

Economics 2600 Public Economics (Taxation)

Professor Michael Smart
GE 268

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Preliminaries

The standard grading scheme for the course is:

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|---------------------|-----|
| Class presentation | 15% |
| Short paper | 25% |
| Final exam | 50% |
| Class participation | 10% |

There is no required textbook, but you may wish to consult:

Richard Tresch, 2002, *Public Finance: A Normative Theory*, 2nd ed, (Amsterdam, Academic Press).

Bernard Salanie, 2003, *The Economics of Taxation*, (Cambridge, MIT Press).

A. B. Atkinson and J. E. Stiglitz, 2015, *Lectures on Public Economics*, (Princeton: Princeton University Press).

James Mirrlees et al., *Dimensions of Tax Design and Tax by Design*, (The Mirrlees Review), available online at ifs.org.uk.

Papers marked * in the following you should definitely read – preferably before they are discussed in class. Please choose a paper to present in class from the ones marked with +. (Details to follow.) Note that not all the topics marked † will be covered this year. Note that you can find all these papers online through the usual sources, or on the course website.

Lectures

1. Introduction

Tresch, chaps. 1-4.

2. Deadweight loss and tax avoidance

*Auerbach, Alan, and J. Hines, 2002, “Taxation and economic efficiency,” secs. 1-2, in A. Auerbach and M. Feldstein, eds., *Handbook of Public Economics*, vol. 3, pp. 1347-1421. (Also NBER Working Paper 8181.)

Diamond, P. and D. McFadden, 1974, “Some uses of the expenditure function in public finance”, *Journal of Public Economics*, 3, 3-22.

Dahlby, Bev and Ergete Ferede, 2012, “The effects of tax rate changes on tax bases and the marginal cost of public funds for Canadian provincial governments,” *International Tax and Public Finance*, Vol. 19, No. 6, pp. 844-883.

3. Measuring deadweight loss

Chetty, Raj, 2009, “Is the taxable income elasticity sufficient to calculate deadweight loss? The implications of evasion and avoidance,” *American Economic Journal: Economic Policy*, 1(2), 31-52.

*Feldstein, M., 1995, "The effects of tax rates on taxable income: A panel study of the 1986 Tax Reform Act," *Journal of Political Economy* 103, 551-572.

Feldstein, M., 1999, "Tax Avoidance and the Deadweight Loss of the Income Tax," *Review of Economics and Statistics*, Vol. 81, No 4, pp. 674-680.

Goolsbee, Austan, 1999, "Evidence on the High-Income Laffer Curve from Six Decades of Tax Reform," *Brookings Papers on Economic Activity*, Vol. 1999, No. 2 (1999), pp. 1-64.

*Saez, E., J. Slemrod, and S. Giertz, 2012, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review," *Journal of Economic Literature*, 50(1), 3-50.

Sillamaa, M. and M. Veall, 2001, "The effect of marginal tax rates on taxable income: A study of the 1988 tax flattening in Canada," *Journal of Public Economics* 80, 341-356.

Weber, Caroline, 2014, "Toward obtaining a consistent estimate of the elasticity of taxable income using difference-in-differences," *Journal of Public Economics*, 117: 90-103.

4. Optimal commodity taxation

Salanie, ch. 2 and 3

*Auerbach, Alan, and J. Hines, 2002, "Taxation and economic efficiency," sec. 3, in A. Auerbach and M. Feldstein, eds., *Handbook of Public Economics*, vol. 3, 2002, 1347-1421. (Also NBER Working Paper 8181.)

Corlett, W.J. and D.C. Hague, 1953, "Complementarity and the Excess Burden of Taxation," *Review of Economic Studies* 21(1): 21-30.

Diamond, P., and J.A. Mirrlees, 1971, "Optimal Taxation and Public Production," *American Economic Review* 61(1):8-27 and 261-278.

*West, Sarah E., and Roberton C. Williams III, 2007, "Optimal taxation and cross-price effects on labor supply: Estimates of the optimal gas tax," *Journal of Public Economics*, Volume 91, Issues 3-4, April 2007, Pages 593-617

+Pomeranz, D., 2015, "No taxation without information: Deterrence and self-enforcement in the value added tax," *American economic review*, 105(8), pp.2539-2569.

5. Taxation of externalities[†]

*Sandmo, A, 1975, "Optimal Taxation in the Presence of Externalities," *Swedish Journal of Economics*, 77, no 1, March, pp. 86-98

+Bovenberg, A. Lans and L. Goulder, 1996, "Optimal environmental taxation in the presence of other taxes: General-equilibrium analyses," *American Economic Review*, v. 86, no. 4 (Sept), pp. 985- 1000.

+Fletcher, Jason M., David E. Frisvold, and Nathan Tefft, 2010, "The effects of soft drink taxes on child and adolescent consumption and weight outcomes," *Journal of Public Economics*, Vol. 94, No. 11-12, pp. 967-974.

+Sallee, James M., 2011, "The Surprising incidence of tax credits for the Toyota Prius," *American Economic Journal: Economic Policy*, Vol. 3, No. 2, pp. 189-219.

Williams, Roberton C. III, 2016, "Environmental Taxation," NBER Working Paper No. 22303
+Martin, R., De Preux, L.B. and Wagner, U.J., 2014, "The impact of a carbon tax on manufacturing: Evidence from microdata," *Journal of Public Economics*, 117, pp.1-14.

6. Income taxation

Salanie, ch. 4-5

Auerbach and Hines, 2002, "Taxation and economic efficiency," sec. 3.

Atkinson, A. B. and J. E. Stiglitz, 1976, "The design of the tax structure: Direct versus indirect taxation," *Journal of Public Economics* 6, 55-75.

*Diamond, P., 1998, "Optimal income taxation: An example with a U-shaped pattern of optimal marginal tax rates," *American Economic Review* 88, 83-95.

Mirrlees, J.A., 1971, "An Exploration in the Theory of Optimal Income Caxation," *Review of Economic Studies* 38(2): 175-208.

*Stiglitz, J. E., 1982, "Self-selection and Pareto efficient taxation," *Journal of Public Economics*.

7. Taxing the rich[†]

*Diamond, Peter, and Emmanuel Saez, 2011, "The case for a progressive tax: From basic research to policy recommendations," *Journal of Economic Perspectives* 25 (4), 165–190

Mankiw, N Gregory. 2013. "Defending the One Percent," *Journal of Economic Perspectives*, 27(3): 21-34.

Milligan, K. and Smart, M., 2015, "Taxation and top incomes in Canada," *Canadian Journal of Economics* 48, 655-681.

Saez, Emmanuel, and Michael R. Veall, 2005, "The Evolution of High Incomes in Northern America: Lessons from Canadian Evidence," *American Economic Review*, Vol. 95, No. 3 (Jun., 2005), pp. 831-849.

8. Income support programs[†]

Akerlof, George, "The Economics of Tagging as Applied to the Optimal Income Tax, Welfare Programs, and Manpower Planning," *American Economic Review*, 1978.

Besley, Timothy and Stephen Coate, "The Design of Income Maintenance Programmes," *Review of Economic Studies*, 1995.

Besley, T. and S. Coate, 1992, "Workfare versus Welfare: Incentive Arguments for work requirements in Poverty Alleviation Programs", *American Economic Review* 82, 249-261.

Blackorby, Charles and David Donaldson, "Cash versus Kind, Self Selection and Efficient Transfers," *American Economic Review*, 1988.

Brewer, Mike, Emmanuel Saez, and Andrew Shephard, 2010, "Means-testing and Tax Rates on Earnings," in *Dimensions of Tax Design: the Mirrlees Review*, J. Mirrlees, et al. (eds), Oxford University Press.

Currie, J., and Firouz Gahvari, 2008, "Transfers in Cash and In-Kind: Theory Meets the Data," *Journal of Economic Literature* 46 #2, June 2008, 333-83.

+Eissa, N. and J.B. Liebman, 1996, "Labour supply response to the Earned Income Tax Credit." *Quarterly Journal of Economics* 111, 605-637.

+Gelber, A., and J. Mitchell, 2012, "Taxes and time allocation: Evidence from single women and men," *Review of Economic Studies* 79, 863-897

Hoynes, Hilary and Jesse Rothstein, 2016, "Tax policy toward low-income families," NBER Working Paper No. 22080.

+Lemieux, T., and K. Milligan, 2008, "Incentive effects of social assistance: A regression discontinuity approach," *Journal of Econometrics* 142, 807-828.

Saez, Emmanuel, 2002, "Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses," *Quarterly Journal of Economics*, Vol. 117, No. 3, pp. 1039-1073.

*Saez, Emmanuel, 2010, "Do Taxpayers Bunch at Kink Points?" *American Economic Journal: Economic Policy*, Vol. 2, No. 3, pp. 180-212.

+Chetty, Friedman and Saez, 2012, "Using differences in knowledge across neighborhoods to uncover the impacts of the EITC on earnings," NBER WP 18232

9. Taxation of the family[†]

Alesina, A., Andrea Ichino, Loukas Karabarbounis, 2007, "Gender Based Taxation and the Division of Family Chores," NBER Working Paper No. 13638, November 2007.

*Boskin, M. J., and Eytan Sheshinski, 1983, "Optimal tax treatment of the family: Married couples," *Journal of Public Economics*, Volume 20, Issue 3, April 1983, Pages 281-297.

Kleven, H., C. Kreiner and E. Saez, 2009, "The Optimal Income Taxation of Couples." *Econometrica* 77, pp. 537-560.

+Immervoll, Herwig, Henrik Jacobsen Kleven, Claus Thustrup Kreiner, and Nicolaj Verdelin, 2011, "Optimal tax and transfer programs for couples with extensive labor supply responses," *Journal of Public Economics*, Vol. 95, No. 11-12, pp. 1485-1500.

Gelber, A., 2014, "Taxation and the Earnings of Husbands and Wives: Evidence from Sweden," *Review of Economics and Statistics*, Vol. 96, No. 2, pp. 287-305.

*Piggott, J., and John Whalley, 1996, "The Tax Unit and Household Production," *Journal of Political Economy*, Vol. 104, No. 2 (Apr., 1996), pp. 398-418.

10. Savings, taxation, and public policy

*Bernheim, B. D., 2002, "Taxation and saving," *Handbook of public economics*, vol. 3, A. Auerbach and M. Feldstein, eds., (Amsterdam, North-Holland).

Chamley, C., 1986, "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives," *Econometrica* 54(3): 607-622.

Judd, K., 1985, "Redistributive Taxation in a Simple Perfect Foresight Model," *Journal of Public Economics*, 28(1): 59-83.

*Chari, VV and Patrick Kehoe, "Optimal Fiscal and Monetary Policy," in Handbook of Macroeconomics, Volume 1C, John Taylor and Michael Woodford, Eds, North Holland, Amsterdam, 1999. (Also Minneapolis Fed Staff Report 251, 1998.), secs. 1-2.

Banks, James and Peter Diamond, 2010, "The Base for Direct Taxation," in Dimensions of Tax Design: the Mirrlees Review, J. Mirrlees, et al. (eds), Oxford University Press.

Saez, Emmanuel and Stefanie Stantcheva, 2016, "A Simpler Theory of Optimal Capital Taxation," NBER Working Paper No. 22664.

Mastrobuoni, G., and M. Weinberg, 2009, "Heterogeneity in intra-monthly consumption patterns, self-control, and savings at retirement," AEJ: EP 1, 163–189.

11. Targeted savings programs[†]

+Chetty, R., Friedman, J.N., Leth-Petersen, S., Nielsen, T.H. and Olsen, T., 2014, "Active vs. passive decisions and crowd-out in retirement savings accounts: Evidence from Denmark," The Quarterly Journal of Economics, 129(3), 1141-1219.

*Engen, E., W. Gale, and J.K. Scholz, 1996, "The Illusory Effects of Saving Incentives," Journal of Economic Perspectives 10, 113-138.

Gale, William G. and John Karl Scholz, 1994, "IRAs and Household Saving," American Economic Review 84, December 1994, 1233-1260.

Gelber, Alexander, 2009, "How Do 401(k)s Affect Saving? Evidence from Changes in 401(k) Eligibility," September 2009.

Poterba, James M., Steven F. Venti and David A. Wise, 1995, "Do 401(k) Contributions Crowd Out Other Personal Saving?" Journal of Public Economics 58, 1995, 1-32.

*Poterba, J., S. Venti, and D. Wise, 1996, "How Retirement Saving Programs Increase Saving," Journal of Economic Perspectives 10, 91-112.

12. Corporate taxation

Salanie, ch. 6

*Auerbach, Alan, 2006, "Who bears the corporate tax? A review of what we know," Tax Policy and the Economy 20, 1-40.

Boadway, R. and Bruce, N., 1984, "A general proposition on the design of a neutral business tax," Journal of Public Economics, 24(2), 231-239.

Robin Boadway, 2015, "Tax Policy for a Rent-Rich Economy" Canadian Public Policy 41, 253-64

+Devereux, Michael P., Li Liu, and Simon Loretz, 2014, "The elasticity of corporate taxable income: New evidence from UK tax records," American Economic Journal: Economic Policy, Vol. 6, No. 2, pp. 19-53.

+Fuest, Clemens, Andreas Peichl, and Sebastian Siegloch, 2015, "Do higher corporate taxes reduce wages? Micro evidence from Germany," IZA Discussion Paper 9606, University of Mannheim.

Mintz, Jack, 1995, "The Corporation Tax: A Survey," *Fiscal Studies*, Vol. 16, No. 4, pp. 23-68.

13. Taxation of dividends[†]

*Auerbach, Alan J., 2002, "Taxation and Corporate Financial Policy," in Auerbach, Alan J. and Martin Feldstein (eds.) *Handbook of Public Economics*, Vol. 3, pp. 1252-1292.

Alstadsaeter, Annette, Martin Jacob, and Roni Michaely, 2017, "Do dividend taxes affect corporate investment?" *Journal of Public Economics* 151, 7483

Boadway, Robin, and Neil Bruce, 1992, "Problems with integrating corporate and personal income taxes in an open economy," *Journal of Public Economics* 48(1), 3966

Bond, Stephen R, Michael P Devereux, and Alexander Klemm, 2007, "The effects of dividend taxes on equity prices: a re-examination of the 1997 UK tax reform," Technical Report

Chetty, Raj, and Emmanuel Saez, 2005, "Dividend taxes and corporate behavior: Evidence from the 2003 dividend tax cut," *The Quarterly Journal of Economics* 120(3), 791833

McKenzie, Kenneth J. and Aileen J. Thompson, 1995, "Dividend Taxation and Equity Value: The Canadian Tax Changes of 1986," *Canadian Journal of Economics*, Vol. 28, No. 2, pp. 463-472.

Smart, Michael, 2017, "Why the dividend tax credit?" working paper.

+Yagan, Danny, 2015 "Capital tax reform and the real economy: The effects of the 2003 dividend tax cut," *The American Economic Review* 105(12), 35313563

14. International taxation[†]

Auerbach, A., and M. P. Devereux, 2017, "Cash-Flow Taxes in an International Setting," Working Paper, University of California at Berkeley.

Desai, M., E. Foley and J. Hines, 2009, "Domestic effects of the foreign activities of US multinationals," *AEJ: EP* 1, 181-203.

*Gordon, Roger, and James Hines, "International taxation," NBER Working Paper 8854.

Gordon, Roger, 1992, "Can Capital Income Taxes Survive in Open Economies?" *Journal of Finance* 47, No. 3, pp. 1159-1180

Hines, James R., 1996, "Altered states: Taxes and the location of foreign direct investment in America," *American Economic Review* 86(5), 1076-1094.

Hines, James R. Jr. 2010. "Treasure Islands." *Journal of Economic Perspectives*, 24(4): 103-26.

Hong, Qing, and Michael Smart, 2010, "In praise of tax havens: International tax planning and foreign direct investment," *European Economic Review* 54, 82-95.

Voget, Johannes, 2011, "Relocation of headquarters and international taxation," *Journal of Public Economics* 95, 1067-1081.

15. Fiscal federalism[†]

*Boadway, R. and J.-F. Tremblay, 2012, "A reassessment of the Tiebout model," *Journal of Pub-*

lic Economics 96, 1063-1078.

Fernandez, R. and R. Rogerson, 1996, "Income Distribution, Communities, and the Quality of Public Education," *Quarterly Journal of Economics*, Vol. 111, No. 1 (Feb., 1996), pp. 135-164.

Oates, Wallace E. (2005), "Toward a Second-Generation Theory of Fiscal Federalism," *International Tax and Public Finance*, Vol. 12, No. 4, pp. 349-373.

16. Tax competition[†]

*J. Wilson, 1999, "Theories of tax competition", *National Tax Journal*, 52, 269-304.

Kanbur, R. and M. Keen 1993, "Jeux sans frontieres: Tax competition and tax co-ordination when countries differ in size", *American Economic Review*, 83, 877-892.

Wildasin, D., 1991, "Income redistribution in a common labor market," *American Economic Review* 81, 757-774.

*M. Feldstein and M. Wrobel, 1998, "Can state taxes redistribute income?" *Journal of Public Economics* 68, 369-396.

+Suarez Serrato, Juan Carlos and Owen Zidar (2016), "Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms," *American Economic Review*, Vol. 106, No. 9. Pp. 2582-2624.

+Moretti, Enrico and Daniel Wilson, 2017, "The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists," *American Economic Review*, 107, 1858–1903.

Gordon, Roger H., and Cullen, Julie Berry, 2012, "Income redistribution in a federal system of governments," *Journal of Public Economics*, vol. 96(11), 1100–1109.

Milligan, K., and M. Smart, 2017, "An estimable model of income redistribution in a federation: Musgrave meets Oates," Working Paper.

Kleven, Henrik Jacobsen, Camille Landais, Emmanuel Saez, and Esben Schultz, 2014, "Migration and Wage Effects of Taxing Top Earners: Evidence from the Foreigners' Tax Scheme in Denmark," *Quarterly Journal of Economics* 129 (1): 33378.

17. Intergovernmental grants[†]

*Boadway, R. and F. Flatters, 1982, "Efficiency and equalization payments in a federal system of government," *Canadian Journal of Economics* 15, 613-633.

Hines, Jim, and R. Thaler. 1995. "Anomalies: The Flypaper Effect." *Journal of Economic Perspectives*, 9: 217-226.

+Knight, B., 2002, "Endogenous Federal Grants and Crowd-Out of State Government Spending: Theory and Evidence from the Federal Highway Aid Program," *American Economic Review* 92, 71-92.

+Pettersson-Lidbom, Per, 2010, "Dynamic commitment and the soft budget constraint: An empirical test," *AEJ: EP* 2, 154–179.

Smart, M., 1998, "Taxation and deadweight loss in a system of intergovernmental transfers,"

Canadian Journal of Economics 31, 189-206.

Smart, Michael, 2007, "Raising taxes through equalization," Canadian Journal of Economics 40, 1188-1212.

18. Long-run fiscal policy[†]

Barro, Robert, 1979, "On the Determination of the Public Debt," Journal of Political Economy 87, 940-971.

*Barro, Robert, 1989, "The Ricardian Approach to Budget Deficits," Journal of Economic Perspectives, Vol. 3, No. 2 (Spring 1989), pages 37-54.

*Bernheim, B. Douglas, 1989, "A Neoclassical Perspective on Budget Deficits," Journal of Economic Perspectives, Vol. 3, No. 2 (Spring 1989), pages 55-72.

Bernheim, B. Douglas, 1987, "Ricardian Equivalence: An Evaluation of Theory and Evidence," NBER Macroeconomics Annual Vol. 2, (1987), pp. 263-304

Kotlikoff, L. J., 2006, "Is the United States bankrupt?" Federal Reserve Bank of St. Louis Review, 235-250.

19. Behavioural public economics[†]

Becker, Gary and Kevin Murphy, "A Theory of Rational Addiction," Journal of Political Economy, 1988.

Bernheim, B. Douglas, 2009, "Behavioral Welfare Economics," Journal of the European Economic Association, Vol. 7, No. 2-3, Pages 267-319

+Chetty, Raj, Adam Looney and Kory Kroft, "Salience and Taxation: Theory and Evidence," American Economic Review, vol. 99(4), pages 1145-77, September.

+Finkelstein, Amy, 2009, "EZ-Tax: Tax Salience and Tax Rates," Quarterly Journal of Economics, Vol. 124, No. 3, Pages 969-1010.

O'Donoghue, Ted, and Matthew Rabin, 2003, "Studying Optimal Paternalism, Illustrated by a Model of Sin Taxes," American Economic Review Papers and Proceedings, 93(2), May 2003, 186-191.

20. Taxation and development[†]

R. Burgess and N. Stern, 1993, "Taxation and Development," Journal of Economic Literature 31, 762-830.

C. B. Mulligan, R. Gil, and X. Sala-i-Martin, 2004, "Do democracies have different public policies than nondemocracies?" Journal of Economic Perspectives 18, 51-74.

R. Gordon and W. Li, 2009, "Tax structures in developing countries: Many puzzles and a possible explanation," Journal of Public Economics 93, 855-866.

Besley, T. and Persson, T., 2011, *Pillars of Prosperity: State Capacity and Economic Development*, OUP, 2011.