

**SYLLABUS: Economics of Public Sector**  
**Module 1, Academic Year 2016-2017**  
**Master of Economics “МИЭ161”**

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**Course Description**

This course focuses on the role of the government in the economy, on the mechanisms and outcomes of government intervention. To better examine these issues, the course is structured into two parts. The first part of the course (called Public Expenditures) explores how governments spend public money. This part provides rationales for government intervention in the market, including public goods and spatial aspects of their provision (local public goods). This leads us to a discussion of local government and fiscal federalism. The second part of the course (called Public Finance) explores how governments raise public money. We will begin by considering the optimal commodity and income taxation, moving then into a discussion of tax evasion and avoidance that coherent to practical tax administration. We will also explore efficiency costs of taxation and tax incidence.

**Topics**

- 0. Introduction: Role of government in the economy
- I. Public Expenditures
  - 1. Public goods
  - 2. Club goods and Local public goods
  - 3. Intergovernmental relations: Fiscal federalism
- II. Public Finance
  - 1. Tax burden and tax incidence
  - 2. Optimal commodity taxation
  - 3. Optimal income taxation
  - 4. Tax evasion and avoidance

**Objective**

The objective of this class is to acquire an understanding of the principles and methods of analyzing various government programs such as taxes and transfers as well as their effects on economic agents.

**Prerequisites**

To take this course, students should have a good knowledge of microeconomics (at the intermediate level). Applied microeconomics and econometrics are recommended.

**Course requirements, attendance, and grading**

The requirements for this course are:

- active class participation (5%),
- weekly homework assignments (25%),
- presentation of an article (30%),

- final examination (40%).

The homework assignments (HA) will account for 25% of the course grade, equally weighted. The article presentation accounts for 30% and final exam accounts for 40% of the course grade. Active class participation represents the remaining 5% of the course grade.

An article for the presentation should be chosen from the list provided by lecturer. Because articles are related to the material studied in class, presentation of articles will be assigned to different dates. The dates for presenting articles that are related to “Public Expenditures” part of the course are September 23 and 30. The date for presenting articles related to “Public Finance” is October 21. You will have an opportunity to choose an article for presentation. An article can be presented by 1 or 2 people.

The final exam will be in-class and closed-book (150 minutes). The final exam covers the material from the whole course. The date of the final exam will be announced. Only verified medical documentation will be accepted to excuse not taking the midterm and final exams at the scheduled time! HAs, readings, and lecture notes will be posted on LMS.

### **Weekly Homework Assignments**

Students should return HAs individually by bringing them to lecture!!! and submitting them at the beginning of the lecture. No HA will be accepted after the deadline (i.e., a failing grade will apply to any late assignment except for exceptional/unexpected circumstances, with valid proof). There will be seven HAs in total. Each HA will be posted on LMS the day after the lecture. The exact due date for submitting the HA will be specified in the assignment. The HAs will be graded based on a 10-point grading scale.

### **Textbook and Readings**

The main resource for study the course is lecture slides that will be posted on LMS. Most readings are from academic journals. The main textbook for the course is

- “*Intermediate Public Economics*” by Jean Hindricks and Gareth D. Myles (any edition).

Other suggested books:

- *Государство и экономическая политика: возможности и ограничения управления*, Хиллман А.Л., (Перевод с английского. Научная редакция перевода В.В. Бусыгин, М.И. Левин. 2009)
- *Lectures on Public Economics* by Anthony Atkinson and Joseph Stiglitz (McGraw Hill, 1986): provides a very good introduction to the theory include.
- *Public Economics and Public Policy*, by Jonathan Gruber (Worth Publishers, 2007 or 2012).

### **Guidelines for Collaboration and Outside Sources**

Discussion with other students about the weekly homework assignments is acceptable and encouraged, but the composition of written assignments should be done individually. Consulting published or Internet sources is also encouraged, but any source that materially influences your views must be cited. Plagiarism is not acceptable, and will be handled according to standard University procedures.

### **List of Articles for Presentation**

1. Hungerman (2005) Are church and state substitutes? Evidence from the 1996 welfare reform

2. \* Andreoni and Payne (2003) Do Government Grants to Private Charities Crowd out Giving or Fund-Raising?
3. \* Gramlich and Rubinfeld (JPE, 1982) Micro Estimates of Public Spending Demand Functions and Tests of the Tiebout and Median-Voter Hypotheses
4. Rhode and Strumpf (AER, 2003) Assessing the Importance of Tiebout Sorting: Local Heterogeneity from 1850 to 1990
5. \* Banzhaf and Walsh (AER, 2008) Do People Vote with Their Feet? An Empirical Test of Tiebout's Mechanism
6. K. Strumpf and F. Oberholzer-Gee (2002) Endogenous policy decentralization: testing the central tenet of economic federalism. *Journal of Political Economy* 110(1):1-36.
7. Chetty, Looney, and Kroft (2010) Salience and Taxation: Theory and Evidence
8. Evans, Ringel, and Stech (1999) Tobacco Taxes and Public Policy to Discourage Smoking
9. Marion and Muehlegger (2008) Measuring Illegal Activity and the Effects of Regulatory Innovation: Tax Evasion and the Dyeing of Untaxed Diesel
10. H. J. Kleven, M. Knudsen, C. T. Kreiner, S. Pedersen, and E. Saez. "Unwilling or Unable to Cheat? Evidence from a Randomized Tax Audit Experiment in Denmark."
11. Gorodnichenko et al. (2009) Myth and Reality of Flat Tax Reform: Micro-Estimates of Tax Evasion Response and Welfare Effects in Russia
12. \* Kopczuk and Slemrod (2003), Dying to Save Taxes: Evidence from Estate Tax Returns about the Death Elasticity, *REStat*

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\* means that only one person can present this paper

## **Course Outline**

### **1. Introduction**

Role of government in the economy; 1st and 2<sup>nd</sup> Welfare Theorems failure; trade-off between efficiency and redistribution; structure of tax expenditure and tax revenue.

### **2. Public goods**

Neoclassical theory; private provision of public goods – under-provision problem; efficient provision of public good – Samuelson Rule; Lindahl prices.

### **3. Club goods and Local public goods**

Model of club goods; club goods with variable utilization and two-part tariff; Local public goods; Tiebout Hypothesis;

### **4. Intergovernmental relations**

Fiscal federalism, centralization v.s. decentralization; cost of uniformity; model of fiscal federalism, model of voluntary risk sharing.

### **5. Tax burden and tax incidence**

Types of taxes; taxes and distortions; Lump-sum tax; commodity taxes; Marshallian deadweight loss; compensating and equivalent variation measures of excess burden; tax incidence in partial equilibrium.

## **6. Optimal commodity taxation**

Ramsey optimal commodity tax model; Inverse Elasticity Rule; Diamond model – accounting for redistributive motives.

## **7. Optimal income taxation**

Progressivity of income tax system; income taxes and labor supply responses; Mirrlees model; Optimal income tax in model with two consumers; Varian model of income taxation as insurance.

## **8. Tax evasion and avoidance**

Evasion v.s. avoidance, Allingham-Sandmo and Yitzhaki model of tax evasion; comparative statics; tax compliance game with strategic tax authority action; tax enforcement.