

# Public Finance

Econ 231-001  
Spring 2008

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Office Hours: Tue 9:15-10:15am or by appointment.

The course URL is linked from: [www.ssc.upenn.edu/~eeckhout/](http://www.ssc.upenn.edu/~eeckhout/)

This course applies the economic method for analyzing the role of government and public policy questions. We analyze the different motives for government intervention, focussing attention on efficiency, inequality and the ability to generate tax revenue. In the light of economic theory, we ask what the role is of government in a market economy and how economic analysis can be used to evaluate public policy. We also consider the major critiques of the economic method and attempts to circumvent them. While discussing applications of policy issues, the aim is to discuss the analytical tools to help understand complicated issues in a stylized manner. At the end of the course, students should be able to evaluate a policy problem and understand the impact the policy will have on citizens' behavior and on the welfare in society. When is policy action required? Why are certain policies more effective than others? How can government intervention be made efficient?

The class will meet **Tuesdays and Thursdays 10:30am-12noon in LOGAN HALL, room LOGN 17**. A course outline is listed below. The course will be evaluated on the basis of a midterm exam, scheduled during regular class times, a final exam and a research paper (written in a team). In addition, there will also be homework assignments. The midterm exam is worth 30% of the grade, the final exam 35%, the research paper 35%. Homeworks will count in the case of tie-break grades. All parts, including homeworks, are compulsory. Total scores of 90 or more get *A-* to *A+*, scores of 75 to 89 get *B-* to *B+* and 60 to 74 get *C-* to *C+*. For general departmental course policies, please visit the econ web site: [www.econ.upenn.edu/Undergraduate/Departmental%20Course%20Policies.htm](http://www.econ.upenn.edu/Undergraduate/Departmental%20Course%20Policies.htm).

For the research component of the course, teams of 5 students will write an original research paper (2000 words) on any chosen aspect of public policy or taxation. The team will analyze the chosen issue and formulate policy prescriptions and/or critically appraise existing policy. The main objective is to base policy prescriptions or appraisal of taxation on the tools developed in the lectures. Students are expected to propose a formal economic model of the problem under discussion. The model must help analyze the problem and serve as the basis for the appraisal of the policy or taxation. The research paper will be presented and defended in class. Each team will also critically discuss the paper of one other team. The research project requirement will be described in greater detail in the third week of classes.

Prerequisites for this course: Economics 001 and 002, and Economics 101. It will be presumed that the student is familiar with the basic aspects of such mathematical concepts as sets, functions, and derivatives.

Timetable.

Due dates Homework Assignments: Thursday February 7, Tuesday February 26, at the start of class.

Submit proposal and team members for the research project: Tuesday February 19.

Midterm Exam: Tuesday March 4.

Presentation and defense of research papers (the paper is due one week before presentation): March 20-April 3.

Final Exam: Thursday May 8, 9:00-11:00am.

The main text used is:

- ROSEN, HARVEY S., *Public Finance*, 2007, eight edition or 2005, seventh edition or 2002, sixth edition or 1999, fifth edition, Norton. (Van Pelt Library HJ257.2.R67 2005/2002/1999)

Additional reading:

- WEIMER, DAVID, AND AIDAN VINING, *Policy Analysis: Concepts and Practice*, 1998, third edition. Prentice Hall (Van Pelt Library H97.W45 1998)
- SUROWIECKI, JAMES, *The Wisdom of Crowds*, 2004 New York, Doubleday (Van Pelt JC328.2 .S87 2004)

## Course Outline

### Introduction

#### Ch. 3 Tools of Normative Analysis

Welfare economics  
The fundamental theorems of welfare economics  
Market failure  
Consumer and producer surplus

#### Ch. 4 Public Goods

Public goods  
Efficient provision  
The privatization debate  
Public choice

#### Ch. 5 Externalities

The nature of externalities  
Private responses to externalities  
Public responses to externalities  
Implications for income distribution

#### Ch. 12 Income Redistribution: Conceptual Issues (See also Weimer and Vining Ch. 7, 134-158)

Distribution of income  
Measuring Inequality  
Rationales for income redistribution  
Discussion questions

#### Ch. 14 Taxation and Income Distribution

Tax incidence  
Partial Equilibrium models

#### Ch. 15 Taxation and Efficiency

Excess Burden

#### Ch. 16 Efficient and Equitable Taxation

Ramsey Rule  
Optimal User Fees  
Optimal Income Taxation

#### Ch. 18 Personal Taxation and Behavior

Labor Supply  
Savings

#### Special Topic. Discrimination

ARROW, KENNETH, "The Theory of Discrimination", in Orley Ashenfelter and Albert Rees, eds., *Discrimination in Labor Markets*, Princeton University Press, 1971, 3-33. (Van Pelt Library - HD4903.5 U58 P73 1971)