

**UNIVERSITY OF TORONTO  
DEPARTMENT OF ECONOMICS**

**ECONOMICS 2601H1S – SPRING 2012**

**PUBLIC ECONOMICS**

**Course Description:**

This course is the second in a two-part graduate sequence in Public Economics. This semester, we will be focusing on externalities, public goods theory, the theory and empirics of local public goods provision (especially, education), and – time permitting – environmental issues (particularly global warming and what, if anything, we should do about it).

The course this semester is designed to introduce you to the (mainly) microeconomic analysis of issues in Public Economics. It has four goals: first, to familiarize you with some basic theory that students of Public Economics should know; second, to acquaint you with some relevant empirical methods (e.g. what is a structural model?); third, to give you experience critiquing existing research; and fourth, to introduce you to some of the interesting work in the field with a view to identifying promising areas for future research.

**Instructor:**

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Please note: the course web site will be used to make course-related announcements, post questions related to papers we are scheduled to discuss in class, and provide some sample problems.

**Lectures:**

Tuesday 4:00pm – 6:00pm in Room GE100, Economics Department, 150 St. George Street.

Office hours will be held directly after class (or email me to fix a time).

## Grading:

Final Examination	56%
Homework Assignments (4)	12%
Referee Reports (2)	22%
Class Participation	10%

The final examination for the course will take place sometime in early/mid April. It will be based heavily on the material covered in the course, including the papers discussed in class (see below). In preparation for the final, I will post some sample questions on the course website to give you a feel for the sorts of question that may appear.

There will be four short homework assignments, each worth 3 percent of the overall grade. I will give these out during class: they will be due back the following class. Their purpose is to engage you with the material being covered at that point. (There may be some purely ‘bonus’ assignments too.)

We will spend an increasing proportion of time as the course progresses discussing interesting or important (or both) papers in the field, listed in the Course Outline overleaf. I will distribute a set of questions related to each paper beforehand to provide a basis for class discussion. Please read these papers carefully, and work through the corresponding questions. As incentives for doing so, some of these questions will appear on the final exam, and the “Class Participation” component of the overall grade will be based on your contribution to this class discussion.

To formalize the allocation of the 10 percent for class participation, I reserve the right to assign a portion of this to mini-presentations based on the assigned questions from the readings. That is, students (with non-zero probability) will have to present parts of the assigned questions.

To ensure that your critiquing skills are on track, I will be assigning two referee reports for you to write. One of these will be assigned in mid-February; you will have a couple of weeks to work on it. The second will be assigned in late-March and will be due in on the last day of class. Together, the assignments are worth 18 percent of the total grade: 8 percent for the first and 10 percent for the second. For the first referee report, students should also submit slides, worth 4 percent. Students will be called on (randomly) to present in class, so everyone should be prepared.

There is a paper (optional for MA students, not optional for Ph.D’s) that can be substituted, in part, for the Final Examination. This is intended for students who wish to get to grips with a strand of literature in Public Economics and to think seriously about improving it. Under this option, a good research paper would identify an interesting research topic in the field, pose a clear research question, demonstrate that the question remains to be answered, and propose a sensible way of answering it. (If theory, set out and work through a model.) Students interested in carrying out research in Public Economics are strongly encouraged to pursue this option, and all Ph.D. students *must* pursue this. [Aside: in the past, students have produced some first-rate term papers for the class.] Any students wishing to pursue this option should make sure they speak to me about their proposed projects before the end of February – the sooner the better.

## **Textbooks:**

For the first part of the course, I will refer to sections from

Richard Cornes and Todd Sandler, *The Theory of Externalities, Public Goods and Club Goods*, Second Edition, Cambridge, 1996.

For econometric background,

Jeffrey M. Wooldridge, *Econometric Analysis of Cross Section and Panel Data*, MIT Press, 2002

is an excellent reference. I would recommend students interested in carrying out empirical work in economics to buy a copy. (Wooldridge also has an introductory text that supplies lots of quick intuition, then developed formally in the graduate book listed above. Both books are worth owning, though they are not cheap.)

I'd also recommend the following:

Dierdre N. McCloskey, *Economical Writing*, 2<sup>nd</sup> edition, Waveland Press, 2000.

Why? In economics and in professional life more generally, a premium attaches to being able to write clearly and well. Thus you should practice, and pay lots of attention to, the art of writing. This book gives some useful pointers.

## ECONOMICS 2601H1S – SPRING 2012

### Graduate Public Economics

#### COURSE OUTLINE – Short Version

The Lectures will cover the topics listed below. We may not get right to the bottom of the list, and additional papers may also be added as we go along.

Starred readings are recommended, providing useful background material. We will discuss readings marked with a **D** in class; please read them before the class discussion. For each of these, I will make a set of questions available beforehand to provide a basis for discussion.

All the ‘**D**’ readings and all the starred readings can be borrowed from me. Most of the important readings listed below are also available in JSTOR, an online journal archive.

*Topic 1:        Preliminaries: Welfare Theorems*

\*Cornes and Sandler, Chapter 2.

\*Varian, Hal R. (1992), *Microeconomic Analysis*, 3<sup>rd</sup> Edition, Norton: Chapter 17 (and for a more general coverage, see Chapter 18). (Mas-Colell *et al.* is a great resource also.)

*Topic 2:        Externalities - Theory*

Characterization of Externalities

\*Cornes and Sandler, Chapter 3.

Responses to Externalities

**D** Chu, C.Y. Cyrus and C. Wang (1998), “Economy of Specialization and Diseconomy of Externalities,” *Journal of Public Economics*, **69**: 249-61.

\*Cornes and Sandler, Chapter 4.

\*Farrell, Joseph (1987), “Information and the Coase Theorem,” *Journal of Economic Perspectives*, **1**(2): 113-129.

**D** Kandel, Eugene and Edward P. Lazear (1992), “Peer Pressure and Partnerships,” *Journal of Political Economy*, **100**(4): 801-817.

Topic 3: **Measuring Externalities - Empirics**

**Peer Effects in the Production of Public Goods**

D Evans, William, Wallace Oates, and Robert Schwab (1992), "Measuring Peer Group Effects: A Study of Teenage Behavior," *Journal of Political Economy*, **100**: 966-991.

**Neighborhood Effects**

D Borjas, George J. (1992), "Ethnic Capital and Intergenerational Mobility," *Quarterly Journal of Economics*, February: 123-50.

Borjas, George J. (1995), "Ethnicity, Neighborhoods, and Human-Capital Externalities," *American Economic Review*, June: 365-90.

D Bertrand, Marianne, Erzo Luttmer, and Sendhil Mullainathan (2000), "Network Effects and Welfare Cultures," *Quarterly Journal of Economics*, August.

\*Cutler, David and Edward Glaeser (1997), "Are Ghettos Good or Bad?" *Quarterly Journal of Economics*, August.

D Sethi, Rajiv and Rohini Somanathan (2004), "Inequality and Segregation," *Journal of Political Economy*, **112**(6), 1296-1321.

Bayer, Patrick, Hanming Fang, and Robert McMillan (2011), "*Separate When Equal: Racial Inequality and Residential Segregation*," NBER Working Paper.

Katz, Lawrence F., Jeffrey R. Kling, and Jeffrey B. Liebman (2000), "Moving to Opportunity in Boston: Early Results of a Randomized Mobility Experiment," Princeton University Working Paper #441 (<http://www.irs.princeton.edu>). Now published in *Econometrica*.

**Identification**

\*Angrist, Joshua D. and Alan B. Krueger (2001), "Instrumental Variables and the Search for Identification: From Supply and Demand to Natural Experiments," Princeton University Working Paper #455 (<http://www.irs.princeton.edu>).

Topic 4: **Public Goods Theory**

\*Atkinson, Anthony B. and Joseph E. Stiglitz (1980), *Lectures on Public Economics*, Chapter 16, New York: McGraw-Hill.

\*Samuelson, Paul (1954), "The Pure Theory of Public Expenditures," *Review of Economics and Statistics*, **36**: 387-9.

Topic 5: **Club Theory, Local Public Goods, and the Tiebout Hypothesis**

\*Atkinson, Anthony B. and Joseph E. Stiglitz (1980), *Lectures on Public Economics*, Chapter 17, New York: McGraw-Hill.

\*Rubinfeld, Daniel (1987), "The Economics of the Local Public Sector," *Handbook of Public Economics*, Vol. II, eds. by A. Auerbach and M. Feldstein, Elsevier, North Holland.

Benabou, Rolando (1993), "Workings of a City," *Quarterly Journal of Economics*, August: 619-652.

Topic 6: **Valuing Local Public Goods**

D Black, Sandra E. (1999), "Do Better Schools Matter? Parental Valuation of Elementary Education," *Quarterly Journal of Economics*, May: 577-599.

\*Bayer, Patrick, Fernando Ferreira, and Robert McMillan (2007), "A Unified Framework for Measuring Preferences for Schools and Neighborhoods," *Journal of Political Economy*, **115**(4): 588-638.

Topic 7: **Competition between Jurisdictions and the Provision of Public Goods**

D Epple, Dennis, and Alan Zelenitz (1981), "The Implications of Competition among Jurisdictions: Does Tiebout Need Politics?" *Journal of Political Economy* **89**(6): 1197-1217.

\*Henderson, J. Vernon (1985), "The Tiebout Model: Bring Back the Entrepreneurs," *Journal of Political Economy* **93**: 248-264.

\*Bayer, Patrick, and Robert McMillan (2011), "Choice and Competition in Local Education Markets," revised version of NBER Working Paper 11802.

\*Clark, Damon (2005), "Politics, Markets, and Schools: Quasi-Experimental Evidence on the Impact of Autonomy and Competition from a Truly Revolutionary UK Reform," mimeo. Now published in the *Journal of Political Economy*.

Hoxby, Caroline Minter (2000), "Does Competition Among Public Schools Benefit Students and Taxpayers?" *American Economic Review* **90**(5): 1209-1238.

Rothstein, Jesse (2006), "Good Principals or Good Peers? Parental Valuation of School Characteristics, Tiebout Equilibrium, and the Incentive Effects of Competition among Jurisdictions," *American Economic Review* **96**(4): 1333-1350.

## Additional Topics

### Topic 8: Education

Barlevy, Gadi and Derek Neal (2010), “Pay for Percentile,” (<http://sites.google.com/site/dereknealsresearch/october10.pdf>). (Forthcoming in the *AER*.)

\*Hanushek, Eric, (1986), “The Economics of Schooling: Production and Efficiency in Public Schools,” *Journal of Economic Literature*, **24**: 1141-77.

D Lazear, Edward P. (2001), “Education Production,” *Quarterly Journal of Economics*, August, **116**(3): 777-803.

\*Nechyba, Thomas (2000), “Mobility, Targeting, and Private School Vouchers,” *American Economic Review*, **90**(1): 130-146.

Rivkin, Steven G., Eric A. Hanushek, and John F. Kain (2005), “Teachers, Schools, and Academic Achievement,” *Econometrica*, **73**(2): 417-458.

\*Todd, Petra E. and Kenneth I. Wolpin (2003), “On the Specification and Estimation of the Production Function for Cognitive Achievement,” *Economic Journal*, **113**: F3-F33.

### Topic 9: Environmental Issues

Greenstone (2003), Henderson (1996), \*Mueller, Mendelsohn and Nordhaus (2011), D Ogawa and Wildasin (2009), Stern (2007), D Weitzman (2008) etc.

### Topic 10: (Neat) Papers by Graduate Students

Hugh’s job market paper (‘jmp’) (2011), Branko’s jmp (2012), Jonas Hjort’s jmp (2012), Mitch Hoffman’s jmp (2012), Eduardo de Souza Rodrigues’s jmp (2012), Lesley Turner’s jmp (2012), Arthur van Benthem’s jmp (2012), and more...