

Public Sector Economics

DPP 5292 – Winter 2023

CEU Vienna

Department of Public Policy

Central European University

No. of credits: 2 US / 4 ECTS

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

Thursday, 13:30 – 15:10, D109

Instructor: [Dr. Michael Dorsch](#), Associate Professor

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Office hours: Wednesday, 15:15 – 16:30, QS B-403

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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. Understand how the government raises revenues through taxation to finance public expenditures and how different forms of taxation and expenditure affect individual decision-making.
5. Appreciate how political dynamics shape public policy decision-making.

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).

Advanced Introduction to Public Choice, Randall Holcombe, 2016.

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

Requirements and evaluation

Class debate	Week 3	15 %
Case study	Week 7	15 %
Presentation	ongoing	20 %
Participation	ongoing	10 %
Final exam	April 4	40 %

Case study and class debate

We will discuss a case study on the politics of environmental policy and have a class debate on income tax systems. Students will be evaluated based on their displayed understanding of the topics and ability to use theoretical tools of economics to analyze the issues. Students will participate in groups of three or four.

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 15 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 (at least 5 of the 15 minutes).

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.

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)

Week 1: 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)

Week 2: 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 (XX discussion leads):

- Gregory Mankiw, Matthew Weinzierl and Danny Yagan, “[Optimal taxation in theory and practice](#),” *Journal of Economic Perspectives*, 23(4): 147 – 174 (2009).
- Enrico Moretti and Daniel J. Wilson, “[Taxing billionaires: Estate taxes and the geographical location of the ultra-wealthy](#),” *American Economic Journal: Economic Policy* (forthcoming). [*]
- Florian Scheuer and Joel Slemrod, “[Taxation and the super rich](#),” *Annual Review of Economics*, 12: 189 – 211 (2020).
- Emmanuel Saez and Gabriel Zucman. “[Progressive wealth taxation](#),” *Brookings Papers on Economic Activity*, 437-533 (2019).
- Jones, C. I. “Taxing top incomes in a world of ideas,” *Journal of Political Economy*, 130: 2227 – 2274 (2022). **[formal theory]**

Week 3: Class debate: How progressive should an income tax system be?

Required class preparation:

- Stantcheva, S. “Understanding tax policy: How do people reason?” *The Quarterly Journal of Economics*, 136: 2309 – 2369.
- Attendance and participation is mandatory

Week 4: 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).

Further reading (XX 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). [*****]
- 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](#),” *Journal of Political Economy*, 128: 32 – 74 (2020). [*****]
- Chambru, Cédric, Emeric Henry, and Benjamin Marx. “The Dynamic Consequences of State-Building: Evidence from the French Revolution,” *Sciences Po Working Paper* (2021). [**IE**]
- Bagnato, Luca. “From Taxation to Fighting for the Nation: Historical Fiscal Capacity and Military Draft Evasion during WWI,” *ETH Zurich PhD Dissertation* (2021). [**IE**]
- Erzo Luttmer and Monica Singhal, “[Tax morale](#),” *Journal of Economic Perspectives*, 28 (4): 149 – 168 (2014).

Week 5: 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 (XX 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**]

- Bronzini, Raffaello, and Eleonora Iachini. “Are Incentives for R&D Effective? Evidence from a Regression Discontinuity Approach,” *American Economic Journal: Economic Policy*, 6: 100 – 134 (2014). [IE]

Week 6: The economics of climate change and markets for pollution allowances

Required reading (XX pages + online material):

- Stiglitz, J. E., Stern, N., Duan, M., Edenhofer, O., Giraud, G., Heal, G. M., & Winkler, H. *Report of the high-level commission on carbon prices* (2017).
- CORE unit 20, [Economics of the environment](#) (sections 20.2, 20.5, 20.6, and 20.9)

Background reading:

- Solomon Hsiang and Robert E. Kopp. “An economist’s guide to climate change science.” *Journal of Economic Perspectives*, 32 (4): 3 – 32 (2018).

Further reading (XX discussion leads):

- Julius J. Andersson, “Carbon taxes and CO₂ emissions: Sweden as a case study.” *American Economic Journal: Economic Policy*, 11 (4): 1 – 30 (2019). [IE]
- Hunt Allcott, “Site selection bias in program evaluation,” *The Quarterly Journal of Economics*, 130 (3): 1117 – 1165 (2015). [IE]
- Shapiro, J. S., and Walker, R. “Why is pollution from US manufacturing declining? The roles of environmental regulation, productivity, and trade,” *American Economic Review*, 108: 3814 – 54 (2018). [*]
- Fabra, N., and Reguant, M. “Pass-through of emissions costs in electricity markets,” *American Economic Review*, 104: 2872 – 99 (2014). [*]

Week 7: Part I. Environmental taxation

Required reading (37 pages):

- Robert C. Williams III. “Environmental taxation,” chapter 3 in *The Economics of Tax Policy*, Oxford University Press (2017).

Week 7: 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

Further reading:

- Murray, B., and Rivers, N. “British Columbia’s revenue-neutral carbon tax: A review of the latest ‘grand experiment’ in environmental policy,” *Energy Policy*, 86: 674 – 683 (2015).
- Pretis, F. “Does a carbon tax reduce CO₂ emissions? Evidence from British Columbia,” *Environmental and Resource Economics*, 1 – 30 (2022).

Week 8: 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 (XX discussion leads):

- Sheilagh Ogilvie, “[The economics of guilds](#),” *Journal of Economic Perspectives*, 28 (4): 169 – 192 (2014).
- Philippe Aghion, Yann Algan, Pierre Cahuc, and Andrei Shleifer. “[Regulation and distrust](#),” *The Quarterly Journal of Economics*, 125 (3): 1015 – 1049 (2010). [*]
- Faccio, Mara. “[Politically connected firms](#),” *American Economic Review*, 96: 369 – 386 (2006). [*]
- Bertrand, Marianne, and Francis Kramarz. “[Does entry regulation hinder job creation? Evidence from the French retail industry](#),” *The Quarterly Journal of Economics*, 117: 1369 – 1413 (2002). [*]
- Bertrand, Marianne, Simeon Djankov, Rema Hanna, and Sendhil Mullainathan. “[Obtaining a driver’s license in India: an experimental approach to studying corruption](#),” *The Quarterly Journal of Economics*, 122: 1639 – 1676 (2007). [*]
- Acemoglu, Daron, Simon Johnson, Amir Kermani, James Kwak, and Todd Mitton. “[The value of connections in turbulent times: Evidence from the United States](#),” *Journal of Financial Economics*, 121: 368 – 391 (2016). [*]

Week 9: 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 (XX discussion leads):

- Hunt Allcott and Matthew Gentzkow. “[Social media and fake news in the 2016 election](#),” *Journal of Economic Perspectives*, 31 (2): 211 – 236 (2017).
- Cascio, Elizabeth U. and Na’ama Shenhav. “[A century of the American woman voter: Sex gaps in political participation, preferences, and partisanship since women’s enfranchisement](#),” *Journal of Economic Perspectives*, 34(2): 24 – 48 (2020).
- Cantoni, Enrico. “[A precinct too far: Turnout and voting costs](#),” *American Economic Journal: Applied Economics* 12: 61 – 85 (2020). [IE]
- Pons, Vincent, and Clémence Tricaud. “[Expressive voting and its cost: Evidence from runoffs with two or three candidates](#),” *Econometrica* 86: 1621 – 1649 (2018). [IE]

Week 10. Income distribution, social mobility, and economic justice

Required reading (46 pages + online material):

- Rosen, chapter 12 (pages 258 – 275)
- CORE unit 19, [Economic inequality](#) (sections 19.1 – 19.4 and 19.10 – 19.11)

Background reading:

- Thomas Piketty. *The Economics of Inequality*. Harvard University Press (2015).

Further reading (XX discussion leads):

- Henry S Farber, Daniel Herbst, Ilyana Kuziemko, Suresh Naidu, “[Unions and Inequality over the Twentieth Century: New Evidence from Survey Data](#),” *The Quarterly Journal of Economics* 136: 1325 – 1385 (2021). [IE]
- Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman. “[Tax evasion and inequality](#),” *American Economic Review* 109 (6): 2073 – 2103 (2019). [*]
- Maitreesh Ghatak and Francois 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]
- Alesina, Alberto, and Nicola Fuchs-Schündeln. “[Good-bye Lenin \(or Not?\): The Effect of Communism on People’s Preferences](#),” *American Economic Review*, 97: 1507 – 1528 (2007). [*]
- Fehr, Dietmar, Johanna Mollerstrom, and Ricardo Perez-Truglia. “[Your Place in the World: Relative Income and Global Inequality](#),” *American Economic Journal: Economic Policy*, 14: 232 – 68 (2022). [IE]

Week 11. Why don’t democracies redistribute more?

Required reading (XX 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).
- Blanchet, Thomas, Lucas Chancel, and Amory Gethin. “[Why Is Europe More Equal than the United States?](#)” *American Economic Journal: Applied Economics*, 14 (4): 480 – 518 (2022).

Further reading (XX discussion leads):

- Amory Gethin, Clara Martínez-Toledano, and Thomas Piketty. “[Brahmin Left versus Merchant Right: Changing Political Cleavages in 21 Western Democracies, 1948-2020](#),” *Quarterly Journal of Economics* (forthcoming)

- Hoy, Christopher, and Franziska Mager, “[Why Are Relatively Poor People Not More Supportive of Redistribution? Evidence from a Randomized Survey Experiment across Ten Countries](#),” *American Economic Journal: Economic Policy*, 13: 299 – 328 (2021). [IE]
- Alberto Alesina, Stefanie Stantcheva, and Edoardo Teso. “[Intergenerational mobility and preferences for redistribution](#),” *American Economic Review*, 108 (2): 521 – 554 (2018). [*]
- Elkjaer, M. and T. Iversen. “[The Democratic State and Redistribution: Whose Interests Are Served?](#)” *American Political Science Review*, 1-16 (2022). [*]
- Shayo, M. “A model of social identity with an application to political economy: Nation, class, and redistribution,” *American Political Science Review*, 103: 147 – 174 (2009). [formal theory]
- Iversen, T., and Soskice, D. “Electoral institutions and the politics of coalitions: Why some democracies redistribute more than others,” *American Political Science Review*, 100: 165 – 181 (2006).

Week 12: 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 (XX discussion leads):

- Aidt, Toke S., and Raphaël Franck. “[Democratization under the threat of revolution: Evidence from the Great Reform Act of 1832](#),” *Econometrica* 83: 505 – 547 (2015) [IE]
- Bursztyn, Leonardo, Davide Cantoni, David Y. Yang, Noam Yuchtman, and Y. Jane Zhang. “[Persistent Political Engagement: Social Interactions and the Dynamics of Protest Movements](#),” *American Economic Review: Insights*, 3 (2): 233 – 50 (2021). [IE]
- Enikolopov, Ruben, Alexey Makarin, and Maria Petrova. “[Social media and protest participation: Evidence from Russia](#),” *Econometrica* 88: 1479 – 1514 (2020). [IE]
- Soumyajit Mazumder, “[The persistent effect of US civil rights protests on political attitudes](#),” *American Journal of Political Science* 62 (4): 922 – 935 (2018). [*]

- Engist, O., Schafmeister, F. “Do political protests mobilize voters? Evidence from the Black Lives Matter protests, *Public Choice* 193: 293 – 313 (2022). [IE]

04/04: Take-home, open-book final exam. Due by 23:59.

EXTRA: Fiscal federalism, decentralization, and integration

Required reading (28 pages):

- Stiglitz, chapter 26 (pages 801 – 829)

Further reading:

- 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).
- Becker, Sascha O., Thiemo Fetzer, and Dennis Novy. “[Who voted for Brexit? A comprehensive district-level analysis](#).” *Economic Policy*, 32 (92): 601 – 650 (2017). [*]

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).
- 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).
- Colantone, I., Stanig, P., “[The trade origins of economic nationalism: Import competition and voting behavior in Western Europe](#),” *American Journal of Political Science*, 62 (4), 936 – 953 (2018). [*]
- Dinas, E., Matakos, K., Xefteris, D., Hangartner, D., “[Waking up the Golden Dawn: Does exposure to the refugee crisis increase support for extreme-right parties?](#)” *Political Analysis*, 1–11 (2019). [IE]