

# **Public Sector Economics**

**SOPP 5292 – Winter 2019**

**CEU Budapest**

**School of Public Policy**

**Central European University**

**No. of credits: 2**

**Course e-learning site: [CEU Moodle](#)**

**Tuesday 11:00 – 12:40, Okt6\*7 room TBD**

**Instructor:** Dr. Michael Dorsch, Associate Professor

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**Office hours:** Wednesday 14:30 – 15:30, Okt6\*7 room 239

**Teaching assistant:** Réka Branyiczki

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**Office hours:** Thursday 17:30 – 18:30, N15 Estratto

## **Course description**

This course provides an introduction to modern public economics. The course begins with the presentation of the basic set of analytical tools used by economists in treating public economics issues and critically examines the rationale for public (governmental) intervention in competitive markets – to provide public goods, deal with externalities, promote social justice, etc. Once the tools of analysis are presented and the need for a public sector has been established, we evaluate public policy responses to the externality problem within the context of environmental policy. The public choice view of regulation is also introduced, before moving on to public finance issues. We will evaluate the evolution of states' fiscal capacities and then critically examine the efficiency effects of taxation, studying the optimal methods of raising public revenues through taxation and the extent to which such efforts should be centralized or decentralized. Political economy issues will also be considered; while the economist may be quick to point out where public policy can be welfare-enhancing, the implementation of policy must work through the machinery of democracy. Special attention is paid to economic inequality, both as an important determinant of political dynamics and as an outcome of the policy-making process. The course will consider the role of non-institutionalized forms of political participation in influencing public policy outcomes.

## Primary learning objectives

1. Strengthen analytical economic skills, covering a range of micro-economic models applied to public economic issues.
2. Critically examine the role of government from an economic point of view.
3. Understand the role of externalities in economic decision-making, in general, and economically analyze the optimal policy responses.
4. Apply the theory of externalities to evaluate the climate crisis and review contemporary economic and political thinking on environmental policy.
5. Understand how the government raises revenues through taxation to finance public expenditures and how different forms of taxation and expenditure affect individual decision-making.
6. Appreciate how political dynamics shape public policy decision-making.
7. Exposure to some hot research topics in public economics: climate change, economic inequality, fiscal capacity, and decentralization.

## Primary textbooks

*Economics of the Public Sector – International Edition 4*, Joseph Stiglitz and Jay Rosengard, 2015 (on reserve at CEU library).

*Public Finance – International Edition 5*, Harvey Rosen and Ted Gayer, 2008 (on reserve at CEU library).

*The Oxford Handbook of Public Choice – Volumes 1 & 2*, Roger Congleton, Bernard Grofman and Stefan Voigt, 2019 (on reserve at CEU library).

*Advanced Introduction to Public Choice*, Randall Holcombe, 2016.

## Additional sources

*Public Finance and Public Policy – Second Edition*, Jonathan Gruber, 2007.

*Public Finance and Public Policy – Third Edition*, Arye Hillman, 2019.

[The Economy](#), by the CORE project

*The Journal of Economic Perspectives*

## Online resources

[Moodle site](#) for the course

## Individual discussion leads

Each student will be responsible for leading at least one class discussion of the further reading materials. Students should anticipate leading a 20 minute discussion and will be evaluated based on their ability to (i) succinctly summarize the chosen paper, (ii) relate the main results of the paper to the day's required reading, and (iii) stimulate discussion on the topic of the day that builds on the reading material that was required of their class peers.

Papers marked with a **[\*]** utilize more technical analytical methodologies. Papers marked with **[IE]** use a methodology from impact evaluation. Students enrolled in Impact Evaluation are required to lead a discussion based on an **[IE]** paper.

## Case study

We will discuss a case study on the politics of environmental policy. Students will be evaluated based on their displayed understanding of the case and ability to use theoretical tools of economics to analyze the issues of the case. Students will discuss the case study in groups of two or three.

## Requirements and evaluation

Case study	January 28	20 %
Presentation	ongoing	25 %
Participation	ongoing	15 %
Final exam	April 4	40 %

## Grading scale

93	≤	A	≤	100
86	≤	A –	<	93
79	≤	B +	<	86
72	≤	B	<	79
65	≤	B –	<	72
58	≤	C +	<	65
0	≤	F	<	58

## Course outline (subject to change)

### **01/07: Role, size, and structure of the public sector**

Required reading (51 pages):

- Stiglitz, chapter 1 (pages 3 – 24)
- Stiglitz, chapter 2 (pages 26 – 56)

Further reading:

- Stiglitz, chapter 7 (pages 163 – 174)
- Stiglitz, chapter 26 (pages 801 – 829)

### **01/14: Market failures: private and public solutions**

Required reading (31 pages):

- Rosen, chapter 5 (pages 71 – 99 and 99 – 102)

Background Reading:

- Ronald Coase, “[The problem of social cost](#),” *Journal of Law and Economics*, 3: 1 – 44 (1960). [Read pages 1 – 10 and 15 – 19]
- CORE unit 12, [Markets, efficiency and public policy](#) (sections 12.2 and 12.3)

Further reading (1 discussion lead):

- Hunt Allcott, Benjamin B. Lockwood and Dmitry Taubinsky, [Should we tax sugar-sweetened beverages? An overview of theory and evidence.](#)” *Journal of Economic Perspectives*, 33 (3): 202 – 227 (2019).
- Tatiana A. Homonoff, “[Can small incentives have large effects? The impact of taxes versus bonuses on disposable bag use.](#)” *American Economic Journal: Economic Policy*, 10 (4): 177 – 210 (2018). [IE]
- Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action*, Cambridge University Press, chapter 1, pp. 1 – 28 (1990).

**01/21: The economics of climate change and markets for pollution allowances**

Required reading (40 pages):

- Joseph Stiglitz, “[Addressing climate change through price and non-price interventions](#)” *NBER Working Paper 25939* (2019).

Background reading:

- CORE unit 20, [Economics of the environment](#) (sections 20.2, 20.5, 20.6, and 20.9)
- Gruber, chapter 6 (pages 150 – 163)

Further reading (3 discussion leads):

- Julius J. Andersson, “[Carbon taxes and CO<sub>2</sub> emissions: Sweden as a case study.](#)” *American Economic Journal: Economic Policy*, 11 (4): 1 – 30 (2019). **[IE]**
- Solomon Hsiang and Robert E. Kopp. “[An economist’s guide to climate change science.](#)” *Journal of Economic Perspectives*, 32 (4): 3 – 32 (2018).
- Kenneth Gillingham and James H. Stock. “[The cost of reducing greenhouse gas emissions.](#)” *Journal of Economic Perspectives*, 32 (4): 53 – 72 (2018).
- Thomas Dietz, Elinor Ostrom, and Paul C. Stern. “[The struggle to govern the commons,](#)” *Science*, 302 (5652): 1907– 1912 (2003). **[together with Ostrom (2010)]**
- Elinor Ostrom, “[Polycentric systems for coping with collective action and global environmental change,](#)” *Global Environmental Change*, 20 (4): 550 – 557 (2010). **together with Dietz, Ostrom, and Stern (2003)]**
- Sam Fankhauser, Caterina Gennaioli, and Murray Collins. “[The political economy of passing climate change legislation: Evidence from a survey,](#)” *Global Environmental Change*, 35: 52 – 61 (2015). **[\*]**
- Giorgos Kallis, Vasilis Kostakis, Steffen Lange, Barbara Muraca, Susan Paulson, and Matthias Schmelzer. “[Research on de-growth,](#)” *Annual Review of Environment and Resources* 43 (1): 291 – 316 (2018).
- Hunt Allcott, “[Site selection bias in program evaluation,](#)” *The Quarterly Journal of Economics*, 130 (3): 1117 – 1165 (2015). **[\*]**

**01/28: Part I. Environmental taxation**

Required reading (37 pages):

- Williams III, Robertson C. “[Environmental taxation](#),” *National Bureau of Economic Research*, No. w22303 (2016).

**01/28: Part II. Case study on the politics of environmental policy**

Required reading (18 pages):

- Anjani Datla, “Pricing carbon: The birth of British Columbia’s carbon tax,” *Harvard Kennedy School Case Number 2062.0* (2016).
- Attendance and participation is mandatory

**02/04: Regulation – Public interest versus rent-seeking**

Required reading (47 pages):

- Randall Holcombe, “Political markets: Interest groups, rent-seeking, and regulatory capture,” *Advanced Introduction to Public Choice*, 73 – 83 (2016).
- Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, “[The regulation of entry](#),” *The Quarterly Journal of Economics*, 117 (1): 1 – 37 (2002).

Further reading (2 discussion leads):

- Sheilagh Ogilvie, “[The economics of guilds](#),” *Journal of Economic Perspectives*, 28 (4): 169 – 192 (2014).
- Daron Acemoglu and James Robinson, “[Economics versus politics: Pitfalls of policy advice](#),” *Journal of Economic Perspectives*, 27: 173 – 192 (2013).
- Roger Congleton, “The political economy of rent creation and rent extraction,” *The Oxford Handbook of Public Choice*, volume 1: 533 – 549 (2019).
- Patrick Dunleavy, “‘The bureaucracy’ as an interest group,” *The Oxford Handbook of Public Choice*, volume 1: 567 – 584 (2019).
- William Shughart II and Diana Thomas, “Interest groups and regulatory capture,” *The Oxford Handbook of Public Choice*, volume 1: 585 – 603 (2019).

**02/11: Public finance – Tax incidence, optimal taxation and debt financing**

Required reading (41 pages):

- Stiglitz, chapter 18 (pages 538 – 552 and 560 – 566)
- Stiglitz, chapter 20 (pages 606 – 610 and 621 – 630)
- Stiglitz, chapter 28 (pages 851 – 852 and 866 – 873)

Further reading (2 discussion leads):

- Wallace Oates and Robert Schwab, “[The window tax: A case study in excess burden](#)” *Journal of Economic Perspectives*, 29: 163 – 80 (2015).
- Peter Diamond and Emmanuel Saez, “[The case for a progressive tax: From basic research to policy recommendations](#),” *Journal of Economic Perspectives*, 25(4): 165 – 190 (2011).
- Enrico Moretti and Daniel J. Wilson, “[Taxing billionaires: Estate taxes and the geographical location of the ultra-wealthy](#),” *NBER Working Paper 26387* (2019). [\*]
- Emmanuel Saez and Gabriel Zucman. “How would a progressive wealth tax work? Evidence from the economics literature,” *UC Berkeley Working Paper* (2019).

**02/18: State capacity and taxation**

Required reading (39 pages):

- Henrik Jacobsen Kleven, “[How can Scandinavians tax so much?](#)” *Journal of Economic Perspectives*, 28(4): 77 – 98 (2014).
- Timothy Besley and Torsten Persson, “[Why do developing countries tax so little?](#)” *Journal of Economic Perspectives*, 28(4): 99 – 120 (2014).

Background reading:

- Timothy Besley and Torsten Persson. “[Taxation and development](#),” In *Handbook of Public Economics*, 5: 51 – 63 (2013).

Further reading (2 discussion leads):

- Mark Dincecco. “[Fiscal centralization, limited government, and public revenues in Europe, 1650 – 1913](#),” *The Journal of Economic History*, 69(1): 48 – 103 (2009). [\*]
- Daron Acemoglu, Davide Cantoni, Simon Johnson, and James A. Robinson. “[The consequences of radical reform: The French revolution](#),” *American Economic Review*, 101 (7): 3286 – 3307 (2011). [IE]

- Davide Cantoni, Cathrin Mohr, and Matthias Weigand. “[The rise of fiscal capacity](#),” *Uni-Muenchen Working Paper* (2019). [\*]
- Raul Sanchez de la Sierra, “On the origins of the state: Stationary bandits and taxation in Eastern Congo,” forthcoming in *Journal of Political Economy* (2019). [\*]
- Erzo Luttmer and Monica Singhal, “[Tax morale](#),” *Journal of Economic Perspectives*, 28 (4): 149 – 168 (2014).

### 02/25: Economic models of politics

Required reading (29 pages + online material):

- Stiglitz, chapter 9 (pages 230 – 259)
- CORE unit 22, [Economics, politics, and public policy](#) (sections 22.5 – 22.8 and 22.10)

Background reading:

- Randall Holcombe, “The politics of left and right,” *Advanced Introduction to Public Choice*, 13 – 23 (2016).
- Meltzer, A.H. and Richard, S.F., “[A rational theory of the size of government](#),” *Journal of Political Economy*, 89: 914 – 927 (1981).
- James Buchanan and Gordon Tullock, “Simple Majority Voting,” chapter 10 of *The Calculus of Consent: Logical Foundations of Constitutional Democracy*, University of Michigan Press (1962).

Further reading (1 discussion lead):

- Hunt Allcott and Matthew Gentzkow. “[Social media and fake news in the 2016 election](#),” *Journal of Economic Perspectives*, 31 (2): 211 – 236 (2017).
- James Adams, “Spatial voting models of party competition in two dimensions,” *The Oxford Handbook of Public Choice*, volume 1: 187 – 207 (2019).
- Michael Lewis-Beck and Mary Stegmaier, “Economic voting,” *The Oxford Handbook of Public Choice*, volume 1: 247 – 265 (2019).
- Serguei Kaniovski, “Turnout: Why do voters vote?,” *The Oxford Handbook of Public Choice*, volume 1: 310 – 332 (2019).



**03/03. Income distribution, social mobility, and economic justice**

Required reading (17 pages + online material):

- Rosen, chapter 12 (pages 258 – 275)
- Villarosa, L. “[Why America’s black mothers and babies are in a life-or-death crisis](#),” *The New York Times Magazine* (2018).

Background reading:

- CORE unit 19, [Economic inequality](#) (sections 19.1 – 19.4 and 19.10 – 19.11)

Further reading (2 discussion leads):

- Alberto Alesina, Stefanie Stantcheva, and Edoardo Teso. “[Intergenerational mobility and preferences for redistribution](#),” *American Economic Review*, 108 (2): 521 – 554 (2018). [\*]
- Maitreesh Ghatak and François Maniquet. “[Universal basic income: Some theoretical aspects](#),” *Annual Review of Economics*, 11: 895 – 928 (2019).
- Rema Hanna and Benjamin A. Olken, “[Universal basic incomes versus targeted transfers: Anti-poverty programs in developing countries](#),” *Journal of Economic Perspectives*, 32 (4): 201 – 226 (2018). [IE]
- Christian Bjørnskov, Axel Dreher, Justina AV Fischer, Jan Schnellenbach, and Kai Gehring. “[Inequality and happiness: When perceived social mobility and economic reality do not match](#),” *Journal of Economic Behavior & Organization*, 91: 75 – 92 (2013).
- Facundo Alvaredo, Anthony Atkinson, Thomas Piketty, and Emmanuel Saez, “[The top 1 percent in international and historical perspective](#),” *Journal of Economic Perspectives*, 27: 3 – 20 (2013).
- Gregory Mankiw, “[Defending the one percent](#),” *Journal of Economic Perspectives*, 27 (3): 21 – 34 (2013).
- Miles Corak, “[Income inequality, equality of opportunity, and intergenerational mobility](#),” *Journal of Economic Perspectives*, 27: 79 – 102 (2013).
- Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman. “[Tax evasion and inequality](#),” *American Economic Review* 109 (6): 2073 – 2103 (2019). [\*]

**03/10: Part I. Why don't democracies redistribute more?**

Required reading (21 pages):

- Adam Bonica, Nolan McCarty, Keith Poole, and Howard Rosenthal, “[Why hasn't democracy slowed rising inequality?](#)” *Journal of Economic Perspectives*, 27: 103 – 124 (2013).

Background reading:

- CORE unit 22, [Economics, politics, and public policy](#) (sections 22.11 – 22.14)

Further reading (1 discussion lead):

- Joseph Stiglitz. “Rent seeking and the making of an unequal society,” *The Price of Inequality*, 35 – 65 (2012).
- Thomas Piketty. “Brahmin left vs merchant right: Rising inequality and the changing structure of political conflict,” *WID Working Paper 7* (2018).
- Raymond Fisman, Pamela Jakiela, Shachar Kariv, and Daniel Markovits. “[The distributional preferences of an elite.](#)” *Science*, 349 (6254): aab0096 (2015).
- Daron Acemoglu, Suresh Naidu, Pascual Restrepo, and James A. Robinson. “[Democracy, redistribution, and inequality,](#)” In *Handbook of Income Distribution*, 2: 1885 – 1909 (2015).
- Michael Dorsch and Paul Maarek. “[Democratization and the conditional dynamics of income distribution,](#)” *American Political Science Review*, 113 (2): 385 – 404 (2019). [\*]
- Ricardo Fuentes-Nieva and Nick Galasso, “[Working for the few: Political capture and economic inequality,](#)” *OXFAM Briefing Paper 178* (2014).

**03/10: Part II. In-class experiment – Inequality and redistribution**

Requirements:

- Attendance and participation is mandatory

**03/17: Political protests and policy outcomes**

Required reading (37 pages):

- Andreas Madestam, Daniel Shoag, Stan Veuger, and David Yanagizawa-Drott. “[Do political protests matter? Evidence from the Tea Party movement,](#)” *The Quarterly Journal of Economics* 128 (4): 1633 – 1669 (2013).

Further reading (2 discussion leads):

- Timur Kuran and Diego Romero, “The logic of revolutions: Rational choice perspectives,” *The Oxford Handbook of Public Choice*, volume 2: 345 – 362 (2019).
- Davide Cantoni, David Y Yang, Noam Yuchtman, Y Jane Zhang, “[Protests as strategic games: Experimental evidence from Hong Kong’s anti-authoritarian movement](#),” *The Quarterly Journal of Economics*, 134 (2): 1021 – 1077 (2019). [IE]
- Marc Sangnier and Yanos Zylberberg, “[Protests and trust in the state: Evidence from African countries](#),” *Journal of Public Economics*, 152: 55 – 67 (2017). [IE]
- Soumyajit Mazumder, “[The persistent effect of US civil rights protests on political attitudes](#),” *American Journal of Political Science* 62 (4): 922 – 935 (2018). [\*]
- Maria Stephan and Erica Chenoweth. “[Why civil resistance works: The strategic logic of nonviolent conflict](#),” *International Security*, 33 (1): 7 – 44 (2008).

### 03/24: Fiscal federalism, decentralization, and integration

Required reading (28 pages):

- Stiglitz, chapter 26 (pages 801 – 829)

Further reading (2 discussion leads):

- Wallace Oates, “[Toward a second-generation theory of fiscal federalism](#),” *International Tax and Public Finance*, 12, 349 – 373 (2005).
- Benjamin Olken, “[Direct democracy and local public goods: Evidence from a field experiment in Indonesia](#),” *American Political Science Review*, 104 (2): 243 – 267 (2010). [IE]
- Jaroslaw Kantorowicz, “Federalism,” *The Oxford Handbook of Public Choice*, volume 2: 72 – 93 (2019).
- Lucie Gadenne and Monica Singhal, “[Decentralization in developing economies](#),” *Annual Review of Economics*, 6 (1): 581 – 604 (2014).
- Enrico Spolaore, “[What Is European integration really about? A political guide for economists](#),” *Journal of Economic Perspectives*, 27 (3): 125 – 44 (2013).

- Ruben Enikolopov and Ekaterina Zhuravskaya. “[Decentralization and political institutions](#).” *Journal of Public Economics* 91 (11-12): 2261 – 2290 (2007). [\*]

**EXTRA: The economics of populism**

Required reading (21 pages):

- Dani Rodrik, “[Populism and the economics of globalization](#),” *Journal of International Business Policy*, 1: 12 – 33 (2018).

Further reading:

- Italo Colantone and Piero Stanig, “[The surge of economic nationalism in Western Europe](#),” *Journal of Economic Perspectives*, 33 (4): 128 – 151 (2019).
- Sergei Guriev and Daniel Treisman, “[Informational autocrats](#),” *Journal of Economic Perspectives*, 33 (4): 100 – 127 (2019).
- Sebastian Edwards, “[On Latin American populism, and its echoes around the world](#),” *Journal of Economic Perspectives*, 33 (4): 76 – 99 (2019).
- Yotam Margalit, “[Economic insecurity and the causes of populism, reconsidered](#),” *Journal of Economic Perspectives*, 33 (4): 152 – 170 (2019).

**04/04: Final exam**