Spring 2003

Econ 344: PUBLIC FINANCE

Dr. Hongli Hennessy                                      Office hrs: MWF(9:30-10:30am), Tue(3:30-4:30pm)
Class hours: T, Th 12:40-2pm                             Office: 560D Heady Hall
Email: hfeng@iastate.edu                                 Phone: 294-6307

Teaching Assistant: Tao Ran                            Email: rantao@iastate.edu
Place for office hours: Econ Help Room                  Office hours: M, W (1:00-2:00pm)

Prerequisites
   Econ 101 (or any other introductory microeconomic course).

Required Textbook (on reserve)

Other Books on Reserve


Grading
   Class participation 5%
   Five Problem Sets 15% (3% each)
   Midterm 1 20%
   Midterm 2 20%
   Final Exam 25%
   Term Paper 15%

Late Problem Sets
   No late problem set will be accepted unless with written excuses from doctors or other legitimate sources. (A student may elect to turn in a problem set before the due date.)
The Final Exam

No explicit question will be asked about the topics covered by midterms. However, students are assumed to know the material covered throughout the class.

The Term Paper

The term paper may be about any topic covered in this class. For example you may write on the future of the U.S. Social Security program, the recent proposal by the President to eliminate the federal income tax on corporate dividends, or the financing of one or two school districts.

The term paper will be graded on a 15-point scale, given that it accounts for 15% of the final grade. The distribution of the 15 points is as follows:

- Your knowledge of the subject, (5 points)
- The quality of economic analysis (e.g., what economic theory is used and how it is used), (5 points)
- The quality of exposition (e.g., spelling, grammar, organization). (5 points)

The length of the paper should be 6-9 double-space pages with 12-point Times New Roman regular font. All margins, including top, bottom, left, and right margins, should be set at one inch.

The schedule of the term paper is as follows.

Stage one: you should have your topic approved by the instructor exactly a week after Midterm 1.

Stage two: the first draft of the paper is due exactly a week after Midterm 2.

Stage three: The final draft of the paper is due on Thursday, May 1.

Late term paper will not be accepted. One point will be deducted for every day you are late for either of the first two stages.

Disabilities

If you have any disability and need assistance, please come to talk to me as soon as possible so that we can make special arrangement.

Assignment and exam schedule (subject to change when unexpected things happen)

<table>
<thead>
<tr>
<th>PS#1: 01/23, Thursday</th>
<th>Midterm1: 02/20, Thursday</th>
</tr>
</thead>
<tbody>
<tr>
<td>PS#2: 02/11, Tuesday</td>
<td>Topic due: 02/27, Thursday</td>
</tr>
<tr>
<td>PS#3: 03/06, Thursday</td>
<td>Midterm2: 04/03, Thursday</td>
</tr>
<tr>
<td>PS#4: 03/25, Tuesday</td>
<td>Draft due: 04/10, Thursday</td>
</tr>
<tr>
<td>PS#5: 04/22, Tuesday</td>
<td>Term paper: 05/01, Thursday</td>
</tr>
</tbody>
</table>
## Course Outline and Reading Assignments
(Subject to revision as the course proceeds)

<table>
<thead>
<tr>
<th>Topics</th>
<th>Reading Assignment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Economic Basics for Government Activities: (Week 1-5)</strong></td>
<td>Chap. 1-3</td>
</tr>
<tr>
<td>- <strong>Introduction to Public Finance</strong></td>
<td></td>
</tr>
<tr>
<td>- Individuals and governments</td>
<td></td>
</tr>
<tr>
<td>- Basics facts of current government spending and financing</td>
<td></td>
</tr>
<tr>
<td>- Analyzing government policy</td>
<td></td>
</tr>
<tr>
<td>- Efficiency and equity</td>
<td></td>
</tr>
<tr>
<td>- <strong>Public Goods</strong></td>
<td>Chap. 4</td>
</tr>
<tr>
<td>- Public goods</td>
<td></td>
</tr>
<tr>
<td>- Public goods and publicly provided goods</td>
<td></td>
</tr>
<tr>
<td>- Efficient output of public goods</td>
<td></td>
</tr>
<tr>
<td>- Market failure with public goods</td>
<td></td>
</tr>
<tr>
<td>- Financing of publicly provided goods</td>
<td></td>
</tr>
<tr>
<td>- Examples of publicly provided goods (defense, education, federal highway system)</td>
<td></td>
</tr>
<tr>
<td>- <strong>Externalities</strong></td>
<td>Chap. 5</td>
</tr>
<tr>
<td>- Classifications of externalities</td>
<td></td>
</tr>
<tr>
<td>- Externalities and market efficiency</td>
<td></td>
</tr>
<tr>
<td>- Remedies for externalities</td>
<td></td>
</tr>
<tr>
<td>- Coase theorem</td>
<td></td>
</tr>
<tr>
<td>- Taxes, subsidies and tradable permits</td>
<td></td>
</tr>
<tr>
<td>- <strong>Multi-government Public Finance</strong></td>
<td>Chap. 20</td>
</tr>
<tr>
<td>- Local and national governments</td>
<td></td>
</tr>
<tr>
<td>- Fiscal federalism</td>
<td></td>
</tr>
<tr>
<td>- Share of responsibilities</td>
<td></td>
</tr>
<tr>
<td>- Spending and financing of local governments</td>
<td></td>
</tr>
<tr>
<td>- Advantage and disadvantage of a decentralized system</td>
<td></td>
</tr>
<tr>
<td>- The Tiebout Model</td>
<td></td>
</tr>
<tr>
<td>- Intergovernmental grants</td>
<td></td>
</tr>
<tr>
<td>- Flypaper effect</td>
<td></td>
</tr>
<tr>
<td>- <strong>Political Economy</strong></td>
<td>Chap. 6</td>
</tr>
<tr>
<td>- Direct democracy (Unanimity rules, majority voting rules, Logrolling)</td>
<td></td>
</tr>
<tr>
<td>- Arrow’s Impossibility Theorem</td>
<td></td>
</tr>
<tr>
<td>- The median voter</td>
<td></td>
</tr>
<tr>
<td>- Representative democracy (Elected politicians, public employees, and special interests)</td>
<td></td>
</tr>
<tr>
<td>- Explanation for government growth</td>
<td></td>
</tr>
</tbody>
</table>
Review 1, Midterm 1 (Week 6)
Week 6, Thr (Feb 20), 12:40-2pm: Midterm 1.

Government Expenditures and the U.S. Policies (Week 7-11)
Week 7, Thr (Feb 27): Topic of term paper approved by the instructor.
Week 10 (March 17-23): Spring Break!

- **Income Redistribution**
  - The state of income distribution in the U.S. and the various measures of income distribution
  - The arguments for and against the redistribution of income by the government from the rich to the poor
  - Social welfare functions and income redistribution
  - The impact of in kind and cash transfers
    - Expenditure Programs for the Poor
      - Welfare program overview
      - TANF (Temporary Aid for Needy Families)
      - EITC (Earned Income Tax Credit)
      - Medicaid, and other programs
      - Welfare programs and work incentives
    - Social Security (SS) and Unemployment Insurance (UI)
      - Overview of social insurance programs
      - Adverse selection and moral hazard
      - The goals, financing, and benefit structure of the SS
      - Income redistribution through SS
      - Economic effects of SS (on savings, work incentives, and bequests)
      - Problems with SS and the various reform options
      - The financing and benefit scheme of UI
        - Health Care
          - Medical insurance in the US
          - The role of government in health care
          - Cost sharing and moral hazard
          - Structure of the Medicare program and how it is financed
          - Factors contributing to rapid medical spending and various proposals to control it
        - Cost-Benefit Analysis
          - Difference between private and social cost-benefit analysis
          - Measuring non-market items (e.g., time, life, and natural resources)
          - The choice of discount rate
          - Consumer surplus and its application
          - Shadow price
Review 2, Midterm 2 (Week 12)
Week 12, Thr (April 3), 12:40-2pm: Midterm 2.

Financing Government Expenditures & the U.S. Revenue System (Week 13-16)

Week 13, Thr (April 10): First draft of term paper due.

- **Taxation, Efficiency, and Income distribution**
  - Tax incidence and tax shifting
  - Tax progressiveness
  - Tax equivalence
  - Lump-sum taxes and distortionary taxes
  - The impact of taxes on prices and efficiency and excess burden of a tax
    - **Personal Income Tax**
    - Some terminology (e.g., exclusion, deduction, exemption, and credit)
    - Tax base, the H-S income, and the rate structure of personal income taxes
    - “Taxes deferred are taxes saved”
    - Marriage tax (penalty)
    - Tax expenditures, their incidence, and how to measure them
  - Effects of income tax on labor supply and personal saving
    - **Corporation Tax**
    - The rationale for corporation tax
    - The tax rate structure of corporate income tax
    - The tax life and useful life of an asset
    - Dividend puzzle, debt versus equity finance, debt puzzle
    - Effects of corporate taxes on investment decisions
    - Incidence of corporate income tax
    - **Budget Balance and Government Debt**
    - Surpluses, deficits, and the national debts; and how to measure budget balance
    - The size of the U.S. deficit and national debt, and their trend over time
    - The burden of national debt
    - Different view on whether national debt is a serious problem
    - Do we need a balanced budget amendment
    - Balanced budget in Iowa
  - **Taxes on Consumption and Wealth**
  - Their rationale
  - Equity and efficiency issues related to them

Final Review: May 1, Thr, 12:40-2pm
Week 16, Thr (May 1): Final draft of term paper due.

Week 17 (May 5-9): finals week. Good Luck!