14.472 - Public Finance II
Peter Diamond/Jon Gruber/Mike Golosov
Spring 2005

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 Norma Coe, nbcoe@mit.edu, E52-361.

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 30% of the grade, and the final will count for the other 60%.

Each section of the reading list is marked with the associated teacher. For Gruber's sections of the course (Sections 3.3, 3.4, 4.2, 4.3, 6.2, 7 and 8), all readings are required (for the longer review papers or evaluation reports, only a light read is necessary). For Diamond's sections of the course, bold readings are required. For Golosov's sections of the course, bold are required. All of Gruber's readings and Diamond's required readings will be available on the web or in a course packet. Required readings guide: *-in packet, **J**-jstor.org, **MIT**- MIT electronic journals, **NBER**-NBER working papers, **O** =available online, link provided under entry.

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:

Gruber is available on Mondays and Wednesdays before class, from 10:30AM to 12 noon, in E52-355. Diamond is available Mondays to Thursday 2:30-3:30 in E52-344 until spring break. Golosov is available Mondays and Wednesdays before class, from 10:30 to 12:00 in E52-243G. To make appointments at other times, just send email to pdiamond@mit.edu, gruberj@mit.edu.,or golosov@mit.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. When at MIT it meets in E51-376, when at Harvard it meets in Littauer M-16. Schedules, seminar notices, and papers are usually available in E52-356. 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 E52-398 (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 Readings

Useful texts

A. Auerbach and M. Feldstein, Handbook of Public Economics: Volumes 1 & 2 & 3 (Amsterdam: North Holland, 1985, 1987, 2003). 4 on the way, chapters available on the web.

A. Atkinson and J. Stiglitz, Lectures in Public Economics (New York: McGraw Hill, 1980).

J. Gruber, Public Finance and Public Policy (New York: Worth Publishers, 2005) [relevant chapters are 12-17 – posted on course web site]

J. Laffont, Fundamentals of Public Economics (Cambridge: MIT Press, 1988).

R.A.Moffit (Ed) Means-Tested Transfer Programs in the United States. National Bureau of Economic Research Conference Report. University of Chicago Press. Chicago and London. 2003.

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R. Tresch, Public Finance (Revised edition), (McGraw-Hill, 2002).

Committee on Ways and Means, Green Book – 2000 edition available at http://aspe.hhs.gov/2000gb/

1. Public goods - DIAMOND

1.1 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.

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.

1.2 Efficient Public Goods Provision

A. Atkinson and N. Stern, "Pigou, Taxation and Public Goods," Review of Economic Studies 41 (1974), 119-128.

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.

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M. King, "A Pigouvian Rule for the Optimal Provision of Public Goods," Journal of Public Economics 30 (1986), 273-292.

J. Laffont, Chapter 2.

1.3 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.

o**P. Diamond, "Optimal Tax Treatment of Private Contributions for Public Goods with and without Warm Glow Preferences", MIT WP**

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.

W. Reece and K. Zieschung, "Consistent Estimation of the Impact of Tax Deductibility on the Level of Charitable Contributions," Econometrica 54 (1985), 271-293.

E. Saez, "The Optimal Treatment of Tax Expenditures" *Journal of Public Economics*, 88(12), 2004, 2657-2684

2. Tax Treatment of Estates - DIAMOND

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.

M. Wilhelm, "Bequest Behavior and the Effect of Heirs Earnings: Testing the Altruistic Model of Bequests," American Economic Review 86 (September 1996), 874-892.

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, et. al, The Role of Annuities in Financing Retirement, MIT Press, 2002.

J. Brown, "Private Pensions, Mortality Risk, and the Decision to Annuitize," Journal of Public Economics, Vol. 82, No. 1, October 2001.

***J. Brown and J. Poterba, "Joint Life Annuities and the Demand for Annuities by Married Couples," The Journal of Risk and Insurance, 67[4], December 2000, 527-54.**

J. Brown, O. Mitchell, J. Poterba, and M. Warshawsky, "Taxing Retirement Income: Non-Qualified Annuities and Distributions from Qualified Accounts," *The National Tax Journal*, Vol. LII, No. 3, September 1999.

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.

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

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J. Brown, "Differential Mortality and the Value of Individual Account Retirement Annuities," 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. 2000.

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

[NBER]**T. Davidoff, J. Brown, and P. Diamond, "Annuities and Individual Welfare," revised version, 2005.**

B. Friedman and M. Warshawsky, "The Cost of Annuities: Implications for Saving Behavior and Bequests," Quarterly Journal of Economics, 105 (1990), 135-154.

L. Kotlikoff and A. Spivak, "The Family as an Incomplete Annuities Market," Journal of Political Economy, 89 (1981), 372-291.

O. Mitchell, J. Poterba, M. Warshawsky, and J. Brown, "New Evidence on the Money's Worth of Individual Annuities," American Economic Review Vol. 89, No. 5, December, 1999.

E. Sheshinski, Optimum and Risk-Class Pricing of Annuities, CESifo WP 873, 2003.

E. Sheshinski, "Utilitarian Pricing of Annuities," unpublished 2004.
<http://economics.huji.ac.il/sheshinski/Utilitarian%20Pricing.pdf>

2.2 Taxing Gifts to Individuals

Kaplow, Louis, A Note on Subsidizing Gifts, Journal of Public Economics, 1995, 58: 469-478

2.3 Income Tax Treatment of Interest Income

Atkinson, A. B. and J. E. Stiglitz, "The Design of Tax Structure: Direct versus Indirect Taxation," Journal of Public Economics, 6, 55-75, 1976.

A. Atkinson and A. Sandmo, "Welfare Implications of the Taxation of Savings," Economic Journal 90 (1980), 529-549.

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2.4 Estate Taxes

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W. Kopczuk, "Optimal Estate Taxation in the Steady State?" unpublished, University of British Columbia.

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.

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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.

E. Saez, "The Desirability of Commodity Taxation under Non-Linear Income Taxation and Heterogeneous Tastes", NBER WP 8029, 2000.

3. Social Security

3.1. Social Insurance Theory - **DIAMOND**

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, "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, Washington DC: The World Bank. 83-103. 1995.

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oM. Feldstein, "Rethinking Social Insurance" Presidential Address to the AEA annual meetings, January 2005, forthcoming, AER, March 2005.

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J. Gruber, Public Finance and Public Policy, Chapter 12

o J. von Weizsaecker, "The Hayek Pension: An Efficient Minimum Pension to Complement the Welfare State" CESifo wp 1064 2003.

3.2 Within Cohort Theoretical Models - **DIAMOND**

***P. Diamond, Taxation, Incomplete Markets and Social Security The 2000 Munich Lectures Cambridge: MIT Press, 2002. Ch. 3 Pgs. 17-32, Ch. 4 Pgs. 33-46, Ch. 6 Pgs. 63-85, Ch. 7 Pgs. 87-114. Notes by Peter Diamond.**

P. Diamond and J. Mirrlees, "A Model of Social Insurance with Variable Retirement," Journal of Public Economics, 10 (1978), 295-336.

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3.3 Social Security, Saving, and Benefit Adequacy Issues - GRUBER

*Attanasio, Orazio, and Agar Brugiavinni, "Social Security and Household's Saving," The Quarterly Journal of Economics, Vol 118, No. 3 (August 2003), pp. 1499-1521.

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NBER M. Hurd and S. Rohwedder, "The Retirement-Consumption Puzzle: Anticipated and Actual Declines in Spending at Retirement," NBER Working Paper #9586, March 2003

NBER E. Hurst, "Grasshoppers, Ants, and Pre-Retirement Wealth: A Test of Permanent Income Consumers," NBER Working Paper #10098, September 2004.

3.4 Social Security and Labor Supply - GRUBER

NBER S. Chan, A. H. Stevens, "What You Don't Know Can't Help You.Pension Knowledge and Retirement Decision Making." NBER Working Paper #10185, December 2003

NBER C. Coile and J. Gruber, "Social Security and Retirement," NBER Working Paper #7830 August 1 2000.

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3.5. Social Security in OLG Growth Models - DIAMOND

A. B. Abel, "Precautionary Savings and Accidental Bequests", American Economic Review, September 1985, 75(4), 777-791.

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3.6 Social Security Reform: Overview & Political Economy - DIAMOND

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