

UP 510  
**Public Economics**

David Bieri

Fall 2012

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Lectures:	T R 8:30am–10:00am
Location:	1227 A&AB
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Email:	<a href="mailto:bieri@umich.edu">bieri@umich.edu</a>
Office hours:	T 10:00am–11:00am; R 2:00pm–3:00pm, or by e-mail appointment
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Office hours:	T R 11:30am–1:00pm

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### Course description

A wide variety of factors affect the economic development of states and local communities. Most prominent are the effects of taxes and local public services, both of which are policy variables that can be directly altered by state and local governments. Another set of policy variables that may affect economic development are government regulations.

The objective of this course is to help students to develop a working knowledge of the economic theory and methods that are widely applicable in the analysis of state and local government expenditure and revenue patterns. Furthermore, this course aims to provide students with a comparative understanding of the different combinations of government units that are operating in the majority of industrialised countries. Students will also gain a firm grasp of the way in which countries differ in their prevailing fiscal arrangements between the central and sub-central levels of government.

#### Prerequisites

Students should ideally be comfortable with basic, undergraduate-level treatment of microeconomics. Experience with urban and regional analysis is useful, but not indispensable.

### Course Readings

#### Required texts

STIGLITZ, J. E. (2000): *Economics of the Public Sector*. New York: W.W. Norton & Company, 3rd edn. [[STZ](#)]

#### Recommended texts

GRUBER, J. (2010): *Public Finance and Public Policy*. New York: Worth Publishers, 3rd edn. [[GRB](#)]

LEVY, J. M. (2010): *Contemporary Urban Planning*. White Plains: Pearson Longman, 9th edn. [[LVY](#)]

**Other assigned readings** will be posted on CTools, see reading list below.

## Course Policies

### Grading

This course will *not* be graded on a curve. This means that the number of top grades is not limited and – by symmetry – the same is also true for low grades. The course-specific grading scheme is as follows:

- In-class assignments, quizzes – 20%
- Midterm take home exam – 40%
- Final exam – 40%

### Late or missed assignments

All work must be submitted by the due date. Late work will be accepted with a penalty of *50% per lecture* past the due date. Exceptions to these rules are not granted without a note from the Dean of Students Office detailing why an excuse should be warranted. Usually, make-up exams will be oral, given as close to the exam date as possible.

### Attendance policy

You are responsible for all material discussed in class. Students are expected to have read all assigned material before class so that they can take an active role in class discussions. Reading is a complement, not a substitute for class attendance.

### Policy on plagiarism and academic honesty

The University of Michigan Honor Code is in effect for this course. Please take the time to read this document and make sure that you understand your responsibilities as a student. I assume that everything you turn in during the semester conforms to the Honor Code and to the usual academic standards governing appropriate student conduct. It is your responsibility to find out what constitutes plagiarism and cheating; a plea of ignorance is not acceptable as a defense. The following statement, taken from the Rackham Graduate School's [Statement on Graduate Academic and Professional Integrity](#), describes the types of violations covered under the Honor System:

A clear sense of academic honesty and responsibility is fundamental to our scholarly community. To that end, the University of Michigan expects its students to demonstrate honesty and integrity in all their academic activities [...] As professionals in training, graduate students assume various roles, depending on the academic program. These include the roles of scholar/researcher, teacher, supervisor of employees, representative to the public (of the University, the discipline and/or the profession), and professional colleague and even the role of provider of services to clients. Therefore, students are responsible for maintaining high standards of conduct while engaged in course work, research, dissertation or thesis preparation, and other activities related to academics and their profession.

Graduate training, like future professional life, includes demands that might tempt some students to violate integrity standards. There are pressures on graduate students to achieve high grades, obtain financial support, meet research or publication deadlines, gain recognition from the scholarly community, and secure employment. Although faculty members can help students to maintain academic integrity despite these pressures, each student has final responsibility for maintaining integrity in his or her individual conduct. Finally, conduct that violates the ethical or legal standards of the University community or of ones program or field of specialization may result in serious consequences, including immediate disciplinary action and future professional disrepute. In support of the Graduate

Schools commitment to maintain high standards of integrity, this policy makes provisions for bringing forward and hearing cases of academic and professional misconduct.

Be advised that plagiarism or other forms of violations of the University of Michigan Honor Code will not be tolerated. I will not hesitate to forward cases of academic dishonesty to the Dean.

### **Class room etiquette**

Everyone who registers for this class is an adult. You are legally able to marry without parental consent, buy a home, pay taxes, vote, work, budget your money, defend your country in military service, etc. You should also be adult enough not to disturb others.

*No electronic devices of any kind will be needed for this course*, unless stated otherwise. Please stow away your laptops and mobile phones for the entire duration of the lecture.

### **CTools**

The **CTools** site for UP 510 is an important component of this course. With similar functionality to Blackboard, CTools is an online environment and UP 510 is assigned a separate page within CTools and is accessible only by the course instructor and the students enrolled in the course. This system provides a convenient way to post announcements, grades, assignments, and online quizzes or homework.

You are responsible for any announcement or assignment posted on CTools, regardless of whether the announcement or assignment was discussed in class. I recommend checking CTools on a regular basis.

### **Important dates during the semester**

Please take note of the following dates over the course of the semester:<sup>1</sup>

R	15 Sep 11	UP590 Expanded Horizons trip.
M	26 Sep 11	Last day for students to drop Fall 2011 classes.
M	10 Oct 11	Nobel Prize in Economics announced.
R	<b>27 Oct 11</b>	Midterm exam.
M	31 Oct 11	<b>iOMe Challenge essay deadline.</b>
M	21 Nov 11	<b>iOMe Challenge video deadline.</b>
W	23 Nov 11	Thanksgiving recess begins.
M	28 Nov 11	Classes resume.
T	13 Dec 11	Classes end.
W	<b>21 Dec 11</b>	Final exam.

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<sup>1</sup>Dates are subject to change.

## Tentative Course Calendar

<i>Topic</i>	<i>Lectures</i>	<i>Readings</i>
I. INTRODUCTION AND REVIEW	week 1–2	STZ1–2, GRB1–2
II. PRINCIPLES OF WELFARE ECONOMICS	week 2–5	
(i) Efficiency		STZ3, GRB7
(ii) Market failure		STZ4
(iii) Equity		STZ5
III. PUBLIC EXPENDITURE THEORY	week 6–8	STZ6, GRB6
(i) Fiscal federalism		STZ26, GRB10
(ii) Public choice		STZ7, GRB9
(iii) Public production		STZ8
(iv) Externalities		STZ9, GRB5–6
IV. THEORY OF TAXATION	week 9–12	STZ17, GRB18
(i) Tax incidence		STZ18, GRB19
(ii) Taxation and efficiency		STZ19, GRB20
(iii) Optimal taxation		STZ20
V. SUB-CENTRAL GOVERNMENT REVENUE	week 12–15	STZ27, GRB25
(i) Property taxes and land-use planning		
(ii) Sales taxes		
(iii) Income taxes		
(iv) Corporate taxes		
(v) Monopoly and regulatory taxes		

*Note:* The three-letter textbook abbreviation followed by a number indicates a given chapter in that textbook, e.g. STZ26 refers to chapter 26 in the Stiglitz text. Additional readings from the reading list below will be assigned to individual lectures.

## Tentative Reading List

Compulsory readings are marked by an asterisk (\*). The rest of the reading is optional, and intended for those interested in pursuing particular topics in more depth. I would encourage you to do as much of the reading as possible. Please familiarise yourself with the material before the lectures, which should enable us to engage in interesting and informed class discussions.

### I. Introduction and review

#### Lecture 1/1: 6 September 2011 (T)

Introduction, syllabus review and key concepts.

\*STZ, chapter 1.

#### Lecture 1/2: 8 September 2011 (R)

\*STZ, chapter 2.

GRB, chapters 1–2.

\*2013 Budget visualisation.

Lecture 2/1: 13 September 2011 (T)

LVY, chapters 1, 19.

\*OSTROM, V., C. M. TIEBOUT, AND R. WARREN (1961): "The Organization of Government in Metropolitan Areas: A Theoretical Inquiry," *American Political Science Review*, 55(4), 831–842.

Lecture 2/2: 15 September 2011 (R)

Expanded Horizons trip, no class.

**II. Principles of welfare economics**Lecture 3/1: 20 September 2011 (T)

\*STZ, chapter 3.

Lecture 3/2: 22 September 2011 (R)

\*BATOR, F. M. (1958): "The Anatomy of Market Failure," *Quarterly Journal of Economics*, 72(3), 351–379.

Lecture 4/1: 27 September 2011 (T)

\*FELD, L. P., AND M. R. SAVIOZ (1997): "Direct Democracy Matters for Economic Performance: An Empirical Investigation," *Kyklos*, 50(4), 507–538.

HINES, J. R. (1999): "Three Sides of Harberger Triangles," *Journal of Economic Perspectives*, 13(2), 167–188.

Lecture 4/2: 29 September 2011 (R)

\*STZ, chapter 4.

GRB, chapter 7.

Lecture 5/1: 4 October 2011 (T)

\*STZ, chapter 5.

\*SANDMO, A. (1995): "Introduction: The Welfare Economics of the Welfare State," *Scandinavian Journal of Economics*, 97(4), 469–476.

**III. Public expenditure theory**Lecture 5/2: 6 October 2011 (R)

\*STZ, chapter 6.

\*GRB, chapter 4.

LVY, chapter 13.

Lecture 6/1: 11 October 2011 (T)

\*MARRON, D. B. (2011): “Spending in Disguise,” *National Affairs*, 3(Summer), 20–34.

\*SAMUELSON, P. A. (1955): “Diagrammatic Exposition of a Theory of Public Expenditure,” *Review of Economics and Statistics*, 37(4), 350–356.

Lecture 6/2: 13 October 2011 (R)

ACSP Conference, no class.

## III.1 Fiscal federalism

Lecture 7/1: 18 October 2011 (T)

\*STZ, chapter 26.

GRB, chapter 10.

LVY, chapter 5.

\*BAICKER, K., J. CLEMENS, AND M. SINGHAL (2011): “The Rise of the States: U.S. Fiscal Decentralization in the Postwar Period,” *Journal of Public Economics*, forthcoming.

\*BIRD, R. M. (1999): *The Encyclopedia of Taxation and Tax Policy* chap. Fiscal Federalism, pp. 151–154. Urban Institute Press, Washington, DC.

FREY, B. S., AND R. EICHENBERGER (2000): *Hayek Revisited* chap. Towards a New Kind of Eurofederalism, pp. 138–153, The Locke Institute Series. Edgar Elgar, Cheltenham.

OATES, W. E. (1999): “An Essay on Fiscal Federalism,” *Journal of Economic Literature*, 37(3), 1120–1149.

PETCHEY, J. (2009): “Theoretical Analysis of Equalization and Spatial Location Efficiency,” *Regional Studies*, 43(7), 899–914.

## III.2 Public choice

Lecture 7/2: 20 October 2011 (R)

\*STZ, chapter 7.

GRB, chapter 9.

\*BUCHANAN, J. M. (1965): “An Economic Theory of Clubs,” *Economica*, 32(125), 1–14.

\*OATES, W. E. (2006): *The Tiebout Model at Fifty* chap. The Many Faces of the Tiebout Model, pp. 21–45. Lincoln Institute of Land Policy, Cambridge, MA.

OSTROM, V. (1975): “Public Choice Theory: A New Approach to Institutional Economics,” *American Journal of Agricultural Economics*, 57(5), 844–850.

ROMER, T. (1988): “Nobel Laureate: On James Buchanan’s Contributions to Public Economics,” *Journal of Economic Perspectives*, 2(4), 165–179.

\*TIEBOUT, C. M. (1956): “A Pure Theory of Local Expenditures,” *Journal of Political Economy*, 64(5), 416–424.

### III.3 Public production

#### Lecture 8/1: 25 October 2011 (T)

\*STZ, chapter 8.

\*BERGSTROM, T. C., AND R. P. GOODMAN (1973): "Private Demands for Public Goods," *American Economic Review*, 63(3), 280–296.

BORCHERDING, T. E., AND R. T. DEACON (1972): "The Demand for the Services of Non-Federal Governments," *American Economic Review*, 62(5), 891–901.

\*BRUECKNER, J. K. (1979): "Equilibrium in a System of Communities with Local Public Goods: A Diagrammatic Exposition," *Economics Letters*, 2(2), 387–393.

### III.4 Externalities

#### Lecture 8/2: 27 October 2011 (R)

\*STZ, chapter 9.

GRB, chapters 5–6.

BAUMOL, W. J. (1972): "On Taxation and the Control of Externalities," *American Economic Review*, 62(3), 307–322.

COASE, R. H. (1960): "The Problem of Social Cost," *Journal of Law and Economics*, 3(1), 1–44.

EUROPEAN SPATIAL DEVELOPMENT PERSPECTIVE (1999): *Towards Balanced and Sustainable Development of the Territory of the European Union*, European Commission, Luxembourg.

## IV. Theory of Taxation

#### Lecture 9/1: 1 November 2011 (T)

\*STZ, chapter 17.

GRB, chapter 18.

### IV.1 Tax incidence

#### Lecture 9/2: 3 November 2011 (R)

\*STZ, chapter 18.

GRB, chapter 19.

### IV.2 Taxation and efficiency

#### Lecture 10/1: 8 November 2011 (T)

\*STZ, chapter 19.

#### Lecture 10/2: 10 November 2011 (R)

NARSC Annual Meetings, no class.

## IV.3 Optimal taxation

Lecture 11/1: 15 November 2011 (T)

\*GRB, chapter 20.

\*MANKIW, N. G., M. WEINZIERL, AND D. YAGAN (2009): "Optimal Taxation in Theory and Practice," *Journal of Economic Perspectives*, 23(4), 147–174.

Lecture 11/2: 17 November 2011 (R)

\*STZ, chapter 20.

Lecture 12/1: 22 November 2011 (T)

ATKINSON, A. B., AND N. H. STERN (1974): "Pigou, Taxation and Public Goods," *Review of Economic Studies*, 41(1), 119–128.

\*SANDMO, A. (1974): "A Note on the Structure of Optimal Taxation," *American Economic Review*, 64(4), 701–706.

Lecture 12/2: 24 November 2011 (R)

Thanksgiving break.

**V. Sub-Central Government Revenue and Regulation**Lecture 13/1: 29 November 2011 (T)

\*STZ, chapter 27.

DALY, G. G. (1969): "The Burden of the Debt and Future Generations in Local Finance," *Southern Economic Journal*, 36(1), 44–51.

DE KAM, F. (ed.) (1999): *Taxing Power of State and Local Government*, no. 1 in OECD Tax Policy Studies. OECD Publications.

## V.1 Property taxes and land-use planning

Lecture 13/2: 1 December 2011 (R)

\*LVY, chapter 9.

\*WILLIS, J. J. (2001): *Property Taxes and Local Government Finance* chap. A History of Property Taxes in America, pp. 123–146. Lincoln Institute of Land Policy, Cambridge, MA.

ZODROW, G. R., AND P. MIESZKOWSKI (1986): "Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods," *Journal of Urban Economics*, 19(3), 356–370.

## V.2 Sales taxes

Lecture 14/1: 6 December 2011 (T)

\*BURGE, G., AND C. ROGERS (2011): "Local Option Sales Taxes and Consumer Spending Patterns: Fiscal Interdependence Under Multi-tiered Local Taxation," *Regional Science and Urban Economics*, 41(1), 46–58.



## V.3 Income taxes

Lecture 14/2: 8 December 2011 (R)

FELD, L. P., AND G. KIRCHGÄSSNER (2001): "Income Tax Competition at the State and Local Level in Switzerland," *Regional Science and Urban Economics*, 31(2), 181–213.

\*OATES, W. E. (2004): *City Taxes, City Spending* chap. What Should Local Governments Tax: Income or Property?, pp. 7–29. Edward Elgar Publishing.

## V.4 Corporate taxes

Lecture 15/1: 13 December 2011 (T)

\*RATHELOT, R., AND P. SILLARD (2008): "The Importance of Local Corporate Taxes in Business Location Decisions: Evidence from French Micro Data," *Economic Journal*, 118(527), 499–514.

## V.5 Monopoly and regulatory taxes

\*IHLANFELDT, K. R. (2006): "Introduction: State and Local Government Regulation and Economic Development," *Journal of Regional Science*, 46(1), 1–3.

Figure 1: Decentralisation of public spending, 2005

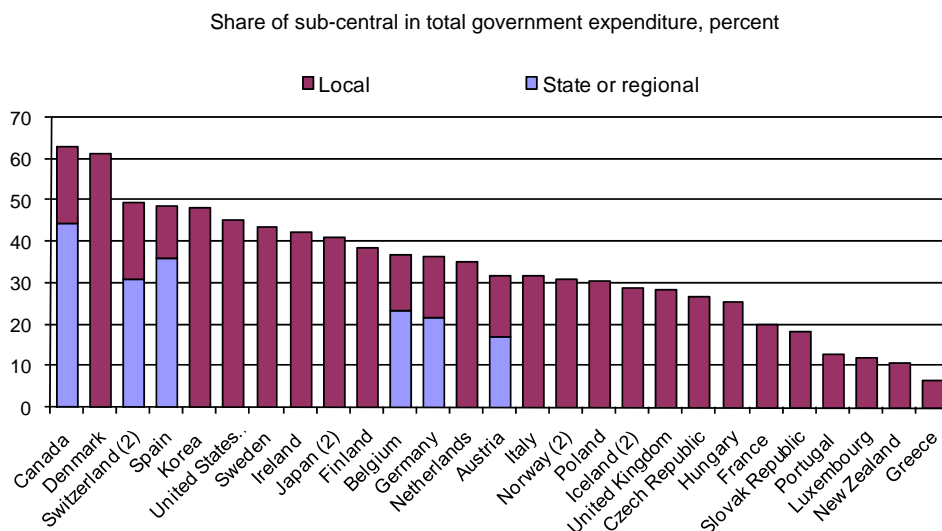
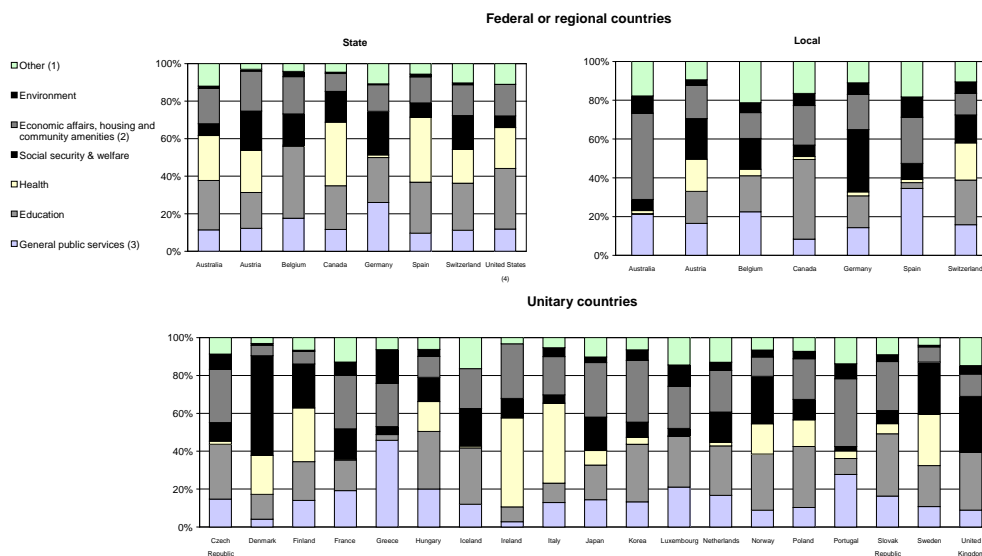


Figure 2: Share of sub-central government spending by main categories\*



\* Notes: (1) Other includes defence, environment protection, recreation, culture and religion. (2) Economic affairs covers general economic, commercial and labour affairs; agriculture, forestry, fishing and hunting; fuel and energy, mining, manufacturing and construction; transport; communication; other industries; research and development economic affairs; economic affairs not else where classified. (3) General public services include public debt transactions. (4) For the United States, the National Accounts do not provide a breakdown between state and local governments.

Source: BLÖCHLIGER, H. (2008): "Market Mechanisms in Public Service Provision," Working Paper 06/08, OECD, Paris, France.; OECD National Accounts except for Australia, Canada, Iceland, Japan and Switzerland.