

Economics 242: Public Finance and Taxation II
Department of Economics, Stanford University

Spring quarter 2015

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Course website: Students enrolled in the class have access to the course website at coursework.stanford.edu

Course description

This is the second quarter of a two-quarter graduate sequence (241 and 242) in Public Economics. The course focuses on the role of government intervention in the economy and covers optimal social insurance, public goods provision, and welfare analysis in behavioral models. We also explore questions in the intersection of public and family economics such as the unit of taxation, intergenerational mobility, and the interaction between social insurance and intra-family insurance. The course also incorporates selected topics of particular importance in developing countries. Throughout, the course covers empirical and theoretical work, aiming to give students a broad overview of the field and to bring them to the research frontier.

The course and its relation to the Public Economics field

The two courses 241 (taught by Professor Caroline Hoxby) and 242 cover complementary topics in the public economics literature, as well as relevant empirical techniques and theoretical models. The two courses are independent and can be taken in isolation. Thus students who are not planning to take public economics as a field can attend any of the two courses. This course (242) should be relevant for those with an interest in applied microeconomics, broadly defined, especially those taking the labor and development fields.

Students who are taking Public Economics as a field of specialization need both courses.

Students who are taking the Public Economics field are strongly encouraged to attend the Public Economics seminar regularly, which meets on Tuesdays from 3:30 to 5:00 pm. The seminar is a great way to become acquainted with both topics and methods in applied microeconomics.

Course requirements

- Problem Sets (data-intensive replication exercises). The problem sets will be uploaded on the course website. Collaboration with others is allowed, but I expect the work you submit to reflect a good deal of individual effort. Please submit separate problem sets and indicate with whom you worked.
- Referee Reports (2-3 pages each). You will be asked to write referee reports on papers that will be uploaded on the course website. The referee reports should go beyond summarizing the paper – they can discuss strengths, weaknesses, and potential extensions of the paper. Please do not collaborate on the referee reports.

- Research proposal. You are asked to develop a research proposal on a public economics topic that is feasible for a second-year paper. If you took Econ 241 in the winter quarter, you should ideally further develop the research idea you had started working on for that class, aiming to have a partial draft of a paper by the end of spring quarter. Our goal is to give you a head start on your second-year paper requirement. If you did not take Econ 241, or if you wish to develop another idea, you are welcome to discuss this with the instructor.
- Final exam.

Students with documented disabilities

Students who may need an academic accommodation based on the impact of a disability must initiate the request with the Office of Accessible Education (OAE). Professional staff will evaluate the request with required documentation, recommend reasonable accommodations, and prepare an Accommodation Letter for faculty dated in the current quarter in which the request is made. Students should contact the OAE as soon as possible since timely notice is needed to coordinate accommodations. The OAE is located at 563 Salvatierra Walk (phone: 723-1066, URL: <http://studentaffairs.stanford.edu/oae>).

General references

There is no textbook for the course, but good references are:

Atkinson, A. and J. E. Stiglitz (1980). Lectures on Public Economics, McGraw-Hill, Singapore.

Auerbach, A. J. and M. Feldstein, ed. (2002) Handbook of Public Economics, Vol. 3 and 4, Elsevier.

Barr, N. and P. Diamond (2008). Reforming Pensions: Principles and Policy Choices, Oxford University Press.

References on empirical methods

Angrist, J. and J. Pischke (2008) Mostly Harmless Econometrics: An Empiricist's Companion, Princeton University Press.

Bertrand, M., Duflo, E., and Mullainathan, S. (2004) "How Much Should We Trust Difference-in-Differences Estimates?" Quarterly Journal of Economics 119(1): 249-275.

Donald, S. and Lang, K. (2007) "Inference with Differences-in-Differences and Other Panel Data," Review of Economics and Statistics 89: 221 - 233.

Imbens, G. W. and Lemieux, T. (2008) "Regression Discontinuity Designs: A Guide to Practice," Journal of Econometrics 142(2): 615-635.

Imbens, G. and J. Wooldridge (2007) What's New in Econometrics: NBER Summer Institute Mini-Course. Available at: <http://www.nber.org/minicourse3.html>

Lee, D. and Lemieux, T. (2010) "Regression Discontinuity Designs in Economics," Journal of Economic Literature 48(2): 281-355.

Lecture topics and readings

Required readings are marked with **. This list is preliminary and will be updated as we go.

1. Inequality and Intergenerational Mobility

**Chetty, Raj, Nathaniel Hendren, Patrick Kline, and Emmanuel Saez, "Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States," *Quarterly Journal of Economics*, 129(4): 1553-1623, 2014.

Boserup, Simon, Claus Kreiner, and Wojciech Kopczuk, "Stability and Persistence of Intergenerational Wealth Formation: Evidence from Danish Wealth Records of Three Generations," mimeo, 2014.

Edlund, Lena and Wojciech Kopczuk, "Women, Wealth, and Mobility," *American Economic Review*, 99(1): 146-78, 2009.

[D] Greenwood, Jeremy, Nezh Guner, Georgi Kocharkov, and Cezar Santos. 2014. "Marry Your Like: Assortative Mating and Income Inequality." *American Economic Review*, 104(5): 348-53.

Kopczuk, Wojciech, Emmanuel Saez, and Jae Song, "Earnings Inequality and Mobility in the United States: Evidence from Social Security Data since 1937," *Quarterly Journal of Economics*, 125(1): 91-128, 2010.

Piketty, Thomas and Emmanuel Saez, "Inequality in the Long-Run," *Science*, 344(6186): 838-843, 2014.

Saez, Emmanuel and Gabriel Zucman, "Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data," NBER Working Paper #20625, 2014.

2. Insuring or taxing the household: joint taxation and endogenous family structure

**Persson, Petra, "Social Insurance and the Marriage Market," mimeo, 2014.

Immervoll, Herwig, Henrik J. Kleven, and Nicolaj Verdelin, "Optimal Tax and Transfer Programs for Couples with Extensive Labor Supply Responses," *Journal of Public Economics*, 95: 1485-1500, 2011.

Kleven, Henrik J., Claes T. Kreiner, and Emmanuel Saez, "The Optimal Income Taxation of Couples," *Econometrica*, 77(2): 537-560, 2009.

3. Social Insurance

3.1 Motivations for government intervention

Asymmetric information

**Rothschild, Michael and Joseph Stiglitz, "Equilibrium in Competitive Insurance Markets," *Quarterly Journal of Economics* 90(4): 629 – 649, 1976.

**Einav, Liran and Amy Finkelstein, "Selection in Insurance Markets: Theory and Empirics in Pictures," *Journal of Economic Perspectives*, 25(1): 115-38, 2011.

**Finkelstein, Amy and James Poterba, "Adverse Selection in Insurance Markets: Policyholder Evidence from the U.K. Annuity Market," *Journal of Political Economy*, 112: 183-208, 2004.

**Hendren, Nathaniel. "Private Information and Insurance Rejections," *Econometrica*, 81(5): 1713-1762, 2013.

Akerlof, George A., "The Market for "Lemons": Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics*, 84(3): 488-500, 1970.

Chiappori, Pierre-André and Bernard Salanie, "Testing for asymmetric information in insurance markets," *Journal of political Economy* 108(1): 56-78, 2000.

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

Einav, Liran, Amy Finkelstein and Paul Schrimpf, "Optimal Mandates and the Welfare Cost of Asymmetric Information: Evidence from the U.K. Annuity Market," *Econometrica*, 78(3): 1031-1092, 2010.

[D] Finkelstein, Amy and Kathleen McGarry, "Multiple Dimensions of Private Information: Evidence from the Long-Term Care Insurance Market," *American Economic Review*, 96(4): 938-958, 2006.

Optimization frictions

**Abaluck, Jason and Jonathan Gruber, "Choice Inconsistencies Among the Elderly: Evidence from Plan Choice in the Medicare Part D program" *American Economic Review*, 101(2): 591-631, 2011.

**Handel, Benjamin, "Adverse selection and Inertia in Health Insurance Markets: When Nudging Hurts" *American Economic Review*, 103(7): 2643-2682, 2013.

Kling, Jeffrey, Sendhil Mullainathan, Eldar Shafir, Lee Vermeulen, and Marian Wrobel, "Comparison Friction: Experimental Evidence from Medicare Drug Plans," *Quarterly Journal of Economics*, 127(1): 199-235, 2012.

Persson, Petra and Uliana Loginova, "Paternalism, Libertarianism, and the Nature of Disagreement," mimeo 2012 [see 2015 version on course website].

Polyakova, Maria. "Regulation of insurance with adverse selection and switching costs: Evidence from Medicare Part D," mimeo, 2013. <http://economics.mit.edu/files/9376>

Spinnewijn, Johannes. "Heterogeneity, Demand for Insurance and Adverse Selection", mimeo 2015.

Moral hazard

Aron-Dine, Aviva, Liran Einav and Amy Finkelstein. "The RAND Health Insurance Experiment, Three Decades Later" *Journal of Economic Perspectives* 27(1):197-222.

[D] Einav, Liran, Amy Finkelstein and Paul Schrimpf, 2015 "The response of Drug Expenditure to Non-Linear Contract Design: Evidence from Medicare Part D. Forthcoming, QJE.

3.2 Unemployment insurance

Theory: optimal unemployment insurance

**Chetty, Raj, "A General Formula for the Optimal Level of Social Insurance," *Journal of Public Economics* 90: 1879-1901, 2006.

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

Baily, Neil, "Some Aspects of Optimal Unemployment Insurance," *Journal of Public Economics*, 10: 379-402, 1978.

Chetty, Raj and Looney, Adam, "Consumption Smoothing and the Welfare Consequences of Social Insurance in Developing Countries," *Journal of Public Economics*, 90(12): 2351 - 2356, 2006.

[D] Spinnewijn, Johannes, "Unemployed but optimistic: Optimal Insurance Design with Biased Beliefs," *Journal of the European Economic Association*, 13(1): 130-167, 2014.

Landais, Camille, Michailat, and Emmanuel Saez, "A Macroeconomic Theory of Optimal Unemployment Insurance," NBER working paper 16526, 2014.

Shimer, Robert and Werning, Ivan, "Reservation Wages and Unemployment Insurance," *Quarterly Journal of Economics* 122(3): 1145-1185, 2007.

Empirics: Worker behavior

**Card, David, Raj Chetty and Andrea Weber, "Cash-on-Hand and Competing Models of Intertemporal Behavior: New Evidence from the Labor Market," *Quarterly Journal of Economics*, 122(4): 1511-1560, 2007.

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

Card, David, Raj Chetty and Andrea Weber, "The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?," *American Economic Review Papers and Proceedings* 97:113-118, 2007.

Cullen, Julie B. and Jonathan Gruber, "Spousal Labor Supply as Insurance: Does Unemployment Insurance Crowd Out the Added Worker Effect?," *Journal of Labor Economics*, 18(3): 546-572, 2000.

[D] Kroft, Kory and Matthew J. Notowidigdo, "Should Unemployment Insurance Vary with the Unemployment Rate? Theory and Evidence," NBER working paper 17173, 2014.

[D] Schmieder, Johannes, Till von Wachter, and Stefan Bender, "The Effects of Extended Unemployment Insurance over the Business Cycle: Evidence from Regression Discontinuity Estimates over Twenty Years," *Quarterly Journal of Economics* 127(2): 701-752, 2012.

[D] Sullivan, Daniel and Till von Wachter. "Job Displacement and Mortality: An Analysis using Administrative Data," *Quarterly Journal of Economics*, 124(3):1265-1306, 2009.

3.3 Disability insurance

NB: Syllabus is preliminary! Mark Duggan guest lecture – he will likely update his syllabus.

**Autor, David H. and Mark D. Duggan, "The Growth in the Social Security Disability Rolls: A Fiscal Crisis Unfolding," *Journal of Economic Perspectives*, 20(3): 71-96, 2006.

**Bound, John, "The Health and Earnings of Rejected Disability Insurance Applicants," *American Economic Review* 79(3): 482 – 503, 1989.

Gruber, Jonathan, "Disability Insurance Benefits and Labor Supply," *Journal of Political Economy* 108(6): 1162 – 1183, 2000.

Maestas, Nicole, Kathleen J. Mullen, and Alexander Strand. "Does Disability Insurance Receipt Discourage Work? Using Examiner Assignment to Estimate Causal Effects of SSDI Receipt." *American Economic Review*, 103(5): 1797-1829, 2013.

Moore, T. (2012) "The Employment Effects of Terminating Disability Benefits: Insights from Removing Drug Addictions as Disabling Conditions," NBER working paper # 19793, 2014.

3.4 Social security

**Bernheim, B. Douglas, Jonathan Skinner, and Steven Weinberg. "What Accounts for the Variation in Retirement Wealth among U.S. Households?," *American Economic Review*, 91(4): 832-857, 2001.

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

**Diamond, Peter A., "A Framework for Social Security Analysis," *Journal of Public Economics* 8(3): 275-298, 1977.

**Manaoli, Day and Andrea Weber, "Nonparametric Evidence of the Effects of Financial Incentives on Retirement Decisions." NBER Working Paper 17320, 2014.

**Persson, Petra, "Social Insurance and the Marriage Market," mimeo, 2014.

Atanasio, Orazio and Agar Brugiavini, "Social Security and Households' Saving," *Quarterly Journal of Economics*, 118(3): 1075-1119, 2003.

[D] Brown, Jeffrey R., Jeffrey R. Kling, Sendhil Mullainathan, and Marian V. Wrobel, "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle," *American Economic Review*, 98(2): 304-09, 2008.

Carroll, Gabriel, James Choi, David Laibson, Brigitte Madrian, and A. Metrick. "Optimal Defaults and Active Decisions," *Quarterly Journal of Economics*, 124(4): 1639-1674, 2009.

Coile, Courtney and Jonathan Gruber, "Social Security and Retirement," *Review of Economics and Statistics* 89(2): 234 – 246, 2007.

Davidoff, Thomas, Jeffrey R. Brown, and Peter A. Diamond. 2005. "Annuities and Individual Welfare." *American Economic Review*, 95(5): 1573-1590.

Diamond, Peter and Peter Orszag, "Saving Social Security," *Journal of Economic Perspectives*, 9(2), 11-32, 2005.

[D] Duflo, Esther, William Gale, Jeffrey Liebman, and Peter Orszag, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block", *Quarterly Journal of Economics*, 121(4): 1311-1346, 2006.

Feldstein, Martin, "The Optimal Level of Social Security Benefits," *Quarterly Journal of Economics* 100(2), 303-320, 1985.

Feldstein, Martin and Leibman, Jeffrey B. "Social Security," *Handbook of Public Economics*, 4: 2245-2324, 2002.

[D] Gelber, A, Jones, D, and Sacks, D. "Earnings Adjustment Frictions: Evidence from the Social Security Earnings Test," NBER WP 19491.

Gruber, Jonathan and David Wise (1999), "Social Security Programs and Retirement Around the World: Introduction and Summary," in Jonathan Gruber and David Wise, eds., *Social Security and Retirement Around the World* (Chicago: University of Chicago Press), p. 1-36.

Hurst, Erik and Mark Aguiar, "Consumption vs. Expenditures," *Journal of Political Economy*, 113(5): 919-948, 2005.

Madrian, Brigitte and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116(4), 1149-1187, 2001.

Scholz, John K., Ananth Seshadri, and Surachai Khitatrakun, "Are Americans Saving Optimally for Retirement?," *Journal of Political Economy*, 114(4): 607-643, 2007.

3.5 Targeting: reaching the right beneficiaries

[D] Bertrand, Marianne, Sendhil Mullainathan, and Eldar Shafir. "A Behavioral-Economics View of Poverty." *American Economic Review* P&P, May 2004, 419-423.

Currie, Janet, "The Take-up of Social Benefits," in Alan Auerbach, David Card and John Quigly (eds.) "Poverty, the Distribution of Income, and Public Policy." New York: Russell Sage. Available at: <http://www.econ.ucla.edu/people/papers/currie/more/takeup.pdf>

[D] Kleven, Henrik and Wojciech Kopczuk, "Transfer Program Complexity and the Take Up of Social Benefits," *American Economic Journal: Economic Policy*, 3(1): 54-90, 2011.

Nichols, A. and R. Zeckhauser, "Targeting Transfers Through Restrictions on Recipients," *American Economic Review* 72 , 372-377.

3.6. Choice of instruments / lessons for insurance design

**Cabral, Marika, Michael Geruso and Neale Mahoney. "Does Privatized Health Insurance Benefit Patients or Producers? Evidence from Medicare Advantage." Mimeo, 2014.

**Gruber, Jonathan, "The Incidence of Mandated Maternity Benefits," *American Economic Review*, 84(3):

622-641, 1994.

Dahl, Gordon, Katrine V. Løken, Magne Mogstad, and Kari Veia Salvanes. "What is the Case for Paid Maternity Leave?" NBER Working Paper No. 19595, 2013.

[D] Duggan, Mark, Amanda Starc and Boris Vabson. 2014. "Who Benefits when the Government Pays More? Evidence from the Medicare Advantage Program." NBER WP 19989.

Meckel, Katherine, "Is the Cure Worse than the Disease? Unintended Consequences of Fraud Reduction in Transfer Programs," mimeo 2015.

[D] Ruhm, Christopher, J., "The Economic Consequences Of Parental Leave Mandates: Lessons From Europe," *Quarterly Journal of Economics*, 113(1): 285-317, 1998.

Summers, Larry, "Some Simple Economics of Mandated Benefits," *American Economic Review*, 79(2): 177-183, 1989.

4. Intra-family transfers, bequests, and estate taxation

**Farhi, Emmanuel and Iván Werning, "Progressive Estate Taxation," *Quarterly Journal of Economics*, 125(2): 635-673, 2009.

Bernheim, Doug, Andrei Shleifer, and Larry Summers, "The strategic bequest motive. *Journal of Political Economy*," 93(6):1045-76, 1985.

Farhi, Emmanuel and Iván Werning, "Inequality and Social Discounting," *Journal of Political Economy*, 115(3): 365-402, 2007.

Kopczuk, Wojceich, "Bequest and tax planning: Evidence from estate tax returns," *Quarterly Journal of Economics*, 122(4): 1801-1854, 2007.

Light, Audrey and Kathleen McGarry, "Why Parents Play Favorites: Explanations for Unequal Bequests," *The American Economic Review*, 94 (5): 1669-1681, 2004.

McGarry, Kathleen, "The Estate Tax and Inter vivos Transfers over Time," *The American Economic Review*, Papers and Proceedings, forthcoming.

Piketty, Thomas and Emmanuel Saez, "A theory of optimal bequest taxation," *Econometrica*, 81(5): 1851-1886, 2013.

5. Public goods

**Samuelson, P. A. (1954) "The Pure Theory of Public Expenditure," *Review of Economics and Statistics* 36(4): 387 – 389.

**Andreoni, J. (1993) "An Experimental Test of the Public Goods Crowding Out Hypothesis," *American Economic Review* 83(5): 1317 – 1327.

**Hungerman, D. (2005) "Are Church and State Substitutes? Evidence from the 1996 Welfare Reform," *Journal of Public Economics* 89(11-12): 2245 – 2267.

Andreoni, J. (1990) "Impure Altruism and Donations to Public Goods: A Theory of Warm Glow Giving," *Economic Journal* 100: 464 – 477.

Andreoni, J. and Payne, A. (2003) "Do Government Grants to Private Charities Crowd Out Giving or Fundraising?" *American Economic Review* 93(3): 792 – 812.

6. Taxation and social insurance around the world

**Besley, Timothy and Torsten Persson, "Taxation and Development" in Auerbach, A, R. Chetty, M.

Feldstein, and E. Saez (eds.) Handbook of Public Economics, 2013.

**Best, Michael, Anne Brockmeyer, Henrik Kleven, Johannes Spinnewijn, and Mazhar Waseem "Production vs Revenue Efficiency with Limited Tax Capacity: Theory and Evidence from Pakistan", Forthcoming Journal of Political Economy.

Carillo, Paul, Dina Pomeranz and Monica Singhal, "Dodging the Taxman: Firm Misreporting and Limits to Tax Enforcement," mimeo 2014.

Dwenger, Nadja, Henrik Kleven, Imran Rasul and Johannes Rickne, "Extrinsic and Intrinsic Motivations for Tax Compliance: Evidence from a Field Experiment in Germany," mimeo 2014.

Kleven, Henrik. "How Can Scandinavians Tax So Much?," Journal of Economic Perspectives, 28(4): 77-98, 2014.

Olken, Ben and Monica Singhal, "Informal Taxation," American Economic Journal: Applied Economics, 3(4):1-28, 2011.