

JANUARY 12, 2016

Econ 9460
Advanced Public Economics II (Taxation)
David L. Sjoquist
Spring 2016

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Office Hours: By appointment
Class Time: Tue & Thurs 4:00-5:15pm
Class Place: 127 Langdale Hall

Public Economics examines government tax and spending policies: what does government do, what are the effects of these actions, and whether these effects “good” or “bad”. Economics 9460 is part of a doctoral-level sequence in public economics, and focuses upon issues in taxation. The course *describes* the major taxes used by developed countries; it *analyzes* the impacts of taxation on the allocation of resources, i.e., economic behavior; and *evaluates* the level and distribution of economic welfare.

COURSE LEARNING OUTCOMES

1. The student should be able to define and understand the effects of taxes on the distribution of income (e.g., the theory of “tax incidence”), and be able to measure the incidence of direct and indirect taxes using both partial and general equilibrium models of tax incidence.
2. The student should be able to define and understand concepts of “tax equity”, be able to evaluate the equity of a tax and of tax systems.
3. The student should be able to define and understand the effects of taxes on the efficiency of resource allocation (e.g., the theory of “excess burden”), and be able to analyze the excess burden of direct and indirect taxes using both partial and general equilibrium models of excess burden.
4. The student should be able to define and understand the effects of taxes on revenues, and be able to derive the revenue maximizing tax rate for a particular type of tax.
5. The student should be able to derive the conditions for optimal commodity and income taxation, including being able to analyze the trade-offs among equity, efficiency, and revenues in any tax system.
6. The student should be able to define and understand positive models of taxation, and be able to analyze their implications for tax structure.
7. The student should be able to analyze the effect of alternative tax regimes on savings, labor, retirement, consumption, and investment decisions.
8. The student should be able to construct and evaluate a model of tax compliance, and be able to analyze the impacts of alternative tax rate and tax administration policies on tax compliance.
9. The student should be able to describe and understand the major revenue sources (e.g., personal income tax, corporate income tax, deficit finance, taxes on consumption, and taxes on wealth).
10. The student should be able to define, understand, and evaluate the principles of public finance in a federal system.

COURSE REQUIREMENTS

The prerequisite for this course is Econ 8100.

There will be two exams (a midterm and final), a paper, and periodic homework assignments.

- Midterm examination worth 25 percent of the final grade will be given on March 1st.
- A comprehensive final exam worth 35 percent of the final grade will be given on April 28th at 4:15 pm.
- An original research paper on a public economics topic of your choice; the research paper is worth 30 percent of the final grade. Details of the paper will be discussed in class.
 - Paper topics with a one paragraph abstract are due February 2th.
 - Annotated outlines (3-5 pages) are due on March 8th.
 - Paper is due no later than April 28th at 4:15 pm.
- The remaining 10 percent of the final grade is based upon periodic graded assignments. You will be told which assignments are to be handed in for grades.

Make up exams and late papers and homework will be allowed only if permission is given prior to the scheduled exam.

GRADES

Grades will be assigned as follows:

- A+: 97-100%
- A: 94-96%
- A-: 90-93%
- B+: 87-89%
- B: 84-86%
- B-: 80-83%
- C+: 77-79%
- C: 74-76%
- C-: 70-73%
- D: 0-69%

BrightSpace

BrightSpace (**BSPACE**) will be used for the course; students are required to check BSPACE for calendar updates, modifications of the syllabus, informational postings, assignments and some readings. BSPACE will also be used to provide presentation materials for class. Please check BSPACE before class for updates.

DISABILITIES

Students who wish to request accommodation for a disability may do so by registering with the Office of Disability Services. Students may only be accommodated upon issuance by the Office of Disability Services of a signed Accommodation Plan and are responsible for providing a copy of that plan to instructors of all classes in which an accommodation is sought.

UNIVERSITY REGULATIONS

Please remember that all university regulations, deadlines, and policies must be observed. In particular, students are expected to follow the GSU Policy on Academic Honesty (Section 409 of the Georgia State University Faculty Handbook). Also, on some date after the mid-point of the course (a date set by the Provost), students on the grade rolls but no longer taking the class will be given a grade of WF, and the last day of class that the student attended or turned in an assignment will be reported to the GSU administration.

COURSE EVALUATION

Your constructive assessment of this course plays an indispensable role in shaping education at Georgia State. Upon completing the course, please take time to fill out the online course evaluation.

OTHER POTENTIAL TOPICS

It is not feasible to cover all of the potential topics that might be part of this course. Here is a list of some of the topics not covered in this course: International tax issues; Taxation and politics; Deficit finance; Corrective taxes; Financing Social Security.

TEXTBOOKS

There are no required textbooks.

The following are graduate level public economics textbooks. Some chapters from some of these books have been assigned.

Richard W. Tresch, *Public Finance: a Normative Theory*, 2nd edition, 2002

Robin Boadway and David Wildasin, *Public Sector Economics*, 2nd edition, 1984

Atkinson and Stiglitz, *Lectures in Public Finance*, 1980

Myles, Gareth D., *Public Economics*, 1995.

Salanie, Bernard, *The Economics of Taxation*, 2003.

Alan J. Auerbach and Martin Feldstein, *Handbook of Public Economics*, there are 5 volumes, 1985, 1987, 2002, 2002, 2013, denoted "Handbook of PE: I - V"

Jha, Raghendra, *Modern Public Economics*, 2009; 2nd edition

Richard Musgrave, *The Theory of Public Finance*, 1959.

OTHER READING

The following provide useful advice to economists (read on your own):

McCloskey, Donald, "Economical Writing," *Economic Inquiry*, April, 1985, 187-222.

Hamermesh, Daniel S., "The Young Economist's Guide to Professional Etiquette," *Journal of Economic Perspectives*, Winter, 1992, 169-179.

Thomson, William, *A Guide for the Young Economist*, MIT Press, 2001

Not required, but I recommend that you read the relevant chapters of an undergraduate public finance textbook in order to give you an overview of taxes and an introduction to the theory of taxation. Here are three good choices:

Harvey S. Rosen and Ted Gayer, *Public Finance*, 9th edition (Chicago, IL: Richard D. Irwin, Inc., 2010).

Jonathan Gruber, *Public Finance and Public Policy*, 3rd edition (New York, NY: Worth Publishers, 2013).

Joseph E. Stiglitz, *Economics of the Public Sector*, 4rd edition (New York, N.Y.: Norton & Company, 2015).

Not required, but for a more extensive "overview" of the U.S. tax system see Slemrod and Bakija, *Taxing Ourselves: A Citizen's Guide to the Debate Over Taxes*, 4th edition, 2008.

Not required, but for some info on taxes around the globe see:

<http://unpan1.un.org/intradoc/groups/public/documents/UN/UNPAN005543.pdf>

http://www.oecdobserver.org/news/fullstory.php/aid/651/The_truth_about_tax_burdens.html

http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-07-031/EN/KS-SF-07-031-EN.PDF

READING LIST

All readings are required unless otherwise noted. Some of the readings can be found on BSPACE, and are so noted.

The course syllabus provides a general plan for the course; deviations may be necessary.

Changes to the required readings are likely to be made during the semester.

Reading denoted with an * should be read first for that section.

I. Introduction [1 class session]

Musgrave, Chapter 1, "A Brief History of Fiscal Doctrine," *Handbook of PE: I*, sections 1, 3, 4, 5, and 7 (BSPACE)

Slemrod, Joel and Jon Bakija (2008), "An Overview of the U.S. Tax System," Chapter 2 of *Taxing Ourselves*. (BSPACE)

Joint Tax Committee, *Overview of the Federal Tax System as in Effect for 2015*. Available at <https://www.jct.gov/publications.html?func=startdown&id=4763>

II. Personal Income Tax

II.A. Design Issues and Structure

Tresch, Chapter 11, "Applying First-Best Principles of Taxation—What to Tax and How" (pp 331-352 only) [Note that pages 352-361 are assigned in section VII.A]. (BSPACE)

II.B. Labor Supply Elasticities

Saez Emmanuel (2010). "Do Taxpayers Bunch at Kink Points?" *American Economic Journal: Economic Policy* 2(3): 180-212.

Eissa, Nada (1995). "Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment." NBER Working Paper 5023.

*Hausman, Jerry A. (1985), "Taxes and Labor Supply," Sections 1– 4 of Chapter 4 in *Handbook of PE: I*. (BSPACE)

Friedberg, L. "The Labor Supply Effects of the Social Security Earnings Test." *Review of Economics and Statistics*, 82 (February 2000), 48-63.

The following are good, recent surveys on taxes and labor supply, but are not assigned.

Keane, Michael (2011). "Labor Supply and Taxes: A Survey." *Journal of Economic Literature*, 59(4), 961-1075

Meghir, Costas and David Phillips (2010). "Labour Supply and Taxes." *Dimensions of Tax Design: The Mirrlees Review*, 202-274. Available at: <http://www.ifs.org.uk/publications/mirrleesreview/>

II.C. Saving

*Atkinson and Stiglitz, Chapter 3, "Taxation, Saving, and Decisions Over Time." (BSPACE)

Bernheim, D., "Taxation and Saving," (Section 4 only) in, *Handbook of P.E.*: III, Chapter 18, or NBER Working Paper No. 7061, 1999.

Summers, Lawrence H. (1981), "Capital Taxation and Accumulation in a Life Cycle Growth Model," *American Economic Review*, 71, 533-544.

Thaler, Richard H. and Shlomo Benartzi, 2004, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving." *Journal of Political Economy*, 112, S164-S187.

II.D. Other Effects of Personal Income Taxes

Bakija, Jon and Bradley Heim (2011). "How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data." *National Tax Journal*, 64 (2, Part 2): 615-650.

Burman, Leonard E. and William Randolph (1994), "Measuring Permanent Responses to Capital Gains Tax Changes in Panel Data," *American Economic Review*, 84, 794-809.

Hanson, Andrew (2012). "Size of Home, Homeownership, and the Mortgage Interest Deduction." *Journal of Housing Economics*, 21, 195-210.

III. The Economic Effects of the Corporate Income Tax

III.A. Investment

*Boadway and Wildasin. Chapter 11, section 5 only. *Public Sector Economics*. (BSPACE)

Edgerton, J. "Investment, Accounting, and the Salience of the Corporate Income Tax," Federal Reserve Board Working Paper, 2012. Available at:
<http://www.federalreserve.gov/pubs/feds/2011/201120/201120pap.pdf>

House, C. and M. Shapiro, "Temporary Investment Tax Incentives: Theory with Evidence from Bonus Depreciation," *American Economic Review* 98 (2008), 737-768.

The following is a standard reference on this topic, but is not assigned.

Auerbach, Alan J. (1983), "Taxation, Corporate Financial Policy, and the Cost of Capital," *Journal of Economic Literature*, 21, 905-940.

III.B. Financing

Myles, section 4.2 of Chapter 8. *Public Economics* (**BSPACE**)

Chetty and Saez, "Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut," *Quarterly Journal of Economics*, 120(3), August 2005, 791-833.

For a more extensive discussion of financial policy see the following, but it is not assigned.

Auerbach, "Taxation and Corporate Financial Policy," in A. Auerbach and M. Feldstein, eds. *Handbook of P. E.: III*. Also available as NBER Working Paper No. 8203.

IV. Taxes on Wealth

Poterba, James M. (2001), "The Estate and Gift Tax and Inter Vivos Giving in the United States", *Journal of Public Economics*, 79 (1), 237-64

McCluskey, Cornia, and Walters (2013). *A Primer on Property Tax*, "Property Tax: A Situation Analysis and Overview" pp 1-26. (**BSPACE**).

V. Economics Efficiency (Welfare Loss)

*Tresch, "The Second-Best Theory of Taxation in One-Consumer Economies with Linear Production Technology", chapter 13 in *Public Finance: A Normative Theory*: pp 399-425 only. (**BSPACE**)

[An alternative source for this material is

Auerbach, Alan J. (1985), "The Theory of Excess Burden and Optimal Taxation," Chapter 2 in *Handbook of PE: I*: 61-86. (**BSPACE**) This is not assigned.]

Ballard, Charles L., John B. Shoven, and John Whalley (1985), "General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States," *American Economic Review*, 75, 128-138.

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

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

VI. Taxes and Taxable Income

Feldstein, (1995) “The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act,” *Journal of Political Economy*, 103(3), 551-572.

Gruber and E. Saez, (2002) “The Elasticity of Taxable Income: Evidence and Implications,” *Journal of Public Economics*, 84, 1-32.

Saez, (2004) “Reported Incomes and Marginal Tax Rates, 1960-2000: Evidence and Policy Implications”, NBER working paper 10273.

Saez, Slemrod, and Giertz (2009) “The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review”, *Journal of Economic Literature* 50(1): 3-50.

VII. Tax Incidence

VII. A. Equity/Fairness

Tresch, Chapter 11, “Applying First-Best Principles of Taxation—What to Tax and How” in *Public Finance: A Normative Theory* (pp 352-361 only). **(BSPACE)**

VII.B. General Theory of Incidence

*Fullerton and Metcalf (2002). “Tax Incidence” in *Handbook of PE-IV*, pp. 1788-1823. **(BSPACE)**

Harberger, Arnold C. (1962), "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, 70, 215-240.

Mieszkowski is the standard reference for the incidence of the property tax, and an interesting reformulation of Mieszkowski is Zodrow and Mieszkowski, but neither is assigned.

Mieszkowski (1972). “The property tax: an excise tax or a profits tax?” *Journal of Public Economics*, 73-96

Zodrow and Mieszkowski (1986), “The new view of the property tax: A reformulation.” *Regional Science and Urban Economics*, 309-327.

VII.C. Empirical Analysis of Tax Incidence

Auerbach, “Who Bears the Corporate Tax? A Review of What We Know” NBER Working Paper 11686, October 2005.

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

Fullerton, Don and Diane Lim Rogers (1991), “Lifetime Versus Annual Perspective on Tax Incidence”

National Tax Journal 44 3): 277-287.

Gravelle, J., and K. Smetters. "Who Bears the Burden of Corporate Taxation in an Open Economy?" NBER Working Paper No. 8280, May 2001.

VIII. Optimal Taxation

*Auerbach, Alan and James Hines (2002), Chapter 21 "Taxation and Economic Efficiency", *Handbook in PE: III*: pp 1361-1384. (**BSPACE**)

Diamond, Peter and Emmanuel Saez (2011), "The Case for a Progressive Tax: From Basic Research to Policy Recommendations," *Journal of Economic Perspectives*, 25(4): 165-190.

Boadway, Robin (2012). *From Optimal Tax Theory to Tax Policy*. MIT Press. [This is a very nice non-technical summary of the optimal tax literature. It is not assigned.]

The following are classics, but are not assigned:

Diamond, Peter A. and James A. Mirrlees (1971), "Optimal Taxation and Public Production, Part I and II," *American Economic Review*, 61, 8-27 and 261-278.

Mirrlees, James A. (1971). "An Exploration in the Theory of Optimal Income Taxation", *Review of Economic Studies*, 38: 175-208.

Samuelson, Paul (1986). "Theory of Optimal Taxation." *Journal of Public Economics* 30:137-43.

IX. Tax Reform

IX.A Description of Alternative Consumption Taxes

AICPA (2009). Chapters 5-9, *Tax Reform Alternatives for the 21st Century*. Available at <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/Tax%20Reform%20Alternatives%202009.pdf>

IX.B Income vs. Consumption Taxes

CBO (1997). *Comparing Income and Consumption Tax Bases*. Executive Summary only. Available at <http://www.cbo.gov/sites/default/files/taxbases.pdf>

Congressional Research Service (2008). *The Flat Tax, Value-Added Tax, and National Retail Sales Tax: Overview of Issues*. Available at <https://stuff.mit.edu/afs/sipb/contrib/wikileaks-crs/wikileaks-crs-reports/RL32603.pdf>

Zodrow, G. (2007). "Should Capital Income Be Subject to Consumption-Based Taxation?" Chap 2 in

Aaron, Burman, and Steuerle (eds), *Taxing Capital Income*. (BSPACE)

Altig, D., A. Auerbach, L. Kotlikoff, K. Smetters, and J. Walliser, (2001) "Simulating Fundamental Tax Reform in the United States," *American Economic Review* 91(2), 574-595.

X. Tax Administration and Compliance

*Allingham, Michael G. and Agnar Sandmo (1972), "Income Tax Evasion: A Theoretical Analysis," *Journal of Public Economics*, 1, 323-338.

Alm, James, Gary H. McClelland, and William D. Schulze (1992), "Why Do People Pay Taxes?" *Journal of Public Economics*, 48, 21-38.

Silvani and Baer (1997). "Designing a Tax Administration Reform Strategy: Experiences and Guidelines," IMF (BSPACE).