

Fiscal Policy and Inequality

1. Introduction

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September 24, 2018

Public Finance - Overview

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- ▶ This module will focus primarily on taxation and its relationship to important economic issues
 - ▶ The origin of states
 - ▶ Effectiveness of public policies
 - ▶ Implications for inequality and redistribution policies

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- ▶ Anything else?

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2. **How** might the government intervene?
3. **What** is the **effect** of those interventions on economic outcomes?
4. **Why** do governments choose to intervene in the way that they do?

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\Rightarrow **Equity-efficiency trade-off**

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4. Public financing of private provision:

4.1 Private education, private pension plans, charitable donations

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- ▶ Example: what is the effect of an increase in tax rates for the top 1% of earners?

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► **Political economy**

- Theory of how the political process produces decisions that affect individuals and the economy
- Example 1: higher taxes overall as voting rights were extended to the full population, rather than only the richest
- Example 2: tariffs for agricultural imports because they have a strong lobby, whereas the rest of the population are almost indifferent

Positive vs. Normative Public Economics

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 - ▶ Often involves **welfare analysis**: what is the best outcome (ie, most efficient) for society as a whole?
 - ▶ Need to set up a social welfare function (SWF) to define what is the society's objective [often controversial]

Empirical methods

- ▶ Randomized experiments
 - ▶ the gold standard for empirical social science
- ▶ Panel regressions
 - ▶ compare differences between treatment and control group, before and after treatment.
- ▶ Synthetical control
 - ▶ use combination of several regions/countries to build a synthetic control group for the “treated” region.
- ▶ Regression discontinuity
 - ▶ Look at outcomes after very close elections to see how politicians matter.
- ▶ Bunching
 - ▶ Look at distortions in behavior around discrete policy thresholds to estimate policy effects.
- ▶ Instrumental variables
 - ▶ the secret sauce of applied microeconometrics

Readings

- ▶ Mostly **academic journal articles**
- ▶ Textbooks useful for certain topics (recommended, but not required):
 - ▶ Salanie (2011): *The Economics of Taxation*
 - ▶ Gruber (2013): *Public Finance and Public Policy*
 - ▶ Angrist and Pischke (2014): *Mastering Metrics: The Path from Cause to Effect*

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- ▶ The exam will not include anything from the readings that wasn't mentioned in the slides.

Homework Assignments

- ▶ There will be three homework assignments.
- ▶ These will ask you to do some applied math and applied statistics:
 - ▶ solve a utility maximization problem:
 - ▶ for example, how many hours will a person work as a function of an income tax?
 - ▶ run an empirical analysis:
 - ▶ for example, how much did wages change in Canton Z after the tax increase?

Course Exam

- ▶ There will be a written exam on the last day of the course that will cover the material from the whole term.
- ▶ We will have a review session.

Term Paper

- ▶ The biggest piece of your grade is a term paper, due a month after the exam.
 - ▶ do a short empirical analysis on a topic related to political economy or public finance.

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- ▶ Why STATA?
 - ▶ Easy to use!
 - ▶ Most applied economists use it
 - ▶ Large on-line community
 - ▶ Drawback: proprietary software