

Economics 576
Economics of Taxation
Syllabus
Spring 2009

Class

Meeting Time: Thursdays, 6pm-8:30pm

Meeting Place: Grant Hall, Room 205

Instructor

Nathan B. Anderson

Office: University Hall, Room 716

Office Hours: Wednesdays, 9am-11am; also by appointment

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Economics 576: The Course

This is a course for Ph.D. students in the economics department. The principal objective of this course is to provide a working knowledge of modern theoretical and empirical techniques for investigating the effects of taxation on economic behavior. Careful consideration is given to the features of sound tax policy design. The course emphasizes tools necessary to understand the economics literature and its implications for current tax policy issues.

Readings

The bulk of the readings will be journal articles. I will attempt to provide links to papers via Blackboard. If you have never taken a class in public finance before, it would be helpful to read through the tax chapters in *Public Finance* (now in its 8th edition) by Harvey Rosen and Ted Gayer, an undergraduate textbook. Substitute other undergraduate public finance books according to your preferences. A good way to acquire some background on the U.S. income tax system and the issues surrounding tax reform is to master the excellent *Taxing Ourselves: A Citizens Guide to the Debate over Taxes* (fourth edition), by Joel Slemrod and Jon Bakija.

Short Responses

During each class I may announce a question to which you must hand in a written response the following week. Questions will be posted online following the class meeting. Each response must be 250 words or less. Some of these questions will be similar to a problem set, while others will be of a more discursive or speculative nature. Class discussion on the due date or on a following class may address the topic of the weekly response, and you may be asked to discuss and defend your response and comment on what other students have to say.

Short Research Papers

Two short research papers are required, each of no longer than 1000 words.

Paper # 1: Describe the tax system of a U.S. state or a foreign country. The paper should use data and economic analysis to (1) describe current major sources of revenue and tax rates, (2) describe the recent history (20-30 years) of the tax system, (3) discuss and

describe any major reforms of the tax system, and (4) evaluate the tax system in terms of equity, efficiency, and simplicity.

Paper #1 Due: Thursday March 19, 2009

Paper # 2: A brief report on a research paper or group of papers, published or not, related to the economics of taxation. Find a paper that you find interesting and which could provide a potential starting point for new research, preferably yours. State what you like about the work and where you think it made a contribution to existing knowledge. Also state where you think there might be room for improvement and where it would be most interesting to take the work further. Be detailed, realistic, and focused in both your criticisms and your suggestions. Make sure to (1) clearly define the contribution of the original paper(s), (2) defend why your suggestion for improvement or advancement is important enough to warrant attention, and (3) state what are likely to be the important theoretical or empirical problems to be overcome. Generally it is a good idea to look at newer literature, possibly still in working paper form, but if you have reason to believe that an old work with some insight still needs following up on, go for it.

Paper #2 Due: Thursday April 30, 2009

Examinations

There will be a final examination given on Thursday, May 7 at the regular class time. Another exam will be given in class on Thursday, February 19. Both exams will be closed-book, and only verified medical documentation will be accepted to excuse not taking either exam at the scheduled time. Exams will be based mostly on material discussed in lectures. Some questions, however, may refer to material only explained fully in the required reading.

Guidelines for Collaboration and Outside Sources

Discussion with other students about the response questions or the research papers is acceptable and encouraged, but the composition of written assignments should be done individually. Consulting published or Internet sources is also encouraged, but any source that materially influences your views should be acknowledged, and plagiarism is not acceptable and will be handled according to standard University procedures.

Grading

- Short Responses: 15%
- Research Papers: 40% (20% each)
- Exam # 1: 15%
- Final Exam: 30%

Useful References

J. Slemrod and J. Bakija. *Taxing Ourselves: A Citizens Guide to the Debate over Tax Reform*. Fourth edition. (Cambridge: MIT Press, 2008).

L. Kaplow. *The Theory of Taxation and Public Economics*. (Princeton: Princeton University Press, 2008).

B. Salanie, *Economics of Taxation*. (Cambridge: MIT Press, 2002).

G. Myles, *Public Economics*. (New York: Cambridge University Press, 1995).

A. Atkinson and J. Stiglitz, *Lectures in Public Economics* (New York: McGraw Hill, 1980).

J. Gruber, *Public Finance and Public Policy*. Second Edition. (New York: Cambridge University Press).

H.S. Rosen and T. Gayer. *Public Finance*. Eighth edition. (McGraw-Hill, 2008).

Tax Policy Center web site, at <http://taxpolicycenter.org>

Tax Incidence

★ Don Fullerton and Gilbert E. Metcalf, “Tax incidence,” in Alan J. Auerbach and Martin Feldstein, eds. *Handbook of Public Economics*, vol. 4 (Amsterdam: North Holland, 2002), 1787-1872.

★ Lawrence Summers, “Some simple economics of mandated benefits,” *American Economic Review*, May 1989, 79 (2), 177-184.

★ James R. Hines Jr., John C. Hlinko, and Theodore J.F. Lubke, “From each according to his surplus: Equi-proportionate sharing of commodity tax burdens,” *Journal of Public Economics*, November 1995, 58 (3), 417-428.

★ Kenneth T. Rosen, “The impact of Proposition 13 on house prices in northern California: A test of the interjurisdictional capitalization hypothesis,” *Journal of Political Economy*, February 1982, 90 (1), 191-200.

★ Oded Palmon and Barton A. Smith, “New Evidence on Property Tax Capitalization,” *Journal of Political Economy*, 1998, 106 (5), 1099-1111.

Laurence Kotlikoff and Lawrence Summers, “Tax incidence,” in Alan J. Auerbach and Martin Feldstein eds. *Handbook of Public Economics*, vol. 2 (Amsterdam: North Holland, 1987), 1043-1092.

★ BOGART, W. T., D. F. BRADFORD, AND M. G. WILLIAMS (1992): “Incidence Effects of a State Fiscal Policy Shift: The Florio Initiatives in New Jersey,” *National Tax Journal*, 45(4), 371–387. Timothy J. Besley and Harvey S. Rosen, “Sales taxes and prices: An empirical analysis,” *National Tax Journal*, June 1999, 52 (2), 157-178.

Arnold C. Harberger, “The incidence of the corporation income tax,” *Journal of Political Economy*, 1962, 215-240.

Joseph A. Pechman, *Who paid the taxes, 1966-1985?* (Washington, DC: Brookings, 1985).

James Poterba, “Lifetime incidence and the distributional burden of excise taxes,” *American Economic Review*, May 1989, 79 (2), 325-330.

David F. Bradford, “Factor prices may be constant but factor returns are not,” *Economic Letters*, 1978, 1, 199-203.

T. Nechyba. “The Benefit View and the New View: Where do we stand 25 years into the debate?” in Wallace Oates editor, *Property Taxation and Local Public Finance* (Lincoln Institute Press: Cambridge, MA, 2002), 113-21.

Martin Feldstein, “The surprising incidence of a tax on pure rent: A new answer to an old question,” *Journal of Political Economy*, 1977, 349-360.

George Fane, “The incidence of a tax on pure rent: The old reason for the old answer,” *Journal of Political Economy*, April 1984, 92, 329-333.

MCDONALD, J. F. (1993): “Incidence of the property tax on commercial real estate: The case of downtown Chicago,” *National Tax Journal*, 46(2), 109–120.

Deadweight Loss

★ Auerbach, Alan J., and James R. Hines Jr., “Taxation and Economic Efficiency,” in Alan J. Auerbach and Martin Feldstein eds., *Handbook of Public Economics*, vol. 3 (Amsterdam: North-Holland, 2002), 1347-1421.

★ Alan J. Auerbach, “The Theory of Excess Burden and Optimal Taxation” in A. Auerbach and M. Feldstein eds., *Handbook of Public Economics*, Vol. 1 (Amsterdam: North-Holland, 1985) secs. 1.1 to 5.4, pp. 61-101 only.

Hines, James R., Jr., 1999, “Three sides of Harberger triangles,” *Journal of Economic Perspectives* 13, 167-188.

Slesnick, Daniel T., 1998, “Empirical approaches to the measurement of welfare,” *Journal of Economic Literature* 36, 2108-2165.

Optimal Taxation and Optimal Tax Systems

★ Auerbach, Alan J., and James R. Hines Jr., “Taxation and Economic Efficiency,” in Alan J. Auerbach and Martin Feldstein eds., *Handbook of Public Economics*, vol. 3 (Amsterdam: North-Holland, 2002), 1347-1421.

★ J. Slemrod, “Optimal Taxation and Optimal Tax Systems,” *Journal of Economic Perspectives*, 4 No. 1 (Winter, 1990): 157-178.

Agnar Sandmo, “Optimal Taxation: An Introduction to the Literature,” *Journal of Public Economics*, 6 No. 1-2 (July/August, 1976): 37-54.

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Saez, Emmanuel, “The desirability of commodity taxation under non-linear income taxation and heterogeneous tastes,” *Journal of Public Economics*, 2002, 83, 217-230.

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James Mirrlees, “An Exploration in the Theory of Optimum Income Taxation,” *Review of Economics Studies*, 38 No. 2 (April, 1971): 175-208.

J. Slemrod, S. Yitzhaki, J. Mayshar, and M. Lundholm, “The Optimal Two-Bracket Linear Income Tax,” *Journal of Public Economics*, 53 No. 2 (February, 1994): 269-90.

Saez, Emmanuel, “Using elasticities to derive optimal income tax rates,” *Review of Economic Studies*, 2001, 68, 205-229.

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Deaton, Angus, “Econometric Issues in Tax Design for Developing Countries,” in D. Newbery and N. Stern eds., *The Theory of Taxation for Developing Countries* (Oxford: Oxford University Press, 1987) pp. 92-113.

Effect of Taxation on Economic Behavior

- ★ FELDSTEIN, M. S. (2008): “Effects of Taxes on Economic Behavior,” *NBER Working Paper Series*.

Measurement of Behavioral Responses

- ★ TRIEST, R. K. (1998): “Econometric Issues in Estimating the Behavioral Response to Taxation: A Nontechnical Introduction,” *National Tax Journal*, 51(4), 761–762.
- ★ SLEMROD, J. (1998): “Methodological Issues in Measuring and Interpreting Taxable Income Elasticities,” *National Tax Journal*, 51(4), 773–788.
- FEENBERG, D. R. (1987): “Are Tax Price Models Really Identified: The Case of Charitable Giving,” *National Tax Journal*, 40(4), 629–633.

Behavioral Response: Taxable Income

- ★ FELDSTEIN, M. S. (1999): “Tax Avoidance and the Deadweight Loss of the Income Tax,” *The Review of Economics and Statistics*, 81(4), 674–680.
- ★ GRUBER, J., AND E. SAEZ (2002): “The elasticity of taxable income: Evidence and implications,” *Journal of Public Economics*, 84, 1–32.
- AUTEN, G., AND R. CARROLL (1999): “The effect of income taxes on household income,” *Review of Economics and Statistics*, 81, 981–693.
- KOPCZUK, W. (2005): “Tax bases, tax rates, and the elasticity of reported income,” *Journal of Public Economics*, 89(11-12), 2093–2119.

Behavioral Response: Labor Supply

- ★ EISSA, N., AND J. B. LIEBMAN (1996): “Labor Supply Response to the Earned Income Tax Credit,” *Quarterly Journal of Economics*, 111(2), 605–637.
- BLUNDELL, R. (1996): “Labour Supply and Taxation,” in *The Economics of Tax Policy*, ed. by M. Devereux, pp. 107–136. Oxford University Press.

BLUNDELL, R., A. S. DUNCAN, AND C. MEGHIR (1998): “Estimating Labor Supply Responses Using Tax Reforms,” *Econometrica*, 66(4), 827–61.

EISSA, N. (1996): “Tax Reforms and Labor Supply,” in *Tax Policy and The Economy*, ed. by J. Poterba, vol. 10, pp. 119–151. MIT Press.

Investment and Investment Location

LUTZ, B. F. (2006): “How Elastic Is Residential Capital Investment to Property Taxation? Evidence from Court Induced Tax Changes,” Board of Governors of the Federal Reserve, unpublished manuscript.

HINES, J. R. (1996): “Altered States: Taxes and the Location of Foreign Direct Investment,” *American Economic Review*, 86(5), 1076–1094.

Tax Evasion and Tax Avoidance

★ SLEMROD, J. (2007): “Cheating Ourselves: The Economics of Tax Evasion,” *Journal of Economic Perspectives*, 21(1), 25–48.

★ ALLINGHAM, M. G., AND A. SANDMO (1972): “Income Tax Evasion: A Theoretical Analysis,” *Journal of Public Economics*, 1(3-4), 323–338.

SLEMROD, J. (2001): “A General Model of the Behavioral Response to Taxation,” *International Tax and Public Finance*, 8(2), 119–128.

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SIVADASAN, J., AND J. SLEMROD (2008): “Tax Law Changes, Income Shifting, and Measured Wage Inequality: Evidence from India,” *Journal of Public Economics*, 92(10-11), 2199–2224.

SLEMROD, J. (2008): “Does It Matter Who Writes The Check to the Government? The Economics of Tax Remittance,” *National Tax Journal*, 61(2), 251–275.

Fiscal Federalism

★ OATES, W. E. (1999): “An Essay on Fiscal Federalism,” *Journal of Economic Literature*, 37(3), 1120–1149.

★ INMAN, R. P., AND D. L. RUBINFELD (1997): “Rethinking Federalism,” *Journal of Economic Perspectives*, 11(4), 43–64.

★ MUSGRAVE, R. A. (1997): “Devolution, Grants, and Fiscal Competition,” *Journal of Economic Perspectives*, 11(4), 65–72.

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- ZODROW, G. R. (2008): “The Property Tax Incidence Debate and the Mix of State and Local Finance of Local Public Expenditures,” *CESifo Economic Studies*.

Local Governments and Local Taxes

Sorting, Voting, and Taxes: Theory (and some Evidence)

- ★ TIEBOUT, C. (1956): “A Pure Theory of Local Expenditures,” *Journal of Political Economy*, 64, 416–424.
- ★ FERNANDEZ, R., AND R. ROGERSON (1996): “Income Distribution, Communities, and the Quality of Public Education,” *Quarterly Journal of Economics*, 111(1), 135–164.
- ★ EPPLE, D., R. FILIMON, AND T. ROMER (1984): “Equilibrium Among Local Jurisdictions: Toward An Integrated Treatment of Voting and Residential Choice,” *Journal of Public Economics*, 24, 281–308.
- EPPLE, D., AND T. J. NECHYBA (2004): “Fiscal Decentralization,” in *Handbook of Regional and Urban Economics*, ed. by J. Henderson, and J. Thisse, vol. 4, chap. 55, pp. 2424–2480. Elsevier.
- ROSS, S., AND J. YINGER (1999): “Sorting and Voting: A Review Of The Literature On Urban Public Finance,” in *Handbook of Regional and Urban Economics*, vol. 3, chap. 47, pp. 2003–2042. Elsevier Science.
- WESTHOFF, F. (1977): “Existence of Equilibria in Economies With a Local Public Good,” *Journal of Economic Theory*, 14, 84–112.
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- Cost Sharing and Local Demand for Public Services*
- ★ BERGSTROM, T. C., AND R. P. GOODMAN (1973): "Private Demands for Public Goods," *The American Economic Review*, 63(3), 280–296.
- ★ ANDERSON, N. B. (2006a): "Beggar Thy Neighbor? Property Taxation of Vacation Homes," *National Tax Journal*, 59(4), 757–780.
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- BRADFORD, D. F., AND W. E. OATES (1971b): "Towards a Predictive Theory of Intergovernmental Grants," *The American Economic Review Papers and Proceedings*, 61(2), 440–448.
- Tax Limitations*
- ★ CUTLER, D. M., D. W. ELMENDORF, AND R. J. ZECKHAUSER (1999): "Restraining the Leviathan: Property Tax Limitations in Massachusetts," *Journal of Public Economics*, 71(3), 313–334.
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