



## Department of Economics Course Outline

		<b>Term:</b>	Fall 2012
<b>Course:</b>	Economics 651 [Public Finance:] Redistribution and Social Insurance	<b>Section:</b>	01
<b>Time:</b>	TR 14:00 – 15:15	<b>Place:</b>	SS 423
<b>Instructor:</b>	Dr. Jean François Wen		
<b>Office:</b>	SS 418	<b>Telephone.:</b>	220-2478
<b>Office Hours:</b>	TR 15:30 – 16:30 or by appointment	<b>E-mail:</b>	<a href="mailto:wen@ucalgary.ca">wen@ucalgary.ca</a>

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

**Book(s) on Reserve:** Public Finance in Canada, 4th edition (Rosen, Wen, and Snoddon, 2012).

### Course Outline:

This is a course on Public Economics, with a particular focus on the ideas and methods most relevant for understanding the economics of expenditure programs that 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 Pareto efficiency, excess burden, social welfare functions, inequality measures, 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 and the Welfare Theorems (1.5 lectures)

Reading:

- Bator, F.M. (1957) The Simple Analytics of Welfare Maximization, *American Economic Review* 47: 22—59.
- Rosen, H., J.-F. Wen, and T. Snoddon (2012) *Public Finance in Canada*, 4<sup>th</sup> edition, McGraw-Hill, chapters 2 and 3 (on reserve).
- Scarth, W. (2010) Stabilization Policy Debates: Assessing the Case for Fiscal Stimulus, in Beach, C., B. Dahlby, and P. Hobson, *The 2009 Federal Budget: Challenge, Response and Retrospect* (Montreal and Kingston: McGill-Queen's University Press): 59—80.

### B. Income Distribution as a Public Good

#### 3. Public Goods (3 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.
- Thurow, L. (1971) Income Distribution as a Pure Public Good, *Quarterly Journal of Economics* 85: 327—36.

#### 4. Pareto Optimal Redistribution (1 lecture)

Reading:

- Hochman, H.M. and J.D. Rodgers (1969) Pareto Optimal Redistribution, *American Economic Review* 59(4): 542—557.

- 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. (\*)

## **B. Income Inequality and Income Instability**

### 5. Decomposing the Income Distribution in Canada (2 lectures)

Reading:

- Beach, C., R. Finnie, and D. Gray (2010) Long-Run Inequality and Short-Run Instability of Men's and Women's Earnings in Canada, *Review of Income and Wealth* 56: 572—596. (\*)
- Morrisette, R. and Y. Ostrovsky (2005) The Instability of Family Earnings and Family Income in Canada, 1986-1991 and 1996-2001, *Canadian Public Policy* 31: 273—302.
- Fortin, N., D. Green, T. Lemieux, K. Milligan, and C. Riddell (2012) Canadian Inequality: Recent Developments and Policy Options, *Canadian Public Policy* 38(2) : 121—145.

## **D. Redistribution in Cash and Kind**

### 6. Progressive Income Taxation (4 lectures)

Reading:

- Kaplow, L. (2007) Optimal Income Transfers, *International Tax and Public Finance* 14: 295—325.
- Stern, H.N. (1976) On the Specification of Models of Optimum Income Taxation, *Journal of Public Economics* 6: 123—62. (\*)
- Stiglitz, J. (1982) Self-Selection Pareto Efficient Taxation, *Journal of Public Economics* 17: 213—40.
- 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 (3 lectures)

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 (3 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.
- Pauly, M.V. (1968) The Economics of Moral Hazard: Comment, *American Economic Review* 58: 531—537. (\*)
- Cohen, Alma, and Peter Siegelman. “Testing for Adverse Selection in Insurance Markets.” *Journal of Risk and Insurance* 77, no. 1 (2010): 39–84.
- Rosen, H., J.-F. Wen, and T. Snoddon (2012) *Public Finance in Canada*, 4<sup>rd</sup> edition, McGraw-Hill, chapter 9 (on reserve).

## 9. Redistributive Taxation as Social Insurance (2 lectures)

## Reading:

- Varian, H. (1980) Redistributive Taxation as Social Insurance, *Quarterly Journal of Economics* 14: 49—68. (\*)
- Eaton, J. and H.S. Rosen (1980) Optimal Redistributive Taxation and Uncertainty, *Quarterly Journal of Economics* 357—364.

## 10. Redistribution and Risk-Taking (3 lectures)

## Reading:

- Bird, E.J. (2001) Does the Welfare State Induce Risk-Taking? *Journal of Public Economics* 80: 357—383.
- 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.
- 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.
- Gordon, D.V. and J.-F. Wen (2012) An Empirical Model of Tax Convexity and Self-Employment. Mimeo.

## 11. Annuities and Public Pensions (if there is time)

## Reading:

- a. Barr, N. (2006) Pensions: Overview of the Issues, *Oxford Review of Economic Policy* 22: 1—14.
- b. Feldstein, M. (1985) The Optimal Level of Social Security Benefits, *Quarterly Journal of Economics* 100: 303—320.
- c. Feldstein, M. (1974) Social Security, Induced Retirement and Aggregate Capital Accumulation, *Journal of Political Economy* 82: 905—26.
- d. Barr, N. (1979) Myths My Grandpa Taught Me, *Three Banks Review* 124: 27—55.
- e. Rosen, H., J.-F. Wen, and T. Snoddon (2012) *Public Finance in Canada*, 4<sup>rd</sup> edition, McGraw-Hill, chapter 11 (on reserve).

**Grade Determination and Final Examination Details:**

There will be three assignments, worth 10 percent each; a mid-term exam worth 30 percent; and a final exam worth 40 percent. The tentative date for the midterm exam is Tuesday, October 23. It will be 2 hours long.

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.

**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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JFW:mi  
2012-09-06