



Department of Economics Course Outline

Term: Winter 2005

Course: Economics 611.13
[Public Finance]

Section: [91]

Time: M 18:30 ? 21:20

Place: SS 423 (subject to change)

Instructor: Dr. Jean François Wen

Office: SS 416

Telephone: 220-2478

Office Hours: TR 14:00 - 16:00

E-Mail: wen@ucalgary.ca

Textbook(s):

n/a

Book(s) on Reserve:

n/a

Course Outline:

This is a course on ?normative? Public Economics theory, with a particular focus on ideas and methods relevant for understanding the economics of ?welfare state? programs of the government in unemployment insurance, pensions, health care, housing, education, and income redistribution. Welfare state programs comprise a very substantial part of government activities. Understanding the efficiency and equity rationales for the welfare state is therefore fundamental to understanding the economic role of government in the modern economy.

The theoretical concepts to be covered include the conditions for Pareto optimality, the welfare theorems, externalities and public goods, ordinal and cardinal social welfare functions, interdependent utility functions, insurance market failures, optimal income taxation, negative income taxes, targeting, in-kind transfers, and unfunded public pensions. We will discuss how these topics relate to actual welfare states programs.

The following list articles will be covered; many are regarded as seminal contributions. (An asterisk means that reading the full paper is indispensable. Where there is no asterisk, the paper may contain considerably more material than will be discussed in class; in those cases, my lecture notes are sufficient and reading the paper, though recommended, is regarded as optional.)

Topics and Reading List

A. Economic Efficiency and the Fundamental Theorems of Welfare Economics

- Introduction to Economic Theory of the Welfare State: History and Issues

Reading:

- Barr, N.A. (1992) Economic Theory and the Welfare State: A Survey and Interpretation, *Journal of Economic Literature* 30: 741-803.

- Pareto Efficiency (1/2 lecture)

Reading:

- Bator, F.M. (1957) The Simple Analytics of Welfare Maximization, *American Economic Review* 47: 22-59.

- Competitive Equilibrium and the Theorems of Welfare Economics (1/2 lecture)
- Classic Market Failures (1 lecture)

Readings:

- Bator, F.M. (1958) The Anatomy of Market Failure, *Quarterly Journal of Economics* 72: 351-79.
- Meade, J. (1952) External Economies and Diseconomies in a Competitive Situation, *Economic Journal* 62: 54-76.
- Bowen, H.R. (1943) The Interpretation of Voting in the Allocation of Economic Resources, *Quarterly Journal of Economics* 58: 27-48.
- Samuelson, P. (1955) Diagrammatic Exposition of a Theory of Public Expenditures, *Review of Economics and Statistics* 37: 350-6.
- Samuelson, P. (1954) The Pure Theory of Public Expenditures, *Review of Economics and Statistics* 36: 387-9.
- Thurow, L. (1971) Income Distribution as a Pure Public Good, *Quarterly Journal of Economics* 85: 327-36.

B. Applications of Pareto Optimality

- Incentives and Excess Burden (1 lecture)

Readings:

- Aaron, H. and G. von Furstenberg (1971) The Inefficiency of Transfers in Kind: The Case of Housing Assistance, *Western Economic Journal* 9, 184-191.
- Lindbeck, A. (1993) Tax Effects versus Budget Effects on Labor Supply, in *The Welfare State: the Selected Papers of Asser Lindbeck, Volume II* (Adelshot: Edward Elgar).

- Pareto Optimal Transfers (1 lecture)

Readings:

- Hochman, H. and J. Rodgers (1969) Pareto Optimal Distribution, *American Economic Review* 59: 542-557. (*)
- Olson, E.O. (1971) Subsidized Housing in a Competitive Market: Reply, *American Economic Review* 61: 220-224.

- Second-Best Methods for Income Redistribution (1.5 lectures)

Readings:

- Browning, M. and Johnson (1984) The Tradeoff Between Equality and Efficiency, *Journal of Political Economy* 92: 175-203. (*)
- Barr, N. (1975) Negative Income Taxation and the Redistribution of Income, *Oxford Bulletin of Economics and Statistics* 37: 29-48. (*)
- Hanushek, E., C.K.Y. Leung, and K. Yilmaz (2003) Redistribution Through Education and Other Transfer Mechanisms, *Journal of Monetary Economics* 50: 1719-1750.

C. Social Welfare Functions

- Ordinal Social Welfare Functions (1/2 lecture)

Reading:

- Samuelson, P. (1956) Reaffirming the Existence of Reasonable Bergson-Samuelson Social Welfare Functions, *Economica* 44: 81-88. (*)
- Samuelson, P. (1967) Arrow's Mathematical Politics. In Hook, S. (ed.), *Human Values and Economic Policy* (New York: New York University Press).

- Cardinal Social Welfare Functions (1/2 lecture)

Reading:

- Harsanyi, J. (1955) Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparisons of Utility, *Journal of Political Economy* 63: 309-21. (*)

- Inequality and Social Welfare Functions (1/2 lecture)

Reading:

- Atkinson, A. (1970) On the Measurement of Inequality, *Journal of Economic Theory* 55: 749-764. (*)

D. Applications of Social Welfare

- Optimal Income Taxation (1 lecture)

Readings:

- Stern, H.N. (1976) On the Specification of Models of Optimum Income Taxation, *Journal of Public Economics* 6: 123-162. (*)
- Atkinson, A. and J. Stiglitz (1980) The Structure of Income Taxation, chapter 13 in *Lectures on Public Economics*. (*)
- Stiglitz, J. (1982) Self-Selection Pareto Efficient Taxation, *Journal of Public Economics* 17: 213-240.

- Incentive Compatible Transfers Mechanisms (1.5 lectures)

Readings:

- Akerlof, G. (1978) The Economics of "Tagging" As Applied to the Optimal Income Tax, Welfare Programs, and Manpower Planning, *American Economic Review* 68: 8-19. (*)
- Blackorby, C. and D. Donaldson (1988) Cash versus Kind, Self-Selection, and Efficient Transfers, *American Economic Review* 78: 691-700. (*)
- Bruce, N. and M. Waldman (1991) Transfers in Kind: Why They Can Be Efficient and Nonpaternalistic, *American Economic Review* 81: 1345-1351.

F. Insurance Market Failures

- Insurance Against Illness and Unemployment (1 lecture)

Readings:

- Rothschild, M. and J.E. Stiglitz (1976) Equilibrium in Competitive Insurance Markets, *Quarterly Journal of Economics* 90: 629-650. (*)
- Pauly, M.V. (1974) Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection, *Quarterly Journal of Economics* 88: 44-62.
- Dahlby, B. (1981) Adverse Selection and Pareto Improvement through Compulsory Insurance, *Public Choice* 37: 547-558.
- Pauly, M.V. (1968) The Economics of Moral Hazard: Comment, *American Economic Review* 58: 531-537. (*)
- Arrow, K. (1963) Uncertainty and the Welfare Economics of Medical Care, *American Economic Review* 53: 942-953.
- Green, D. and W.C. Riddell (1993) The Economic Effects of Unemployment Insurance in Canada: An Empirical Analysis of UI Disentitlement, *Journal of Labor Economics* 11: S96-S147.

- Annuities and Public Pensions (1.5 lectures)

Readings:

- Feldstein, M. (1985) The Optimal Level of Social Security Benefits, Quarterly Journal of Economics 100: 303-320. (*)
- Feldstein, M. (1974) Social Security, Induced Retirement and Aggregate Capital Accumulation, Journal of Political Economy 82: 905-926. (*)
- Barr, N. (1979) Myths My Grandpa Taught Me, Three Banks Review 124: 27-55.
- Samuelson, P. (1958) An Exact Consumption Loan Model of Interest With and Without the Contrivance of Money, Review of Economics and Statistics 66.

- Social Insurance (1 lecture)

Readings:

- Varian, H. (1980) Redistributive Taxation as Social Insurance, Quarterly Journal of Economics 14: 49-68. (*)
- Eaton, J. and H.S. Rosen (1980) Optimal Redistributive Taxation and Uncertainty, Quarterly Journal of Economics 357-364.

Grade Determination and Final Examination Details:

There will be four assignments, worth 10 percent each; a mid-term exam worth 20 percent; and a final exam worth 40 percent. The tentative date for the midterm exam is Wednesday, March 2 from 6:30-8:30 PM.

Tests and final exams are marked on a numerical (percentage) basis, then converted to letter grades. The course grade is then calculated using the weights indicated above. As a guide to determining standing, these letter grade equivalences will generally apply:

A+	90-100	B	70-74	C-	56-58
A	85-89	B-	65-69	D+	53-55
A-	80-84	C+	62-64	D	50-52
B+	75-79	C	59-61	F	0-49

If, for some reason, the distribution of grades determined using the aforementioned conversion chart appears to be abnormal the instructor reserves the right to change the grade conversion chart if the instructor, *at the instructor's discretion*, feels it is necessary to more fairly represent student achievement.

A passing grade on any particular component of the course is not required for a student to pass the course as a whole.

Non-programmable calculators will be allowed during the writing of tests or final examinations.

There will be a 3 hour final examination scheduled by the Department of Economics.

Tests and exams will not involve multiple choice questions.

Notes:

Students seeking reappraisal of a piece of graded term work (term paper, essay, etc.) should discuss their work with the Instructor within two weeks of the work being returned to the class.

Safewalk / Campus Security: 220-5333

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