

Econ 8801 and Econ 8802, Fall 2014 and Spring 2015  
 Department of Economics  
 University of Minnesota  
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This is a class in Public Economics – the economics of taxation, spending, government programs, etc.

Below is a rough outline of how the class will go. It is not set in stone. If someone in the class has some ideas about what they would like to do, I'm game for that too.

The class will be a mix of lectures (by me) and presentations (by you).

If you're taking the class for credit, you'll be required to take responsibility for one class session over the two minis, Econ 8801 and Econ 8802. This can be either ½ a class session in each mini, or one full session in either mini.

At the start, I will cover most of the class meetings with lectures to give you a chance to think about and prepare your presentations. (See the class schedule.)

These presentations will be either discussions of alternative sources from the reading list not discussed by me, and/or factual presentations about existing social welfare programs both in the U.S. and in other countries.

Examples of what you might discuss/present are on the last couple of pages here.

## ***Rough Outline for Class***

### ***I. Endogenous Populations—Fertility Choice and Immigration***

1. The Barro and Becker Model of Fertility Choice as an Example and Positive Theory – Long Term Trends and Fluctuations
2. Efficient Populations Definitions and Examples – Larry
  - a) Efficiency and the Barro/Becker Model; b) Examples of Inefficiencies – i) can't get kids income, ii) parents and kids disagree with no commitment, iii) pollution, greenhouse gases and the kids tax, iv) urbanization, infectious diseases (and other externalities) and limited movement to the city.
3. Immigration – Zach and Filippo?.

Principal References:

Barro and Becker  
Becker and Barro

Jones and Schoonbroodt  
Jones and Schoonbroodt

Golosov, Jones and Tertilt, “Efficiency with Endogenous Population Growth,” *Econometrica*, 2007.

Borjas?

## ***II. Ramsey Taxation***

1. Optimality of Lump Sum Taxation (Notes) and some related background ideas (a lump sum equivalence result in a Ramsey setting and the taxing of leisure).

2. Two simple results on Ramsey Taxation – linear taxes

a) homothetic utility and the uniform commodity taxation result

b) the Diamond and Mirrlees intermediate goods result

Principal Reference:

Class Notes on Lump Sum Taxation

“Optimal Fiscal and Monetary Policy,” Chari and Kehoe, *Handbook of Public Economics*, 1999.

## ***III. Optimal Taxation with Private Information, Static***

Why not lump-sum? Non-linear taxation and a Mirrlees example in a static model (Notes)

Principal References:

Discrete Types:  
Class Notes

Continuous Types:  
Class Notes

Mirrlees, J. (1971): “An Exploration in the Theory of Optimum Income Taxation,”  
*Review of Economic Studies*, 38, 175–208.

“Optimal income taxation: an example with a U-shaped pattern of optimal marginal tax rates,”  
PA Diamond - *American Economic Review*, 1998

Saez, E., (2001), "Using Elasticities to Derive Optimal Income Tax Rates," *Review of Economic Studies*, 68, 205-229.

#### ***IV. Optimal Taxation with Private Information, Dynamic***

The Inverse Euler Equation and Immiseration

Principal References: Class Notes

Golosov, M., N. Kocherlakota, and A. Tsyvinski (2003): "Optimal Indirect and Capital Taxation," *Review of Economic Studies*, 70, 569–587.

Principal Reference: Class Notes

Thomas, J. and T. Worrall (1990), "Income Fluctuation and Asymmetric Information: An Example of a Repeated Principal-Agent Problem". *Journal of Economic Theory*, 51, 367-90.

Hosseini, Jones and Shourideh, "Risk Sharking, Inequality and Fertility,"

#### ***V. Existing Elements of the Social Safety Net – Social Security***

- a) Description – U.S. / Others?
- b) History
- c) Rationales
  - i) Missing or Imperfect Annuity Markets
  - ii) Irrational Savings Behavior
  - iii) Old Age Poverty
  - iv) Intergenerational Insurance
  - v) No Commitment by Government and Altruism
  - vi) Efficient Retirement Ages and Bequests
  - vii) dynamic inefficiency – Samuelson and the OLG inefficiency
  - viii) redistribution,

#### ***VI. Existing Elements of the Social Safety Net – Everything Except SS***

II. Social Security Disability Insurance

- a) Description – U.S. / Others
  - b) History
  - c) Rationales
    - i) Missing or Imperfect Disability Insurance Markets
- ref: Golosov and Tsvinsky

ii) Old Age Poverty?

### III. Medicare – U.S. / Others

Health and the safety net –

Larry Lecture: Ales, Hosseini and Jones, "Is There "Too Much" Inequality in Health Spending Across Income Groups?"

Background Reading: Hall, R. and C. Jones, "The Value of Life and the Rise in Health Spending," QJE, 2007.

Other Sources: Braun, A., Kopecky, K. and Koreshkova, T., "Old, Sick, Alone and Poor: A Welfare Analysis of Old-Age Social Insurance Programs," working paper, Fed. Res. Atlanta.

a) Description

b) History

c) Rationales

i) Irrational Savings Behavior

ii) Missing or Imperfect Health Care Insurance Markets

iii) Missing or Imperfect Income Insurance Markets?

iv) Old Age Poverty

v) Intergenerational Insurance

vi) No Commitment by Government and Altruism

vii) Redistribution

-- payments proportional to income, benefits independent of income

### IV. Medicaid (Health Part, Nursing Home Part)

a) Description

b) History

c) Rationales

i) Poverty

ii) Missing or Imperfect Income Insurance Markets

iii) Missing or Imperfect 'Ability' Insurance Markets/

iv) Redistribution

-- payments proportional to income, benefits independent of income

Look at National Health Accounts for data????

### V. Other Countries – pensions and medical care, e.g., Universal Medical Insurance (non U.S.)

- a) Description – compare to U.S.
- b) History – compare to U.S.
- c) Rationales
  - i) Irrational Savings Behavior
  - ii) Missing or Imperfect Annuity Markets
  - iii) Old Age Poverty
  - iv) Intergenerational Insurance
  - v) Redistribution
- payments proportional to income, benefits independent of income

## VI. AFDC/Food Stamps/Section 8 housing

- a) Description
- b) History
- c) Rationales
  - i) Non-Utilitarian Altruism
  - ii) Missing ex ante ‘type’ insurance markets
  - iii) Missing income insurance markets

Why do we have the government provide some goods and services to the poor – housing, food, medical care, schooling – but not others? In some sense this is back to Freidman’s old question: Why not just give them money? You can’t have it be that it is altruism in utility, then you’d just give them money. What if there are two kinds of goods – good ones and evil ones and there is only altruism with respect to good ones? What kinds of income insurance programs, etc, would this generate?

## ***VII. Inequality and Redistribution – The Top 1%***

No planned Lectures on this topic. See References for possible papers for presentations.

### ***Further References on These Topics:***

#### ***I. Endogenous Populations—Fertility Choice and Immigration***

Immigration – George Borjas at JFK, Harvard is the person people talk about for this topic, mostly about what are the effects on wages from increased immigration.

“Rethinking the Gains from Immigration: Theory and Evidence from the U.S.,” Gianmarco I. P. Ottaviano and Giovanni Peri, October 2005.

“Rethinking the Effects of Immigration on Wages,” Gianmarco I. P. Ottaviano and Giovanni Peri, October 2006.

“Rethinking the Effect of Immigration on Wages,” Gianmarco I.P. Ottaviano, (Bocconi University and CEPR) and Giovanni Peri, (University of California, Davis and NBER), March 2010.

#### ***IV. Optimal Taxation with Private Information, Dynamic***

##### *Taxation of Capital Income:*

Kocherlakota, N. R. (2010): *The New Dynamic Public Finance*, Princeton University Press.

“Capital Taxation: Quantitative Explorations of the Inverse Euler Equation” Emmanuel Farhi and Ivan Werning.

“Optimal Taxation of Entrepreneurial Income: A Mirrleesian Approach to Capital Accumulation,” Ali Shourideh, 2011.

##### *Miscellaneous:*

Benabou, R., “Tax and Education Policy in a Heterogeneous-Agent Economy: What Levels of Redistribution Maximize Growth and Efficiency?,” *Econometrica*, March 2002, pp. 481-517.

Piketty, T. and E. Saez, “A Theory of Optimal Inheritance Taxation,” *Econometrica*, September 2013, pp. 1851-1886.

##### *Dynamics and Immiseration*

Green, E. J., (1987), “Lending, and the Smoothing of Uninsurable Income,” in Edward C. Prescott and Neil Wallace, Eds., *Contractual Arrangements for Intertemporal Trade*, 3-25. University of Minnesota Press, Minneapolis.

Atkeson, A. and R. E. Lucas, Jr. (1992), “On Efficient Distribution With Private Information,” *The Review of Economic Studies*, 59, 427-453.

C. Phelan, (2006), “Opportunity and Social Mobility,” *Review of Economic Studies*, vol. 73(2), pp. 487-505.

“Progressive Estate Taxation,” Emmanuel Farhi and Ivan Werning, *Quarterly Journal of Economics*, May 2010, vol 125 (2).

“Inequality and Social Discounting,” Emmanuel Farhi and Ivan Werning, *Journal of Political Economy*, June 2007, Vol. 115(3).

C Sleet, S Yeltekin, (2005), “Social credibility, social patience and long run inequality,” manuscript, Carnegie Mellon University.

C Sleet, S Yeltekin, (2006) “Credibility and Endogenous Societal Discounting,” Carnegie Mellon University.

Golosov and Lovino, (2013), “Social Insurance, the Ratchet Effect and Lack of Commitment.”

*Dynamic contracting with Correlated Shocks*

Fernandes, A. and C. Phelan (2000), “A Recursive Formulation for Repeated Agency with History Dependence,” *Journal of Economic Theory*, 91, 223-247.

Doepke, M. and R. M. Townsend (2006), “Dynamic Mechanism Design with Hidden Income and Hidden Actions,” *Journal of Economic Theory*, 126, 235-286.

“Insurance and Taxation over the Life Cycle,” Emmanuel Farhi and Ivan Werning.

“Optimal Dynamic Taxes,” Mikhail Golosov, Maxim Troshkin and Aleh Tsyvinski, July 2010

## ***V. Existing Elements of the Social Safety Net – Social Security***

References:

### ***A. Big Picture ideas on What Should Social Security Do***

Diamond, P. (1977): “A Framework for Social Security Analysis,” *Journal of Public Economics*, 275–298

Diamond, P. (2004): “Social Security,” *American Economic Review*, 94 (1), 1–24

Feldstein, M. (2005): “Rethinking social insurance,” *American Economic Review*, 1–24.

Prescott, E. C. (2004): “Why Does the Government Patronize Us?”, *The Wall Street Journal*

([http://www.minneapolisfed.org/research/prescott/wsj/WSJ\\_11-11-04\\_Why\\_Does\\_the\\_Government\\_Patronize\\_Us.pdf](http://www.minneapolisfed.org/research/prescott/wsj/WSJ_11-11-04_Why_Does_the_Government_Patronize_Us.pdf))

Prescott, E. C. (2004): “It’s Irrational to Save”, “?”, *The Wall Street Journal*

([http://www.minneapolisfed.org/research/prescott/wsj/WSJ\\_12-29-04\\_It%27s\\_Irrational\\_to\\_Save.pdf](http://www.minneapolisfed.org/research/prescott/wsj/WSJ_12-29-04_It%27s_Irrational_to_Save.pdf))

### ***B. Surveys on the Theoretical and Empirical Research on Social Security***

Mulligan, Casey B. and Sala-i-Martin, Xavier (1999), *Social Security in Theory and Practice (I): Facts and Political Theories*, NBER Working Paper No. W7118.

Mulligan, Casey B. and Sala-i-Martin, Xavier (1999), *Social Security in Theory and Practice (II): Facts and Political Theories*, NBER Working Paper No. W7119.

### *C. How Well Social Security performs as Social Insurance*

Brown J, Coronado J. L. and Fullerton D. (2009): “Is Social Security Part of the Social Safety Net?” ([http://works.bepress.com/cgi/viewcontent.cgi?article=1052&context=don\\_fullerton](http://works.bepress.com/cgi/viewcontent.cgi?article=1052&context=don_fullerton))

Fullerton D. and Must B. (2005) “Income Redistribution from Social Security”

([http://works.bepress.com/cgi/viewcontent.cgi?article=1032&context=don\\_fullerton](http://works.bepress.com/cgi/viewcontent.cgi?article=1032&context=don_fullerton))

Hugget M. and Para C. (2010): “How Well Does U.S. Social Insurance System Provide Social Insurance?”, *Journal of Political Economy*.

### **Normative Rationales for Social Security (possibly an incomplete list)**

#### *D. Missing or Imperfect Annuity Markets:*

Hubbard, R. G. and K. L. Judd (1987): “Social Security and Individual Welfare: Precautionary Saving, Borrowing Constraints, and the Payroll Tax,” *American Economic Review*, 77, 630–46.

Hosseini, Roozbeh, (2010) “Adverse Selection in the Annuity Market and the Role for Social Security,” Working Paper, Arizona State University 2010.

([http://www.public.asu.edu/~rhossein/Roozbeh\\_Hosseini/Research\\_files/Hosseini\\_Annuity\\_SS\\_Final.pdf](http://www.public.asu.edu/~rhossein/Roozbeh_Hosseini/Research_files/Hosseini_Annuity_SS_Final.pdf))

Caliendo, F. N., Guo, L. and Hosseini, R. (2012): “Social Security is NOT a Substitute for Annuities”

([http://www.public.asu.edu/~rhossein/Roozbeh\\_Hosseini/Research\\_files/Annuities.pdf](http://www.public.asu.edu/~rhossein/Roozbeh_Hosseini/Research_files/Annuities.pdf))

#### *E. ‘Irrational’ (time inconsistent?) Saving Behavior*

Feldstein, Martin, “The Optimal Level of Social Security Benefits,” *Quarterly Journal of Economics*, C (1985), 303–320.

Laibson, David, “Golden Eggs and Hyperbolic Discounting, *Quarterly Journal of Economics*, CXII (1997), 443–477.

Laibson, David, Andrea Repetto, and Jeremy Tobacman, “Self-Control and Saving for Retirement,” *Brookings Paper on Economic Activity*, 1 (1998), 91–196.

Imrohoroglu A., S. Imrohoroglu, and D.H. Joines (2003), “Time-Inconsistent Preferences and Social Security”. *Quarterly Journal of Economics* 118(2).

There are many theoretical papers on self-control (e.g. by Gul and Pasendorfer, etc) that motivate this literature

#### *F. Intergenerational Risk Sharing*

Chattopadhyay, Subir and Piero Gottardi (1999), “Stochastic OLG Models, Market Structure, and Optimality,” *Journal of Economic Theory*, Elsevier, vol. 89(1), pages 21-67, November.

Krueger, Dirk and Felix Kubler, “Pareto-Improving Social Security Reform when Financial Markets Are Incomplete!,” *The American Economic Review*, 2006, 96 (3), 737-755.



Ball, Laurence and Gregory Mankiw (2007), “Intergenerational Risk Sharing in the Spirit of Arrow, Debreu, and Rawls, with Applications to Social Security Design”, *Journal of Political Economy*, University of Chicago Press, vol. 115, pages 523-547

Gottardi, P. and Kubler, F. (2010): “Social Security and Risk Sharing”

([http://www.eui.eu/Personal/Gottardi/eass\\_sept.24\\_10.pdf](http://www.eui.eu/Personal/Gottardi/eass_sept.24_10.pdf))

Olovsson, Conny, “Quantifying the risk-sharing welfare gains of social security”, *Journal of Monetary Economics*, 2010, 57 (3), 364{375.

Petterman, W. and Sommer, K. (2013): “How Well Did Social Security Mitigate the Effects of the Great Recession?” ([http://williampeterman.com/pdfs/social\\_security\\_8.pdf](http://williampeterman.com/pdfs/social_security_8.pdf))

*G. There are many papers on efficiency of equilibrium in an stochastic OLG model which are related to the previous group*

Henning Bohn, “Social Security and Demographic Uncertainty: The Risk-Sharing Properties of Alternative Policies”

Dirk Krueger, “Public Insurance against Idiosyncratic and Aggregate Risk: The Case of Social Security and Progressive Income Taxation.”

*H. Dynamic Inefficiency in OLG Economies*

Diamond, P. (1965), "National Debt in a Neoclassical Growth Model", *American Economic Review*, 55, 1126-1150.

Mankiw N.G., Abel A, Summers L, Zeckhauser R., “Assessing Dynamic Inefficiency: Theory and Evidence”, *Review of Economic Studies*, 1989.

*I. No Commitment by Government and Altruism*

I hear people talk about it (e.g. Prescott). Have not seen a serious paper on it yet.

*J. Efficient Retirement, Sort of Related:*

Shourideh, A. and M. Troshkin, “Providing Efficient Incentives to Work: Retirement Ages and the Pension System,” Dec 2011

## ***VII. Inequality and Redistribution – The Top 1%***

*Journal of Economic Perspectives*, Summer 2013, has several summaries of the recent work on documenting and studying the change in the income distribution over the last 30 or so years. The first article is by Thomas Piketty and Emmanuel Saez who have made a living out of this issue over the last 10 years in one way or another. They cite many of their own earlier papers if you want to look for something else to present beyond this summary paper.

## ***VIII. Readings on Immigration***

George Borjas, “Self-Selection and the Earnings of Immigrants” in the *AER*, 1987.

See [http://public.econ.duke.edu/~vjh3/e262p\\_07S/readings/Roy\\_Model\\_Simple\\_Case.pdf](http://public.econ.duke.edu/~vjh3/e262p_07S/readings/Roy_Model_Simple_Case.pdf) for a nice set of notes on this paper and the use of the Roy model of self-selection by earnings for this application.

A list of his publications (many of which are on immigration) is located here:

<http://www.hks.harvard.edu/fs/gborjas/journal.html>

Of particular interest might be the two survey articles, *Journal of Economic Literature*, December 1994 and *Journal of Economic Perspectives*, Spring 1995.

[Sustaining Fiscal Policy Through Immigration](#), *Journal of Political Economy*, 2000, vol. 108 (2), pp. 300-23

Borjas, "[The Labor Demand Curve is Downward Sloping: Reexamining the Impact of Immigration on the Labor Market](#)," *Quarterly Journal of Economics*, November 2003.

**"The Impact of the Mariel Boatlift on the Miami Labor Market,"** David Card, *Industrial and Labor Relations Review*, Vol. 43, No. 2. (Jan., 1990), pp. 245-257.

**"Optimal Migration: A World Perspective,"** Benhabib and Jovanovic, January 2007, NBER wp # 12871.

Some papers by John Kennan and his student from U of Wisconsin:

["The Effect of Expected Income on Individual Migration Decisions,"](#) (Kennan and James R. Walker), *Econometrica*, 79(1), January 2011, 211-251

["Modeling Individual Migration Decisions,"](#) (Kennan and James R. Walker), in Zimmermann, Klaus F. and A. F. Constant (eds.), *International Handbook on the Economics of Migration*, Cheltenham: Edward Elgar Publishing Ltd., 2013, forthcoming.

["Open Borders,"](#) John Kennan, *Review of Economic Dynamics*, April 2013, forthcoming.

[Immigration Restrictions and Labor Market Skills](#)

By John Kennan; University of Wisconsin Madison

Immigrant Wage Assimilation, Selective Emigration, and the Welfare State

By Kayuna Nakajima; University of Wisconsin Madison