

Fall 2020

ECONOMICS 1410 / KENNEDY SCHOOL SUP-125
Public Economics: Designing Government Policy
Stefanie Stantcheva and Stan Veuger

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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, social security, environmental protection, and state and local policy. The course emphasizes recent empirical research on policy issues and will teach students how to conduct such studies.

The first half of the course, taught by Professor Stantcheva, 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 provision of public goods, and social insurance.

The second half of the course, taught by Professor Veuger, will highlight recent empirical research on business taxation, the regulatory state, political economy, and multilevel government. In this part we will also see how the theoretical and empirical approaches covered in the course can be and have been used to inform and assess the economic policy response to the COVID-19 crisis, in particular in the United States and Europe.

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 3:00 to 4:15 during the first half of the course, MW 3:00 to 4:00 during the second half.
- 2) Policy discussion – One per week during the second half of the course. Time and specific topics TBD. Topics will most likely include Pandemic Unemployment Insurance, the Payroll Protection Program, the Black Lives Matter protests, and the European Union’s Recovery and Resilience Facility, though much can happen between now and October.
- 2) Sections – One per week. Time TBD.
- 3) Readings – Jonathan Gruber, *Public Finance and Public Policy (6th edition)*, is the recommended textbook. Other readings are listed below.
- 4) Assignments will be posted on the course website, which should be checked regularly: <https://canvas.harvard.edu/courses/74528>

Grading: Grades will be based on a final exam (50 percent) and four problem sets (50 percent). Students writing a term paper do not have to sit the final exam and will only have to complete two problem sets. Instead, the term paper will count for 75 percent of the grade.

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 21.

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 the exam. 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.
2. Grading option. Students may enroll in the course on a Pass/Fail basis with permission of the instructors.
3. Adding the course late. The last day to add the course without a fee is September 21.
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 an XID at:

<https://xid.harvard.edu/xid-apps/displaySSCreateForm.do>

5. 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.
6. 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/>

7. Exams. The final exam will be held in class on December 2. Unless you are planning on writing a term paper, you should only enroll in the class for credit if you can be in attendance to take the final on this date.

Term Paper

A term paper proposal is due on 9/25. Proposals should be about 5 pages in length, explaining the i) motivation; ii) question asked; iii) related literature; iv) empirical strategy or theoretical model; v) data to be used (if any); vi) results expected or hoped for. The complete paper is due on December 2.

Most term papers use Stata, which is available for download at: <https://downloads.fas.harvard.edu/>

Papers from previous years include the following.

1. An analysis of the salience of payroll taxes relative to income taxes, and its implications for welfare and policy (using data from the Panel Survey of Income Dynamics)
2. Measurement of the 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)

LECTURE DATES

1. Wednesday, September 2
Monday, September 7
2. Wednesday, September 9
 3. Monday, September 14
4. Wednesday, September 16
 5. Monday, September 21
6. Wednesday, September 23
Monday, September 28
7. Wednesday, September 30
 8. Monday, October 5
9. Wednesday, October 7
Monday, October 12
10. Wednesday, October 14
 11. Monday, October 19
12. Wednesday, October 21
 13. Monday, October 26
14. Wednesday, October 28
 15. Monday, November 2
16. Wednesday, November 4
 17. Monday, November 9
18. Wednesday, November 11
 19. Monday, November 16
20. Wednesday, November 18
 21. Monday, November 23
Wednesday, November 25
 22. Monday, November 30
23. Wednesday, December 2
- Stantcheva - Intro; Income Distribution, Poverty, Taxes and Transfers
No Class (Labor Day)
Stantcheva - Theoretical Tools for Public Economics
Stantcheva - Tax Incidence
Stantcheva - Optimal Labor Income Taxation
Stantcheva - Taxes and Labor Supply [**AEO letters due; PS1 assigned**]
Stantcheva - Taxes and Reported Income
No Class (Yom Kippur)
Stantcheva – Externalities [**PS1 due**]
Stantcheva - Public Goods [**PS2 assigned**]
Stantcheva - Social Insurance (intro) and Health Insurance (Part I)
No Class (Columbus Day)
Stantcheva - Stantcheva: Health Insurance (Part II)
Stantcheva - Unemployment Insurance, Disability Insurance, Workers’ Compensation; Review [**PS2 due**]
Veuger – Empirical Tools for Public Economics
Veuger – The Federal Budget
Veuger – Politics and Policy
Veuger – Politics and Policy [**PS3 assigned**]
Veuger – Business Taxation
Veuger – Tax Reform
Veuger – Multilevel Government [**PS 3 due**]
Veuger – Multilevel Government [**PS4 assigned**]
Veuger – Regulation
Veuger – Old-Age Pensions and Social Security
No Class (Thanksgiving)
Veuger – Health Care Policy [**PS 4 due**]
Examination

READINGS

September 2: Income Distribution, Poverty, Taxes and Transfers

Stantcheva

Gruber, Chapters 17 and 18

Piketty, Thomas, and Emmanuel Saez (2003) "Income Inequality in the United States, 1913-1998," *The Quarterly Journal of Economics* 118(1): 1-41. (optional)

Atkinson, Anthony B., Thomas Piketty, and Emmanuel Saez (2011) "Top Incomes in the Long-Run of History," *Journal of Economic Literature* 49(1): 3-71. (optional)

September 9: Theoretical Tools for Public Economics

Stantcheva

Gruber, Chapter 2

Saez, Emmanuel and Stefanie Stantcheva (2016) "Generalized Social Marginal Welfare Weights for Optimal Tax Theory," *American Economic Review* 106(1): 24-45.

September 14: Tax Incidence

Stantcheva

Gruber, Chapter 19

Chetty, Raj, Adam Looney, and Kory Kroft (2009) "Salience and Taxation: Theory and Evidence," *American Economic Review* 99(4): 1145-1177. (optional)

Doyle Jr, Joseph J., and Krislert Samphantharak (2008) "\$2.00 Gas! Studying the Effects of a Gas Tax Moratorium," *Journal of Public Economics* 92(3): 869-884. (optional)

September 16: Optimal Labor Income Taxation

Stantcheva

Gruber, Chapter 20 and 21

Diamond, Peter, and Emmanuel Saez (2011) "From Basic Research to Policy Recommendations: The Case for a Progressive Tax," *Journal of Economic Perspectives* 25(4): 165-190. (optional)

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

Saez, Emmanuel (2002) "Optimal Income Transfer Programs: Intensive versus Extensive Labor Supply Responses," *The Quarterly Journal of Economics* 117(3): 1039-1073. (optional)

September 21: Taxes and Labor Supply

Stantcheva

Gruber, Chapter 21

Chetty, Raj, John Friedman and Emmanuel Saez (2013) “Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings,” *American Economic Review* 103(7): 2683-2721. (optional)

Eissa, Nada, and Jeffrey B. Liebman (1996) “Labor Supply Response to the Earned Income Tax Credit,” *The Quarterly Journal of Economics* 111: 605-637. (optional)

Saez, Emmanuel “Do Taxpayers Bunch at Kink Points?” (2010) *American Economic Journal: Economic Policy*, 2: 180-212. (optional)

Pencavel, John (1986) “Labor Supply of Men: A Survey,” *Handbook of Labor Economics*, Volume 1, Chapter 1. (optional)

Heckman, James, and Mark Killingsworth (1986) “Female Labor Supply: A Survey,” *Handbook of Labor Economics*, Volume 1, Chapter 2. (optional)

September 23: Taxes and Reported Income

Stantcheva

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

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

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

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

September 30: Externalities

Stantcheva

Gruber, Chapter 5 and 6

Gruber, Jonathan (2001) “Tobacco at the Crossroads: The Past and Future of Smoking Regulation in the United States,” *Journal of Economic Perspectives* 15(2): 193-212. (optional)

Nordhaus, William D. (2006) “After Kyoto: Alternative Mechanisms to Control Global Warming,” *American Economic Review* 96(2): 31- 34. (optional)

October 5: Public Goods

Stantcheva

Gruber, Chapter 1 and 7

October 7 and 14: Social Insurance (Intro) and Health Insurance

Stantcheva

Gruber, Chapter 12, 15, and 16

Case, Anne and Angus Deaton (2017) “Mortality and Morbidity in the 21st Century,” *Brookings Papers in Economic Activity*. (optional)

Currie, Janet, and Jonathan Gruber (1997) “The Technology of Birth: Health Insurance, Medical Interventions, and Infant Health,” *NBER Working Paper 5985*. (optional)

Finkelstein, Amy, Sarah Taubman, Bill Wright, Mira Bernstein, Jonathan Gruber, Joseph P. Newhouse, Heidi Allen, and Katherine Baicker (2012) “The Oregon Health Insurance Experiment: Evidence from the First Year,” *The Quarterly Journal of Economics* 127(3): 1057-1106. (optional)

Einav, Liran, Amy Finkelstein, and Paul Schrimpf (2013) “The Response of Drug Expenditures to Nonlinear Contract Design: Evidence from Medicare Part D,” *NBER Working Paper 19393*. (optional)

October 19: Unemployment & Disability Insurance, Workers’ Compensation

Stantcheva

Gruber, Chapter 14

Bound, John (1989) “The Health and Earnings of Rejected Disability Insurance Applicants,” *American Economic Review* 79(3): 482-503. (optional)

Card, David, Raj Chetty, and Andrea Weber (2007) “The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?” *American Economic Review* 97(2): 113-118. (optional)

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

October 21: Empirical Methods for Public Economics

Veuger

Gruber, Chapter 3

Angrist, Joshua, and Jörn-Steffen Pischke (2010) “The Credibility Revolution in Empirical Economics: How Better Research Design is Taking the Con out of Econometrics”, *Journal of Economic Perspectives* 24(2): 3-30. (optional)

Athey, Susan, and Guido W. Imbens (2017) “The State of Applied Econometrics: Causality and Policy Evaluation,” *Journal of Economic Perspectives* 31(2): 3-32.

Diamond, Rebecca, and Timothy J. McQuade (2019) "Who Wants Affordable Housing in their Backyard? An Equilibrium Analysis of Low-Income Property Development," *Journal of Political Economy*, 127(3): 1063-1117. (optional)

Linden, Leigh, and Jonah E. Rockoff (2008) "There Goes the Neighborhood? Estimates of the Impact of Crime Risk on Property Values from Megan's Laws," *American Economic Review* 98(3): 1103-1127. (optional)

Low, Hamish, and Costas Meghir (2017) "The Use of Structural Models in Econometrics," *Journal of Economic Perspectives* 31(2): 33-58. (optional)

October 26: The Federal Budget

Veuger

Gruber, Chapter 4

Congressional Budget Office. *The 2019 Long-Term Budget Outlook*. June 2019.

Capretta, James C. (2019) "The Congressional Budget Process: A Brief Primer," *AEI Economic Perspectives* 2018-02 (February). (optional)

Discussion 1: COVID-19 Labor Policy Responses in the EU and the US (Tentative)

Ganong, Peter, Pascal J. Noel, and Joseph S. Vavra (2020) "US Unemployment Insurance Replacement Rates During the Pandemic," NBER Working Paper No. 27216.

October 28 and November 2: Politics and Policy

Veuger

Gruber, Chapter 9

Baker, Scott R., Nicholas Bloom, and Steven J. Davis (2016) "Measuring Economic Policy Uncertainty," *Quarterly Journal of Economics* 131(4): 1593–1636. (optional)

Downs, Anthony (1957). "An Economic Theory of Political Action in a Democracy," *Journal of Political Economy* 65(2): 135–150. (optional)

Madestam, Andreas, Daniel Shoag, Stan Veuger, and David Yanagizawa-Drott (2013) "Do Political Protests Matter? Evidence from the Tea Party Movement," *Quarterly Journal of Economics* 128(4): 1633-1685.

Stephens-Davidowitz, Seth (2014) "The Cost of Racial Animus on a Black Candidate: Evidence using Google Search Data," *Journal of Public Economics* 118: 26-40. (optional)

Discussion 2: Black Lives Matter Protests and the 2020 U.S. Election (Tentative)

Enos, Ryan D., Aaron R. Kaufman, Melissa L. Sands (2019) “Can Violent Protest Change Local Policy Support? Evidence from the Aftermath of the 1992 Los Angeles Riot” *American Political Science Review* 113(4): 1012–1028.

Wasow, Omar (Forthcoming) “Agenda Seeding: How 1960s Black Protests Moved Elites, Public Opinion and Voting,” *American Political Science Review*.

November 4: Business Taxation

Veuger

Gruber, Chapter 24

Levmore, Saul, and Hideki Kanda (1991) “Taxes, Agency Costs, and the Price of Incorporation,” *Virginia Law Review* 77: 211-256. (optional)

Mahon, James, and Eric Zwick (2017) “Tax Policy and Heterogeneous Investment Behavior,” *American Economic Review* 107(1): 217-48. (optional)

Smith, Matthew, Danny Yagan, Owen Zidar, and Erick Zwick (2019) “Capitalists in the Twenty-First Century,” *Quarterly Journal of Economics* 134: 1675-1745. (optional)

Suárez Serrato, Juan Carlos, and Owen Zidar (2016) “Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms,” *American Economic Review* 106(9): 2582-2624. (optional)

November 9: Tax Reform

Veuger

Gruber, Chapter 25

Chetty, Raj, and Emmanuel Saez (2005) “Dividend Taxes and Corporate Behavior: Evidence from the 2003 Dividend Tax Cut,” *Quarterly Journal of Economics* 120(3): 791–833. (optional)

Smith, Matthew, Owen Zidar, and Eric Zwick (2020) “Top Wealth in America: New Estimates and Implications for Taxing the Rich.” Mimeo: Chicago Booth, NBER, Princeton, and US Treasury Department. (optional)

Yagan, Danny (2015) "Capital Tax Reform and the Real Economy: The Effects of the 2003 Dividend Tax Cut," *American Economic Review* 105(12): 3531-3563. (optional)

Zwick, Eric (Forthcoming) “The Costs of Corporate Tax Complexity,” *American Economic Journal: Economic Policy*.

Discussion 3: COVID-19 Business Support Programs in the EU and the US (Tentative)

Guerrieri, Veronica, Guido Lorenzoni, Ludwig Straub, and Iván Werning (2020) “Macroeconomic Implications of COVID-19: Can Negative Supply Shocks Cause Demand Shortages?” NBER Working Paper No. 26918.

November 11 and 16: Multilevel Government

Veuger

Gruber, Chapter 10 and 11

Ganong, Peter, and Daniel Shoag (2017) “Why Has Regional Income Convergence in the U.S. Declined?” *Journal of Urban Economics* 102 (November): 76-90.

Hoxby, Caroline (2000) “Does Competition among Public Schools Benefit Students and Taxpayers?” *American Economic Review* 90(5): 1209-1238. (optional)

Shoag, Daniel, and Stan Veuger (2018) “Shops and the City: Evidence on Local Externalities and Local Government Policy from Big-Box Bankruptcies,” *Review of Economics and Statistics* 100(3): 440-453. (optional)

Shoag, Daniel, Cody Tuttle, and Stan Veuger (2019) “Rules versus Home Rule: Local Government Responses to Negative Revenue Shocks,” *National Tax Journal* 72(3): 543-574. (optional)

Tiebout, Charles (1956) “A Pure Theory of Local Expenditures,” *Journal of Political Economy* 64(5): 416-424. (optional)

Discussion Session 4: The European Union’s COVID-19 Recovery Fund (Tentative)

Hamilton, Steven, and Stan Veuger (2020) “A Recession is a Public Health Necessity – Let’s Keep It Short,” *VoxEU*, March 21.

November 18: Regulation

Chapter 5 and 8

Clemens, Jeffrey (2008) “Opium in Afghanistan: Prospects for the Success of Source Country Drug Control Policies,” *Journal of Law and Economics* 51(3): 407-432.

Clemens, Jeffrey, and Michael Wither (2019) “The Minimum Wage and the Great Recession: Evidence of Effects on the Employment and Income Trajectories of Low-Skilled Workers,” *Journal of Public Economics* 170: 53-67.

Gruber, Jonathan (1994) “The Incidence of Mandated Maternity Benefits,” *American Economic Review* 84(3): 622-641. (optional)

Shoag, Daniel, and Stan Veuger (Forthcoming) ““Ban the Box” Measures Help High-Crime Neighborhoods,” *Journal of Law and Economics*. (optional)

Summers, Lawrence (1989) “Some Simple Economics of Mandated Benefits,” *American Economic Review* 79(2): 177-183. (optional)

Weitzman, Martin L. (1974) “Prices vs. Quantities,” *Review of Economic Studies* 41(4): 477-491. (optional)

Discussion 5: Implications of the COVID-19 Epidemic for State and Local Budgets (Tentative)

Clemens, Jeffrey, and Stan Veuger (2020) “Implications of the Covid-19 Pandemic for State Government Tax Revenues.” NBER Working Paper No. 27426.

November 23: Old-Age Pensions and Social Security

Veuger

Gruber, Chapter 13

Beshears, John, James J. Choi, David Laibson, Brigitte C. Madrian, William L. Skimmyhorn (2019) “Borrowing to Save? The Impact of Automatic Enrollment on Debt,” *NBER Working Paper* No. 25876. (optional)

Coile, Courtney, Kevin S. Milligan, and David A. Wise, “Health Capacity to Work at Older Ages: Evidence from the U.S.” in David A. Wise (ed.) *Social Security Programs and Retirement around the World: The Capacity to Work at Older Ages*. Chicago: University of Chicago Press, 2017. 359 – 394. (optional)

Feldstein, Martin, 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. (optional)

Organization for Economic Co-operation and Development (2019) “Pensions at a Glance 2019: OECD and G20 Indicators.” November 27.

November 30: Health Care Policy

Veuger

Gruber, Chapter 15 and 16

Congressional Budget Office. *The 2019 Long-Term Budget Outlook*. June 2019.

Agha, Leila, Soomi Kim, and Danielle Li (2020) “Insurance Design and Pharmaceutical Innovation,” NBER Working Paper No. 27563.

Clemens, Jeffrey (2015) “Regulatory Redistribution in the Market for Health Insurance,” *American Economic Journal: Applied Economics* 7(2): 109-134. (optional)

Clemens, Jeffrey, and Joshua Gottlieb (2014) “Do Physicians' Financial Incentives Affect Treatment Patterns and Patient Health?” *American Economic Review* 104(4): 1320-1349. (optional)

Clemens, Jeffrey, and Joshua Gottlieb (2017) "In the Shadow of a Giant: Medicare's Influence on Private Payment Systems," *Journal of Political Economy* 125(1): 1-39.

Discussion Session 6: Pricing COVID-19 Treatments and Vaccines (Tentative)

Kremer, Michael, Christopher Snyder, and Natalia Drozdoff (2016) "Vaccines, Drugs, and Zipf Distributions," *VoxEU*, January 29.