



## Department of Economics Course Outline

		<b>Term:</b>	Fall 2009
<b>Course:</b>	Economics 651 [Public Finance:] Redistribution and Social Insurance	<b>Section:</b>	01
<b>Time:</b>	TR 14:30 – 15:45	<b>Place:</b>	SS 423 (subject to change)
<b>Instructor:</b>	Dr. Jean François Wen		
<b>Office:</b>	SS 418	<b>Telephone.:</b>	220-2478
<b>Office Hours:</b>	MW 14:30 – 15:45	<b>E-mail:</b>	<a href="mailto:wen@ucalgary.ca">wen@ucalgary.ca</a>

**Textbook(s):** n/a

**Book(s) on Reserve:** n/a

### Course Outline:

This is a course on normative theory in Public Economics, with a particular focus on the ideas and methods most relevant for understanding the economics of expenditure programs, which are designed to redistribute income or to provide social insurance against risks faced by households. These programs include employment insurance, health care, pensions, subsidized housing, and progressive taxation. Such “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 Pareto efficiency, excess burden, social welfare functions, public goods, insurance market failures, optimal income taxation, in-kind transfers, and social insurance. We will discuss how these topics relate to actual welfare states programs.

Most of the following list articles will be discussed; 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. Pareto Efficiency and Competitive Equilibrium

#### 1. Pareto Efficiency (1/2 lecture)

Reading:

- Musgrave, R.M. (1996) The Role of the State in Fiscal Theory, *International Tax and Public Finance* 3: 247—258. (\*)
- Bator, F.M. (1957) The Simple Analytics of Welfare Maximization, *American Economic Review* 47: 22—59.

#### 2. Competitive Equilibrium (1/2 lecture)

Reading:

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

### B. Market Failures and Excess Burden

#### 3. Public Goods (1 and 1/2 lectures)

Reading:

- Samuelson, P. (1955) Diagrammatic Exposition of a Theory of Public Expenditures, *Review of Economics and Statistics* 37: 350—6. (\*)
- Bowen, H.R. (1943) The Interpretation of Voting in the Allocation of Economic Resources, *Quarterly Journal of Economics* 58: 27—48.
- Warr, P. (1963) The Private Provision of a Public Good is Independent of the Distribution of Income, *Economic Letters* 13: 207—211.
- Boadway, R., Z. Song, and J.-F. Tremblay (2007) Commitment and Matching Contributions to Public Goods, *Journal of Public Economics* 91: 1664—1683. (♠)
- Thurow, L. (1971) Income Distribution as a Pure Public Good, *Quarterly Journal of Economics* 85: 327—36.
- Hochman, H. and J. Rogers (1969) Pareto Optimal Distribution, *American Economic Review* 59: 542—57.
- Von Furstenburg, G.M. and D.C. Mueller (1971) The Pareto Optimal Approach to Income Redistribution: a Fiscal Application, *American Economic Review* 61: 628—637. (♠)

#### 4. 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. .../3

- 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).

### C. Social Welfare

#### 5. Social Welfare Functions (1 lecture)

Reading:

- Samuelson, P. (1956) Reaffirming the Existence of Reasonable Bergson-Samuelson Social Welfare Functions, *Economica* 44: 81—8. (\*)
- Hau, T.D. (1986) Distributional Cost-Benefit Analysis in Discrete Choice, *Journal of Transport Economics and Policy* 20: 313—38.
- Jorgenson, D. (1990) Aggregate Consumer Behavior and the Measurement of Social Welfare, *Econometrica*, September. (♠)
- Atkinson, A. (1970) On the Measurement of Inequality, *Journal of Economic Theory* 55: 749—64. (\*)
- Shorrocks, A.F. (1983) Ranking Income Distributions, *Economica* 50: 3—17.

### D. Redistribution

#### 6. Progressive Income Taxation (1 and 1/2 lectures)

Reading:

- Stiglitz, J. (1982) Self-Selection Pareto Efficient Taxation, *Journal of Public Economics* 17: 213—40.
- Stern, H.N. (1976) On the Specification of Models of Optimum Income Taxation, *Journal of Public Economics* 6: 123—62. (\*)
- Slemrod, J., S. Yitzhaki, J. Mayshar, and M. Lundholm (1994) The Optimal Two-Bracket Linear Income Tax, *Journal of Public Economics* 53: 269—290.

#### 7. In-Kind Transfers (1 lecture)

Reading:

- Blackorby, C. and D. Donaldson (1988) Cash versus Kind, Self-Selection, and Efficient Transfers, *American Economic Review* 78: 691—700. (\*)
- Olson, E.O. (1971) Subsidized Housing in a Competitive Market: Reply, *American Economic Review* 61: 220—224. (\*)

### E. Risk and Insurance

#### 8. Insurance Against Illness and Unemployment (2 lectures)

Reading:

- 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.
- Rothschild, M. and J.E. Stiglitz (1976) Equilibrium in Competitive Insurance Markets, *Quarterly Journal of Economics* 90: 629—650. (\*)
- Dahlby, B. (1981) Adverse Selection and Pareto Improvement through Compulsory Insurance, *Public Choice* 37: 547—58.
- Crocker, K.J. and A.S. (1985) The Efficiency of Competitive Equilibria in Insurance Markets with Asymmetric Information, *Journal of Public Economics* 26: 207—219. (♠)
- Pauly, M.V. (1968) The Economics of Moral Hazard: Comment, *American Economic Review* 58: 531—537. (\*)
- Dworkin, R. (1993) Justice in the Distribution of Health Care, *McGill Law Review* 38: 883—889.

#### 9. Social Insurance (1 lecture)

##### Reading:

- Eaton, J. and H.S. Rosen (1980) Optimal Redistributive Taxation and Uncertainty, *Quarterly Journal of Economics* 357—364. (\*)
- Varian, H. (1980) Redistributive Taxation as Social Insurance, *Quarterly Journal of Economics* 14: 49—68. (\*)
- Barr, N. (2006) Pensions: Overview of the Issues, *Oxford Review of Economic Policy* 22: 1—14. (♠)
- Barr, N. and P. Diamond (2006) The Economics of Pensions, *Oxford Review of Economic Policy* 22: 15—39. (♠)

#### 10. Redistribution and Risk-Taking (1 lecture)

##### Reading:

- Bird, E.J. (2001) Does the Welfare State Induce Risk-Taking? *Journal of Public Economics* 80: 357—383. (♠)
- Clemens, C. and M. Heinemann (2006) On the Effects of Redistribution on Growth and Entrepreneurial Risk-Taking, *Journal of Economics* 88: 131—158.
- Domar, E.D. and R.A. Musgrave (1944) Proportional Income Taxation and Risk-Taking, *Quarterly Journal of Economics* 58: 388—422.
- Penalosa-Garcia, C., and J.-F. Wen (2008) Redistribution and Entrepreneurship with Schumpeterian Growth, *Journal of Economic Growth* 13: 57—80.
- Ilmakunnas, P. and V. Nanniainen (2001) Entrepreneurship, Economic Risks, and Risk Insurance in the Welfare State: Results with OECD Data 1978—93, *German Economic Review* 2(3): 195—218. (♠)
- Sinn, H.-W. (1996) Social Insurance and Risk Taking, *International Tax and Public Finance* 3: 259—280. (♠)
- Meyer, J. (1987) Two-Moment Decision Models and Expected Utility Maximization, *American Economic Review* 77: 421—430.
- Kanbur, S.M. (1981). "Risk Taking and Taxation: An Alternative Perspective," *Journal of Public Economics* 15, 163—184. .../5

**Grade Determination and Final Examination Details:**

There will be three assignments, worth 10 percent each; a student presentation of a journal article, worth 10 percent; a mid-term exam worth 20 percent; and a final exam worth 40 percent. The tentative date for the midterm exam is Thursday, October 22 from 2:30-4:30 PM.

The student in-class presentations will occur near the end of the course. Each student should take about 30 to 45 minutes to present the main ideas of an article on the welfare state. The presentation should be accompanied by a handout describing the ideas and key derivations. The article must be pre-approved by the instructor or selected from articles marked with a ♠ in the reading list.

Tests and final exams are marked on a numerical (percentage) basis, then converted to letter grades. The course grade is then calculated using the weights indicated above. As a guide to determining standing, these letter grade equivalences will generally apply:

A+	90-100	B	70-74	C-	56-58
A	85-89	B-	65-69	D+	53-55
A-	80-84	C+	62-64	D	50-52
B+	75-79	C	59-61	F	0-49

A passing grade on any particular component of the course is not required for a student to pass the course as a whole.

Non-programmable calculators will be allowed during the writing of tests or final examinations.

There will be a 3 hour final examination scheduled by the Department of Economics.

Tests and exams will not involve multiple choice questions.

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**Notes:**

- Students seeking reappraisal of a piece of graded term work (term paper, essay, etc.) should discuss their work with the Instructor *within fifteen days* of the work being returned to the class.
- It is the student's responsibility to request academic accommodations. If you are a student with a documented disability who may require academic accommodation and have not registered with the Disability Resource Centre, please contact their office at 403-220-8237. Students who have not registered with the Disability Resource Centre are not eligible for formal academic accommodation. You are also required to discuss your needs with your instructor no later than fourteen (14) days after the start of this course.

Safewalk / Campus Security: 403-220-5333  
Emergency Assembly Point – Professional Faculties Food Court  
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2009-09-01