

ECO401H1S: TOPICS IN ECONOMIC POLICY

Course Information

Instructor: Linda Wang

E-mail: ld.wang@mail.utoronto.ca

Office Hours: Monday 12pm-2pm, 150 St. George Street, #70, or by appointment

TA: Huilan Xu, 150 St. George Street, huilan.xu@mail.utoronto.ca

Syllabus, problem sets, and presentation/paper guidelines are all posted online at: portal.utoronto.ca.

Contacting me: You are encouraged to drop in my office hours, or make an appointment to talk to me. If you want to email me, include ECO401H1S in the subject of your message and try to use your UofT email address. If I do not respond within 48 hours please re-send the message, in case that your original email has not been received.

Course Goals

This course covers material on (I) Welfare Economics and Incidence and Efficiency Cost of Government Policies, (II) Taxation and Redistribution, (III) Social Insurance, (IV) Economics of Mandates. The emphasis will be on the theoretical and empirical evaluation of public policy. The course will be a project-oriented capstone course, designed to give students a background in the economic analysis of public policy, with a focus on empirical (evidence-based) analysis.

Class meetings

Monday, 10am-12pm, BA3012

Friday, 1pm-2pm, BA3012

Friday class are reserved for tutorials sometimes and students' presentations in the second half of the course.

Prerequisites

ECO200Y1/ECO204Y1/ECO206Y1;

ECO202Y1/ECO208Y1/ECO209Y1;

ECO220Y1/ECO227Y1/(STA220H1,STA255H1)/(STA257H1,STA261H1);

At least one FCE in ECO at the 300 level or higher.

You must meet the prerequisites before taking this course. The Department of Economics will check them and remove students who fail to meet the prerequisites. I cannot waive them.

Evaluations

There will be two problem sets (15% each), a class presentation and a critical review (20% + 20%), and a midterm test (30%).

Important Dates

February 5 – Problem Set #1 Due
February 26 – Midterm Test
March 19 – Problem Set #2 Due
March 9/16/19/23/26 and April 2 – Class Presentations
April 4 – Paper Due

COURSE POLICIES

1) Midterm Test

The midterm test will be held on Monday, February 26th during class time, 10:10am – 12:00pm at BA3012.

Questions will be in a similar format to the questions on the problem sets.

Students who miss the term test will be given a mark of zero, unless **within one week of the midterm**, they contact the instructor to explain the reason for missing the test. An original medical certificate note must subsequently be submitted.

The note should be provided using the University of Toronto Student Medical Certificate. The form should be completed by a Medical Doctor, including her/his OHIP registration number, and the note must clearly state that on the date of the midterm, the student was too sick to write the test.

Students with a valid reason for missing the test will arrange to write a make-up test within two weeks after the term test. Consistent with university policy, no accommodation will be provided for missing the make-up test, and a grade of zero will be assigned.

2) Problem Sets

The problem sets are due at the beginning of class on February 5 and March 19. The penalty for lateness is 3% per day, which means students will get zero if they do not hand in their problem sets by February 9 and March 23. All students must hand in their own problem sets, but are welcome to help each other out.

3) Presentations and Critical Review

Each student will choose an empirical academic paper and present the paper in class. The length of the presentation will be around 15 minutes, including time for questions and discussion. The student will be prepared to discuss the following:

- (i) What is the main question of the paper?
- (ii) How does the paper contribute to the academic literature?
- (iii) What is the research design and empirical strategy?

- (iv) What are the main results of the paper?
- (v) What are some of the drawbacks of the research design?
- (vi) Are there alternative explanations for the empirical results?

Each student will write a critical review (approximately 12 pages) about the paper they chose to present. The review will summarize the paper, evaluate the contribution, and list other related research after the publication of the paper. The essay is due April 4. The penalty for lateness is 2% per day, including weekends. An electronic copy is required to submit to Turnitin.com

“Normally, students will be required to submit their course essays to Turnitin.com for a review of textual similarity and detection of possible plagiarism. In doing so, students will allow their essays to be included as source documents in the Turnitin.com reference database, where they will be used solely for the purpose of detecting plagiarism. The terms that apply to the University’s use of the Turnitin.com service are described on the Turnitin.com web site”.

For more information on Turnitin.com, please contact portal.help@utoronto.ca.

The university provides resources to help students in their writing. You are encouraged to work with the writing center at the college or campus where you’re registered. More information can be found at <http://writing.utoronto.ca/>

More details on the presentation and critical review will be provided later.

4) Appealing an exam

Appeals regarding the grading of a test must be submitted to the instructor or the TA in writing, *within one week of your receipt of the graded work*. The test cannot be written in pencil. The *entire exam* will be re-marked, which might result in a lower grade than the original.

5) Accessibility needs

The University of Toronto is committed to accessibility. If student requires accommodations for a disability, or have any accessibility concerns about the course, the classroom or course materials, please contact Accessibility Services as soon as possible: disability.services@utoronto.ca or <http://studentlife.utoronto.ca/accessibility>.

6) Academic misconduct

Academic integrity is essential to the pursuit of learning and scholarship in a university, and to ensuring that a degree from the University of Toronto is a strong signal of each student’s individual academic achievement. As a result, the University treats cases of cheating and plagiarism very seriously. The University of Toronto’s Code of Behaviour on Academic Matters (www.governingcouncil.utoronto.ca/policies/behaveac.htm) outlines the behaviours that constitute academic dishonesty and the processes for addressing academic offences. Potential offences include, but are not limited to:

In papers and assignments:

Using someone else's ideas or words without appropriate acknowledgement.

Submitting your own work in more than one course without the permission of the instructor.

Making up sources or facts.

Obtaining or providing unauthorized assistance on any assignment.

On tests and exams:

Using or possessing unauthorized aids.

Looking at someone else's answers during an exam or test.

Misrepresenting your identity.

In academic work:

Falsifying institutional documents or grades.

Falsifying or altering any documentation required by the University, including (but not limited to) doctor's notes.

All suspected cases of academic dishonesty will be investigated following procedures outlined in the Code of Behaviour on Academic Matters. If you have questions or concerns about what constitutes appropriate academic behaviour or appropriate research and citation methods, you are expected to seek out additional information on academic integrity from your instructor or from other institutional resources (see <http://academicintegrity.utoronto.ca/>).

7) Class rules

All students should arrive on time and be prepared to participate in class discussion. For the second half of the courses, each student is expected to ask the presenter questions and or provide feedback.

LECTURE SCHEDULE – WINTER 2017

Section I: Welfare economics, incidence and efficiency cost of government policies

January 8 Introduction and roadmap
January 15 Welfare economics
January 22 Incidence and efficiency cost of government policies
Problem Set 1 Distributed
January 26 Tutorial #1

Section II: Labour Income Taxation and Redistribution

IIA. Theoretical Aspects: Optimal Income Taxation and Redistribution

January 29 Optimal income taxation and transfer programs

IIB. Empirical Aspects: Behavioral Responses to Taxes and Transfers

February 5 Labor supply responses to taxation and transfers
Problem Set 1 Due
Problem Set 2 Distributed
February 12 Responses of Taxable Income to Tax Rates, In-kind transfers
February 16 Tutorial #2
February 26 Midterm

Section III: Social Insurance

March 5 Asymmetric information: adverse selection and moral hazard
March 12 Overview of social insurance and unemployment insurance

Class Presentations

March 9
March 16
March 19 Problem Set 2 Due
March 23
March 26
April 2

READING MATERIAL

Most of the course material will be covered during the lecture. Most readings are available on JSTOR through the U of T library.

Bold: required reading.

*: reading emphasized in class.

0. GENERAL REFERENCES

Background Reading: The most popular undergraduate textbooks

J. Gruber, Public Finance and Public Policies, 3rd edition, Worth Publishers, 2009.

H. Rosen, Public Finance, 7th edition, McGraw Hill, 2005.

H. Rosen, J. Wen, T. Snoddon, B. Dahlby, R. Smith, Public Finance in Canada, 3rd edition, McGraw-Hill, 2008.

J. Stiglitz, Economics of the Public Sector, 3rd edition, Norton, 1999.

References on Empirical Methods:

Angrist, J.D. and A. B. Krueger (2001), “Instrumental Variables and the Search for Identification: From Supply and Demand to Natural Experiments,” *Journal of Economic Perspectives*, 15(4): 69-85.

A. Angrist and J.S. Pischke, Mostly Harmless Econometrics. Princeton University Press, 2008.

I: WELFARE ECONOMICS, TAX INCIDENCE AND EFFICIENCY COST OF TAXATION

Week 1: Introduction and roadmap

Noah, T. (2010). “Introducing the Great Divergence”, *Slate Magazine*.

Piketty, T. and E. Saez (2003). “Income Inequality in the United States, 1913-1998”, *Quarterly Journal of Economics*, 118(1): 1-39.

Saez, E. and M. Veall (2005). “The Evolution of High Incomes in North-America: Lessons from the Canadian Evidence”, *American Economic Review*, 95(3): 831-849.

Week 2: Traditional welfare economics and behavioral welfare economics

Congdon, W., Kling, J., and S. Mullainathan (2011). “Policy and Choice: Public Finance Through the Lens of Behavioral Economics”, *Brookings Institution Press*, Washington, D.C.

Kroft, K. (2011). Book Review: “Policy and Choice: Public Finance Through the Lens of Behavioral Economics”, *Journal of Economic Literature*, 49(4): 1241-1250.

Reinhardt, U. (2010). “Is ‘More Efficient’ Always Better?”, *New York Times Economix Blog*

Reinhardt, U. (2010). “When Value Judgments Masquerade as Science”, *New York Times Economix Blog*

Week 3: Incidence and efficiency cost of government policies

Taxation

Auerbach, A. (1985). “The Theory of Excess Burden and Optimal Taxation,” in A. Auerbach and M. Feldstein, *Handbook of Public Economics*, 1: 61-127. Amsterdam: North Holland. Sections 1, 2, 3.1, and 4.

Chetty, R. (2009). “Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods”, *Annual Review of Economics*, 1: 451-488.

*Chetty, R., Looney A. and K. Kroft. “Salience and Taxation: Theory and Evidence,” *American Economic Review*, 99(4): 1145-1177.

Gruber, J. and B. Koszegi (2001). “Is Addiction Rational? Theory and Evidence”, *Quarterly Journal of Economics*, 116(4): 1261-1305.

*Hendren, Nathaniel (2016). “The Policy Elasticity,” *Tax Policy and the Economy*, 30.1: 51-89.

Hines, J. R. (1999). “Three Sides of Harberger Triangles,” *Journal of Economic Perspectives*, 13(2): 167-188.

*Marion, J. and E. Muehlegger (2008). “Measuring Illegal Activity and the Effects of Regulatory Innovation: Tax Evasion and the Dyeing of Untaxed Diesel”, *Journal of Political Economy*, 116(4): 633-666.

O’Donoghue, T. and M. Rabin (2006). “Optimal Sin Taxes,” *Journal of Public Economics*, 90: 1825-1849.

Willig, R. (1976). “Consumer’s Surplus Without Apology”, *American Economic Review*, 66(4): 589-597.

Price ceilings and price floors

Davis, L. and L. Kilian (2011). “The Allocative Cost of Price Ceilings in the U.S. Residential Market for Natural Gas”, *Journal of Political Economy*, 119(2): 212-241.

Glaeser, E. and E. Luttmer (2003). “The Misallocation of Housing Under Rent Control”, *American Economic Review*, 93(4): 1027-1046.

II: LABOUR INCOME TAXATION AND REDISTRIBUTION

Week 4: Optimal Income Taxation and the Design of Optimal Transfer Programs

Diamond, P. and E. Saez (2011). “The Case for a Progressive Tax: From Basic Research to Policy Recommendations,” *Journal of Economic Perspectives*, 25(4): 165-90.

*Piketty, T. and E. Saez (2007). “How Progressive is the US Federal Tax System? A Historical and International Perspective”, *Journal of Economic Perspectives*, 21(1): 3-24.

Heady, C. (1993). “Optimal Taxation as a Guide to Tax Policy: A Survey”, *Fiscal Studies*, 14(1): 15-41.

*Saez, E. (2001). “Using Elasticities to Derive Optimal Income Tax Rates”, *Review of Economics Studies*, 68: 205-229.

*Akerlof, G. (1978). “The Economics of Tagging as Applied to the Optimal Income Tax”, *American Economic Review*, 68(1): 8-19.

Blank, R. (2002). “Evaluating Welfare Reform in the United States”, *Journal of Economic Literature*, 40(4): 1105–1166.

*Nichols, A. and R. Zeckhauser (1982). “Targeting Transfers Through Restrictions on Recipients”, *American Economic Review*, 72(2): 372-377.

*Saez, E. (2002). “Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses”, *Quarterly Journal of Economics*, 117: 1039-1073.

Week 5: Labor Supply Responses to Taxation and Transfer Programs

*Ashenfelter, O. and M. Plant (1990). “Non-Parametric Estimates of the Labor Supply Effects of Negative Income Tax Programs”, *Journal of Labor Economics*, 8: 396-415.

Chetty, R. (2012). “Bounds on Elasticities with Optimization Frictions: A Synthesis of Micro and Macro Evidence on Labor Supply”, *Econometrica*, 80: 969–1018.

Chetty, R., Friedman, J., Olsen, T. and L. Pistaferri (2011). “Adjustment Costs, Firm Responses, and Micro vs Macro Labor Supply Elasticities: Evidence from Danish Tax Records”, *Quarterly Journal of Economics*, 126(2): 749-804.

Eissa, N. and J. Liebman (1996). “Labor Supply Response to the Earned Income Tax Credit”, *Quarterly Journal of Economics*, 111: 605-637.

Goolsbee, A. (2000). “What Happens When You Tax the Rich? Evidence from Executive Compensation”, *Journal of Political Economy*, 108: 352-378.

Heckman, J. (2000). “Causal Parameters and Policy Analysis in Economics: A Twentieth Century Retrospective”, *Quarterly Journal of Economics*, 115(1): 45-97.

*Imbens, G., D. Rubin and B. Sacerdote (2001). “Estimating the Effect of Unearned Income on Labor Earnings, Savings, and Consumption: Evidence from a Survey of Lottery Players”, *American Economic Review*, 91: 778-794.

*Kleven, H. (2014). “How Can Scandinavians Tax So Much?” *Journal of Economic Perspectives*, 28(4): 77-98.

Moffitt, R. (2003), “The Negative Income Tax and the Evolution of U.S. Welfare Policy,” *Journal of Economic Perspectives*, 17(3): 119-140.

*Saez, E. (2010) “Do Taxpayers Bunch at Kink Points?” *American Economic Journal: Economic Policy*, 2(3): 180-212.

Week 6: Responses of Taxable Income to Tax Rates, In-kind transfers

*Feldstein, M. (1995). “The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act”, *Journal of Political Economy*, 103: 551-572.

*Giertz, S., Saez, E. and J. Slemrod (2012). “The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review”, *Journal of Economic Literature*, 50.1: 3-50.

Hoynes, H. and Schanzenbach, D. (2009). “Consumption Responses to In-Kind Transfers: Evidence from the Introduction of the Food Stamp Program”, *American Economic Journal – Applied Economics*, 1(4): 109-139.

Schanzenbach, D. (2011). “What Are Food Stamps Worth?” Princeton University Industrial Relations Section Working Paper #468.

III. SOCIAL INSURANCE

Week 8: Asymmetric information: adverse selection and moral hazard

Einav, L. and A. Finkelstein (2011), “Selection in Insurance Markets: Theory and Empirics in Pictures,” *Journal of Economic Perspectives*, 25(1): 115-38.

Cullen, M., Einav, L. and A. Finkelstein (2011). “Estimating Welfare in Insurance Markets Using Variation in Prices”, *Quarterly Journal of Economics*, 123(3): 877-921.

Rothschild, M. and J. Stiglitz (1976). "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information", *Quarterly Journal of Economics*, 90(4): 629-650.

Week 9: Social insurance: unemployment insurance

Chetty, R. (2009). "Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods", *Annual Review of Economics*, 1: 451-488.

*Chetty, R. (2008). "Moral Hazard vs. Liquidity and Optimal Unemployment Insurance", *Journal of Political Economy*, 116(2): 173-234.

Feldstein, M. (1976), "Seven Principles of Social Insurance", *Challenge*, November/ December 1976, 6-11.

Gruber, Jon (1997). "The Consumption Smoothing Benefits of Unemployment Insurance", *American Economic Review*, 87(1): 192-205.

Krueger, A. B. and B. D. Meyer (2002). "Labor supply effects of social insurance", *Handbook of Public Economics*, chapter 33, pp: 2327-2392.

Nicholson, W. and K. Needels (2006). "Unemployment Insurance: Strengthening the Relationship between Theory and Policy", *Journal of Economic Perspectives*, 20(3): 47-70.