.lse.ac.uk/ec426.htm>

Course organisation

Teaching

Lectures: There are weekly two-hour lectures in the MT and LT. Who does what is indicated in the schedule below by the lecturers' initials.

Classes: The lectures are supplemented by one-hour classes, which run from week 2 of the MT.

Written work: Students submit written work and / or presentations in the weekly classes. In week 11 of MT there will be a mock exam.

Reading list: Readings are set out below: most are available in the LSE Library's electronic journals collection <http://www.lse.ac.uk/library/home.aspx>. Further references will be provided during the lectures.

Assessment: (1) A *two-hour written examination* in week 0 of the Lent Term. (2) A *two-hour written examination* in the Summer Term. Copies of previous examinations can be obtained from the Library website. (3) An *extended essay*, due in May 2017. The written examinations and the extended essay each account for half the marks. Extended essay topics from previous years are available on the course web site.

Useful references

All material handed out in lecture is available on line: <http://econ.lse.ac.uk/courses/ec426/>, <http://darp.lse.ac.uk/ec426.htm>

The following general references have useful coverage of many of the topics:

Theory:

Atkinson, A. and J. E. Stiglitz (2015). *Lectures on Public Economics*, Princeton University Press.

Auerbach, A. J. and M. Feldstein (eds.), *Handbook of Public Economics*, vol. 1 (1985), vol. 2 (1987), vol. 3 (2002), vol. 4 (2002), vol. 5 (2013) Elsevier, Amsterdam.

Institute for Fiscal Studies, *Mirrlees Review: Reforming the Tax System for the 21st Century*, Volume 1 (2010): Dimensions of Tax Design, Volume 2 (2011): Tax by Design. Oxford University Press, Oxford. Both volumes are available online: <http://www.ifs.org.uk/mirrleesReview>

Salanié, B. (2003). *The Economics of Taxation*, MIT Press, Cambridge.

Empirical Methods:

Angrist, J. and A. Krueger (2001). "Instrumental Variables and the Search for Identification: From Supply and Demand to Natural Experiments." *Journal of Economic Perspectives* 15, 69-87.

Angrist, J. and S. Pischke (2009). *Mostly Harmless Econometrics: An Empiricist's Companion*, Princeton University Press, Princeton.

[Duflo, E. \(2002\). "Empirical Methods," MIT Mimeo.](#)

Meyer, B. (1995). "Natural and Quasi-Experiments in Economics." *Journal of Business and Economic Statistics* 13, 151-161.

Although policy examples will be drawn from a range of countries, students may find it useful to consult the following sources of information on recent UK experience:

The UK Treasury website (<http://www.hm-treasury.gov.uk>) provides a range of documents on economic policies and the public finances, including the annual publication, *Financial Statement and Budget Report* (the 'Red Book'), published each year on Budget Day.

The HM Revenue and Customs website, (<http://www.hmrc.gov.uk>) includes information on the tax structure and statistics on tax payments (by income group, by type of tax, etc.) and overall revenues raised.

The National Statistics website (<http://www.statistics.gov.uk>) provides a wide range of current and historical data on economic and social indicators (as presented in the annual publications such as *National Income and Expenditure* (the 'Blue Book') and *Social Trends*).

Good sources of international fiscal statistics and research include the websites of the OECD (<http://www.oecd.org/>), the International Monetary Fund (<http://www.imf.org/>) and the World Bank (<http://www.worldbank.org/>).

Lecture topics (Michaelmas term)

1. Welfare Analysis in Public Economics [FAC]

Criteria for social judgment. Income, utility and welfare. The ethical basis for redistribution. Rules for comparing economic states. Inequality, happiness and social values.

[Atkinson, A.B. \(2015\)](#) *Inequality: What can be done?* Harvard University Press, London.

[Cowell, F.A. \(2011\)](#), *Measuring Inequality*, Oxford University Press, 3rd edition. Chaps 2 and 3.

[Cowell, F.A. \(2016\)](#) "Inequality and Poverty Measures", in *Oxford Handbook of Well-Being and Public Policy*, edited by Matthew D. Adler and Marc Fleurbaey

2. Welfare analysis: mobility and opportunity [FAC]

Dynamic evaluation of income distributions, Mobility, meaning and measurement. Models of inequality of opportunity. Lessons for policy.

[Benabou, R. and E. Ok \(2001\)](#) "Social mobility and the demand for redistribution: The POUM hypothesis," *Quarterly Journal of Economics* 116, 447-87.

[Van de gaer, D., Schokkaert, E. and Martinez, M. \(2001\)](#) "Three meanings of intergenerational mobility", *Economica* 68, 519-537.

[Amiel, Y. Bernasconi, M. Cowell, F. A. and Dardanoni, V. \(2015\)](#), "Do we value mobility?" *Social Choice and Welfare*, 44, 231-255.

3. Wealth distribution and taxation [FAC]

The nature and composition of wealth. Comparisons across countries and through time. Models of wealth dynamics. Forms of taxation. The bequest motive and tax responses. Taxation and inequality in the long run.

[Cowell, F.A. \(2012\)](#) "Bequests, taxation and the distribution of income and wealth," *Review of Public Economics*, 200, 75-93

[Cremer, H. and Pestieau, P. \(2006\)](#) "Wealth transfer taxation: a survey of the theoretical literature," in Serge-Christophe Kolm and Jean Mercier Ythier, eds., *Handbook on the Economics of Giving, Reciprocity and Altruism*, Vol. 2, Elsevier, chapter 16, 1107-1134.

[Kopczuk, W. \(2013\)](#) "Taxation of Transfers and Wealth," *Handbook of Public Economics*, 5, 329-390

[Piketty, T. \(2000\)](#) "Theories of persistent inequalities," in Atkinson, A. B. and Bourguignon, F. (eds) *Handbook of Income Distribution*, North Holland, Amsterdam, pp 429-476

4. Design: public goods [FAC]

The general design problem; relation to social welfare; types of goods and the problem of characterising and implementing an efficient allocation; mechanisms for providing public goods.

[Morgan, J. \(2000\)](#), "Financing Public Goods by Means of Lotteries", *Review of Economic Studies*, 67, 761-784., 2012

[Rondeau, D., Poe, G. and Schulze, W., \(2005\)](#) "VCM or PPM? A comparison of the performance of two voluntary public goods mechanisms," *Journal of Public Economics*, 89, 1581-1592

5. Design: taxation [FAC]

Principles of design for taxation. Information and incentives in an income- tax model. Optimal commodity taxes and the generalised Ramsey rule. Optimal taxation with production. Integration with income taxation: do we need indirect taxes? Informational problems

Atkinson and Stiglitz (2015), Lecture 12.

[Coady, D. and Drèze, J. \(2002\)](#), "Commodity taxation and social welfare: the generalized Ramsey rule", *International Tax and Public Finance*, 9, 295-316.

[Kaplow, L. \(2006\)](#) "On the Undesirability of Commodity Taxation Even When Income Taxation is Not Optimal," *Journal of Public Economics*, 90, 1235-1250.

6-7. Behavioural responses: labour supply [HJK]

- Blundell, R. and T. MaCurdy (1999). "Labor Supply: A Review of Alternative Approaches," in O. Ashenfelter and D. Card (eds.), *Handbook of Labor Economics* vol. 3A, Elsevier Science B.V.: Amsterdam.
- Chetty, R., J. Friedman, T. Olsen, and L. Pistaferri (2011).** "Adjustment Costs, Firm Responses, and Micro vs. Macro Labor Supply Elasticities: Evidence from Danish Tax Records." *Quarterly Journal of Economics* 126, 749-804.
- Chetty, R., J. Friedman, and E. Saez (2013). "Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings." *American Economic Review* 103, 2683-2721.
- Eissa, N. (1995).** "Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment." NBER Working Paper No. 5023.
- Eissa, N. and J. Liebman (1996).** "Labor Supply Response to the Earned Income Tax Credit." *Quarterly Journal of Economics* 111, 605-37.
- Kleven, H. (2014). "How Can Scandinavians Tax So Much?" *Journal of Economic Perspectives* 28(4), Fall 2014, 77-98.
- Kleven, H. (2016).** "Bunching," forthcoming *Annual Review of Economics* 8, 2016.
- Kleven, H. and M. Waseem (2013). "Using Notches to Uncover Optimization Frictions and Structural Elasticities: Theory and Evidence from Pakistan." *Quarterly Journal of Economics* 128, 669-723.
- Saez, E. (2010). "Do Taxpayers Bunch at Kink Points?" *American Economic Journal: Economic Policy* 2, 180-212.

8. Behavioural responses: taxable income [HJK]

- Feldstein, M. (1995). "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act." *Journal of Political Economy* 103, 551-572.
- Kleven, H. (2014). "How Can Scandinavians Tax So Much?" *Journal of Economic Perspectives* 28(4), Fall 2014, 77-98.
- Kleven, H., and E. Schultz (2014).** "Estimating Taxable Income Responses using Danish Tax Reforms." *American Economic Journal: Economic Policy* 6(4), 271-301.
- Saez, E., J. Slemrod, and S. Giertz (2012).** "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." *Journal of Economic Literature* 50, 3-50.

9-10. Policy design: income taxes [HJK]

- Diamond, P. (1998).** "Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates." *American Economic Review* 88, 83-95.
- Diamond, P. and E. Saez (2011). "From Basic Research to Policy Recommendations: The Case for a Progressive Tax." *Journal of Economic Perspectives* 25, 165-190.
- Piketty, T. and E. Saez (2013).** "Optimal Labor Income Taxation," in A. Auerbach, R. Chetty, M. Feldstein, and E. Saez (eds.), *Handbook of Public Economics* vol. 5, Elsevier, Amsterdam.
- Saez, E. (2001). "Using Elasticities to Derive Optimal Income Tax Rates." *Review of Economics Studies* 68, 205-229.

Lecture topics (Lent term)

11. Policy design: transfer programs [HJK]

- Akerlof, G. (1978).** "The Economics of 'Tagging' as Applied to Optimal Income Tax, Welfare Programs, and Manpower Planning." *American Economic Review* 68, 8-19.
- Kleven, H. (2014).** "How Can Scandinavians Tax So Much?" *Journal of Economic Perspectives* 28, Fall 2014.
- Mankiw, N.G. and M. Weinzierl (2010).** "The Optimal Taxation of Height: A Case Study of Utilitarian Income Redistribution." *American Economic Journal: Economic Policy* 2, 155-176.
- Nichols, A. and R. Zeckhauser (1982).** "Targeting Transfers through Restrictions on Recipients." *American Economic Review* 72, 372-77.
- Saez, E. (2002).** "Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses." *Quarterly Journal of Economics* 117, 1039-1073.

12. Tax compliance [HJK]

- Kleven, H. (2014).** "How Can Scandinavians Tax So Much?" *Journal of Economic Perspectives* 28(4), Fall 2014, 77-98.
- Kleven, H., M. Knudsen, C. Kreiner, S. Pedersen, and E. Saez (2011).** "Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark." *Econometrica* 79, 651-692.
- Luttmer, E., and M. Singhal (2014).** "Tax Morale." *Journal of Economic Perspectives* 28(4), Fall 2014, 149-168.
- Slemrod, J. and S. Yitzhaki (2002).** "Tax Avoidance, Evasion and Administration," in A. Auerbach and M. Feldstein (eds.), *Handbook of Public Economics* Vol. 3, Elsevier, Amsterdam.

13. Taxation and development [HJK]

- Besley, T. and T. Persson (2013).** "Taxation and Development," in A. Auerbach, R. Chetty, M. Feldstein, and E. Saez (eds.), *Handbook of Public Economics* vol. 5, Elsevier, Amsterdam.
- Besley, T. and T. Persson (2014).** "Why Do Developing Countries Tax So Little?" *Journal of Economic Perspectives* 28(4), Fall 2014, 99-120.
- Best, M., A. Brockmeyer, H. Kleven, J. Spinnewijn, and M. Waseem (2015).** "Production vs Revenue Efficiency with Limited Tax Capacity: Theory and Evidence from Pakistan." *Journal of Political Economy* 123(6), 1311-1355.
- Gordon, R. and W. Li (2009).** "Tax structures in developing countries: Many puzzles and a possible explanation." *Journal of Public Economics* 93, 855-866.
- Jensen, A. (2016).** "Employment Structure and the Rise of the Modern Tax System." LSE Working Paper, January 2016.
- Kleven, H., C. Kreiner, and E. Saez (2016).** "Why Can Modern Governments Tax So Much? An Agency Model of Firms as Fiscal Intermediaries." *Economica* 83, 219-246, 2016.

14. Policy design: social insurance [JS]

- (a) Recent trends in Government Spending (b) Rationales for Social Insurance (c) Sufficient Statistics Approach
- [Chetty R. \(2009\).](#) "Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods," *Annual Review of Economics* 1, 451-488.
- [Chetty, R. and Finkelstein, A. \(2013\).](#) "Social Insurance: Connecting Theory to Data," Chapter 3 in *Handbook of Public Economics*, Vol 5.
- Gruber, J. (2007).** Chapter 14-16. *Public Finance and Public Policy*. Worth Publishers, New York.

15. Policy design: unemployment insurance and moral hazard [JS]

- (a) Baily Formula (b) Evidence for Moral hazard (c) Evidence for Consumption Smoothing
- [Gruber, J. \(1997\).](#) "The Consumption Smoothing Benefits of Unemployment Insurance," *American Economic Review* 87, 192-205.
- [Schmieder, J., Von Wachter, T. and S. Bender \(2012\).](#) "The Effects of Extended Unemployment Insurance Over the Business Cycle: Regression Discontinuity Estimates over 20 years," *Quarterly Journal of Economics*, 127(2): 701-752.
- [Spinnewijn, J. \(2015\).](#) "Unemployed but Optimistic: Optimal Insurance Design with Biased Beliefs," *Journal of European Economic Association*, 13(1), 130-167.

16. Policy design: health insurance and adverse selection [JS]

(a) Adverse Selection: Theory (b) Adverse Selection: Empirics (c) Rise in Health Spending (d) Impact of HI on Spending and Health

[Currie, J. and J. Gruber \(1996b\)](#). "Health Insurance Eligibility, Utilization of Medical Care, and Child Health," *Quarterly Journal of Economics*, 111(2), 431-466.

[Einav, L., Finkelstein, A. and M. Cullen. \(2010\)](#). "Estimating Welfare in Insurance Markets Using Variations in Prices," *Quarterly Journal of Economics*, 125(3): 877-921.

[Newhouse, J. \(1992\)](#). "Medical Care Costs: How Much Welfare Loss?" *Journal of Economic Perspectives* 6(3), 3-21.

17. Policy design: pensions [JS]

(a) Social Security Design and Reform, (b) Social Security and Labor, (c) Annuities, (d) Social Security and savings

Barr, N. and P. Diamond (2006). "The Economics of Pensions." *Oxford Review of Economic Policy* 22(1), 15-39.

[Chetty, R., Friedman, J., Leth-Petersen, S., Nielsen, T. and T. Olsen \(2014\)](#). "Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark", *Quarterly Journal of Economics*, 129(3): 1141-1219.

Gruber, J. (2007). Chapter 13. *Public Finance and Public Policy*. Worth Publishers, New York.

18. Education [JS]

(i) Reasons for government intervention in education: market failure and redistribution. (ii) The crowd-out effect of free public schools. (iii) The arguments for and against school choice and school vouchers. (iv) Measuring the returns to education. (v) Human capital investment versus job market signalling.

Chetty, R., Friedman, J., Hilger, N., Saez, E., Schanzenbach, D., and D. Yagan (2011). "How Does Your Kindergarten Classroom Affect Your Earnings? Evidence from Project STAR." *Quarterly Journal of Economics* 126(4): 1593-1660.

Gruber, J. (2007). Chapter 11. *Public Finance and Public Policy*. Worth Publishers, New York.

Rouse, C. (1998). "Private School Vouchers and Student Achievement: An Evaluation of the Milwaukee Parental Choice Program." *Quarterly Journal of Economics* 113, 553-602.

19. Externalities [JS]

(a) Externalities, property rights and the Coase Theorem (b) Choice of policy instruments: price regulation versus quantity regulation (c) Environmental taxation

Edlin, A. and P. Karaca-Mandic (2006). "The Accident Externality from Driving," *Journal of Political Economy* 114(5), 2006.

[Fullerton, D. A Leicester and S Smith \(2010\)](#) "Environmental Taxes", *Dimensions of Tax Design* (The Mirrlees Review, vol. 1), ch. 5. See especially part A (pp 423-449).

Gruber, J. (2007). Chapters 5 and 6. *Public Finance and Public Policy*. Worth Publishers, New York.

20. Behavioural public economics [JS]

(a) Bounded rationality, bounded willpower, bounded self-interest. (b) Implications for normative analysis: welfare economics and revealed preference. (c) Implications for positive analysis: examples.

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

Mullainathan, S., Congdon W. and J. Kling (2011). *Policy and Choice: Public Finance through the Lens of Behavioral Economics*. Washington, DC: Brookings Institution Press

[Mullainathan, S. and Thaler, R. \(2001\)](#), "Behavioral economics", *International Encyclopaedia of the Social and Behavioral Sciences*

[Spinnewijn, J. \(2016\)](#), "Heterogeneity, Demand for Insurance and Adverse Selection," *American Economic Journal: Economic Policy*, forthcoming.