

ECONOMICS 1410 / KENNEDY SCHOOL SUP-125 Public Economics: Designing Government Policy**Professors Martin Feldstein and Stefanie Stantcheva****Teaching Fellow:** Yazan Al-Karablieh (yzal@g.harvard.edu)

Course Description: This course analyzes what role the government plays and should play in a market economy, especially those policies that work through taxes and government spending. It covers topics such as tax and welfare policy, unemployment insurance, environmental protection, education policy, social security, and the implications of behavioral economics for public policy. The course emphasizes recent empirical and theoretical research on policy issues and will teach students how to conduct such studies.

The first half of the course, taught by Professor Feldstein, will cover the basic principles of public economics. These principles will be used to shed light on current questions and debates on tax policy. The second half of the course, taught by Professor Stantcheva, will discuss recent research papers that extend some of the traditional principles and point toward new theories. This part of the course will also teach students current econometric and theoretical methods used in applied microeconomics.

Prerequisites: Economics 1010a or 1011a or permission of the instructors. Familiarity with multivariate calculus and econometrics (at the level of economics 1123 or 1126) is desirable.

Course Mechanics:

- 1) Lectures – Two lectures per week. MW(F) 2:00 to 3:30 in Sever 102.
- 2) Sections – One per week. Room and time TBA.
- 3) Readings – Jonathan Gruber, *Public Finance and Public Policy* (3rd edition), is the textbook. Other required readings are listed below.
- 4) Assignments will be posted on the course website, which should be checked regularly:

<https://canvas.harvard.edu/courses/9617>

Grading: Grades will be based on a midterm exam (30 percent), final exam (50 percent), and problem sets (20 percent). Senior thesis and master's thesis writers may choose to omit the midterm and have their grade based on the final exam (75 percent) and problem sets (25 percent). Because you will have two weeks to complete each problem set and in order to allow the solutions to be posted quickly on the course webpage, late problem sets will not be accepted.

Term Paper Option: Students may write a term paper that contains *original* research on a topic in public economics. The term paper satisfies the Economics Department's writing requirement for economics concentrators. See below for more details on this option.

Academic accommodations: Students needing academic accommodations because of a documented disability must present their Faculty Letter from the Accessible Education Office (AEO) by Monday, September 18.

Collaboration: Discussion and the exchange of ideas are essential to academic work. You are encouraged to consult with your classmates on the choice of paper topics and to share sources. You may find it useful to discuss your chosen topic with your peers, particularly if you are working on the same topic as a classmate. However, you should ensure that any written work you submit for evaluation is the result of your own research and writing and that it reflects your own approach to the topic. You must also adhere to standard citation practices in this discipline and properly cite any books, articles, websites, lectures, etc. that have helped you with your work. If you received any help with your writing (e.g., feedback on drafts), you must also acknowledge this assistance.

No collaboration of any kind is allowed during exams. On problem sets, you may consult with your classmates and the teaching staff. However, you must write up your own solutions in your own words based on your own understanding.

Frequently asked questions:

1. Textbook. You are welcome to buy any edition of the textbook. The textbook provides useful background material but the lectures do not follow any book. Therefore, attending class is critical. The textbook would be an especially useful resource for students interested in writing a senior honors thesis or term paper on a policy related topic.
2. Grading option. The course must be taken for a letter grade. However, you are welcome to sit in on the lectures if you choose not to take the class for credit.
3. Adding the course late. The last day to add the course without a fee is September 18. You may add the course until this date, but only if you have attended the lectures and kept up with the readings. Borrowing notes from others is not sufficient. Therefore, if you think that you may want to take the course for credit, you should attend class and complete the coursework on-time (e.g., readings, problem sets, term paper proposals), as if you are enrolled in the course. We may ask to see your class notes before signing your add form.
4. Cross-registration and website access. The course is open to students from other faculties and from MIT. In order to view the files on the course website, students enrolled in the course will need to log-in with a Harvard University ID and pin. Students enrolled through the Kennedy School course or who otherwise do not have a HUID can sign up for a XID at:
<https://xid.harvard.edu/xid-apps/displaySSCreateForm.do>
5. Course meetings. The course meets on Monday and Wednesday most weeks. Some weeks we will also meet on Friday, as noted in the outline of the lecture schedule on the following pages. In the event of lectures needing to be rescheduled during the term, additional Friday meetings may need to be added and will be announced in class in advance.

6. Attendance. Students who are enrolled in the course for credit are responsible for all material covered and any course announcements made in lecture and section. You should only enroll in the class for credit if you can attend class regularly. Students who have had to miss more than one or two lectures in the past have had difficulty on problem sets and exams and have not done well in the course.

7. Other readings. Academic journal articles listed on the reading list below will be distributed electronically for your convenience. Please see the course website for details on the procedure that we will use. All articles should also be available to Harvard College students for free by searching for the title in Google Scholar:

<http://scholar.google.com.ezp-prod1.hul.harvard.edu/schhp?inst=harvard.edu>

or as working papers through the National Bureau of Economic Research website:

<http://www.nber.org.ezp-prod1.hul.harvard.edu>

8. Exams. The midterm exam will be held in class on October 16. You should only enroll in the class for credit if you can be in attendance to take the midterm on this date. The date, time, and location of the final exam will be assigned by the registrar's office. It is tentatively scheduled for December 12 at 9am.

No notes or books are allowed during either exam. You may use a calculator.

Term paper option

Students writing a term paper will have modified assignments. The term paper along with a term paper proposal and modified versions of problem set 1 and 2 will together count for 20 percent of the grade. The term paper proposal and modified problem set 1 are due on 9/30. The modified problem set 2 is due on 11/16. The completed term paper is due 3 days before the final exam.

Most term papers use Stata, which is available for download at:

<https://downloads.fas.harvard.edu>

Papers from previous years include the following.

- 1 The effect of the Bush tax cuts on the spread between tax-exempt and taxable securities (using data on yields from Baker Library at HBS)
- 2 Using asset prices to measure the general equilibrium incidence of supreme court rulings on producers of GMO foods (using Fama-French and CRSP data from the WRDS database)
- 3 The effect of professional sports franchises and stadiums on employment and local economic growth

- 4 The effect of top marginal tax rates on executive compensation (using ExecuComp data from the WRDS database)
- 5 Gender inequality and intergenerational mobility (using female-male wage gaps constructed from the CPS and intergenerational mobility data from the Equality of Opportunity project)

ECONOMICS 1410: LECTURE DATES

Wednesday, August 30	Feldstein & Statcheva – Introduction to Ec1410 Feldstein: Labor Supply, Taxable Income and Deadweight Losses 1
Monday, September 4	Holiday – Labor Day
Wednesday, September 6	Feldstein: Labor Supply, Taxable Income and Deadweight Losses 2
Monday, September 11	Feldstein: Distributional Effects of Taxes, Inequality and Fairness Issues 1
Wednesday, September 13	Feldstein: Distributional Effects of Taxes, Inequality and Fairness Issues 1
Friday, September 15	Feldstein: Taxes and Savings 1 (PS 1 assigned)
Monday, September 18	Stantcheva: Income Distribution, Poverty, Taxes and Transfers
Wednesday, September 20	Stantcheva: Theoretical Tools for Public Economics
Monday, September 25	Feldstein: Taxes and Savings 2
Wednesday, September 27	Feldstein: Taxes and Risk Taking
Monday, October 2	Feldstein: Tax Reform
Wednesday, October 4	Feldstein: Tax Reform; Corporates Taxes
Wednesday, October 11	Feldstein: Budget Deficits
Friday, October 13	Feldstein: Social Security 1
Monday, October 16	Mid-Term Exam
Friday, October 20	Social Security 2
Monday, October 30	Feldstein: Cost Benefits Analysis

ECONOMICS 1410: LECTURE DATES

Wednesday, November 1	Stantcheva: Tax Incidence
Monday, November 6	Stantcheva: Optimal Labor Income Taxation
Wednesday, November 8	Stantcheva: Taxes and Labor Supply
Monday, November 13	Stantcheva: Taxes and Reported Income
Wednesday, November 15	Stantcheva: Externalities
Monday, November 20	Stantcheva: Public Goods
Wednesday, November 22	Stantcheva: Social Insurance (intro) and Health Insurance (Part I)
Monday, November 27	Stantcheva: Health Insurance (Part II)
Wednesday, November 29	Stantcheva: Unemployment Insurance, Disability Insurance, Workers' Compensation

ECONOMICS 1410: READINGS*Labor Supply, Taxable Income, and Deadweight Losses*

Feldstein

[Optional background reading] Gruber, Chapter 21

Martin Feldstein, "Effects of Taxes on Economic Behavior," *National Tax Journal*, March 2008.

Martin Feldstein, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act," *Journal of Political Economy*, 1995, 551-572.

Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax," *Review of Economics and Statistics*, November 1999.

Nada Eissa, "Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment," *NBER Working Paper 5023*, February 1995.

Henrik Kleven et al, "Taxation and International Migration of Superstars: Evidence from the European Football Market," *NBER Digest*, April 2011. (full NBER working paper summarized in digest available at <http://www.nber.org/papers/w16545>)

Ufuk Akcigit et al, "Taxation and the International Mobility of Inventors," *NBER Digest*, June 2015. (full NBER working paper summarized in digest available at <http://www.nber.org/papers/w21024>)

Zarek C. Brot-Goldberg et al, "The Impact of High Deductibles on Health Care Spending," *NBER Digest*, December 2015. (full NBER working paper summarized in digest available at <http://www.nber.org/papers/w21632>)

Martin Feldstein, "How Big Should Government Be?" *National Tax Journal*, June 1997, 197-213.

Distributional Effects of Taxes, Inequality and Fairness Issues

Feldstein

[Optional background reading] Gruber, Chapter 19

Martin Feldstein, "Are US Middle Class Incomes Really Stagnating?" *Project Syndicate*, June 30, 2015.

Martin Feldstein, "Remarks at the Brookings Institution Conference on Productivity," September 8, 2016.

Martin Feldstein, "Underestimating the Real Growth of GDP, Personal Income, and Productivity," *Journal of Economic Perspectives*, Vol 31, No. 2, Spring 2017, pp 145-64

Bruce Meyer and Nikolas Mittag, "Current Population Survey Overestimates Poverty Rate," *NBER Digest*, February 2016. (full NBER working paper summarized in digest available at <http://www.nber.org/digest/feb16/w21676.html>)

Christopher Jencks, "Why the Very Poor Have Become Poorer," *New York Review of Books*, June 9, 2016.

Martin Feldstein, "Reducing Poverty, Not Inequality," *The Public Interest*, No. 137, Fall 1999, pp 33-41.

Martin Feldstein, "The Uncounted Trillions in the Inequality Debate," *The Wall Street Journal*, December 13, 2015.

[Optional] Matthew Rognlie, "Deciphering the fall and rise in the net capital share," *Brookings Papers on Economic Activity*, Spring 2015.

Martin Feldstein, "Piketty's numbers don't add up," *The Wall Street Journal*, May 15, 2014.

Congressional Budget Office, "The Distribution of Household Income and Federal Taxes, 2013," June 8, 2016.

Taxes and Savings

Feldstein

[Optional background reading] Gruber, Chapter 22

Martin Feldstein, "The Welfare Cost of Capital Income Taxation," *Journal of Political Economy*, 1978

[Optional] Martin Feldstein, Joel Slemrod, and Shlomo Yitzhaki, "The Effects of Taxation on the Selling of Corporate Stock and the Realization of Capital Gains" *Quarterly Journal of Economics*, Vol. CXIV No. 4, pp. 777-791, (June 1980).

Martin Feldstein, "The Effects of Taxes on Efficiency and Growth," *Tax Notes*, May 8, 2006. (available at <http://www.nber.org/feldstein/taxanalysis.pdf>)

James M. Poterba, Steven F. Venti and David A. Wise, "How Retirement Savings Programs Increase Saving," *Journal of Economic Perspectives* 10(4), Fall 1996, 91-112.

Eric M. Engen, William G. Gale, and John Karl Scholz, "The Illusory Effects of Savings Incentives," *Journal of Economic Perspectives* 10(4), Fall 1996, 113-138.

September 18: Income Distribution, Poverty, Taxes and Transfers

Stantcheva

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapters 17 and 18

Piketty, Thomas, and Emmanuel Saez. "Income inequality in the United States, 1913-1998." *The Quarterly Journal of Economics* 118.1 (2003): 1-41 (optional)

Atkinson, Anthony B., Thomas Piketty, and Emmanuel Saez. "Top Incomes in the Long Run of History." *Journal of Economic Literature* 49.1 (2011): 3-71.(optional)

September 20: Theoretical Tools for Public Economics

Stantcheva

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapter 2

Saez, Emmanuel and Stefanie Stantcheva "Generalized Social Marginal Welfare Weights for Optimal Tax Theory," *American Economic Review* 2016. Accessible here: <https://scholar.harvard.edu/stantcheva/publications/generalized-social-welfare-weights-optimal-tax-theory>

Taxes and Risk-Taking

Feldstein

[Optional background reading] Gruber, Chapter 23

Martin Feldstein, "Personal taxation and portfolio composition: an econometric analysis," *Econometrica* 44: 631-649, 1976.

Alan J. Auerbach, "Capital Gains Taxation in the United States: Realizations, Revenue and Rhetoric," *Brookings Papers on Economic Activity* 1988:2, 595-631.

James M. Poterba, "Venture Capital and Capital Gains Taxation," in Tax Policy and the Economy, Volume 3, Cambridge, MIT Press, 1989.

Tax Reform

Feldstein

Martin Feldstein, "Tax Reform: Evidence of 1986," *The Wall Street Journal*, October 14, 2011.

Douglas Elmendorf, "'Dynamic scoring': Why and how to include macroeconomic effects in budget estimates for legislative proposals," *Brookings Paper on Economic Activity*, Fall 2015.

Martin Feldstein, "Raising Revenue by Limiting Tax Expenditures," Tax Policy and the Economy, Vol. 29, 2015.

Martin Feldstein, "Want to Boost the Economy? Lower Corporate Tax Rates," *The Wall Street Journal*, February 15, 2011.

Martin Feldstein, "Capital Taxation Policy," *National Taxation Association Luncheon Address*, November 20, 2015.

Martin Feldstein, "How to achieve stronger US growth," *Journal of Policy Modeling* 36(4): 649-653, July–August 2014.

[Optional] N. Gregory Mankiw, Matthew Weinzierl, and Danny Yagan, "Optimal Taxation in Theory and Practice," *Journal of Economic Perspectives*, Fall 2009, 23(4), 147-74.

Martin Feldstein. "Options for Corporate Tax Reform," *Brookings Panel on Economic Activity*, September 8, 2017.

Budget Deficits

Feldstein

Martin Feldstein, "America's Exploding Deficit," *Project Syndicate*, July 25, 2016.

Congressional Budget Office, "The Budget and Economic Outlook: 2016 to 2026," January 25, 2017, January 2017.

Congressional Budget Office, "The 2016 Long-Term Budget Outlook," July 12, 2016 (Chapter 1).

Martin Feldstein, "Dealing with Long Term Deficits," *AER Papers and Proceedings*, May 2016.

Martin Feldstein, "Preventing a National Debt Explosion," in Tax Policy and the Economy, 25(1): 109-144, September 2011.

Martin Feldstein, "An \$800 billion mistake," *The Washington Post*, January 29, 2009.

Martin Feldstein. "Balancing Lost Revenue the Reagan Way," *Wall Street Journal*, April 26, 2017.

[Optional background reading] Gruber, Chapter 12 and 13

Martin Feldstein, "Rethinking Social Insurance," *American Economic Review*, March 2005, pp 1-24.

Martin Feldstein, "Seven Principles of Social Insurance," *Challenge*, November/December 1976, 6-11.

Congressional Budget Office, "The 2016 Long-Term Budget Outlook," July 12, 2016 (chapter 2).

Martin Feldstein and Andrew Samwick, "Potential Paths of Social Security Reform," *Tax Policy and the Economy*, Vol. 16, 2002, pp 181-224.

Martin Feldstein. "Saving Social Security," *Project Syndicate*, February 28, 2014.

Martin Feldstein. "How to Make the Tax System Fairer and Save Social Security," Wall Street Journal, July 19, 2017.

Martin Feldstein, "Structural Reform of Social Security," *Journal of Economic Perspectives*, Spring 2005, pp 33-55.

Courtney Coile et al, "Health Capacity to Work at Older Ages: Evidence from the U.S.," *NBER Digest*, April 2016. (full NBER working paper summarized in digest available at <http://www.nber.org/papers/w21940>)

Jonathan Gruber and David Wise, "Social Security Programs and Retirement Around the World," in J. Gruber and D. Wise, eds., *Social Security and Retirement Around the World*, Chicago: University of Chicago Press, 1999.

Lawrence Kotlikoff, "Privatization of Social Security: How It Works and Why It Matters," *Tax Policy and the Economy*, 1997, pp 1-32.

Alan Gustman, et. al. "Distributional Effects of Means Testing Social Security: Income vs. Wealth," NBER Working Paper 22424, Summarized in NBER Digest September 2016.

Martin Feldstein and Jeffrey Liebman, "The Distributional Effects of an Investment Based Social Security System," in Martin Feldstein and Jeffrey Liebman, eds., The Distributional Aspects of Social Security and Social Security Reform, Chicago: University of Chicago Press, 2002, 263-326.

November 1: Tax Incidence

Stantcheva

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapter 2

Chetty, Raj, Adam Looney, and Kory Kroft. "Salience and Taxation: Theory and Evidence." The American Economic Review 99.4 (2009): 1145-1177 (optional).

Doyle Jr, Joseph J., and Krislert Samphantharak "\$2.00 Gas! Studying the effects of a gas tax moratorium." Journal of Public Economics 92.3 (2008): 869-884 (optional).

November 6: Optimal Labor Income Taxation

Diamond, P. and E. Saez "From Basic Research to Policy Recommendations: The Case for a Progressive Tax", Journal of Economic Perspectives, 25.4, (2011): 165-190. (optional)

Piketty, Thomas and Emmanuel Saez "Optimal Labor Income Taxation," Handbook of Public Economics, Volume 5, Amsterdam: Elsevier-North Holland, 2013.

Saez, Emmanuel. "Optimal income transfer programs: intensive versus extensive labor supply responses." The Quarterly Journal of Economics 117.3 (2002): 1039-1073.(optional)

November 8: Taxes and Labor Supply

Chetty, R., J. Friedman and E. Saez "Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings", American Economic Review, 2013, 103(7), 2683-2721 (optional)

Eissa, N. and J. Liebman "Labor Supply Response to the Earned Income Tax Credit", Quarterly Journal of Economics, Vol. 111, 1996, 605-637 (optional)

Saez, E. "Do Taxpayers Bunch at Kink Points?", American Economic Journal: Economic Policy, Vol. 2, 2010, 180-212 (optional)

Pencavel, J. "Labor Supply of Men: A Survey", Handbook of Labor Economics, Vol. 1, Chapter 1, 1986 (optional)

Heckman, J. and M. Killingsworth "Female Labor Supply: A Survey" Handbook of Labor Economics, Vol. I, Chapter 2, 1986 (optional)

November 13: Taxes and Reported Income

Saez, Emmanuel, Joel Slemrod, and Seth H. Giertz. "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." *Journal of Economic Literature*, 50(1) (2012): 3-50 (optional)

Piketty, Thomas, Emmanuel Saez, and Stefanie Stantcheva "Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities," *American Economic Journal: Economic Policy*, 6(1), 2014 (optional)

Akcigit, Ufuk, Salomé Baslandze, and Stefanie Stantcheva. "Taxation and the International Mobility of Inventors", *American Economic Review* 106 (10), 2016, 2930–2981 (optional)

Goolsbee, A. "What Happens When You Tax the Rich? Evidence from Executive Compensation", *Journal of Political Economy*, Vol. 108, 2000, 352-378 (optional)

November 15: Externalities

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapters 5 and 6.

Gruber, Jonathan. "Tobacco at the crossroads: the past and future of smoking regulation in the United States." *The Journal of Economic Perspectives* 15.2 (2001): 193-212 (optional).

Nordhaus, William D. "After Kyoto: Alternative mechanisms to control global warming." *The American Economic Review* 96.2 (2006): 31- 34 (optional).

November 20: Public Goods

Gruber, Jonathan, Public Finance and Public Policy, Fifth Edition, 2016 Worth Publishers, Chapter 1

Gruber, Jonathan, Public Finance and Public Policy, Fifth Edition, 2016 Worth Publishers, Chapter 7

November 22: Social Insurance (intro) + Health Insurance Part I

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapter 12

Gruber, Jonathan, *Public Finance and Public Policy*, 2016 Worth Publishers, Chapter 15 and 16

Case, Anne and Angus Deaton. "Mortality and morbidity in the 21st century", *Brookings Papers in Economic Activity*, 2017 (optional)

Currie, Janet, and Jonathan Gruber. "The technology of birth: Health insurance, medical interventions, and infant health." No. WP 5985. National Bureau of Economic Research, 1997 (optional)

Finkelstein, Amy, Sarah Taubman, Bill Wright, Mira Bernstein, Jonathan Gruber, Joseph P. Newhouse, Heidi Allen, and Katherine Baicker. "The Oregon Health Insurance Experiment: Evidence from the First Year." *The Quarterly Journal of Economics* 127, no. 3 (2012): 1057-1106 (optional)

Einav, Liran, Amy Finkelstein, Paul Schrimpf "The Response of Drug Expenditures to non-linear Contract Design: Evidence from Medicare Part D," NBER Working Paper 19393, 2013 (optional)

November 27: Health Insurance Part II

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapter 15 and 16

Case, Anne and Angus Deaton. "Mortality and morbidity in the 21st century", *Brookings Papers in Economic Activity*, 2017 (optional)

Currie, Janet, and Jonathan Gruber. "The technology of birth: Health insurance, medical interventions, and infant health." No. WP 5985. National Bureau of Economic Research, 1997 (optional)

Finkelstein, Amy, Sarah Taubman, Bill Wright, Mira Bernstein, Jonathan Gruber, Joseph P. Newhouse, Heidi Allen, and Katherine Baicker. "The Oregon Health Insurance Experiment: Evidence from the First Year." *The Quarterly Journal of Economics* 127, no. 3 (2012): 1057-1106 (optional)

Einav, Liran, Amy Finkelstein, Paul Schrimpf "The Response of Drug Expenditures to non-linear Contract Design: Evidence from Medicare Part D," NBER Working Paper 19393, 2013 (optional)

November 29: Unemployment Insurance, Disability Insurance, Workers' compensation.

Gruber, Jonathan, Public Finance and Public Policy, 2016 Worth Publishers, Chapter 14

Bound, John. "The Health and Earnings of Rejected Disability Insurance Applicants." American Economic Review 79.3 (1989): 482-503 (optional)

Card, David, Raj Chetty, and Andrea Weber. "The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?." The American Economic Review 97.2 (2007): 113-118 (optional)

Gruber, Jonathan. "The Consumption Smoothing Benefits of Unemployment Insurance." The American Economic Review (1997) (optional)