

University of Wisconsin–Madison, Department of Economics
Economics 742: Topics in Public Economics

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Professor Scholz
Fall 2006-07

Economics 742 examines the literature in several applied, empirical areas of public economics, focusing particularly on tax and expenditure policy. The purpose of this course is to gain an understanding of the literature and to develop insight into current research issues in the field. The reading list is too long to be covered in this course. It is provided to give some of the important citations in the areas I will cover. Pay very close attention to papers marked ** and read papers marked with *. The prerequisites for the course are Economics 711 and 713 and a graduate level course in econometrics.

Papers and Texts:

There is no required textbook for the course. Some useful textbooks in public economics are given at the beginning of this reading list. Gruber (an undergrad text) is available in the bookstore.

Lectures:

Mondays and Wednesdays 1:00-2:30, 6232 Social Science. There will be no class on Wednesday, November 15.

Grading:

I will assign four (or so) problem sets that will be collected and (lightly) graded. You should feel free to work together on these, but you must turn in your own work. The problem sets will sometimes make use of the statistical packages Stata or Gauss, available for classroom and research use in the social science computer center. If you have not yet done so, please become familiar with the computer center on the third floor of social science and get whatever authorization you need to use their machines.

There will be an in-class final exam to be scheduled at a mutually agreeable time. Grades will be based on a combination of problem sets (30 percent), the final exam (60 percent), and class participation (10 percent).

Course Web Site:

I will post course material at http://www.ssc.wisc.edu/~scholz/teaching_742.htm

Field Paper:

For students in the public economics field, a field paper is due August, 2007. If you are writing a field paper in Public, start talking to the public faculty (Professors Brown, Cooley, Wolfe, or me) sometime before the summer (ideally well before the summer).

Grievance Procedure:

A blurb about the Economics Department grievance procedure is on the last page of the syllabus.

Journal Abbreviations for the Syllabus

AER	American Economic Review	BPEA	Brookings Papers on Economic Activity
Econ	Econometrica	JEL	Journal of Economic Literature
JEP	Journal of Economic Perspectives	JHR	Journal of Human Resources
JPE	Journal of Political Economy	JPubE	Journal of Public Economics
NTJ	National Tax Journal	QJE	Quarterly Journal of Economics

Useful General References

- Atkinson, A. and J. Stiglitz, Lectures in Public Economics, New York: McGraw Hill, 1980
- Auerbach, A. and M. Feldstein, Handbook of Public Economics, Volumes 1-4, Amsterdam: North Holland, 1985, 1987, 2002, and 2002
- Hindriks, Jean and Gareth D. Myles, Intermediate Public Economics, MIT Press, 2006
- Laffont, J.J., Fundamentals of Public Economics, Cambridge, MA: MIT Press, 1988
- Myles, G. Public Economics, Cambridge: Cambridge University Press, 1995
- Quigley, J. and E. Smolensky, Modern Public Finance, Harvard University Press, 1994
- Gruber, Jonathan. Public Finance and Public Policy, 1st edition, Worth Publishers, 2005 (unusually good undergraduate text)
- Salanie, B., The Economics of Taxation, Cambridge, MIT Press, 2003
- Starret, D., Foundations of Public Economics, Cambridge: Cambridge University Press, 1988
- Stiglitz, J. Economics of the Public Sector, 3rd edition, Norton, 1999 (undergraduate text)
- Tresch, Richard. Public Finance: A Normative Theory. Academic Press, 2002

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," JEP, Winter, 1992, 169-179
- Thomson, William, A Guide for the Young Economist, MIT Press, 2001

I. Introduction

- * Feldstein, Martin, "The Transformation of Public Economics Research: 1970-2000," JPubE, December, 2002, 319-326

II. Optimal Taxation and Evasion

- * Auerbach, Alan J. and James R. Hines, "Taxation and Economic Efficiency," Handbook of Public Economics, Vol. 3, 1347-1421
- * Slemrod, Joel and Shlomo Yitzhaki, "Tax Avoidance, Evasion, and Administration," Handbook of Public Economics, Vol. 3, 1423-1470
- * Parry, Ian W. H. and Kenneth A. Small, "Does Britain or the United States Have the Right Gasoline Tax?" American Economic Review, September, 2005, 1276-1289

III. Tax Rates and Taxable Income

- ** Feldstein, Martin, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform," JPE, June 1995, 551-572
- ** Goolsbee, Austan, "What Happens When You Tax the Rich? Evidence From Executive Compensation," JPE, April 2000, 352-78
- * Gruber, Jonathan and Emmanuel Saez, "The Elasticity of Taxable Income: Evidence and Implications," JPubE, April 2002
- * Emmanuel Saez and Michael R. Veall, "The Evolution of High Incomes in Northern America: Lessons from Canadian Evidence," AER, June 2005, 95(3), 831-849

- Slemrod, Joel, "Methodological Issues in Measuring and Interpreting Taxable Income Elasticities," NTJ, December, 1998, 773-88
- Carroll, Robert, "Do Taxpayers Really Respond to Changes in Tax Rates? Evidence From the 1993 Tax Act," OTA Working Paper, July, 1998
- Goolsbee, Austan, "It's Not About the Money: Why Natural Experiments Don't Work on the Rich," NBER Working Paper #6395
- M. Bianchi, B. Gudmundsson, and G. Zoega, "Iceland's Natural Experiment in Supply-Side Economics," AER, 91, December 2001, 1564-1579

IV. Taxation and Saving, and Tax Incentives to Promote Household Saving

- ** Venti, Steve and David Wise, "Have IRAs Increased U.S. Saving? Evidence from Consumer Expenditure Surveys," QJE, 1990, pp. 661-698
- ** Gale, William G. and John Karl Scholz, "IRAs and Household Saving," AER, December, 1994, 1233-1260

- * Madrian, Bridget and D. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Saving Behavior," QJE, 116, November 2001, 1149-1187
- * Bernheim, B. Douglas, "Taxation and Saving," Handbook of Public Economics, volume 3. 1173-1249
- Poterba, Jim, Steve Venti, and David Wise, "How Retirement Saving Programs Increase Saving," JEP, Fall 1996, 91-112
- Engen, Eric M., William G. Gale, and John Karl Scholz, "The Illusory Effects of Saving Incentives," JEP, Fall 1996, 113-138
- Gale, William G., "The Effects of Pensions on Household Wealth: A Re-Evaluation of Theory and Evidence," JPE, August 1998, 706-723

V. Are Americans Preparing Adequately for Retirement?

- ** Bernheim, B. Douglas, Jonathan Skinner and Steven Weinberg, "What Accounts for the Variation in Retirement Wealth Among U.S. Households?" AER, 91 (2001), 832-857
- ** Scholz, John Karl, Ananth Seshadri, and Surachai Khitatrkun, "Are Americans Saving 'Optimally' for Retirement?" mimeo, 2005, forthcoming JPE
- * Gale, William G. And Karen M. Pence, "Are Successive Generations Getting Wealthier, and If So, Why?" BPEA, 2006(1), 155-234

- Hubbard, Glenn, Jon Skinner, and Steve Zeldes, "The Importance of Precautionary Motives in Explaining Individual and Aggregate Saving," JPE, April, 1995, 360-399
- Engen, Eric M., William G. Gale and Corrie E. Uccello, "The Adequacy of Household Saving," Brookings Papers on Economic Activity, 1999 (2), 65-165
- Banks, James, Richard Blundell, and Sarah Tanner, "Is There a Retirement-Savings Puzzle?" American Economic Review, September, 1998, 769-788
- Attanasio, Orazio, "A Cohort Analysis of Saving Behavior by U.S. Households," Journal of Human Resources, Summer, 1998, 575-609
- Boskin, Michael, "Taxation, Saving, and the Rate of Interest," JPE, Part 2, April 1978, pp. 3-27
- Howrey, E. and Saul Hymans, "The Measurement and Determinants of Loanable Funds Saving," BPEA, 1978
- Hall, Robert, "Intertemporal Substitution in Consumption," JPE, 96, 1988, pp. 337-357
- Jappelli, Tullio and Marco Pagano, "Saving, Growth, and Liquidity Constraints," QJE, February, 1994, 83-109
- Slemrod, Joel, "Fear of Nuclear War and Intercountry Differences in Saving," Economic Inquiry, 28, 1990, pp. 647-657

VI. Taxation and Individual Financial Behavior

- ** Poterba, James, "Taxation, Risk-Taking, and Household Portfolio Behavior," Handbook of Public Economics, volume 3. 1110-1171
- * Burman, Leonard and William Randolph, "Measuring Permanent Responses to Capital Gains Tax Changes in Panel Data," American Economic Review, September, 1994
- Auerbach, Alan, "Retrospective Capital Gains Taxation," AER, 1991
- Auerbach, Alan J., Leonard E. Burman and Jonathan M. Siegal, "Capital Gains Taxation and Tax Avoidance: New Evidence From Panel Data," NBER Working Paper #6399
- Poterba, James, "How Burdensome are Capital Gains Taxes?" JPubE, 33, 1987, 157-172
- Stiglitz, Joseph, "Some Aspects of Capital Gains Taxation," JPubE, 21, 1983, 257-294

VII. The Corporate Income Tax, Capital Structure and Other Aspects of Financial Policy

- * Chetty, Raj and Emmanuel Saez, "Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut," QJE, August 2005, 70(3), 791-833
- * Auerbach, Alan J., "Taxation and Corporate Financial Policy," Handbook of Public Economics, volume 3. 1251-1292
- Auerbach, Alan J., "Who Bears the Corporate Tax? A Review of What We Know," NBER Working Paper #11686
- Graham, John R., "Taxes and Corporate Finance: A Review," Review of Financial Studies, 16:4, Winter 2003
- MacKie-Mason, Jeffrey, "Do Taxes Affect Corporate Financing Decisions?," Journal of Finance, 1990
- Givoly, D. (and coauthors), "Taxes and Capital Structure: Evidence From Firms' Response to the Tax Reform Act of 1986," Review of Financial Studies, 5(2), 1992
- Gordon, Roger and Burton Malkiel, "Corporation Finance", in How Taxes Affect Economic Behavior, Aaron and Pechman (eds), Brookings, 1981

- Jensen, Michael, and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Cost and Capital Structure," Journal of Financial Economics, 3, 1976
- Miller, Merton, "Debt and Taxes," Journal of Finance, May, 1977
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- Modigliani, Franco and Merton Miller, "Corporation Income Taxes and the Cost of Capital: A Correction," AER, June 1963
- Myers, Stewart, "Determination of Corporate Borrowing," Journal of Financial Economics, 5, 1977
- Ross, Stephen, "The Determination of Financial Structure: The Incentive Signaling Approach," Bell Journal, Spring, 1977
- Bernheim, B. Douglas and Adam Wanz, "A Tax-Based Test of the Dividend Signaling Hypothesis," AER, June, 1995, 532-551
- Auerbach, Alan "Wealth Maximization and the Cost of Capital," QJE, August, 1979
- Bernheim, B. Douglas, "Tax Policy and the Dividend Puzzle," Rand Journal of Economics, 1991
- Bhattacharya, Sudipto, "Imperfect Information, Dividend Policy, and 'The Bird in the Hand' Fallacy," Bell Journal, Spring, 1979
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- Miller, Merton and Franco Modigliani, "Dividend Policy, Growth and Valuation of Shares," Journal of Business, October, 1961
- Poterba, James and Lawrence Summers, "The Economic Effects of Dividend Taxation," in Recent Developments in Corporate Finance, E. Altman and M. Subrahmanyam, (eds.), Dow Jones Irwin, 1985
- Scholz, John Karl, "A Direct Examination of the Dividend Clientele Hypothesis," JPubE, 1992, 261-285
- Shefrin, Hersh and Meir Statman, "Explaining Investor Preference for Cash Dividends," Journal of Financial Economics, 13, 1984

VIII. The Earned Income Tax Credit: Taxes and Labor Supply at Low Incomes

- ** Hotz, V. Joseph, Charles H. Mullin and John Karl Scholz, 2005, "The Earned Income Tax Credit and Labor Market Participation of Families on Welfare," mimeo, UCLA and University of Wisconsin – Madison
- ** Meyer, Bruce D. and Dan T. Rosenbaum, 2001, "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers," QJE, CXVI(3), August, 1063-1114
- Hotz, V. Joseph and John Karl Scholz, "The Earned Income Tax Credit," in Means-Tested Transfer Programs in the U.S., Robert Moffitt, Editor, The University of Chicago Press and NBER, 2003
- Scholz, John Karl, "The Earned Income Tax Credit: Participation, Compliance, and Anti-poverty Effectiveness," NTJ, March, 1994, 59-81
- Ellwood, David, "The Impact of the Earned Income Tax Credit and Other Social Policy Changes on Work and Marriage in the United States," NTJ, 53, 2000, 1063-1106

IX. Income Transfer Programs

- * Fang, Hanming and Michael P. Keane, "Assessing the Impact of Welfare Reform on Single Mothers," BPEA, 2004(1), 1-116
- * Blank, Rebecca, "Evaluating Welfare Reform in the U.S.," JEL, December 2002, 1105-1166

- Moffitt, Robert, "Economic Effects of Means-Tested Transfers in the U.S.," Tax Policy and the Economy, 2002, 1-35
- Levine, Kara and John Karl Scholz, "The Evolution of Income Support Policy in Recent Decades," with Kara Levine, in Understanding Poverty, S. Danziger and R. Haveman (eds), Harvard University Press and Russell Sage Foundation, 2002, 193-228 (see http://www.ssc.wisc.edu/~scholz/Research/recent_papers.htm)
- Ellwood, David, "Anti-Poverty Policy for Families in the Next Century: From Welfare to Work and Worries," Journal of Economic Perspectives, Winter 2000, 187-198
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- Blank, Rebecca M. and Patricia Ruggles, "When Do Women Use Aid to Families with Dependent Children and Food Stamps?" JHR, Winter, 1996, 57-89
- Hoynes, Hilary Williamson, "Welfare Transfers in Two-Parent Families: Labor Supply and Welfare Participation Under AFDC-UP," Econ, March, 1996, 295-332
- Moffitt, Robert, "Welfare Programs and Labor Supply," NBER Working Paper #9168, Handbook of Public Economics, volume 4
- Moffitt, Robert, "Incentive Effects of the U.S. Welfare System: A Review," JEL, March, 1992, 1-61
- Moffitt, Robert A., 1998, "The Effects of Welfare on Marriage and Fertility," in Welfare, the Family and Reproductive Behavior, R. Moffitt (ed.), National Academy Press, 50-97
- Akerlof, George, "The Economics of Tagging as Applied to the Optimal Income Tax," American Economic Review, 1978, 8-19
- Besley, Timothy and Stephen Coate, "The Design of Income Maintenance Programmes," ReStud, April 1995, 187-221
- Saez, Emmanuel, "Optimal Income Transfer Programs: Intensive versus Extensive Labor Supply Responses," QJE, August 2002, 1039-1073
- Zeckhauser, Richard, "Optimal Mechanisms for Income Transfers," AER, June 1971, 324-334
- Nichols, A. and Richard Zeckhauser, "Targeting Transfers Through Restrictions on Recipients," AER, 72(2), May 1982, 372-377
- Gruber, Jonathan, "Medicaid" NBER Working Paper #7829, in Means-Tested Transfer Programs in the U.S., Robert Moffitt, Editor, The University of Chicago Press and NBER, 2003, 15-77
- Cutler, David and Jonathan Gruber, "Does Public Insurance Crowd Our Private Insurance?" QJE, 111, May 1996, 391-430
- Currie, Janet, "U.S. Food and Nutrition Programs," in Means-Tested Transfer Programs in the U.S., Robert Moffitt, Editor, The University of Chicago Press and NBER, 2003, 199-289
- Daponte, Beth Osbourne, Seth Sanders and Lowell Taylor, "Why Do Low-Income Households Not Use Food Stamps? Evidence from an Experiment," Journal of Human Resources, Summer 1999, 612-28
- Bitler, Marianne, Janet Currie, and John Karl Scholz, "WIC Eligibility and Participation," JHR, 38, 2003, 1139-1179

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Garces, Eliana, Duncan Thomas and Janet Currie, "Longer Term Effects of Head Start," NBER WP #8054, December 2000

Currie, Janet and Matthew Neidell, "Getting Inside the 'Black Box' of Head Start Quality: What Matters and What Doesn't?" NBER Working Paper 10091, November 2003

X. Social Security and Social Insurance

- * Feldstein, Martin, "Rethinking Social Insurance," AER, March 2005, 1-24
- * Orszag, Peter, and Joseph Stiglitz, "Rethinking Pension Reform: Ten Myths About Social Security Systems," mimeo, September 1999
- * Autor, David and Mark G. Duggan, "The Rise in Disability Reciprocity and the Decline in Unemployment," QJE, 2003

Krueger, Alan B. and Bruce D. Meyer, "Labor Supply Effects of Social Insurance," NBER Working Paper #9014, Handbook of Public Economics, volume 4

Gruber, Jonathan, "Disability Insurance Benefits and Labor Supply," JPE, 108, 2000, 1162-1183

Meyer, Bruce, "Lessons from the U.S. Unemployment Insurance Experiments," JEL, March 1995, 91-131

Feldstein, Martin and Jeffrey Liebman, "Social Security," Handbook of Public Economics, volume 4, 2245-2315

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Gruber, Jonathan and David Wise, "Social Security Programs and Retirement Around the World," NBER Working Paper #6134, "Introduction and Summary," in Social Security and Retirement Around the World, University of Chicago Press, 1999, p. 1-36

Aaron, Henry J and John B. Shoven, Should the United States Privatize Social Security?, The Alvin Hansen Symposium on Public Policy, Harvard University, MIT Press, 1999

Diamond, Peter A., "Proposals to Restructure Social Security," JEP, Summer, 1996, 67-88

Feldstein, Martin, "The Missing Piece in Policy Analysis: Social Security Reform," AER, May, 1996, 1-14

Feldstein, Martin and Andrew Samwick, "Two Percent Personal Retirement Accounts: Their Potential Effects on Social Security Tax Rates and National Saving," NBER Working Paper #6540

Gramlich, Edward M., "Different Approaches for Dealing with Social Security," JEP, Summer, 1996, 55-66

Samuelson, Paul, "An Exact Consumption Loan Model of Interest with and without the Social Contrivance of Money," JPE, December, 1958

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- Bernheim, Douglas, "The Economic Effects of Social Security: Towards a Reconciliation of Theory and Measurement," JPubE, 1987, 273-304
- Feldstein, Martin, "The Optimal Level of Social Security Benefits," QJE, May, 1985 300-20
- Feldstein, Martin, "Should Social Security be Means Tested?" JPE, 1987, 468-84
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- Coile, Courtney and Jonathan Gruber, "Social Security and Retirement," NBER Working Paper #7830, August 2000
- Burtless, Gary, "Social Security, Unanticipated Benefit Increases, and the Timing of Retirement," REStud, 53, 1986
- Diamond, Peter and Jerry Hausman, "Individual Retirement and Savings Behavior," JPubE, 23, 1984
- Friedberg, Leora, "The Labor Supply Effects of the Social Security Earnings Test," ReStat, 82, February 2000, 48-63
- Feldstein, Martin, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," JPE, September, 1974 (also comment in 1982)
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- Congressional Budget Office, "Social Security and Private Saving: A Review of the Empirical Evidence," July 1998
- Hurd, Michael, "Research on the Elderly: Economic Status, Retirement, Consumption and Saving," JEL, June, 1990, 565-637
- Lumsdaine, Robin L. and David A. Wise, "Aging and Labor Force Participation: A Review of Trends and Explanations," in Aging in the United States and Japan, Noguchi and Wise (eds.), University of Chicago Press, 7-41

XI. Intergovernmental Fiscal Relations

- * Gordon, Nora, "Do Federal Grants Boost School Spending? Evidence from Title I," *Journal of Public Economics*, 88, 2004, 1771-1792
 - * Knight, Brian, "Endogenous Federal Grants and Crowd-Out of State Government Spending: Theory and Evidence from the Federal Highway Program," AER, 92, 2002, 71-92
 - * Black, Sandra, "Do Better Schools Matter? Parental Valuation of Elementary Education," QJE, May, 1999
- Hines, James and Richard Thaler, "Anomalies: The Flypaper Effect," *Journal of Public Economics*, 1995

There are many other issues in public economics that I would love to cover if there was more time. As you continue to study the field and develop topics for your research, the following citations may come in handy.

Tax Incidence

- Fullerton, Don and Gilbert E. Metcalf, "Tax Incidence," NBER Working Paper #8829, Handbook of Public Economics, volume 4
- Cutler, David, "Tax Reform and the Stock Market: An Asset Price Approach," AER, December, 1988, 1107-1117
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Expenditure Incidence

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The Theory of Labor Taxation

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Understanding Economic Behavior: Nonstructural Approaches

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Taxes and Labor Supply

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Excise Taxes

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- Besley, Timothy J. and Harvey S. Rosen, "Vertical Externalities in Tax Setting: Evidence from Gasoline and Cigarettes," NBER Working Paper #6517
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Estate Taxes

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Property Taxes

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- McGuire, Therese J., "Proposition 13 and Its Offspring: For Good or for Evil?" National Tax Journal, March 1999, 129-38

The Corporate Income Tax and Investment

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Grievance Procedure

The Department of Economics has developed a grievance procedure through which you may register comments or complaints about a course, an instructor, or a teaching assistant. The Department continues to provide a course evaluation each semester in every class. If you wish to make anonymous complaints to an instructor or teaching assistant, the appropriate vehicle is the course evaluation. If you have a disagreement with an instructor or teaching assistant, we strongly encourage you to try and resolve the dispute with him or her directly. The grievance procedure is designed for situations where neither of these channels is appropriate.

If you wish to file a grievance, you should go to room 7238 Social Science and request a Course Comment Sheet. When completing the comment sheet, you will need to provide a detailed statement that describes what aspects of the course you find unsatisfactory. You will need to sign the sheet and provide your student identification number, your address, and a phone number where you can be reached. The Department plans to investigate comments fully and will respond in writing to complaints.

Your name, address, phone number, and student ID number will not be revealed to the instructor or teaching assistant involved and will be treated as confidential. The Department needs this information, because it may become necessary for a commenting student to have a meeting with the department chair or a nominee to gather additional information. A name and address are necessary to provide a written response.