

## ECONOMICS 681B: PUBLIC FINANCE II

### READING LIST

SPRING 2002

MONDAY, WEDNESDAY 9:00-10:20AM

WILLIAM BRAINARD AND HANMING FANG

In Public Finance II (681B) we will cover seven topics in the field of public economics: (I) Public Goods; (II). Discrimination and Affirmative Actions; (III). Welfare and Social Security Reforms; (IV). Social Norms and Culture; (V). Externality Theory; (VI). Economics of Scale, Non-convexities and Network Externalities; (VII). Private and Social Risk and Social Discount Rate. Lectures will cover some important papers on the reading list. The primary goals of the lectures are to provide a broad understanding of the public finance literature and to introduce many of the theoretical and empirical approaches practiced in the field. We encourage and require active class discussions, which are important for the students to develop their abilities to read economics papers critically and articulate their insights and criticisms of these papers.

**Course Requirements:** (1). Students will be expected to make short presentations and participate actively in class discussion; (2). Students will also be expected to either extend the short research paper you wrote in the Fall term or write another short paper. Empirical papers, which can also be submitted for the econometrics paper requirement, are encouraged; (3). There will be an oral final examination.

### TOPIC I: PUBLIC GOODS PROVISION

#### **BOOKS:**

Anthony Atkinson and Joseph Stiglitz (1980): *Lectures on Public Economics*. McGraw-Hill Book Company: New York. Lecture 16: Public Goods and Publicly Provided Private Goods.

Jean-Jacques Laffont (1988): *Fundamentals of Public Economics*. MIT Press: Cambridge, MA. Chapter 2.

#### **CLASSICAL PAPERS:**

Paul A. Samuelson (1954): "The Pure Theory of Public Expenditure", *Review of Economics and Statistics*, Vol. 36, 387-389.

Charles M. Tiebout (1956): "A Pure Theory of Local Expenditures", *Journal of Political Economy*, Vol. 64, 416-424.

Truman Bewley (1981): "A Critique of Tiebout's Theory of Local Expenditures", *Econometrica*, Vol 49, 713-740.

## READING LIST:

### A. STATIC MODELS OF PRIVATE PROVISION OF PUBLIC GOODS:

[D] Theodore Bergstrom, Lawrence Blume and Hal Varian (1986), "On the Private Provision of Public Goods", *Journal of Public Economics*, 29(1), February, pp. 25-49.

Theodore Bergstrom, Lawrence Blume and Hal Varian (1992), "Uniqueness of Nash Equilibrium in Private Provision of Public Goods: An Improved Proof", *Journal of Public Economics*, 49(3), December, pp. 391-92.

Douglas Bernheim (1986), "On the Voluntary and Involuntary Provision of Public Goods", *American Economic Review*, Vol 76, pp789-793.

James Andreoni (1998), "Toward a Theory of Charitable Fund-Raising", *Journal of Political Economy*, 106(6), December, pp. 1186-1213.

[D] John Morgan (2000), "Financing Public Goods by means of Lotteries", *Review of Economic Studies*, October, pp.761-784.

### B. PRIVATE PROVISION OF PUBLIC GOODS IN LARGE ECONOMIES:

Rafael Rob (1989), "Pollution Claim Settlements under Private Information", *Journal of Economic Theory*, 47, 307-333.

[D] George J. Mailath and Andrew Postlewaite (1990), "Asymmetric Information Bargaining Problems with Many Agents", *Review of Economic Studies*, 57(3), July, pp. 351-67.

### C. DYNAMIC VOLUNTARY PROVISION OF PUBLIC GOODS:

Anat Admati and Motty Perry (1991), "Joint Projects without Commitment", *Review of Economic Studies*, 58, pp 259-276.

Leslie Marx and Steven Matthews (2000), "Dynamic Voluntary Provision of Public Goods", *Review of Economic Studies*, April 2000, p.327-358.

### D. LOCAL PUBLIC GOODS :

Charles M. Tiebout (1956): "A Pure Theory of Local Expenditures", *Journal of Political Economy*, Vol. 64, 416-424.

Truman Bewley (1981): "A Critique of Tiebout's Theory of Local Expenditures", *Econometrica*, Vol 49, 713-740.

Oates, W.E. (1969): "The Effects of Property Taxes and Local Public Spending on Property Value: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis", *Journal of Political Economy*.

Gramlich, E and Rubinfeld (1982): “Micro Estimates of Public Spending Demand Functions and Tests of the Tiebout and Median-Voter Hypothesis,” *Journal of Political Economy*, 536-560.

Gyourko, Joseph and Joseph Tracy (1991): “The Structure of Local Public Finance and the Quality of Life”, August, *Journal of Political Economy*, 774-806.

## TOPIC II: DISCRIMINATION AND AFFIRMATIVE ACTIONS

### **BOOKS:**

Gary S. Becker (1957), *The Economics of Discrimination*, Chicago: University of Chicago Press.

Ian Ayres (2001), *Pervasive Prejudice? Unconventional Evidence of Race and Gender Discrimination*, Chicago: University of Chicago Press.

### **CLASSICAL PAPERS:**

Kenneth Arrow (1973), “The Theory of Discrimination”, in O. Ashenfelter and A. Rees ed., *Discrimination in Labor Markets*, Princeton, NJ: Princeton University Press, 3-33.

Stephen Coate and Glenn C. Loury (1993), “Will Affirmative Action Policies Eliminate Negative Stereotypes?”, *American Economic Review*, December, Vol 83, 1220-40.

### **READING LIST:**

#### **A. TASTE BASED DISCRIMINATION:**

Gary S. Becker (1957), *The Economics of Discrimination*, Chicago: University of Chicago Press.

#### **B. STATISTICAL DISCRIMINATION AND AFFIRMATIVE ACTION**

[D] Kenneth Arrow (1973), “The Theory of Discrimination”, in O. Ashenfelter and A. Rees ed., *Discrimination in Labor Markets*, Princeton, NJ: Princeton University Press, 3-33.

[D] Stephen Coate and Glenn C. Loury (1993), “Will Affirmative Action Policies Eliminate Negative Stereotypes?”, *American Economic Review*, December, Vol 83, 1220-40.

Glen Loury (1992). “Incentive Effects of Affirmative Action”. *Annals of American Academic Political and Social Science*, Vol 523: 19-29.

Andrea Moro and Peter Norman (2000), “Affirmative Action in a Competitive Economy”, Forthcoming, *Journal of Public Economics*.

#### **C. LOOKING FOR EVIDENCE OF DISCRIMINATION**

[D] Gary Becker: “The Evidence Against Banks Doesn’t Prove Bias”, *Business Week*, April 19, 1993.

Gary Becker: “Nobel Lecture: The Economic Way of Looking at Behavior”, *Journal of Political Economy*, 101(3), June 1993, pages 385-409.

Ian Ayres and Joel Waldfogel, “A Market Test for Race Discrimination in Bail Setting”, *Stanford Law Review*, May 1994: 987-1046.

**Symposia on Discrimination in Product, Credit and Labor Markets**, *Journal of Economic Perspectives*, Spring 1998, including the following articles and comments by Kenneth Arrow, James Heckman and Glenn Loury.

- John Yinger: “Evidence on Discrimination in Consumer Markets”
- William A. Darity and Patrick Mason: “Evidence on Discrimination in Employment: Codes of Color, Codes of Gender”.
- Helen Ladd: “Evidence on Discrimination in Mortgage Lending”.

Ian Ayres and Peter Siegelman (1995), “Race and Gender Discrimination in Negotiation for the Purchase of a New Car”, *American Economic Review*.

Penny Goldberg: “Dealer Price Discrimination in New Car Purchases: Evidence from the Consumer Expenditure Survey”, *Journal of Political Economy*, June 1996, pp. 622-54.

James Heckman and Peter Siegelman, “The Urban Institute Audit Studies: Their Methods and Findings”, in *Clear and Convincing Evidence: Measurement of Discrimination in America*, edited by Michael Fix and Raymond J. Struyk, Washington: Urban Institute Press, 1993.

### **C. DISTINGUISHING TASTE-BASED DISCRIMINATION AND STATISTICAL DISCRIMINATION:**

Audra J. Bowlus and Zvi Eckstein (2001), “Discrimination and Skill Differences in an Equilibrium Search Model,” Forthcoming, *International Economic Review*.

[D] John Knowles, Nicola Persico and Petra Todd, “Racial Bias in Motor-Vehicle Searches: Theory and Evidence,” *Journal of Political Economy*, February 2001.

### **D. OTHER EMPIRICAL STUDIES:**

James Heckman and John Donohue: “Continuous vs. Episodic Change: The Impact of Affirmative Action and Civil Rights Policy On The Economic Status of Blacks”, *Journal of Economic Literature*, Vol. 29, No. 4, December, 1991, pp. 1603-1643.

Andrea Moro (2001), “The Effect of Statistical Discrimination on Black-White Wage Differentials: Estimating a Model with Multiple Equilibria”, manuscript, University of Minnesota.

## TOPIC III: PUBLIC POLICIES: WELFARE AND SOCIAL SECURITY REFORMS

### **A. WELFARE REFORMS: FACTS AND ANALYSIS**

- [D] Robert Moffitt (1992), “Incentive Effects of the U.S. Welfare System: A Review”, *Journal of Economic Literature*, 30(1), March, pp. 1-61.
- Jeff Grogger and Charles Michalopoulos (1999), “Welfare Dynamics under Term Limits”, NBER Working Paper No. 7353.
- Jeff Grogger (2000), “Time Limits and Welfare Use”, NBER Working Paper No. 7709.
- [D] Timothy Besley and Stephen Coate (1992). “Workfare versus Welfare Incentive Arguments for Work Requirements in Poverty-Alleviation Programs.” *American Economic Review* **82** (1): 249-61.
- [D] Michael P. Keane and Robert Moffitt (1998), “A Structural Model of Multiple Welfare Program Participation and Labor Supply”, *International Economic Review*, 39(3), August, pp. 553-89.
- [D] Michael P. Keane (1995), “A New Idea for Welfare Reform”, *Federal Reserve Bank of Minneapolis Quarterly Review*, 19(2), Spring, pp. 2-28.
- Keane, M. and K. Wolpin (2001). Estimating Welfare Effects Consistent with Forward Looking Behavior, Part I: Lessons from a Simulation Exercise. Forthcoming, *Journal of Human Resources*.
- Keane, M. and K. Wolpin (2001). Estimating Welfare Effects Consistent with Forward Looking Behavior, Part II: Empirical Results. Forthcoming, *Journal of Human Resources*.
- Christopher A. Swann (1998), “Welfare Reform when Agents are Forward-looking”, mimeo, University of Virginia.
- Hanning Fang and Dan Silverman (2001), “On the Compassion of Time-Limited Welfare”.
- Hanning Fang and Dan Silverman (2001), “Time Inconsistency and Welfare Program Participation: Evidence from the NLSY”, manuscript.
- B. SOCIAL SECURITY REFORMS**
- [D] Peter Diamond (1977): “A Framework for Social Security Analysis”. *Journal of Public Economics*, Vol. 8, No. 3, December 1977: 275-298.
- [D] Olivia Mitchell and Stephen Zeldes. “Social Security Privatization: A Structure for Analysis”, *American Economic Review*, May 1996: 363-367.
- [D] Andrew Abel: “The Effects of Investing Social Security Funds in the Stock Market When Fixed Costs Prevent Some Households from Holding Stocks,” *American Economic Review*, 91, 1 (March 2001), 128-148.
- John Geanakoplos, Olivia Mitchell and Stephen Zeldes: “Would a Privatized Social Security System Really Pay a Higher Rate of Return?”, *Framing the Social Security Debate. Values, Economics, and Politics*, R.D. Arnold, M. Graetz and A. Munnell, eds., National Academy of Social Insurance, 1998, pp. 137-157.

#### TOPIC IV. SOCIAL NORMS AND CULTURAL EFFECTS

- Kenneth Arrow (1971): “Political and Economic Evaluation of Social Effects and Externalities” in M. Intriligator, ed., *Frontiers of Quantitative Economics*. Amsterdam: North-Holland, 3-25.
- [D] Harold Cole, George Mailath and A. Postlewaite, Social Norms, Savings Behavior and Growth” (1992). *Journal of Political Economy* 100, 1092-125.
- Hanming Fang: “Social Culture and Economic Performance” (2001). *American Economic Review* 91, 924-937.
- [D] Alberto Bisin and Thierry Verdier: “Beyond the Melting Pot: Cultural Transmission, Marriage, and the Evolution of Ethnic and Religious Traits”, *Quarterly Journal of Economics*, August 2000, 955-988.

#### TOPIC V: EXTERNALITIES

##### **A. Social v. Private Costs and Benefits**

- Baumol and Oates (1993). *The Theory of Environmental Policy*. 2nd Edition. Cambridge University Press. Chapters 1-4 (pp.1-56)
- Coase (1960). “The Problem of Social Cost.” *Journal of Law and Economics*. 3: 1-44.
- Turvey (1963). “On Divergences Between Social Cost and Private Cost.” *Economica*. 30: 309-13.
- Farrell ((1986). “Information and the Coase Theorem.” *Journal of Economic Perspectives*. 1(2): 113-29.

##### **B. Examples**

- Ayres and Levitt (1998), “Measuring Positive Externalities from Unobservable Victim Precaution: An Empirical Analysis of Lojack” QJE (Feb. 1998)
- Engel, Fischer and Galetovic” Highway Auctions and Real Estate Values” (working paper)
- Nordhaus, “Preface to Controversies” and Coase, “The Lighthouse in Economics” *Journal of Law and Economics*.

##### **C. Pigou and Ramsey**

- Hahn (1989). “Economic Prescriptions for Environmental Problems: How the Patient Followed the Doctor’s Orders.” *Journal of Economic Perspectives*. 3(2): 95-114.
- Hoel (1997). “Emission Taxes Versus Other Environmental Policies.” Mimeo. Department of Economics, University of Oslo.

Sandmo (1975). "Optimal Taxation in the Presence of Externalities." *Swedish Journal of Economics*. 77: 86-98.

Goulder (1995). "Environmental Taxation and the Double Dividend: A Reader's Guide." *International Tax and Public Finance*. 2: 157-183.

#### **D. Regulation, Markets**

Weitzman, M.L. "Free Access vs Private Ownership as Alternative Systems to Managing Common Property," *JET*, 8, pp. 225-234 (1974).

Montgomery (1972). "Markets in Licenses and Efficient Pollution Control Programs." *Journal of Economic Theory*. 5: 395-418.

Hahn (1984). "Market Power and Transferable Property Rights." *Quarterly Journal of Economics*. 99(4): 753-765.

Gianessi, Peskin, and Wolff (1979). "The Distributional Effects of Uniform Air Pollution Policy in the United States." *Quarterly Journal of Economics*. 93(2): 281-301.

Robinson (1985). "Who Pays for Industrial Pollution Abatement?" *The Review of Economics and Statistics*. 67(4): 702-06.

Spulber (1985). "Effluent Regulation and Long-Run Optimality." *Journal of Environmental Economics and Management*. 12:103-116.

Schmalensee, R. et al, "SO2 Trading," *JEP* v. 12 #3 (Summer 1998).

Joskow, Schmalensee and Bailey (1998), "The Market for Sulfur Dioxide Emissions," *AER* (Sept. 1998)

Brown, G.M. et al, "Endangered Species Act," *JEP* v. 12 #3 (Summer 1998).

Edlin, A. (1999) "Per-Mile Premiums for Auto Insurance," unpublished.

Goulder (1995). "Environmental Taxation and the Double Dividend: A Reader's Guide." *International Tax and Public Finance*. 2: 157-183.

#### **E. Uncertainty**

Weitzman (1974). "Prices v. Quantities." *Review of Economic Studies*. 41: 447-491.

Adar and Griffen (1976). "Uncertainty and the Choice of Pollution Control Instruments." *Journal of Environmental Economics and Management*. 3: 178-188.

Fishelson (1976). "Emission Control Policies Under Uncertain." *Journal of Environmental Economics and Management*. 3:189-197.

Roberts and Spence (1976). "Effluent Charges and Licenses Under Uncertainty." *Journal of Public Economics*. 5:193-208.

Weitzman (forthcoming), "Landing Fees vs. Harvest Quotas with Uncertain Fish Stocks," *Journal of Environmental Economics and Management*.

TOPIC VI: ECONOMIES OF SCALE/ NON-CONVEXITIES / NETWORK EXTERNALITIES

Williamson, O.(1966), "Peak Load Pricing and Optimal Capacity." *AER*, Sept. 1966

Joskow and Kahn ( 2001), " A Quantitative Analysis of Pricing Behavior in California's Wholesale Electricity Market During Summer 2000" ( working paper)

Baumol and Bradford (1972). "Detrimental Externalities and Non-Convexity of the Production Set." *Economica*. 39(154): 160-76.

Burrows (1996). "Non-convexities and the Theory of External Costs." *The Handbook of Environmental Economics*. Daniel W. Bromley (ed), pp.243-271.

TOPIC VII: PRIVATE AND SOCIAL RISK/DISCOUNTING PUBLIC INVESTMENTS

Atkinson and Stiglitz, Ch 15 sec 4.

Arrow and Lind, "Uncertainty and the Evaluation of Public Investments," AER, June 1970

Brainard and Dolbear, "Social Risk and Financial Markets," AER Vol 61 May 1971.

Weitzman, M. ( 2001) "Gamma Discounting" AER March 2001

Cooper, R. (forthcoming) Discounting the Distant Future.