

ECON 731: Public Finance

Winter 2019

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Office: Kenneth Taylor Hall (KTH) 412

Lecture: Friday 11:00 am – 2:00 pm in KTH 334

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COURSE DESCRIPTION

This course one of two courses in the graduate public economics sequence at McMaster University. This course explores topics in the economics of government expenditures. We will study the rationales for government intervention in market economies, including the presence of asymmetric information in markets, externalities and public goods. Topics covered include: social insurance programs (health care, unemployment insurance and pensions and retirement savings incentives), policies that address positive and negative externalities and public goods. For each topic, we will (i) use insights from economic theory to illustrate the rationale for government intervention and the trade-offs associated with specific policy interventions and (ii) discuss the empirical evidence on the effects of policy interventions on consumers, firms and government finances.

PREREQUISITES

There is no prerequisite for this course.

COURSE OBJECTIVES

By the end of the course students should be able to:

- Describe the reasons why governments intervene in market economies
- Have a good understanding of the theoretical models and empirical techniques used in modern public economics
- Be familiar with academic articles and reports (required readings) covered in the course
- Be able to critique existing research, with the aim of identifying promising areas for future research (including your own research)

CLASS FORMAT

Three hours of lecture per week. Students are expected to come to each class and participate by asking questions and responding to questions I will pose to the class.

COURSE MATERIALS AND TEXTS

There is no required textbook for this course. Most required readings are academic journal articles that can be accessed online through the university's library website. To access the university's library resources off-campus, go to <https://library.mcmaster.ca/>.

That being said, an excellent textbook that I recommend for students planning to study public economics at the Ph.D. level is

Atkinson, Anthony B. and Joseph E. Stiglitz. 2015. *Lectures on Public Economics: Second Edition*. Princeton, New Jersey: Princeton University Press.

AVENUE TO LEARN

Many course materials, including the syllabus, announcements, lecture slides and grades, will be posted on the course Avenue to Learn page. Students are expected to check the ECON 731 Avenue to Learn course page regularly.

Students should be aware that, when they access the electronic components of this course, private information such as first and last names, user names for the McMaster e-mail accounts, and program affiliation may become apparent to all other students in the same course. The available information is dependent on the technology used. Continuation in this course will be deemed consent to this disclosure. If you have any questions or concerns about such disclosure please discuss this with the course instructor.

COURSE EVALUATION – OVERVIEW

1. Assignment 1 - 5%, due February 8, 2019
2. Midterm – 25%, held on February 15, 2019
3. Assignment 2 - 5%, due March 8, 2019
4. Class presentation – 5%, held in class during the last two weeks of the semester
5. Research proposal – 25%, due on April 12, 2019
6. Final Exam - 35%, date to be announced

COURSE EVALUATION – DETAILS

Assignment 1 (5%), due February 8, 2019

The format of Assignment 1 will be short-answer and problem based. The assignment will cover material covered in the course, up to and including class on Friday, February 1, 2019.

Assignment 1 is due at the beginning of class on Friday, February 8, 2019. While I encourage you to talk to your classmates about the assignment, each student must submit their own hard copy of the assignment.

Midterm Test (25%), held on February 15, 2019 in KTH 334

A midterm test will be held on Friday, February 15, 2019 during class time. The format of the midterm test will be short-answer and problem-based. The location for the midterm test is KTH 334. The midterm will cover all the material (i.e. lectures, readings and Assignment 1) covered in the course up to, and including class on Friday, February 8, 2019.

No make-up midterms or early writes are provided.

McMaster ID cards must be presented to write the midterm test and the final exam.

Assignment 2 (5%), due March 8, 2019

The format of Assignment 2 will be short-answer and problem based. The assignment will cover material covered in the course, up to and including class on Friday, March 1, 2019. Assignment 2 is due at the beginning of class on Friday, March 8, 2019. While I encourage you to talk to your classmates about the assignment, each student must submit their own hard copy of the assignment.

Research Proposal/Term Paper (25%), due April 12, 2019

Research proposal: The aim of the research proposal is to identify an interesting, unanswered research topic/question in public economics and proposal a viable way of answering the question. The specific instructions for the research proposal will be posted to the course Avenue to Learn page and will be discussed in class. The research proposal is mandatory for PhD students.

Term paper: The aim of the term paper is to develop the ability of students to critically analyze a recent policy change made by the Government of Canada or any provincial or local government. The policy change must either currently be under consideration or implemented within that last three years. The specific instructions for the term paper will be posted to the course Avenue to Learn page and will be discuss in class. Masters students have the option of choosing from the term paper or research proposal.

Topics for the research proposal and term paper must be approved by me by **February 28, 2019**. I encourage you to see me in office hours before then to discuss the topic you wish to choose.

Class Presentation (5%), held during the final two weeks of the semester

Students will present their research proposal or term paper in class. The goal of the class presentation is to help students improve their presentations skills and to receive feedback on their topic before submitting their final proposal or paper. The specific instructions for the class presentation will be posted to the course Avenue to Learn page.

Final Exam (35%), held during the 2019 Winter Term Final Examination Period

A 3-hour final exam will be held during the 2019 Winter Term Final Examination Period (Thursday, April 11, 2019 to Monday, April 29, 2019). The Office of the Register will schedule the date, time and location of the final exam and I will post this information to the course Avenue to Learn page as soon as it is available.

The format of the final exam will be short-answer and problem-based. The final exam is cumulative but more weight will be placed on topics covered after the midterm.

McMaster ID cards must be presented to write the midterm test and the final exam.

Students should plan to be on campus during the entirety of the final examination period. Travel plans are not a sufficient reason to have a final exam deferred. The Deferred Exam Policy is available at: <https://registrar.mcmaster.ca/exams/deferred/>.

COURSE POLICIES

Grades

Grades will be based on the McMaster University grading scale:

MARK	GRADE
90-100	A+
85-90	A
80-84	A-
77-79	B+
73-76	B
70-72	B-
67-69	C+
63-66	C
60-62	C-
57-59	D+
53-56	D
50-52	D-
0-49	F

Grade Adjustment Techniques

A combination of particular distributional and absolute measures will be used to determine the course grades. The university grading system will be relied on as a benchmark.

Submission of Assignments

Both Assignment 1 and Assignment 2 are due at the beginning of class on the due dates listed in the syllabus. I will accept both hand-written and typed assignments.

Late Assignments

The two assignments, the midterm test, the group presentation and final exam are not optional. A penalty will be applied to assignments that are not submitted by the start of class on the due date. Each day of (unexcused) late submission results in a penalty of 5% (weekends are not excluded). This also applies to assignments sent by email, and in this case, the time of receipt of the email by the recipient is guarantor of the time of delivery.

Slides for the Group Presentation must be submitted to me within 24 hours of the presentation date. A 5% penalty will be deducted for groups that submit their slides after this deadline.

Absences, Missed Work, Illness (MSAF)

All absences leading to missed assignments, the midterm test, group presentation and final exam are subject to the appropriate policy and processes.

Note that the MSAF reporting system is only valid for 3 days following a missed evaluation (assignment, midterm, group presentation). You cannot use the MSAF reporting system for the midterm test because it is worth 30% of the final course grade.

In the event a student is unable to write the midterm or present on the schedule date, or if either of the assignments cannot be submitted by the due date, then students must report to their

Faculty Office and provide the appropriate documentation. For more information, see <https://socialsciences.mcmaster.ca/current-students/absence-form>.

Calculators and iClickers

Only McMaster Standard Calculators (Casio FX 991 MS or MS Plus) will be allowed during both the midterm test and the final exam. iClickers will not be used in the course.

UNIVERSITY POLICIES

Academic Integrity Statement

You are expected to exhibit honesty and use ethical behavior in all aspects of the learning process. Academic credentials you earn are rooted in principles of honesty and academic integrity.

Academic dishonesty is to knowingly act or fail to act in a way that results or could result in unearned academic credit or advantage. This behavior can result in serious consequences, e.g. the grade of zero on an assignment, loss of credit with a notation on the transcript (notation reads: "Grade of F assigned for academic dishonesty"), and/or suspension or expulsion from the university.

It is your responsibility to understand what constitutes academic dishonesty. For information on the various types of academic dishonesty please refer to the [Academic Integrity Policy](#).

The following illustrates only three forms of academic dishonesty:

1. Plagiarism, e.g. the submission of work that is not one's own or for which credit has been obtained.
2. Improper collaboration in group work.
3. Copying or using unauthorized aids in tests and examinations.

Academic Accommodation of Students with Disabilities

Students who require academic accommodation must contact Student Accessibility Services (SAS) to make arrangements. Academic accommodations must be arranged before classes or academic work begins, and for each term of study. Student Accessibility Services can be contacted by phone 905-525-9140 ext. 28652 or e-mail sas@mcmaster.ca. For further information, consult McMaster University's Policy for [Academic Accommodation of Students with Disabilities](#).

Academic Accommodation for Religious, Indigenous and Spiritual Observances

Students who require academic accommodation due to an Observance must submit a RISO form to their Faculty office, electronically or in person, normally within ten working days from the beginning of each term in which they are anticipating a need for Accommodation. For further information, consult McMaster University's [Policy on Academic Accommodation for Religious, Indigenous and Spiritual Observances](#).

Faculty of Social Sciences E-mail Communication Policy

Effective September 1, 2010, it is the policy of the Faculty of Social Sciences that all e-mail communication sent from students to instructors (including TAs), and from students to staff, must originate from the student's own McMaster University e-mail account. This policy protects

confidentiality and confirms the identity of the student. It is the student's responsibility to ensure that communication is sent to the university from a McMaster account. If an instructor becomes aware that a communication has come from an alternate address, the instructor may not reply at his or her discretion.

Please include ECON 731 in the subject line and include both your full name and student ID in any emails you send to me.

In general, email is not the best way to communicate questions about course material or the assignments. These types of questions should be asked during office hours. Consequently, I will only respond to emails that deal with administrative questions (e.g. missing an assignment or a logistical question).

Course Modification

The instructor and university reserve the right to modify elements of the course during the term. The university may change the dates and deadlines for any or all courses in extreme circumstances. If either type of modification becomes necessary, reasonable notice and communication with the students will be given with explanation and the opportunity to comment on changes. It is the responsibility of the student to check his/her McMaster email and course websites weekly during the term and to note any changes.

WEEKLY COURSE SCHEDULE (AND/OR IMPORTANT DATES)

Lecture	Date	Topic
1	January 11, 2019	Introduction and Refresher on Empirical Methods
2	January 18, 2019	Welfare Economics and the Efficiency Cost of Government Policies
3	January 25, 2019	Asymmetric Information, Moral Hazard and Social Insurance Part I: Health Insurance
4	February 1, 2019	Asymmetric Information, Moral Hazard and Social Insurance Part II: Unemployment Insurance
5	February 8, 2019	Pensions, Social Security and the Economics of Retirement Saving
6	February 15, 2019	Midterm Test
Reading Week (no classes)		
7	March 1, 2019	Externalities Part I: Theory
8	March 8, 2019	Externalities Part II: Empirical Evidence
9	March 15, 2019	Public Goods

10	March 22, 2019	Fiscal Federalism
11	March 29, 2019	Class presentations
12	April 5, 2019	Class presentations

WEEKLY COURSE SCHEDULE WITH READING LIST

The readings marked with an asterisk * are mandatory and will be covered in class.

Section I: Introduction and Refresher on Empirical Methods (January 11)

*Angrist, Joshua D. and Jörn-Steffen Pischke. 2009. *Mostly Harmless Econometrics: An Empiricist's Companion*. Princeton, New Jersey: Princeton University Press.

Chapters 1, 2, 3 (sections 3.1 and 3.2 only), 4 (section 4.1 only), 5 (sections 5.1 and 5.2 only), and 6

Angrist, Joshua D. and Alan 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.

Atkinson, Anthony B. and Joseph E. Stiglitz. 2015. *Lectures on Public Economics: Second Edition*. Princeton, New Jersey: Princeton University Press.

Chapter 1

Section II: Welfare Economics and the Efficiency Cost of Government Policies (January 18)

Atkinson, Anthony B. and Joseph E. Stiglitz. 2015. *Lectures on Public Economics: Second Edition*. Princeton, New Jersey: Princeton University Press

Chapter 11

*Chetty, Raj. 2009. "Sufficient Statistics for Welfare Analysis: Theory and Evidence." *Annual Review of Economics* 1, 451-488.

Hendren, Nathaniel. 2016. "The Policy Elasticity." In Jeffrey R. Brown (eds.). *Tax Policy and the Economy*, Volume 30, pages 51-89.

Varian, Hal R. 1992. *Microeconomic Analysis: Third Edition*. W.W. Norton & Company.

Chapters 17 and 18.

Section III: Asymmetric Information, Moral Hazard and Social Insurance (January 25 and February 1)

Part I (January 25)

Cullen, Mark R., Liran Einav and Amy Finkelstein. 2010. "Estimating Welfare in Insurance Markets Using Variation in Prices." *Quarterly Journal of Economics* 123(3), 877-921.

*Finkelstein, Amy, Nathaniel Hendren and Mark Sheppard. 2017. "Subsidizing Health Insurance for Low-Income Adults: Evidence from Massachusetts." NBER Working Paper 23668, National Bureau of Economic Research. <http://www.nber.org/papers/w23668>

*Einav, Liran and Amy Finkelstein. 2011. "Selection in Insurance Markets: Theory and Empirics in Pictures." *Journal of Economic Perspectives* 25(1), 115-138.

Part II (February 1)

*Chetty, Raj. 2008. "Moral Hazard vs. Liquidity and Optimal Unemployment Insurance." *Journal of Political Economy* 116(2), 173-234.

*Gruber, Jonathan. 1997. "The Consumption Smoothing Benefits of Unemployment Insurance." *American Economic Review* 87(1), 192-205.

Krueger, Alan B. and Bruce D. Meyer. 2002. "Labor Supply Effects of Social Insurance." In Alan J. Auerbach and Martin Feldstein (eds.). *Handbook of Public Economics*, Volume 4, pages 2327-2392.

*Kroft, Kory, Fabian Lange and Matthew J. Notowidigdo. 2013. "Duration Dependence and Labor Market Conditions: Evidence from a Field Experiment." *Quarterly Journal of Economics* 128(3), 1123-1167.

Kroft, Kory and Matthew J. Notowidigdo. 2016. "Should Unemployment Insurance Vary with the Unemployment Rate? Theory and Evidence." *Review of Economic Studies* 83(2), 1092-1124.

Spinnewijn, Johannes. 2015. "Unemployment but Optimistic: Optimal Insurance Design with Biased Beliefs." *Journal of the European Economic Association* 13(1), 130-167.

Section IV: Public Pensions, Social Security and the Economics of Retirement Saving (February 8)

Bernheim, B. Douglas. 2002. "Taxation and saving." In Alan J. Auerbach and Martin J. Feldstein (eds.). *Handbook of Public Economics*, Volume 3, pages 1173-1249.

*Chetty, Raj, John N. Friedman, Soren Leth-Petersen, Torben H. Nielsen and Tore Olsen. 2014. "Active vs. Passive Decisions and Crowd-out in Retirement Savings Accounts: Evidence from Denmark." *Quarterly Journal of Economics* 129(3), 1141-1219.

Friedman, John N. 2016. "Tax Policy and Retirement Savings." in Alan J. Auerbach and Kent Smetters (eds.). *The Economics of Tax Policy*. Oxford University Press.

Lavecchia, Adam M. 2018. "Do Catch-up Limits Raise Retirement Saving? Evidence from a Regression Discontinuity Design." *National Tax Journal* 71(1): 121-154.

*Messacar, Derek. 2017. "Crowd-out, education, and employer contributions to workplace pensions: Evidence from Canadian tax records." *Review of Economics and Statistics*, forthcoming.

Section III: Externalities (March 1 and March 8)

Part I: Theory (March 1)

*Metcalf, Gilbert E. 2009. "Market-Based Policy Options to Control U.S. Greenhouse Gas Emissions," *Journal of Economic Perspectives*, 23(2), 5-27.

Kaplow, Louis. 2012. "Optimal Control of Externalities in the Presence of Income Taxation." *International Economic Review* 53(2), 487-509.

Part II: Empirics (March 8)

*Clay, Karen and Joshua Lewis and Edson Severnini. 2016. "Canary in a Coal Mine: Infant Mortality, Property Values, and Tradeoffs Associated with Mid-20th Century Air Pollution." NBER Working Paper 22155, National Bureau of Economic Research. <http://www.nber.org/papers/w22155>.

*Deschenes, Olivier and Michael Greenstone and Joseph S. Shapiro. 2017. "Defensive Investments and the Demand for Air Quality: Evidence from the NOx Budget Program." *American Economic Review* 107(10), 2958-2989.

Lipscomb, Molly and Ahmed Mushfiq Mobarak. 2017. "Decentralization and Pollution Spillovers: Evidence from the Re-drawing of County Borders in Brazil." *Review of Economic Studies* 84(1), 464-502.

Murphy, Joshua. 2017. "The Value of Reducing Power Plan Emissions: New Evidence from the Clean Air Interstate Rule." <https://joshmurphyeconomics.wordpress.com/job-market-paper/>

Mas, Alexandre and Enrico Moretti. 2009. "Peers at Work." *American Economic Review* 99(1), 112-145.

Section IV: Public Goods (March 15)

*Samuelson, Paul. 1954. "The Pure Theory of Public Expenditures." *Review of Economics and Statistics* 36(4), 387-389.

Atkinson, Anthony B. and Joseph E. Stiglitz. 2015. *Lectures on Public Economics: Second Edition*. Princeton, New Jersey: Princeton University Press

Chapter 16

Section VI: Fiscal Federalism (March 22)

*Boadway, Robin and Jean-Francois Tremblay. 2012. "Reassessment of the Tiebout model." *Journal of Public Economics* 96(11-12), 1063-1078.

*Oates, Wallace E. 1999. "An Essay on Fiscal Federalism." *Journal of Economic Literature* 37(3), 1120-1149.

Milligan, Kevin E. and Michael G. Smart. 2019. "An estimable model of income redistribution in a federation: Musgrave meets Oates." *American Economic Journal: Economic Policy* 11(1), <http://faculty.arts.ubc.ca/kmilligan/research/papers/Musgrave-Oates-Final.pdf>

OTHER NOTES

Attendance Policy

Class attendance is necessary to your learning and to your ability to successfully complete this course. Students are responsible for all material presented in the lectures. Obtaining and learning about missed material is the responsibility of the student.

Electronic Device Policy

Cell phones must be turned off or muted for the duration of all lectures. Laptops or tablets may only be used to take notes or to view lecture material.