

## Overview

We will cover the material via a combination of tutorial essays and presentations. The essay weeks are 2, 3, 4, 6 and 8. The presentation weeks will be 1, 5 and 7. On presentation weeks, you should prepare a (fairly detailed but half essay length maximum) handout on *both* presentation topics and copies for your tutorial partner also. I will ask you each to present a topic at random in the tutorial. This will give you the best incentive to cover the material thoroughly.

## Books

Each of the following books is a useful reference for several of the tutorial topics:

### Both Theory and Applied Topics:

S. Connolly and A. Munro *Economics of the Public Sector* (1999)

### Mainly Theory:

C.V. Brown and P.M. Jackson *Public Sector Economics* (4<sup>th</sup> Edition, 1990)

A. B. Atkinson and J. E. Stiglitz *Lectures on Public Economics* (1980)

J. Hindriks and G.D. Myles *Intermediate Public Economics* (2006, MIT Press)

G. D. Myles *Public Economics* (1995)

### Mainly Applied:

N. Barr *The Economics of the Welfare State* (3<sup>rd</sup> Edition, 1998, or 4<sup>th</sup> Edition, 2004)

D. Miles, G.D. Myles and I. Preston *The Economics of Public Spending* (2003)

## Week 1 - Inequality and Income Transfers

### Key concepts

Social welfare functions; Measurement of inequality; justifications for redistribution based on (i) increasing social welfare (ii) providing insurance. The benefit system and welfare reform.

### Reading

#### Books:

N. Barr, *The Economics of the Welfare State*, chapters 1-8,10,11.

S. Connolly and A. Munro (1999), *Economics of the Public Sector*, chapters 1-3,14-17.

J. Hills (2004), *Inequality and the State*, especially chapters 2,3,4,7,8.

J. Hindriks and G. Myles, *Intermediate Public Economics*, chapter 12, 13.

Atkinson and Stiglitz, *Lectures on Public Economics*, McGraw-Hill, 1980, Lecture 11.

#### Articles:

Sen A. "Personal Utilities and Public Judgements: or What's Wrong with Welfare Economics?" *Economic Journal*, 89, 537-58, 1979, reprinted in A. Sen, "Choice, Welfare and Measurement" Blackwell, 1982.

Dasgupta, P. "Utilitarianism, Information and Rights" in Sen, A and B. Williams, *Utilitarianism and Beyond*, Cambridge University Press, 1982, pp.199-218.

T. Clark and A. Leicester (2004), 'Inequality and Two Decades of British Tax and Benefit Reforms', *Fiscal Studies*, 25 (2), 129-158.

M. Brewer, A. Goodman, J. Shaw and L. Sibieta (2006) , *Poverty and Inequality in Britain: 2006*, Institute for Fiscal Studies Commentary No. 101, available at: [www.ifs.org.uk/comms/comm101.pdf](http://www.ifs.org.uk/comms/comm101.pdf) (See also the update for 2007: [www.ifs.org.uk/bns/bn73.pdf](http://www.ifs.org.uk/bns/bn73.pdf) )

A. B. Atkinson (1995) *Incomes and the Welfare State*, Chapter 12: "On targeting and family benefits"

R. A. Moffit (2003) 'The Negative Income Tax and the Evolution of U.S. Welfare Policy', *Journal of Economic Perspectives*, 17 (3), 119-140.

R Blundell (2000) "Work incentives and 'in-work' benefit reforms: a review" *Oxford Review of Economic Policy*, 16, 27-44.

## Questions

### Presentation 1

Should the redistributive and insurance functions of the social security system be separated? Is the legitimate function of the Social Security system to redistribute income over the lifecycle, between individuals, or both?

### Presentation 2

(a) How should child poverty be defined? Can welfare economics provide a coherent justification for why a policy-maker should care about it?

(b) Assess the advantages and disadvantages of the following policies to reduce child poverty:

1. the current UK child tax credit system
2. returning to a system of universal flat-rate child benefits

## Week 2 - Commodity Taxation

### Key concepts

Duality theory in consumer choice; Ramsey taxation; inverse elasticity rule

### Reading

Hindriks, J. and G. Myles, *Intermediate Public Economics*, MIT Press, 2006, chapter 14.

Atkinson and Stiglitz, Lecture 12.

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

Myles, chapter 4.

Stern, "The Theory of Optimal Commodity and Income Taxation: An Introduction", in Newbery and Stern, eds, *The Theory of Taxation for Developing Countries*, OUP, 1987.

Sandmo, "Optimal taxation: an introduction to the literature", *Journal of Public Economics*, 1976.

### References:

Diamond, P. and J. Mirrlees, "Optimal taxation and public production", *American Economic Review*, 1971.

### Essay Question

"Commodity taxes should be inversely proportional to demand elasticities."

"Commodity taxes should be higher for goods that are complementary with leisure."

"Commodity taxes should be lower for goods consumed by the poor."

"When lump sum taxation of individuals is possible, the best system of commodity taxes is not to have any at all. When everyone is identical, there are no impediments to lump sum taxes. Thus the Ramsey rule for commodity taxation is redundant."

Are these statements true? If so, how can they be reconciled?

## Week 3 - Income Taxation and Labour Supply

### **Key concepts**

Microeconomics of taxation and labour supply; incentive effects of income tax; optimal income tax; empirical evidence on labour supply.

### **Reading**

Hindriks, J. and G. Myles, *Intermediate Public Economics*, MIT Press, 2006, chapter 15.

Myles, G. *Public Economics* Cambridge University Press, 1995, chapter 5.

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

Atkinson and Stiglitz, lectures 2 and 13,

Blundell, R. (1992) "Labour Supply and Taxation: a Survey" *Fiscal Studies* 13 (3), 15-40.

### References:

MaCurdy, T. (1992) "Work Disincentive Effects of Taxes: a Re-examination of Some Evidence" *American Economic Review Papers and Proceedings*, May 1992.

Bosworth, B. and G. Burtless (1992) "Effects of Tax Reform on Labor Supply, Investment and Savings" *Journal of Economic Perspectives*, 6 (1), winter.

### **Essay Question**

What principles ought to govern the determination of the marginal rate of income tax? Should marginal income tax rates rise with income?

## Week 4 – Debt and Taxes Over Time

### Key concepts

Two period model; overlapping generation model; tax equivalence; intertemporal government budget constraint; other modelling approaches; debt in a growing economy; optimality; sustainability.

### Reading

Barr, N. (2004), *The Economics of the Welfare State*, 4<sup>th</sup> edition, chapter 9.

Connolly, S. and A. Munro (1999), *Economics of the Public Sector*, Prentice Hall, chapters 12 and 18.

Hindriks, J. and G. Myles (2006), *Intermediate Public Economics*, MIT Press, chapters 19-21.

Rosen, H. (2004), *Public Finance*, McGraw Hill, chapters 18 and 19.

### More advanced:

Myles, G. (1995), *Public Economics*, CUP, chapters 13-15.

Auerbach, A. and M. Feldstein, (eds), (2002), *Handbook of Public Economics*, vols. 3 and 4, Elsevier. Chapters 17, 18, 24, 27 and 32 are the most relevant here.

### Articles:

Samuelson, P. (1958), '[An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money](#)', *Journal of Political Economy*, 467-482.

Diamond, P. (1965), '[National Debt in a Neoclassical Growth Model](#)', *American Economic Review*, 1126-1150.

Barro, R. (1974) '[Are Government Bonds Net Wealth?](#)', *Journal of Political Economy*, 1095-1117.

Buiter, W. (1985) '[A Guide to Public Sector Debt and Deficits](#)', *Economic Policy*, 13-79.

Buiter, W. (1997) '[Generational Accounts, Aggregate Saving and Intergenerational Distribution](#)', *Economica*, 605-626.

### Essay Question

What principles should be used to determine the spread of the cost of public expenditure over time?

How should these principles be applied to expenditure on:

- (a) Old age pensions.
- (b) New infrastructure.
- (c) Unemployment benefits.

## Week 5 – Pension Reform and Corporation Tax

### **Reading on Pension Reform:**

#### Key concepts

Consumption smoothing and the life cycle model. Demographics. Private, contributory and tax-based systems. Funded versus unfunded systems. Pension reform

Books: See reading list for week 4.

#### Articles:

Banks, J. and C. Emmerson (2000), 'Public and Private Pension Spending: Principles, Practice and the Need for Reform', *Fiscal Studies*, 1-63.

Diamond, P. et al (2005), 'Symposium: Social Security Reform', *Journal of Economic Perspectives*, Spring, 3-55.

Department for Work and Pensions (2006) *Security in retirement: towards a new pensions system*, available at [Security in retirement - Executive Summary](#).

Barr, N. and P. Diamond (2006), 'The Economics of Pensions', *Oxford Review of Economic Policy*, 22 (1), 15-38.

For further analysis of pension reform see the March 2005 issue of *Fiscal Studies* and the Spring 2006 issue of the *Oxford Review of Economic Policy*.

### **Reading on Corporation Tax:**

#### Key concepts:

Rationale for taxing companies; alternative forms of corporation tax; neutrality; relationship with personal tax.

#### Articles:

Meade Report (1978) *The Structure and Reform of Direct Taxation*, IFS, Ch. 12.

Atkinson and Stiglitz, (1980), Lecture 5.

Auerbach, A.J. (1983) "Taxation, Corporate Financial Policy and the Cost of Capital" *Journal of Economic Literature*, 21.

Kay and King, (1990, 5th ed) Chs. 10, 11, 12, 14.

Devereux, M.J. and H. Freeman (1991) "A general neutral profits tax" *Fiscal Studies*, August.

King, M.A. and M.H. Robson (1993), "United Kingdom", in D.W. Jorgenson and R. Landau (eds) *Tax Reform and the Cost of Capital* Brookings. (Also introduction by Jorgenson)

Mintz, J. (1995) "The Corporation Tax: a Survey" *Fiscal Studies*, Vol 16 no.4 23-68.

Cnossen, S. (1996) "Company Taxes in the EU: Criteria and Options for Reform", *Fiscal Studies*, vol 17 no. 4, 66-97.

Isaac, J. (1997) "A comment on the Viability of the Allowance for Corporate Equity", *Fiscal Studies*, vol 18 no.3, 303-318.

## **Presentation Questions**

### Presentation 1:

“The corporation tax is a bad tax whose time has passed.” (Economist 2004) Discuss.

### Presentation 2:

"Having a fully-funded pension system would be desirable but moving towards it is not."



## Week 6 – Education and Local Government

### **Reading on Local Public Goods:**

(See also the reading list on [market failure](#) for core microeconomics)

#### Theory:

S. Connolly & A. Munro, *Economics of the Public Sector*, chapters 4, 5

A. Mas-Colell, M. Whinston & J. Green, *Microeconomic Theory*, chapter 11

Weitzman (1974), “Prices versus Quantities”, *Review of Economic Studies*, 41, 477-491

#### Local public goods and jurisdictional issues:

S. Connolly & A. Munro, *Economics of the Public Sector*, chapter 24

D. C. Mueller (1989) *Public Choice II*, chapter 9

Oates, W. (1999), “An Essay on Fiscal Federalism”, *Journal of Economic Literature*, 37, 1120-49

J. Rothstein (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), pp. 1333-1350. Available at: <http://www.princeton.edu/~jrothst/research.html>.

Rubinfeld, D. (1987), “The Economics of the Local Public Sector”, in A. Auerbach & M. Feldstein (eds.) *Handbook of Public Economics* Vol. 2, North Holland

Tiebout, C. (1956), “A Pure Theory of Local Expenditure”, *Journal of Political Economy*, 64, 416-424

### **Reading on Education:**

#### Key concepts:

Human capital. Returns to education. Private and social costs and benefits. Policy issues: state versus private financing, equity and family background, school resources. Quasi-markets and educational reform in the UK.

#### Overview:

N. Barr, *The Economics of the Welfare State*, chapter 13.

S. Connolly and A. Munro (1999), *Economics of the Public Sector*, chapter 20.

### Articles:

J. Dutta, J. Sefton and M. Weale (1999) "Education and Public Policy", *Fiscal Studies*, 20(4) (reprinted in Myles, Miles and Preston).

Policy Forum on "Quasi-Markets", *Economic Journal*, September 1991

E. A. Hanushek (2002) "Publicly provided education" in *The Handbook of Public Economics*, vol 4, edited by A. Auerbach and M. Feldstein

S. Machin and M. Stevens (2004) "The Assessment: Education", *Oxford Review of Economic Policy*, Summer. See also articles by Johnson, and Blanden and Gregg.

### Evidence:

L. Dearden (1999) "The effects of families and ability on men's education and earnings in Britain", *Labour Economics*, 6: 551-67.

L. Feinstein and J. Symons (1999) "Attainment in secondary school", *Oxford Economic Papers*, 51(2), 300-21

S. Bradley and J. Taylor (2002) "The effect of the quasi-market on the efficiency-equity trade-off in the secondary school sector", *Bulletin of Economic Research*, 54(3), 295-314.

J. Rothstein (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), pp. 1333-1350. Available at: <http://www.princeton.edu/~jrothst/research.html>.

### **Essay question:**

(a) Is education best analysed as a public good, a merit good or a private good; a consumption good or an investment good? What are the implications for public provision and financing? Are there any significant differences in this regard between primary, secondary and tertiary education?

(b) Analyse and compare the impact of the following policies on the UK secondary education system:

1. allowing parents unrestricted choice of school in the maintained secondary school sector in the U.K. and allowing such schools to select pupils, including on the basis of ability
2. allocating pupils in the maintained secondary school sector to the geographically nearest school which has an available place, and not permitting selection by schools
3. allowing elected local government bodies to choose between the above two options for their jurisdiction

## Week 7 – Health Care and Cost-benefit Analysis

### Reading on health care

#### Key concepts:

Efficiency and equity in the provision of healthcare. Uncertainty and information in healthcare and health insurance markets. Alternative healthcare systems and cross-country comparisons. NHS reform: the internal market and after.

#### Books:

N. Barr, *The Economics of the Welfare State*, chapter 12.

S. Connolly and A. Munro (1999), *Economics of the Public Sector*, chapter 19.

P. Zweifel and F. Breyer (1997), *Health Economics*

#### Articles:

A. Blomqvist (1991) "The doctor as double agent: information asymmetry, health insurance and medical care", *Journal of Health Economics*, 10, 411-432.

B.A. Weisbrod (1991) "The health care quadrilemma: an essay on technological change, insurance, quality of care and cost containment", *Journal of Economic Literature* 29, 523-552.

T. Besley and M. Gouveia (1994) "Healthcare", *Economic Policy*, October.

D. M. Cutler (2002) "Healthcare and the public sector" in *The Handbook of Public Economics*, vol 4, edited by A. Auerbach and M. Feldstein.

C Propper, S. Burgess and K. Green (2004), 'Does Competition between hospitals improve the quality of care? Hospital Death Rates and the NHS Internal Market', *Journal of Public Economics*, 88(7-8), 1247-72.

C. Propper (2001) "Expenditure on healthcare in the UK: A review of the issues", *Fiscal Studies*, June (reprinted in Myles, Miles and Preston).

J. Le Grand (2002) "The Labour Government and the National Health Service", *Oxford Review of Economic Policy*, Summer.

King's Fund (2005) *An Independent Audit of the NHS under Labour (1997-2005)*. Available at: [www.kingsfund.org.uk/resources/publications/an\\_independent.html](http://www.kingsfund.org.uk/resources/publications/an_independent.html)

King's Fund (2006) *Spending on Health Care: How Much is Enough?*

Available at: [http://www.kingsfund.org.uk/resources/publications/spending\\_on.html](http://www.kingsfund.org.uk/resources/publications/spending_on.html)

## **Reading on Cost-benefit analysis:**

Connolly & Munro, *Economics of the Public Sector*, chapters 5, 7, 24

Boadway, R.W. and Bruce, N. (1984) *Welfare Economics*, Blackwell, chapter 10.

Dreze, J. and Stern, N.H. (1987) The Theory of Cost-Benefit Analysis in Auerbach, A.J. and Feldstein, M.S. (eds.), *Handbook of Public Economics*, Volume II. North-Holland.

Jones-Lee, M.W. (1989) *The Economics of Safety and Physical Risk*, Martin Robertson

Layard, R. and Glaister, S. (eds.) (1994) *Cost-Benefit Analysis* (2nd ed.)

Pollak, R.A. (1998) Imagined Risks and Cost-Benefit Analysis, *American Economic Review*, p and p, May, 376-380

## **Presentation Questions:**

### Presentation 1:

What are the theoretical advantages and disadvantages of allowing (i) patients to choose between NHS primary care providers; and (ii) purchasers to choose between NHS secondary care providers? Drawing on these arguments and empirical studies of past internal market reforms, evaluate the principle of choice within the NHS.

### Presentation 2:

How should cost-benefit analysis be used in the evaluation of new drug treatments in the NHS?

## **Week 8 – Political Economics**

### **Key concepts:**

Public choice; theories of public expenditure: median voter equilibria, probabilistic voting and lobbying in the context of a simple model of public finance.

### **Reading:**

Bergstrom, T. & R. Goodman (1973), “Private Demands for Public Goods”, *American Economic Review*, 63, 280-296

Connolly & Munro, Ch. 8, 9

Hotelling, H. (1929), “Stability in Competition”, *Economic Journal*, 39, 41-57

Downs, A. (1957), *An Economic Theory of Democracy*, Harper Row

Olson, M. (1965), *The Logic of Collective Action*, Harvard University Press

Becker, G. (1983), “A Theory of Competition Among Pressure Groups for Political Influence”, *Quarterly Journal of Economics*, 98, 371-400

Meltzer, A. & S. Richards (1981), “A Rational Theory of the Size of Government”, *Journal of Political Economy*, 89, 914-927

D. C. Mueller, *Public Choice II*, chapters 10-11, 16-18

T. Persson & G. Tabellini, *Political Economics*, chapter 3

### **Essay Question**

Is representative democracy compatible with economic efficiency?