

ECON 535
PUBLIC FINANCE
MIDDLE EAST TECHNICAL UNIVERSITY
SPRING 2014
SYLLABUS AND OUTLINE
(Subject to change)

INSTRUCTOR:

Dr. Pınar Derin-Güre

Contact Information:

“Best way to contact me is” *e-mail:* pderin@metu.edu.tr

I usually check my emails everyday.

Office: A05, Faculty of Economics and Administrative Science, A Building

Tel: 312-210-3043 (Office)

Office Hours: Tuesday 14:00-15:00pm and Thursday 15:00-17:00pm

CLASSES:

Friday 9:40 - 12:30am (FZ15)

COURSE WEB PAGE:

All necessary material will be posted on the course webpage at: <http://online.metu.edu.tr>

DESCRIPTION:

This course will provide a graduate level overview of public economics. We will mainly cover taxation, social security, government spending and public goods. It is hard to cover all-important public economics subjects in one semester so this class will be more like a small summary of a graduate level public economics. Most of the papers that will read will be based on US economy but we can have some arguments in class on the specific Turkish cases.

READINGS:

Useful References:

Graduate Level

G. Myles, Public Economics. Cambridge University Press, 1995.

Dynamic Fiscal Policy, Alan Auerbach and Laurence Kotlikoff, Cambridge, England: Cambridge University Press, 1987.

Dynamic Fiscal Policy, Dirk Krueger, unpublished manuscript.

Handbook of Public Economics, Alan J. Auerbach and Martin Feldstein, North-Holland

Handbook of Public Economics, Auerbach, A., Chetty, R., M. Feldstein, and E. Saez, eds., Volume 5, Amsterdam: North Holland, 2013 (web)

Reforming the Tax System for the 21st Century The Mirrlees Review, Mirrlees, J. Oxford University Press, (2 volumes) 2009 and 2010. (web)

The Theory of Taxation and Public Economics. Kaplow, L. Princeton University Press, 2008.

The Economics of Taxation, B. Salanie. Cambridge: MIT Press, 2003.

Fundamentals of Public Economics. J.J. Laffont, MIT Press, 1988.

Undergraduate Level

Gruber, J. Public Finance and Public Policies, 4th edition, Worth Publishers, 2013.

Rosen, H. Public Finance, 7th edition, McGraw Hill, 2005.

Stiglitz, J. Economics of the Public Sector, 3rd edition, Norton, 1999.

GRADING INFORMATION (PROBLEM SETS AND EXAMS):

The course grades will be based on: a midterm (30%), a final (non-cumulative exam, 30%), a term paper (30%) and class attendance and participation will be (10%; 5 % attendance, 5% participation).

All exams are closed book.

IMPORTANT DATES:

FIRST MIDTERM DATE: 4 April 2014.

FINAL EXAM DATE: 5 June 2014.

TERM PAPER DUE: 23 May 2014.

COURSE POLICY:

If you have any conflicts with the exams let me know in advance. If you miss an exam without an acceptable legal document/reason (for example, illness supported by a medical report), no make-up exam will be given.

Attendance is a part of your grade too so please try not to miss classes.

HONESTY CLAUSE:

You are expected to be honest in all of your academic work. Students caught cheating or otherwise violating the rules of academic conduct will receive a zero grade for the class, and will be deferred to the Dean's office.

If you have any questions about my expectations, please ask.

COURSES OUTLINE (Tentative, subject to change w/ the instructor's discretion):

1. Introduction

Government Economic Activity in Turkey and in the World.

2. Tax Incidence

Partial Equilibrium Incidence:

Kotlikoff, L., and L. Summers, "The Theory of Tax Incidence", The Handbook of Public Economics, Chapter 16.

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

B. Salanie. The Economics of Taxation, Cambridge: MIT Press, 2003, Chapter 1.

Poterba, J. (May 1989), "Lifetime Incidence and the Distributional Burden of Excise Taxes," American Economic Review 79, 325-330.

Partial Equilibrium Empirical Applications:

Evans, W., J. Ringel, and D. Stech. (1999) "Tobacco Taxes and Public Policy to Discourage Smoking," in Tax Policy and the Economy, vol. 13, ed. J. Poterba, MIT Press: Cambridge.

Adda J. and F. Cornaglia (2006) "Taxes, Cigarette Consumption and Smoking Intensity," American Economic Review, 96(4): 1013—1028,.

Besley T., and H. Rosen. "Sales Taxes and Prices: An Empirical Analysis," National Tax Journal 52, (1999).

General Equilibrium Incidence:

A. Harberger. "The Incidence of the Corporation Income Tax," Journal of Political Economy, 1962, 215-240.

L. Kotlikoff and L. Summers. "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, Sections 2.2.1-2.2.3 and 2.3. and 3.1

Fullerton, D., and G. Metcalf. "Tax Incidence." In Handbook of Public Economics. Vol. 4. Edited by A. Auerbach and M. Feldstein. Amsterdam, The Netherlands: North Holland, 2002. ISBN: 9780444823151.

M. Feldstein and C. Horioka, "Domestic Savings and International Capital Flows," Economic Journal, 90(358), June 1980, 314-329.

Asset Price Approach:

D. Cutler, "Tax Reform and the Stock Market: An Asset Price Approach," American Economic Review, 78(5), December 1988, 1107-1117.

J. Poterba, "Tax Subsidies to Owner-Occupied Housing: An Asset Market Approach," Quarterly Journal of Economics, 99(4), November 1984, 729-752.

L. Summers, "Taxation and Corporate Investment: A q-Theory Approach," Brookings Papers on Economic Activity, 1981:1, 67-127.

3. Efficiency Cost of Taxation

Auerbach A., "The Theory of Excess Burden and Optimal Taxation," in A. Auerbach and M. Feldstein, Handbook of Public Economics, Volume 1, 61-127. Amsterdam: North Holland, 1985. Sections 1, 2, 3.1, and 4.

P. Diamond and D. McFadden, "Some Uses of the Expenditure Function in Public Finance," Journal of Public Economics 3 (1974), 3-21.

Hausman, J. "Efficiency Effects on the U.S. Economy from Wireless Taxation." National Tax Journal 53 (2000): 733-742.

C. Ballard, J. Shoven, and J. Whalley, "General Equilibrium Computations of the Marginal Welfare Cost of Taxes in the United States," American Economic Review, March 1985, 128-138.

A. Harberger, "The Measurement of Waste," American Economic Review, 54(3), 1964, 58-76.

Applications:

R. Chetty. "Is the Taxable Income Elasticity Sufficient to Calculate Deadweight Loss? The Implications of Evasion and Avoidance," *American Economic Journal: Economic Policy*: 1(2): 31–52, 2009.

L. Goulder and R. Williams. "The Substantial Bias from Ignoring General Equilibrium Effects in Estimating Excess Burden, and a Practical Solution," *Journal of Political Economy*, 2003, 111:898-927.

J. Marion and E. Muehlegger. "Measuring Illegal Activity and the Effects of Regulatory Innovation: Tax Evasion and the Dyeing of Untaxed Diesel," *Journal of Political Economy* 116:4, p.633-666, August 2008.

J. Poterba, "Taxation and Housing: Old Questions, New Answers," *American Economic Review* 82(2): 237-242, May 1992.

4. Optimal Taxation

Optimal commodity taxation:

A. Auerbach, "The Theory of Excess Burden and Optimal Taxation," in A. Auerbach and M. Feldstein, *Handbook of Public Economics*, 1985, Volume 1, 61-127, Section 5.

F. Ramsey, "A Contribution to the Theory of Taxation," *Economic Journal*, 37, 1927, 47-61.

Sandmo, A., (1976) "Optimal Taxation: An Introduction to the Literature, *Journal of Public Economics*, July,, 37-54.

Diamond, P. and J. Mirrless, (1971) "Optimal Taxation and Public Production," *American Economic Review*, March and June

Auerbach A. and J. Hines, "Taxation and Economic Efficiency," in A. Auerbach and M. Feldstein, 2002, *Handbook of Public Economics*, Volume 3, 61-125.

Optimal income taxation:

Diamond, P. (1998) "Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates," *American Economic Review*, 88, March, 83-95.

Saez, E. (2001) "Using Elasticities to Derive Optimal Income Tax Rates," *Review of Economics Studies*, 68, , 205-229, Sections 1-3 and 5.

J. Mirrlees, "An Exploration in the Theory of Optimal Income Taxation," *Review of Economic Studies*, 38, 1971, 175-208.

B. Salanie, *The Economics of Taxation*, Cambridge: MIT Press, 2003, Chapter 4.

Capital Taxation and Dynamic Models

Auerbach, A., L. Kotlikoff, and J. Skinner (1987) "The Efficiency Gains from Dynamic Tax Reform," *International Economic Review*, 24,.

Chamley, C. (1986) "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives," *Econometrica*, 54 607-622.

Feldstein M., (1978), "The Welfare Cost of Capital Income Taxation," *Journal of Political Economy* 86 329-52.

Labor Supply and Taxation

J. Hausman "Taxes and Labor Supply," in A. Auerbach and M. Feldstein, eds, *Handbook of Public Finance*, Vol I, North Holland 1985, sections 1-3.

E. Saez, "Do Taxpayers Bunch at Kink Points?" *American Economic Journal: Economic Policy*, forthcoming, August 2009.

L. Friedberg (2000) "The Labor Supply Effects of the Social Security Earnings Test," *Review of Economics and Statistics* 82(1), 48-63.

Eissa, N. "Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment." NBER Working Paper No. 5023, February 1995.

Kumar, A. "Taxes, Deadweight Loss, and Intertemporal Female Labor Supply: Evidence from Panel Data." Federal Reserve Bank of Dallas, 2004.

T. Lemieux, B. Fortin, and P. Fréchet (1994), "The Effect of Taxes on Labor Supply in the Underground Economy," *American Economic Review*, 84, 231-254.

T. Mroz (1987) "The Sensitivity of An Empirical Model of Married Women's Hours of Work to Economic and Statistical Assumptions," *Econometrica*, 55.4 (July), 765-799.

Tax Rates and Taxable Income

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

Slemrod, J. "Methodological Issues in Measuring and Interpreting Taxable Income Elasticities." *National Tax Journal* 51 (1998): 773-788.

5. Tax Amnesties, Tax Evasion and Tax Morale

Slemrod, Joel and Yitzhaki, Shlomo, (2002) "Tax avoidance, evasion, and administration" *Handbook of Public Economics*, in: A. J. Auerbach & M. Feldstein (ed.), *Handbook of Public Economics*, edition 1, volume 3, chapter 22, pages 1423-1470 Elsevier.

G. Myles, *Public Economics*. Cambridge University Press, 1995, Chapter 12.

Torgler, Benno and Schneider, Friedrich, (2009) "The impact of tax morale and institutional quality on the shadow economy" *Journal of Economic Psychology*, Elsevier, vol. 30(2), pages 228-245, April.

Clotfelter, Charles T, (1983) "Tax Evasion and Tax Rates: An Analysis of Individual Returns," *The Review of Economics and Statistics*, MIT Press, vol. 65(3), pages 363-73, August.

Andreoni J., Brian Erard and Jonathan Feinstein, 1998. "Tax Compliance," *Journal of Economic Literature*, American Economic Association, vol. 36(2), pages 818-860, June.

Allingham, M. G., and A. Sandmo (1972) "Income tax evasion: A theoretical analysis", *Journal of Public Economics* 1, 323–338.

Arindam Das Gupta & Dilip Mookherjee, (1995) "Tax Amnesties in India; An Empirical Evaluation," Boston University - Institute for Economic Development 53, Boston University, Institute for Economic Development.

Alm, J. and W. Beck (1993) "Tax Amnesties and Compliance in the Long Run: A Time Series Analysis, *National Tax Journal*, Vol.46 no. 1 pp. 53-60.

6. Deficits, Government Spending and Crowding Out

Auerbach and Kotlikoff Chapter 6.

Jagadeesh Gokhale & Kent Smetters, (2003) "Fiscal and generational imbalances: new budget measures for new budget priorities," *Policy Discussion Papers*, Federal Reserve Bank of Cleveland, issue Dec.

Auerbach, A. J., J. Gokhale, and L. J. Kotlikoff, (1991) "Generational Accounts: A Meaningful Alternative to Deficit Accounting," in D. Bradford, ed., *Tax Policy and the Economy* 5. Cambridge, MA, MIT Press: 55-110.

Kotlikoff, L. J. (1993) "From Deficit Delusion to the Fiscal Balance Rule: Looking for an Economically Meaningful Way to Assess Fiscal Policy," *Journal of Economics*, 7, 17-41.

Voyvoda, Ebru & Yeldan, Erinc, (2005) "Managing Turkish debt: An OLG investigation of the IMF's fiscal programming model for Turkey," *Journal of Policy Modeling*, Elsevier, vol. 27(6), pages 743-765, September.

Salman F., (2004) "Balancing Turkey's Intertemporal Budget Gap," Working Papers 0408, Research and Monetary Policy Department, Central Bank of the Republic of Turkey

Akçay O. Cevdet, C. Emre Alper & Suleyman Ozmucur, (2001) "Budget Deficit, Inflation and Debt Sustainability: Evidence from Turkey(1970-2000)," Working Papers 2001/12, Bogazici University, Department of Economics.

7. Social Security

Feldstein, M., "Social Security, Induced Retirement and Aggregate Capital Accumulation," *Journal of Political Economy*, Sept./Oct., 1974, 905-26.

Kotlikoff, Laurence J. & Smetters, Kent & Walliser, Jan, 2007. "Mitigating America's demographic dilemma by pre-funding social security," *Journal of Monetary Economics*, Elsevier, vol. 54(2), pages 247-266, March.

Hausman J.(1985) "Taxes and Labor Supply," in A. Auerbach and M. Feldstein, eds, *Handbook of Public Finance*, Vol I, North Holland, sections 1-3.

Friedberg L.(2000) "The Labor Supply Effects of the Social Security Earnings Test," *Review of Economics and Statistics* 82(1), 48-63.

Saez E., (2009) "Do Taxpayers Bunch at Kink Points?" *American Economic Journal: Economic Policy*, forthcoming.

Kenc T. and S. Sayan, (2001) "Demographic Shock Transmission from Large to Small Countries: An Overlapping Generations CGE Analysis," *Journal of Policy Modeling*, Vol. 23, No. 6, pp. 677- 702.

Sayan S.and A. Kiraci, (2001)"Parametric Pension Reform with Higher Retirement Ages: A Computational Investigation of Alternatives for a Pay-As-You-Go Based Pension System," *Journal of Economic Dynamics and Control*, Vol. 25, No. 6-7,pp. 951-966.

Derin-Gure, P. (2010)"Simulating Social Security Reform in Turkey" miemo.

8. Public Good Provision and Charitable Giving

Samuelson, P. "The Pure Theory of Public Expenditure" *Review of Economic Statistics*, 36, 1954, 387-389

Oakland, W. "Theory of Public Goods" *Handbook of Public Economics*, Chapter 9.

Bergstrom, T., L. Blume and H. Varian, " On the Private Provision of Public Goods", *Journal of Public Economics*, 29, 1986 25-49.

Andreoni, James, (1990). "Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving?," *Economic Journal*, Royal Economic Society, vol. 100(401), pages 464-77, June.

Gerald E. Auten & Holger Sieg & Charles T. Clotfelter, (2002) "Charitable Giving, Income, and Taxes: An Analysis of Panel Data," *American Economic Review*, American Economic Association, vol. 92(1), pages 371-382, March

Clotfelter, Charles T., (1997). "The Economics of Giving," Working Papers 97-19, Duke University, Department of Economics.

Derin-Gure P., Uler N. (2009) "Charitable Giving under Inequality Aversion" Economics Letters, Volume 107, Issue 2, Pages 208-210

Yörük, Baris K., (2009) "How responsive are charitable donors to requests to give?," Journal of Public Economics, Elsevier, vol. 93(9-10), pages 1111-1117, October.

9. Defense and Peace Economics (can be excluded if we do not have time)

Stiglitz, Chapter 13

Handbook of Defense Economics, K Hartley, T. Sandler, 2007

Economics of Terrorism:

Abadie, A.(2004) "Poverty, Political Freedom, and the Roots of Terrorism", National Bureau of Economic Research, Inc., NBER Working Papers: No. 10859.

Krueger, A.B. and D.D. Laitin (2007) "Kto Kogo?: A Cross-Country Study of the Origins and Targets of Terrorism", Terrorism, Economic Development, and Political Openness edited by Philip Keefer, Norman Loayza, Cambridge University Press.

Derin-Gure Pinar (2009) "Does Terrorism Have Economic Roots?" Boston University Working Paper

Derin-Gure Pinar (2010) "Separatist Terrorism and the Economic Conditions in Southeastern Turkey" forthcoming in Defense and Peace Economics.

TERM PAPER

In this course I expect you to write a term paper. Term paper is worth 30%.

THE MOST IMPORTANT POINT IS NOT TO COPY OR DOWNLOAD ANOTHER PAPER THAT YOU DID NOT WRITE or you wrote before!!! I know that internet serves a lot of things nowadays including many different options of home works and term papers you can simply download and hand it in. There are several ways to track that so please do not copy and paste.

As I expect you to do an original work. The most important thing is to find a subject that you like in public economics. As you want to take this class I assume that you have an interest in public economics/ finance. Any topic that you think is interesting in this class or your prior knowledge in public economics.

Start with an interesting research question. We live in an economic world with a lot of fiscal problems and questions and government interventions. I am sure you come up with many interesting questions when you read newspapers; talk with your family and friends. You can look at the economic papers and their research questions. You can look for options to apply the papers that we use in class to Turkey.

After having a research question you need to look at the literature. Most probably you are not the first one with that interesting question. Check what has been done and think what you can do.

At this stage it might be hard to work on a theoretical model but if you want to I totally support you. If you are more an empirical person, try to get the data to find out your research question and then use econometric techniques.

Do not forget that your paper should be different than a newspaper article. You need to find a scientific way to answer your research question. You need to convince yourself and me that you worked well to answer your question.

Writing what you want to say briefly is very important. Quality is important, not quantity. Writing a quality paper shortly is much more difficult than putting every unnecessary information. Of course a paper with two pages is a bad sign too.

If you consider the term project subject as a master's dissertation subject in the future then I will expect you to make a proper literature survey and finish the data collection or decision on the theoretical tools and you can hand in an unfinished but much more detailed work.

Term Paper Grading Rules	
Original and interesting research question	10%
Proper outline of the paper (introduction, abstract, methodology, conclusion)	10%
Proper use of empirical or theoretical tools	10%
Proper review of prior papers in the area	10%
Quality of the paper (how well did you answer the research question you asked)	60%