

14.472 - Public Finance II
Peter Diamond/Mark Duggan
Spring 2002

Meetings:

The course will meet Mondays and Wednesdays from 1-2:30 in E51-361??. There will be additional meetings to discuss problem sets at times to be arranged. The teaching assistant for the course is Rebecca Zarutskie rzarutsk@MIT.EDU, E52-201.

Requirements:

There will be three problem sets, a mid-term take-home exercise, and an in-class final exam. The problem sets will count for 10% of the grade, the mid-term exercise will count for 35% of the grade, and the final will count for the other 55%.

14.472 Home Page:

There is a 14.472 home page (<http://web.mit.edu/14.472/www>) on the World Wide Web. Copies of the reading list, problem sets, and some handouts and problem set answer sheets will be available on the home page.

Office Hours:

Duggan is available on Mondays and Wednesdays before class, from 10:30AM to 12 noon, in E52-371. Diamond is available Mondays and Wednesdays 2:30-3:30 in E52-344; also Tuesdays and Thursdays after spring break. To make appointments at other times, just send email to pdiamond@mit.edu or mduggan@midway.uchicago.edu.

Public Finance Field Requirements:

The Public Finance field requirement consists of two courses: 14.471 (Public Finance I) and 14.472 (Public Finance II). In some cases, 14.474 (Advanced Topics in Public Economics) may be combined with 14.471 to satisfy the field requirement.

Public Finance Seminar and Luncheon Meeting:

The Public Finance Seminar plays an important part in raising current “hot topics” and permitting students to meet some of the outstanding scholars in the field. Seminars take place Monday afternoons from 4:00-5:30. The seminar alternates between Harvard and MIT and when at MIT meets in E51-151. Schedules, seminar notices, and papers are usually available in E52-352. The seminar is not restricted to thesis writers, and first and second year students are encouraged to attend. We also have an informal Monday luncheon in E52-244 398??(noon) where thesis writers present their work in progress; students planning to specialize in public finance are welcome to attend.

14.472 - Public Economics II

P. Diamond/M. Duggan

Spring 2002

Useful texts

- A. Auerbach and M. Feldstein, Handbook of Public Economics: Volumes 1 & 2 (Amsterdam: North Holland, 1985 and 1987).
- A. Atkinson and J. Stiglitz, Lectures in Public Economics (New York: McGraw Hill, 1980).
- J. Laffont, Fundamentals of Public Economics (Cambridge: MIT Press, 1988).
- G. Myles, Public Economics (New York: Cambridge University Press, 1995).
- J. Pechman, Federal Tax Policy, Fifth Edition (Washington: Brookings Institution, 1987).
- J. Stiglitz, Economics of the Public Sector, Second Edition (New York: Norton, 1988).

1. Public goods**1.1 Efficient Public Goods Provision**

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- C. Ballard and D. Fullerton, "Distortionary Taxes and the Provision of Public Goods," Journal of Economic Perspectives 6 (Summer 1992), 117-131.

R. Boadway and M. Keen, Public Goods, Self-Selection and Optimal Income Taxation, International Economic Review v34, n3 (August 1993): 463-78

- T. Gaube, "When do Distortionary Taxes Reduce the Optimal Supply of Public Goods?" Journal of Public Economics, 76 (May 2000), 151-180.
- L. Kaplow, The Optimal Supply of Public Goods and the Distortionary Cost of Taxation
National Tax Journal v49, n4 (December 1996): 513-33
- M. King, "A Pigouvian Rule for the Optimal Provision of Public Goods," Journal of Public Economics 30 (1986), 273-292.
- J. Laffont, Chapter 2.
- J. Morgan, "Financing Public Goods by Means of Lotteries," mimeo, Princeton, 1996.

Pirtillä, Jukka, and Matti Tuomala, On optimal nonlinear taxation and public good provision in an overlapping generations economy, Journal of Public Economics, 79, 3, 485-502, March 2001.

P. Samuelson, "The Pure Theory of Public Expenditure," Review of Economics and Statistics 36 (November 1954), 387-389.

1.2 Providing Public Goods with Asymmetric Information: Preference Revelation

A. Atkinson and J. Stiglitz, Chapter 10.

J. Laffont, Chapters 4, 5.

A. Sen, Collective Choice and Social Welfare (San Francisco: Holden Day, 1970), Chapters 1-3.

N. Tideman and G. Tullock, "A New and Superior Process for Making Social Choices," Journal of Political Economy 84 (1976), 1145-1159.

H. Varian, "A Solution to the Problem of Externalities When Agents Are Well-Informed," American Economic Review 84 (December 1994), 1278-1293.

1.3 Voluntary Private Provision of Public Goods and Private Charity

J. Andreoni, Impure Altruism and Donation to Public Goods; A Theory of Warm Glow Giving, Economic Journal, 100, 1990. 464-477

J. Andreoni, "An Experimental Test of the Public Goods Crowding Out Hypothesis," American Economic Review 83 (December 1993), 1317-1327.

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

H. Demsetz, "The Private Production of Public Goods," Journal of Law and Economics 13 (1970), 293-306.

H. Hansmann, "Nonprofit Enterprise in the Performing Arts," Bell Journal of Economics 12 (1981), 341-361.

B. Kingma, "An Accurate Measurement of the Crowd-Out Effect, Income Effect, and Price Effect for Charitable Contributions," Journal of Political Economy 97 (October 1989), 1197-1207.

J. Ledyard, "Public Goods: A Survey of Experimental Research," in J. Kagel and A. Roth, eds., The Handbook of Experimental Economics (Princeton: Princeton University Press, 1995), 111-194.

R. Roberts, "Financing Public Goods," Journal of Political Economy 95 (1987), 420-437.

Steinberg, Richard, Voluntary Donations and Public Expenditures in a Federalist System, The American Economic Review, Vol. 77, No. 1. (Mar., 1987), pp. 24-36.

1.4 Income Tax Deduction of Charitable Donations

- A. B. Atkinson The Income Tax Treatment of Charitable Contributions, in Public and Urban Economics: Essays in the Honor of William S. Vickrey, ed. R Grieson, NY DC Heath, 1976
- C. Clotfelter, Federal Tax Policy and Charitable Giving, Chicago Press, 1985
- C. Clotfelter, "The Impact of Tax Reform on Charitable Giving: A 1989 Perspective," in J. Slemrod, ed., Do Taxes Matter? (Cambridge: MIT Press, 1990), 203-235.
- M Feldstein A Contribution to the Theory of Tax Expenditures; The Case of Charitable Giving, The Economics of Taxation., ed. H Aaron and M. Boskin, 99-122. Brookings, 1980.
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- E. Saez, The Optimal Treatment of Tax Expenditures, NBER WP 8037, 2000.
- E. Saez, The Desirability of Commodity Taxation under Non-Linear Income Taxation and Heterogeneous Tastes, NBER WP 8029, 2000.

2. Tax Treatment of Donations, Gifts and Estates

2.1 Background

2.1.1 Individual Motivation

- J. Altonji, F. Hayashi, and L. Kotlikoff, "Parental Altruism and Inter Vivos Transfers: Theory and Evidence," Journal of Political Economy 105 (December 1997), 1121-1166.
- A. Bernheim, A. Shleifer, and L. Summers, "The Strategic Bequest Motive," Journal of Political Economy 93 (December 1985), 1045-1076.
- Carroll, Christopher D., Why do the rich save so much, in Joel B Slemrod (ed.) Does Atlas Shrug? The Economic Consequences of Taxing the Rich, Harvard University Press, 2000.
- M. Hurd, "Savings of the Elderly and Desired Bequests," American Economic Review, 77 (1987), 298-312.
- M. Hurd, "Mortality Risk and Bequests," Econometrica 57 (1989): 779-813.
- L. Kotlikoff, "Intergenerational Transfers and Saving," Journal of Economic Perspectives 2 (Spring 1988), 41-58.

F. Modigliani, "The Role of Intergenerational Transfers and Lifecycle Saving in the Accumulation of Wealth," Journal of Economic Perspectives 2 (Spring 1988), 15-40.

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2.1.2 Annuities

J. Brown, "How Should We Insure Longevity Risk in Pensions and Social Security?" Center for Retirement Research Issue in Brief, August 2000.

J. Brown, O. Mitchell, J. Poterba, and M. Warshawsky, The Role of Annuities in Financing Retirement, MIT Press, 2002.

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J. Brown and J. Poterba, "Joint Life Annuities and the Demand for Annuities by Married Couples," *The Journal of Risk and Insurance*, December 2000.

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J. Brown and M. Warshawsky, "Longevity-Insured Retirement Distributions from Pension Plans: Regulatory and Market Issues," forthcoming, in W. Gale, J. Shoven and M. Warhsawsky, Public Policies and Private Pensions, Brookings Institution.

J. Brown, "Are the Elderly Really Over-Annuitized? New Evidence on Life Insurance and Bequests," 2001, in D. Wise, ed., Themes in the Economics of Aging, University of Chicago Press for NBER.

J. Brown, "Redistribution and Insurance: Mandatory Annuitization with Mortality Heterogeneity," Center for Retirement Research working paper, March 2001.

J. Brown, O. Mitchell, and J. Poterba, "The Role of Real Annuities and Indexed Bonds in an Individual Accounts Retirement Program," 2001, in J. Campbell and M. Feldstein, Risk Aspects of Investment-Based Social Security Reform. University of Chicago Press for NBER.

J. Brown, "Mortality Risk, Inflation Risk, and Annuity Products," 2000, NBER Working Paper No. 7812, and forthcoming in Z. Bodie, B. Hammond, O. Mitchell, and S. Zeldes, Financial Innovations in Retirement Income, University of Pennsylvania Press for the Pension Research Council.

J. Brown, "Differential Mortality and the Value of Individual Account Retirement Annuities," 2000, NBER Working Paper No. 7560, and forthcoming in M. Feldstein and J. Liebman, The Distributional Effects of Social Security Reform, University of Chicago Press for NBER.

A. Brugiavini, "Uncertainty Resolution and the Timing of Annuity Purchases," Journal of Public Economics 50 (1993), 31-62.

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2.2 Taxing Gifts to Individuals

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2.3 Estate Taxes

H. Aaron and A. Munnell, "Reassessing the Role for Wealth Transfer Taxes," National Tax Journal 45 (June 1992), 119-144.

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- L. Kaplow, A Framework for Assessing Estate and Gift Taxation, NBER WP 7775, 2000.**
- W. Kopczuk, "The Trick is to Live: Is the Estate Tax Social Security for the Rich?" unpublished, University of Michigan.
- J. Laitner and H. Ohlsson, "Bequest Motives: A Comparison of Sweden and the United States," Journal of Public Economics, 79 (January 2001), 1, 205-236.
- K. McGarry, "The Cost of Equality: Unequal Bequests and Tax Avoidance," Journal of Public Economics, 79 (January 2001), 1, 179-204.
- K. McGarry, "Inter Vivos Transfers or Bequests? Estate Taxes and the Timing of Parental Giving," Tax Policy and the Economy, 2000, 14, 93-122.
- J. Poterba, "The Estate Tax and After-Tax Investment Returns," NBER Working Paper 6337, December 1997.
- J. Poterba, "The Estate and Gift Tax and Inter Vivos Giving in the United States," Journal of Public Economics, 79 (January 2001), 1, 237-264.

Papers from CRR conference, October, 2001

3. Social Security

3.1. Social Insurance Theory

- G. Akerlof, "The Market for Lemons," Quarterly Journal of Economics 85 (1970), 488-500. (in P. Diamond & M. Rothschild, Uncertainty in Economics, (New York: Academic Press, Revised Edition, 1989).
- A.B. Atkinson, "Income Maintenance and Social Insurance," in A. Auerbach and M. Feldstein, eds., Handbook of Public Economics Volume 2 (Amsterdam: North Holland, 1987), 779-908.
- P. Diamond, "A Framework for Social Security Analysis," Journal of Public Economics 8 (1977), 275-298.**
- P. Diamond, "Issues in Social Insurance," 1993 Nancy L. Schwartz Memorial Lecture, Northwestern University in Frontiers of Research in Economic Theory: The Nancy L. Schwartz Memorial Lectures, 1983-1997, Jacobs, Kalai and Kamein, eds., Cambridge University Press, 1998.
- P. Diamond, "Government Provision and Regulation of Economic Support in Old Age," in Bruno and Pleskovic (eds.), Proceedings of the Seventh Annual World Bank Conference on Development Economics, 1995, Washington DC: The World Bank. 83-103.

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- M. Feldstein, "Seven Principles of Social Insurance," Challenge (November 1976).
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- S. Shavell, "On Moral Hazard and Insurance," Quarterly Journal of Economics 93 (1979), 541-562. (also Section 6, "Experience Rating," in mimeo).
- Robert J. Shiller, *Macro Markets*, Clarendon Press Oxford, 1993.
- J. von Weizsaecker, Hayek's obvious corollary, unpublished, University of Munich, 2000.**
- C. Wilson, "The Nature of Equilibrium in Markets with Adverse Selection," Bell Journal of Economics, (Spring 1980), 108-130.

3.2 Within Cohort Theoretical Models

P. Diamond, Munich Lectures:

- Chapter 3. Models of Optimal Lifetime Taxation with Time-Consistent Preferences,**
- Chapter 4. Models of Optimal Lifetime Taxation with Time-Inconsistent Preferences,**
- Chapter 6. Models of Optimal Retirement Incentives with Varying Disutility of Labor**
- Chapter 7. Models of Optimal Retirement Incentives with Varying Life Expectancy**

- P. Diamond and J. Mirrlees, "A Model of Social Insurance with Variable Retirement," Journal of Public Economics, 10 (1978), 295-336.
- P. Diamond and J. Mirrlees, "Social Insurance with Variable Retirement and Private Saving," Journal of Public Economics (forthcoming).
- P. Diamond and J. Mirrlees, "Payroll-Tax Financed Social Security with Variable Retirement," Scandinavian Journal of Economics, 88 (1986), 25-50.
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- M. Feldstein, "Should Social Security Be Means Tested?," Journal of Political Economy 95 (1987), 468-484.
- M. Feldstein, "Should Social Security Benefits Increase with Age?" March 1987, NBER Working Paper #2200.

R. G. Hubbard and K. Judd, "Social Security and Individual Welfare: Precautionary Saving, Borrowing Constraints, and the Payroll Tax," American Economic Review, (September 1987), 630-646.

3.3 Social Security, Saving, and Benefit Adequacy Issues

J. Banks, R. Blundell, and S. Tanner, "Is There a Retirement Savings Puzzle?," American Economic Review 88 (1998), 769-788.

D. Bernheim, "Dissaving After Retirement: Testing the Pure Lifecycle Hypothesis," in Z. Bodie, J. Shoven, and D. Wise, eds., Issues in Pension Economics, (Chicago: University of Chicago Press, 1987), 237-283.

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J. Brown and J. Poterba, "Joint Life Annuities and Annuity Demand by Married Couples," mimeo, MIT, 1998.

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- A. Gustman and B. Steinmeyer, "Effects of Pensions on Savings: Analysis with Data From the Health and Retirement Survey," mimeo, Dartmouth College
- K. C. Holden and C. Zick, 1998, Insuring against the Consequences of Widowhood in a Reformed Social Security System, in Arnold, R. Douglas, Michael J. Graetz, and Alicia H. Munnell, Framing the Social Security Debate, Values, Politics, and Economics, Washington: National Academy of Social Insurance, distributed by Brookings Institution Press.**
- M. Hurd, "Research on the Elderly: Economic Studies, Retirement, and Consumption and Saving," Journal of Economic Literature 28 (June 1990), 565-637.
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3.3.1 Early entitlement age

- R. Burkhauser, K. Couch, and J. Phillips, "Who Takes Early Social Security Benefits? The Economic and Health Characteristics of Early Beneficiaries," The Gerontologist 36 (1996), 789-799.
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- M. V. Leonesio, D. R. Vaughn, and B. Wixon, "Early Retirees under Social Security: Health Status and Economic Resources," Social Security Bulletin, 64, 4, 1-16 (2000).
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3.4 Social Security and Labor Supply

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3.5. Social Security in OLG Growth Models

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