

Public Economics

Spring term, 2019-2020 academic year

Professor Leonid Polishchuk (lpolishchuk@hse.ru)

About the course

This course deals with economic role of the government. Variations of government performance across the globe explain why nations prosper or fail, and economics provides valuable insights into such matters.

Historically, the government was viewed by economists as an institution in charge of preventing market failures by means of regulation and public expenditures. More recently the focus has expanded to consider the government as a supplier, guardian and enforcer of institutions – “rules of the game” in economy and society. Institutions are outcomes of public choice, and reflect politics, culture, and history – hence modern public economics touches upon and overlaps with political economy, law and economics, social economics and anthropology, etc.

This course combines elements of the traditional and modern views of public economics. In accordance with the tradition, it reviews main types and causes of market failures, and includes primers on public goods and taxation. Next, the course proceeds to the agency relations between government and society/private sector under different political regimes, most notably democracy and autocracy, and explores the impact of such regimes for public policy and institutions.

How the state should be organized to better serve its economic roles? To answer this question, the course introduces main ideas and tools of constitutional design, which compares different systems of government (mechanisms of accountability, scale and scope, fiscal and regulatory tools etc.) from the point of view of achievable economic outcomes. A part of such analysis is another standard chapter of public economics, i.e. economics of federalism.

The government triad includes, in addition to legislative and executive branches, the judicial branch, and hence there is a section in the course covering selected topics from the law and economics.

The course also looks inside the government “black box” by studying the incentives of public servants, and explores government pathologies such as rent-seeking, corruption, and patronage.

Since the quality of governance is closely related to norms and values in the society, the course deals with the economic role of civic culture, i.e. the collective ability of the society

to hold politicians and bureaucrats accountable, and with the social traits required to discipline and/or substitute for the government.

Prerequisites

Students are expected to have studied intermediate microeconomics. Technical issues, if any, which exceed such level, are explained in class. Knowledge of social and political theories is a plus, but not a requirement. The language of instruction is English.

Reading

There are no textbooks covering the content of the course. The course is largely self-contained, and good lecture and seminar notes should suffice to get high scores. Students are encouraged to read original journal articles and books recommended at each lecture (selected bibliography is presented below).

Some parts of the course material are covered in the following textbooks:

Atkinson, A., and J. Stiglitz. (1980) Lectures in Public Economics. McGraw-Hill

Hillman, A. (2003) Public Finance and Public Policies. Responsibilities and Limitations of Government. Cambridge University Press URL:

<http://eds.b.ebscohost.com/eds/detail/detail?vid=3&sid=1b79240d-a9f2-47c2-9f10-2f845e3791fb%40sessionmgr101&bdata=JnNpdGU9ZWRzLWxpdmU%3d#AN=edsjsr.30026043&db=edsjsr>

Hindriks, J. and G.Myles (2013). Intermediate Public Economics. MIT Press. URL:

<http://eds.b.ebscohost.com/eds/detail/detail?vid=5&sid=1b79240d-a9f2-47c2-9f10-2f845e3791fb%40sessionmgr101&bdata=JnNpdGU9ZWRzLWxpdmU%3d#AN=edsnuk.vt1s000884845&db=edsnuk>

Grading

There will be four take-home problem sets (10% of the course grade each), and a final open-book test (60% of the grade).

Make-ups

The first make-up will be an open-book supervised test. The second and last make-up will be before a program-designated committee.

Course outline

1. Market failures

Individual rationality and public interest. Sub-optimality of market equilibria. Economics of externalities. Public goods and commons. The problem of collective action. Voluntary contributions to public goods provision. Private solutions of the coordination problem: the Coase Theorem and Lindahl Equilibrium

2. Tax theory primer

Choice of taxes and public expenditures. Taxation and social welfare. How to choose tax bases and schedules? Informational restrictions. Deadweight loss of taxation. Commodity taxes and the Ramsey rule. Income tax theory. Mirrlees economy and optimal income tax. Credibility of tax regimes: the capital levy problem

3. Agency problem between government and society

Principal-agent problem in the public sector. Common agency. Conflict of interest between government and society. Fiscal policies and incentives to supply public goods in democracies and autocracies. Political risks of modernization and development. Preference aggregation: direct and representative democracy

4. Government design

Economic analysis of constitution. Economics of checks and balances. Constitutional design under the “veil of ignorance”: choosing a majority rule. Why are reforms delayed: endorsement ex ante and ex post. Proper scope of government and public-private partnership

5. Economics of federalism

Local public goods. Inter-jurisdictional spillovers. Preference polarization and Oates Decentralization Theorem. Fiscal competition and “the race to the bottom”. Market-preserving federalism. Tiebout model. Economic and political decentralization

6. Economic analysis of law

Economic role of courts and the rule of law. Externalities and dispute resolution. Contract law: efficient breach, damages and enforcement. Economic significance of property rights. Economics of litigation. Legal origins and the rise of regulatory state

7. Government performance and pathologies Incentives in public sector.

Monitoring and career concerns. Societal expectations and bureaucratic performance. Economics of corruption. Centralized and decentralized corruption. Economic costs of corruption. Political and economic transactions between public and private sectors

8. Public economics of civil society

Political collective action problem. Political foundations of democracy and the rule of law. "Civicness" and government performance. Social capital and welfare state. Collective voice vs. collective exit. Institutions and culture: an interplay

Selected bibliography

- Acemoglu, D., and J. Robinson. (2006) Economic Backwardness in Political Perspective. *American Political Science Review*, 100(1), 115-131.
- Acemoglu, D., and J. Robinson (2013). *Why Nations Fail? The origins of Power, Prosperity, and Poverty*. Random House LLC.
- Aghion, Ph., A. Alesina, and F. Trebbi. (2004) Endogenous Political Institutions. *Quarterly Journal of Economics*, 119(2), 565-611.
- Algan, Y., Cahuc, P., and M. Sangnier. (2011) Efficient and Inefficient Welfare States. CEPR Discussion Paper 8229.
- Besley, T., and S. Coate. (2003) Centralized vs. Decentralized Provision of Local Public Goods: A Political Economy Approach. *Journal of Public Economics*, 87 (12), 2611-2637.
- Besley, T., and T. Persson. (2011) *Pillars of Prosperity*. Oxford University Press.
- Bergstrom, T., L. Blume, and H. Varian. (1986). On the Private Provision of Public Goods. *Journal of Public Economics*, 29 (1), 25-49.
- Dewatripont, M., I. Lewitt, and J. Tirole. (1999) The Economics of Career Concerns, Part II: Application to Mission and Accountability of Government Agencies. *Review of Economic Studies* 66 (1), 199-217
- Djankov, S., et al. (2002). The Regulation of Entry. *Quarterly Journal of Economics*, 117(1), 1-37.
- Glaeser, E., and A. Shleifer. (2003) The Rise of Regulatory State. *Journal of Economic Literature*, 41(2), 401-425.
- Hart, O., A. Shleifer, and R. Vishny. (1997) The Proper Scope of Government: Theory and Applications to Prisons. *Quarterly Journal of Economics*, 112 (4), 1127-1161.
- McGuire, M., and M. Olson. (1996) The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force. *Journal of Economic Literature*, 34(1), 72-96.
- Micelli, Th. (2004) *The Economic Approach to Law*. Stanford University Press.
- Nannicini, T., A. Stella, G. Tabellini, and U. Troiano. (2013) Social Capital and Political Accountability. *American Economic Journal: Economic Policy* 5 (2), 222-250.
- Shleifer, A., and R. Vishny. (1994) Politicians and Firms. *Quarterly Journal of Economics*, 109(4), 95- 1025.

Persson, T., and G. Tabellini. (2000). Political Economics. Explaining Economic Policy. MIT Press.

Persson, T., G. Roland, and G. Tabellini. (1997) Separation of Powers and Political Accountability. Quarterly Journal of Economics 112 (4), 310-327.

Polishchuk, L. Institutional Performance. (2013) In: M. Alexeev, Sh. Weber (eds.) Handbook of Russian Economy, Oxford University Press.

Qian, Y., and G. Roland. (1998) Federalism and the Soft Budget Constraint. American Economic Review, 88(5), 1143-1162.

Shleifer A. and R. Vishny. (1993) Corruption. Quarterly Journal of Economics 108(3): 599-617.

Weingast, B. (1997) The Political Foundations of Democracy and the Rule of Law. American Political Science Review, 91(2), 245-263.

Special Equipment and Software Support

The following software programs from local HSE network (by contract) will be used in class:

- Microsoft Windows 7 Professional RUS
- Microsoft Windows 10
- Microsoft Windows 8.1 Professional RUS

The multi-media projector will be required for presentations as well.