



Department of Economics Course Outline

Term: Winter 2006

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 theory of Public Economics, with a particular focus on ideas and methods relevant for understanding the economics of "welfare state" programs, such as unemployment insurance, pensions, health care, subsidized 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, social welfare functions, interdependent utility functions, insurance market failures, optimal income taxation, negative income taxes, 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

- General Equilibrium and Pareto Efficiency (1 lecture)

Reading:

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

- Classic Market Failures (1 lecture)

Reading:

- Bator, F.M. (1958) The Anatomy of Market Failure, *Quarterly Journal of Economics* 72: 351-79.
- Bowen, H.R. (1943) The Interpretation of Voting in the Allocation of Economic Resources, *Quarterly Journal of Economics* 58: 27-48.
- Meade, J. (1952) External Economies and Diseconomies in a Competitive Situation, *Economic Journal* 62: 54-76.
- 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.

- Incentives and Excess Burden (1 lecture)

Reading:

- 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)

Reading:

- Hochman, H. and J. Rodgers (1969) Pareto Optimal Distribution, *American Economic Review* 59: 542-57. (*)
- Thurow, L. (1971) Income Distribution as a Pure Public Good, *Quarterly Journal of Economics* 85: 327-36.
- Olson, E.O. (1971) Subsidized Housing in a Competitive Market: Reply, *American Economic Review* 61: 220-224.

B. Social Welfare Functions

- Ordinal Social Welfare Functions (1 lecture)

Reading:

- Jorgenson, D. (1990) Aggregate Consumer Behavior and the Measurement of Social Welfare, *Econometrica*, September.
- Samuelson, P. (1956) Reaffirming the Existence of Reasonable Bergson-Samuelson Social Welfare Functions, *Economica* 44: 81-98. (*)

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

Reading:

- Atkinson, A. (1970) On the Measurement of Inequality, *Journal of Economic Theory* 55: 749-764. (*)
- Shorrocks, A.F. (1983) Ranking Income Distributions, *Economica* 50: 3-17.

C. Limits to Redistribution

- Equity Versus Efficiency Tradeoff (1 lecture)

Reading:

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

- Incentive Compatibility and In-Kind Transfers (1/2 lecture)

Reading:

- Blackorby, C. and D. Donaldson (1988) Cash versus Kind, Self-Selection, and Efficient Transfers, *American Economic Review* 78: 691-700. (*)

D. Linear Progressive Income Taxation

- Optimal Linear Income Taxation (1 lecture)

Reading:

- Atkinson, A. and J. Stiglitz (1980) The Structure of Income Taxation, chapter 13 in *Lectures on Public Economics*. (*)
- Slemrod, J. and Yitzhaky, S. and J. Mayshar (1991) The Optimal Two-Bracket Linear Income Tax, NBER No. 3847. (*)
- Stern, H.N. (1976) On the Specification of Models of Optimum Income Taxation, *Journal of Public Economics* 6: 123-62. (*)

- Stiglitz, J. (1982) Self-Selection Pareto Efficient Taxation, *Journal of Public Economics* 17: 213-40.

E. Insurance Market Failures

- Insurance Against Illness and Unemployment (1 lecture)

Reading:

- Arrow, K. (1963) Uncertainty and the Welfare Economics of Medical Care, *American Economic Review* 53: 942-73.
- Dahlby, B. (1981) Adverse Selection and Pareto Improvement through Compulsory Insurance, *Public Choice* 37: 547-58.
- 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.
- 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.
- Pauly, M.V. (1968) The Economics of Moral Hazard: Comment, *American Economic Review* 58: 531-537. (*)
- Rothschild, M. and J.E. Stiglitz (1976) Equilibrium in Competitive Insurance Markets, *Quarterly Journal of Economics* 90: 629-650. (*)
- Social Insurance (1 lecture)

Reading:

- Atkinson, A.B. (1991) Social Insurance: The Fifteenth Annual Lecture of the Geneva Association *Review* 38: 883-889.
- Dworkin, R. (1993) Justice in the Distribution of Health Care, *McGill Law Review* 38: 883-898.
- Eaton, J. and H.S. Rosen (1980) Optimal Redistributive Taxation and Uncertainty, *Quarterly Journal of Economics* 95: 357-364.
- Varian, H. (1980) Redistributive Taxation as Social Insurance, *Quarterly Journal of Economics* 14: 49-68. (*)
- Annuities and Public Pensions (1 lecture)

Reading:

- 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: 905-26. (*)

F. Time Inconsistency

- Time Consistent Transfers (1 lecture)

Reading:

- Bruce, N. and M. Waldman (1991) Transfers in Kind: Why They Can Be Efficient and Nonpaternalistic, *American Economic Review* 81: 1345-51.