ECO401H1F Section L0101: TOPICS IN ECONOMIC POLICY

Course Information

Instructor: Kory Kroft
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Office Hours: Thursday, 1pm-3pm,
TA: Steven Ryan, steven.ryan@mail.utoronto.ca
Delivery: Syllabus, lecture slides, and problem sets, are all posted online at:
                 q.utoronto.ca

Course Description and Learning Objectives

This course covers material on (I) Welfare Economics and Incidence and Efficiency
Cost of Government Policies, (II) Taxation and Redistribution, and (III) Social Insurance.
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 rules

All students must arrive on time and be prepared to participate in class discussion.

Class meetings

Wednesday, 10:10am-12pm, FE135
Friday, 1:10pm-2pm, UC256

Tutorials

Tutorials will sometimes be held on Friday, 1:10pm-2pm (see schedule below). They will
be used mainly for discussing problem sets, as well as to introduce STATA.

Prerequisites

One course from A, B and C:

A) Microeconomic Theory: (ECO200Y1/ECO204Y1/ECO206Y1)
B) Macroeconomic Theory: (ECO202Y1/ECO208Y1/ECO209Y1)
C) Quantitative Methods in Economics: (ECO220Y1/ECO227Y1)

Statistics: (STA237H1,STA238H1)/(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.

Requirements

There will be three problem sets (45%), a class presentation (20%), and a midterm test (35%).

Important Dates

October 12 – Problem Set #1 Due
October 26 – Midterm Test
November 16 – Problem Set #2 Due
November 23/30 and December 7 – Class Presentations
December 7 – Problem Set #3 Due

Software

The course involves a significant amount of computing, and students must learn and use a sophisticated statistical software package. STATA is highly recommended, and is the *only* package that will be supported by the instructor and TA.

Students should purchase **STATA/BE**, available online at:
https://www.stata.com/order/new/edu/profplus/student-pricing/

Unless you are planning to use STATA in the future, a six month license will be sufficient.
After orders are placed online, you will need to provide STATA with a photo of your T-Card to confirm your status a student. They will contact you over the email you provide, which should be your @mail.utoronto.ca address.

Familiarity with EXCEL is also useful.

COURSE POLICIES

1) Midterm Test

The midterm test will be held on Wednesday, October 26 during class time (10:10am – 12:00pm)

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

If you miss the midterm, you will be given a grade of 0 unless you make a declaration of absence via ACORN the day of the test and contact me before or on the day of the test to indicate that you will not be able to write the test. It is an academic offence to feign illness to avoid a test.

If a student has been excused from the midterm, he or she will be permitted to write the make-up test. The make-up midterm will be given **on Friday, November 4, 12:10pm-2:00pm**. The test will also be 2 hours.

- It may not be the exact same format as the midterm test itself.
- Consistent with university policy, there is no "make-up" test for the make-up test. A grade of zero will be applied if a student fails to write the make-up test.

2) Problem Sets

The problem sets are due <u>at the beginning of class</u> on the assigned dates (October 12, November 16 and December 7). Late problem sets will receive a grade of zero, unless you make a declaration of absence via ACORN and contact me about your assignment.

All students must hand in their own problem sets, but are welcome to help each other out. This means writing your own code and running your own output for empirical problem sets. Any evidence of copying/cutting/pasting from each other will be treated as plagiarism. To protect against incidence of a group member not contributing equally, please consider noting that "grading will be assessed on individual bases in group work assignment."

3) Group Presentations

You and one other student will be required to choose an empirical academic paper, <u>from a pre-selected list that I will provide</u>, and present the paper in class. The length of the presentation will be around 15 minutes, including time for questions and discussion. You should 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?

Should you miss your presentation, you will be given a grade of 0 unless you present me with a declaration of absence on ACORN, and inform me beforehand. If a student has been excused from his/her presentation on appropriate grounds, with appropriate notice (same day), the student will be required to make his/her presentation in the next available slot, unless they are medically unable – which will require a new declaration of absence.

4) Code of Behavior on Academic Matters

I have a zero-tolerance policy for any form of academic misconduct. Academic offenses, such as plagiarism or cheating during tests are serious academic offenses and could result in punishments ranging from failing the course to suspension or expulsion from the university.
Please read the University's Code of Behaviour on Academic Matters. It applies to all your academic activities and courses. The Code prohibits all forms of academic dishonesty including, but not limited to, cheating, plagiarism, and the use of unauthorized aids. Violating the Code may lead to penalties up to and including suspension or expulsion from the University. You are expected to know the Code and inform yourself of acceptable academic practices – ignorance of the Code or the acceptable academic practices is not a valid defense if you are accused of a violation.

5) Appealing a test

Appeals regarding the grading of a test must be submitted to me or the TA in writing, *within two weeks of your receipt of the graded work*. You must include the test with your written appeal. I shall re-grade the **entire test** and this might result in a lower grade than the original.

6) Academic Accommodations

Occasionally students will need to apply for an academic accommodation due to disability, illness, religious observance, or personal emergency.

All requests for an academic accommodation due to disability are handled by the University of Toronto's Accessibility Services, not the instructor. For disability-related accommodations, Accessibility Services staff will determine suitable accommodations on a case-by-case basis based on recommendation from health providers and with student input.

Students who require consideration for missed academic work for **any non-disability related reason** (e.g., COVID, cold, flu and other illness or injury, family situation) should report their absence through the online absence declaration – **until otherwise indicated by the University. A Verification of Illness form is not currently required, but may become required should the public health situation change**.

If a non-disability related accommodation request is made along with an absence declaration on ACORN, a resolution will be determined by the instructor. This may take the form of any alternate deliverable, deadline extension, reweighted course grade calculation, make-up test, or another solution deemed appropriate by the instructor. If an accommodation request is not made along with an absence declaration, the missed or late deliverable will be subject to an academic penalty. The extent of the penalty is at the discretion of the instructor.

7) Mental Health and Wellness

Feeling distressed? Are you in crisis? There's help. Call Good2Talk: 1-866-925-5454 (Ontario); text GOOD2TALK to 686868. Free, confidential helpline with professional counselling, information and referrals for mental health, addictions and well-being, 24/7/365. You can also contact [My Student Support Program (MySSP)](#) 1-844-451-9700 (North America); 001-416-380-6575 (Outside of North America) or the [U of T Employee & Family Assistance Program (EFAP)](#) 1-800-663-1142 (toll-free); 1-866-398-9505 (TTY); 604-689-1717 (collect). Visit ["Feeling Distressed?"](#) for more resources.

Are you in immediate danger? For Personal Safety – Call 911, then Campus Community Police* UTSG Police: 416-978-2222 | U of T Mississauga Police: 905-569-4333 | U of T Scarborough Police 416-978-2222 |
Centre for International Experience Safety Abroad 416-946-3929.
*24/7/365; Campus Community Police can direct your call to the right service.

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LECTURE SCHEDULE – FALL 2022

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

1	September 14	Introduction and roadmap
2	September 21	Welfare economics
3	September 28	Incidence and efficiency cost of government policies
		Problem Set 1 Distributed
	September 30	Tutorial #1

Section II: Labour Income Taxation and Redistribution
IIA. Theoretical Aspects: Optimal Income Taxation and Redistribution

4	October 5	Optimal income taxation and transfer programs

IIB. Empirical Aspects: Behavioral Responses to Taxes and Transfers

5	October 12	Labor supply responses to taxation and transfers
		Problem Set 1 Due
		Problem Set 2 Distributed
6	October 19	Responses of Taxable Income to Tax Rates, In-kind transfers
	October 21	Tutorial #2
7	October 26	**Midterm**

Section III: Social Insurance

8	November 2	Asymmetric information: adverse selection and moral hazard
9	November 16	Overview of social insurance and unemployment insurance
		Problem Set 2 Due
		Problem Set 3 Distributed
	November 18	Tutorial #3

Class Presentations
10   November 23
11   November 30
12   December 7   **Problem Set 3 Due**

READING MATERIAL

Most of the course material will consist of detailed lecture notes which will be posted on Quercus before the start of each class. There will also be some required readings, which can be found below. Students should aim to complete the readings for each week before viewing the lecture. Students can access most of the readings using 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 (2013). "The Policy Elasticity," Harvard University Working Paper. 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. ECO 401 H, Syllabus Winter 2021, Page 7

*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. (2011). "Bounds on Elasticities with Optimization Frictions: A Synthesis of Micro and Macro Evidence on Labor Supply", forthcoming Econometrica.

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 (2011). "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review", Journal of Economic Literature.

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.

<u>**III. SOCIAL INSURANCE**</u>

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.