

Public Finance
Econ 330-001, Fall 2019

Instructor: Joshua K. Bedi (I don't have a PhD yet, so you can just call me Josh)

Class Time: Tuesday, 7:20-10:00 PM

Class Location: Robinson Hall B111

Office Hours: Monday 1:00 PM – 3:00 PM

Friday 1:00 PM – 3:00 PM

If the above times do not work for you, I can also meet by appointment

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Course Overview

This course provides an economic analysis of the finances of public institutions, with public institutions usually taking the form of some type of government. Modern democratic governments directly control more than a third of gross national product (GDP) and influence much of the rest through fiscal and regulatory policies. In analyzing the public sector, we note that public sector economics differs slightly from private sector economics. In private sector economics, or a market economy, each person makes her choice; in public sector economics a group of individuals must bargain and agree on a set of choices and rules that will affect everyone in that group. If private sector economics is the economics of two, public sector economics is the economics of three or more.

Traditionally, public economics has dealt with the finances of public institutions, usually taking the form of government. In turn, public finance is a field of public sector economics that examines aspects of the public sector such as government spending (expenses), taxation (revenue), and debt. However, I will interpret public finance rather broadly and delve into other aspects of public sector economics.

In this course, we will cover the traditional topics of public finance. We also cover intergovernmental financial relationships; types, incidences, and consequences of taxation; other sources of governmental income; governmental expenditures and their effect; public economic enterprises; public borrowing; and debt management and its economic effect.

Importantly, we will be utilizing traditional tools in the economic way of thinking in order to analyze government behavior and its effects. This means we will treat political actors as rational, selfish, utility-maximizing individuals, much like we do with private actors like firms and households. While the context may differ between public and private sector economic analysis, the rules of rational, individual decision-making still apply in the public sector, and incentives, opportunity costs, and scarcity remain important concepts even when analyzing the public sector. Most importantly, although public sector economics is the economics analysis of three or more individuals, it is important to remember that concepts like “collective interest” or the “will of the American people” are vacuous phrases – collectives do not make choices, only individuals. It is not America that decides on policy, but a multitude of bargaining individuals operating within

and changing sets of rules. Much like a market economy is a spontaneous order, so too is the political economy.

Prerequisites: Intermediate Microeconomics (ECON 306)

Required Reading:

Randy Holcombe, Public sector economics: the role of government in the American economy, Prentice Hall 2006 – This will be the main text with which I work and the only text you will need to purchase. All other reading I assign will be provided by me either through email or Blackboard.

Grading:

The following assignment weights are my contract with you. While I will not accept late work and will not provide make-up opportunities, I will also not deviate from this weighting system. However, if for some reason you are unable to attend an exam day (or you just don't want to attend), I will allow every student the chance to forgo taking one midterm exam (you must take the final). If a student elects this option, the midterm the student takes will count double, regardless of the score (so choose wisely).

Daily Reading Quizzes: 15%

Final Exam: 30%

Midterm 1: 20%

Midterm 2: 20%

Homework: 15%

To encourage participation, I will also grant a “bonus” opportunity at the end of the semester. I will keep track throughout the semester of who contributes to class discussion. If, at the end, I decide you have contributed enough to class discussion throughout the semester, I will boost your final grade by one deviation (so, if you end with an B+, I will give you an A-; if you end with a C-, I will give you a C, etc.) If you are worried I will be unable to match your face with your name and that you deserve this boost, you may email me a headshot with your name at the end of the semester. However, whether or not I give this boost will be up to my discretion.

Disability Resource Center:

If you are a student with a disability requiring academic accommodation, you will need to contact the Disability Resource Center (703-993-2474). All academic accommodations must be arranged through that office.

Honor Code:

Students must know and follow the George Mason University Honor Code. If I catch you cheating on an assignment, I will, at the very least, grant you a 0 on that assignment, and, at the most, I will grant you a 0 for the entire course. I lean towards the latter option, because the first time a student is caught cheating (much like the first time a thief is caught stealing) is rarely the first time that student has cheated.

Schedule:

Unlike the grading weights for this course, the schedule and readings are subject to change at my discretion, but I promise to leave you ample time to readjust your schedules if I decide to make such a change.

1. 08/27/19: Introduction and Principles for Analyzing Government

Politics and Economics, The Activities of Government, The Market Economy, The Role of Government, The Market System and Individual Rights, The “Public Interest” (why is this in quotes?), The Pareto Criteria, Other Measures Of “The Public Interest,” Positive and Normative Economics, Equity And Efficiency: The Goals of Public Policy

Readings: Holcombe Chapters 1 & 2

Read, Leonard E. *I, pencil*. Vol. 8. No. 12. Freeman, 1958:

<https://fee.org/resources/i-pencil/>

Hayek, Friedrich August. "The use of knowledge in society." *The American economic review* 35.4 (1945): 519-530:

<https://object.cato.org/sites/cato.org/files/articles/hayek-use-knowledge-society.pdf>

Hayek, Friedrich August. "Why the Worst Get on Top." *The Road to Serfdom* (1944):

https://fee.org/resources/the-road-to-serfdom-chapter-10-why-the-worst-get-on-top/?gclid=CjwKCAjw7O_pBRA3EiwA_lmtfhIRY_S6vqwtCfu3P4Q4e-BmhPrRM-u4TU7N4qghNurDy_Q2_lmbvxocUcQQAvD_BwE

2. 09/03/19: Property Rights and Economic Efficiency and Positive Principles of Taxation

Property Rights, Poorly Defined Property Rights, Overuse of Resources with poorly defined property rights, The Coase Theorem, Small Numbers and Large Numbers, The Common Pool Problem, Government versus Private Ownership, Property Rights and Entitlements, Land Use Planning, Tax Shifting, Elasticities and Tax Incidence, The Welfare Cost of Taxation, Excess Burden and Individual Choice, Minimizing the Excess Burden of Taxation, Additional Costs of the Tax System, Earmarked Taxes

Readings: Holcombe Chapters 3 & 10

Demsetz, Harold. "Toward a theory of property rights." *Classic papers in natural resource economics*. Palgrave Macmillan, London, 1974. 163-177:

https://econ.ucsb.edu/~tedb/Courses/Ec100C/Readings/Demsetz_Property_Rights.pdf

3. 9/10/19: Principles of Tax Policy, Taxes on Economic Transactions, and the Taxation of Income

The Benefit Principle; The Ability to Pay Principle; Implementing Ability to Pay; Progressive, Proportional, and Regressive Taxes; Sumptuary Taxes; Politics and Tax Policy; Tax Policy in the Real World; Excise Taxes, Unit Taxes, and Ad Valorem Taxes; User Charges; Import and Export Taxes and Quotas (let's talk about immigration); General Sales Taxes; Turnover Taxes; The Value Added Tax; Sales, Consumption, and Income Taxes; Definitions of Income; The Income-Leisure Trade-Off; The Backward-Bending Supply Curve of Labor; Tax Rates and Tax Revenues; Average and Marginal Tax Rates; The Double Tax on Saving (what are other things that are double taxed? private education? anything else?)

Readings: Holcombe Chapters 11, 12, & 13

4. 9/17/19: Public Debt and The Government Budgeting Process

The Government Budget Constraint; The Federal Budgeting Process; Incrementalism; Politics and the Federal Budget; Entitlements; Off-Budget Expenditures; Program Budgets vs. Line Item Budgets; Cost-Benefit Analysis; The Discount Rate; Average and Marginal Benefits; Taxing and Spending
Readings: Holcombe Chapter 17

5. 9/24/19: Midterm I

6. 10/1/19: Externalities and Public Goods

The definition of an Externality; Public Policy Towards Externalities; Negative Externalities in a Supply and Demand Framework; Taxation vs. Regulation; Marketable Pollution Rights; The Optimal Amount of Pollution; Positive Externalities (is education a positive externality?); Technological and Pecuniary Externalities; Marginal and Inframarginal Externalities; Collective Consumption Goods; The Optimal Output of a Collective Consumption Good; Pure and Impure Collective Consumption Goods; Public Policy Toward Collective Consumption Goods; Non-excludability; Non-excludability and Collective Consumption in Public Goods; Public Policy Toward Public Goods
Readings: Holcombe Chapters 4 & 5

7. 10/8/19: The Economic Role of the State and A Theory of Collective Action

Protection of Rights; Government Production; Government Regulation; The Capture Theory of Regulation; Redistribution; Stabilization; Can the Government Perform These Functions; Will the Government Perform These Functions; The Free Rider Problem; The Holdout Problem; Consent and Coercion; Collective Action and Collective Decision Making; The Pareto Principle and the Rule of Unanimity; Optimal Departures from Unanimity; Optimal Club Output and Club Size; Representative Democracy; The Economic Model of Democracy; Optimal Constitutional Rules; The Evolution of Cooperation; The Normative Basis for Government
Readings: Holcombe Chapters 6 & 7

8. 10/15/19: Taxation and Redistribution and Government Redistribution Programs

Principles of Taxation and Redistribution; Equality as a Social Goal; Equality of Opportunity and Equality of Results; The Goal of Equality; Charity as a Collective Consumption Good; Progressive Taxation and Wage Adjustment; Distributive Government; Redistributive Programs and the Poor; The Politics of Redistribution; Cash vs. Payment in Kind (do we care about poor people or do we care about poor people getting milk?); The Negative Income Tax (a guaranteed minimum income with incentives); Temporary Aid to Needy Families; Food Stamps (what are the perverse incentives associated with this program?); Housing Subsidies; Homelessness
Readings: Holcombe Chapters 18 & 19

9. 10/22/19: Public Sector Demand

The Median Voter Model; Representative Democracy; The Cyclical Majority; Information and Incentives; Public Sector Demand in Theory and in the Real World; Economic Efficiency and the Median Voter; Meltzer-Richard's Model
Readings: Holcombe Chapter 8

Meltzer, Allan H., and Scott F. Richard. "A rational theory of the size of government." *Journal of political Economy* 89.5 (1981): 914-927:
<https://www-jstor-org.mutex.gmu.edu/stable/pdf/1830813.pdf?refreqid=excelsior%3Ad90eb146b42929b0e5e03866d750ee71>

10. 10/29/19: Supply and Demand in Political Markets

Special Interests and Government Programs; Logrolling and Political Exchange; Agenda Control; Rent Seeking; Public Sector Suppliers; The Public Sector Bargaining Process; The Government as an Interest Group; Fiscal Federalism

Readings: Holcombe Chapter 9

Tullock, Gordon. "The welfare costs of tariffs, monopolies, and theft." *Economic Inquiry* 5.3 (1967): 224-232:
<http://cameroneconomics.com/tullock%201967.pdf>

11. 11/5/19: Other Theories of Public Choice

The Myth of Democratic Failure; The Myth of the Rational Voter

Readings: Wittman, Donald. "Why democracies produce efficient results." *Journal of Political Economy* 97.6 (1989): 1395-1424:

<https://www-jstor-org.mutex.gmu.edu/stable/pdf/1833245.pdf?refreqid=excelsior%3Aa8748499d4f517ba14734bc3a2e84a74>

Caplan, Bryan. "Rational irrationality and the microfoundations of political failure." *Public Choice* 107.3-4 (2001): 311-331:
<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.412.9748&rep=rep1&type=pdf>

12. 11/12/19: Midterm II

13. 11/19/19: Social Security and Education

The Social Security Payroll Tax; The Burden of the Payroll Tax; Coverage; The Pay-as-You-Go System of Financing; The Political Determination of Benefits and Costs; Social Security and Capital Accumulation; The Growth of the Social Security Program; Social Security as an Investment; The Future of Social Security; Proposals for Reform; The Growth in Education: Students and Expenditures (do we have too many literate people in the U.S.); Rationales for Government Involvement; The Level of Government Financing; Competition, Vouchers, and School Choice; The Payoff to Education

Readings: Holcombe Chapters 20 & 21

14. 11/26/19: Health Care and Public Defense

Rationales for Government Involvement; Public Health; Health Insurance; Moral Hazard and Adverse Selection; Health Insurance Incentives; The Evolution of Twentieth-Century Health Care; Government Health Care Programs; Health Care Reform; Interest Groups and Health Care Reform; The Level of Military Expenditures; Military Procurement Contracts; Procurement vs. Life-Cycle Costs; Conscription vs. Volunteers (why do we use more physical capital than we did in the Vietnam War); Is National Defense Really a Public Good

Readings: Holcombe Chapters 22 & 23

15. 12/3/19: Dictatorship and Anarchy

The Economics of Autocracy and Majority Rule; The Paradox of Public Goods Provision (are they really public goods); Is Government Necessary or Inevitable

Readings: McGuire, Martin C., and Mancur L. Olson Jr. "The economics of autocracy and majority rule." (1996): 72-96:

<https://www-jstor-org.mutex.gmu.edu/stable/pdf/2729410.pdf?refreqid=excelsior%3Aa2ca8af9282b4036f02eedd13abb7cf3>

Holcombe, R. "Government: Unnecessary but inevitable." *Stringham E* (2007): 354-370:

https://www.independent.org/pdf/tir/tir_08_3_1_holcombe.pdf

Leeson, Peter T., and Edward P. Stringham. "Is government inevitable? Comment on Holcombe's analysis." *The Independent Review* 9.4 (2005): 543-549:

https://www.peterleeson.com/Is_Gov_t_Inevitable.pdf

Holcombe, Randall G. "Is government inevitable? Reply to Leeson and Stringham." *The Independent Review* 9.4 (2005): 551-557:

<https://www-jstor-org.mutex.gmu.edu/stable/pdf/24562085.pdf?refreqid=excelsior%3A00bb8d669d34862707462916c55538b6>

16. 12/7/19: Final Exam