

## **Public Finance Doctoral Examination**

### **Ground Rules:**

- You are permitted a bibliography or list of references to bring with you into the exam. Otherwise, no notes, articles, books, internet, or any other supporting materials are permitted during the examination.
- You should not identify yourself in the exam, so as to assist in making this a blind grading process.
- You are not to discuss the questions with your colleagues as you prepare your answers.
- Your answers are to be turned in by 5:00 PM.

You should have sufficient time for the examination. Before you begin to write, it would be helpful for you to spend some time on reflection and on organizing your thoughts. Quantity is not a substitute for quality in answering these questions.

### **[General] Answer one of the following two questions:**

1. Jamaica's current government recently turned to the International Monetary Fund (IMF) for financial assistance in order to slow the economic demise of the country. In an effort to meet fiscal targets set by the IMF, the Jamaican government has decided to implement a bank transactions tax (BTT). The BTT will be due on all withdrawals from deposit taking institutions regardless of the mode of withdrawal (online, ATM, point of sale, check, bank transfers). The BTT will be collected by the financial institution that originates the withdrawal and remitted to the government monthly. The BTT liability is also independent of the use of the withdrawal so that withdrawals for final consumption and for purchase of business inputs will be subject to the BTT. The government also recently enacted legislation that restricts cash transactions; it is illegal to pay or receive cash of more than \$1 million JA dollar (~\$10,000 USD) or to break a single transaction into multiple parts that each equal to less than \$1 mil. It is also worth noting that Jamaica has the usual mix of taxes: value added tax, personal and corporate income taxes, property tax, custom duties, and excise taxes (alcohol, tobacco, fuel).

Evaluate Jamaica's proposed policy, considering the context that Jamaica is a small, highly indebted, developing country with a large shadow economy and widespread corruption.

2. Research by Piketty and Saez suggests that pre-tax income inequality in the U.S. has increased in the past two decades (1992-2012), with the share of income going to the top 1% of the income distribution increasing from around 15% to over 20% while the share of the top 0.1% increased from 6% to over 11%. Discuss the impact that such an increase in inequality is likely to have had on the federal fiscal system, and discuss whether tax policy could be a potential cause of the increase in this measure of inequality. Discuss how public finance policy might be used to influence income inequality concerns.

**[Taxation] Answer one of the following two questions:**

3. The California State Senate is considering SB 1372 (2014) which would determine the corporate income tax rate in the state to the ratio of the pay of the company's CEO to the pay of its median worker ("ratio"). Rates would range from 7% if the ratio is not over 25, to 13 % if the ratio is over 400. The intent of the policy is to induce companies to put more money in the hands of average employees, as opposed to further enriching their executives. The special tax rates would apply only to publicly-traded corporations. Analyze the tax policy proposal.
4. In his FY 2015 budget proposals, President Obama proposed implementing the "Buffet Rule" through the imposition of a "Fair Share Tax." Under this proposal, taxpayers with adjusted gross income (AGI) of more than \$1 million a year would be required to calculate their overall taxes paid (taking into account regular income tax, AMT, and the employee portion of payroll taxes) and compare it to 30% of AGI minus 28% of deductible charitable contributions. If the former is less than the latter, they would be required to pay a fraction  $\alpha$  of the difference, where  $\alpha = \min[(AGI - \$1 \text{ million}) / (\$1 \text{ million}), 1]$ .

First, evaluate such a proposal in light of the criteria for good tax policy. Second, discuss the likely impact that this increase would have on incomes and on charitable giving given the current state of the literature. Third, discuss how one might estimate the impact of this tax if it was passed, including the method that could be used, and the assumptions and data required.

**[Budgeting] Answer one of the following two questions:**

5. Although it was published in 1940, an article frequently referenced in the public administration literature is a paper by V. O. Key, titled "The Lack of a Budgetary Theory." What problem was Key discussing? Would his article make any sense if submitted for publication today? What does the

literature tell us about the problem? How does it matter for work in the practice of government finance?

6. Since around 2008, Congress has exhibited a rather distinct lack of regard for existing law, and its own internal rules, regarding the federal budgetary process. [Witness: no joint budget resolution has been brought to the floor of the Senate since 2007.] The net result of such disregard for rules has been a collapse of fiscal discipline, leading to enormous federal budget deficits, and unprecedented growth in the federal debt. The accumulating debt has largely been in response to the economic recession, and recent the bailout of the U.S. financial sector. Be that as it may, the U.S. fiscal situation as of 2014 has placed in sharp relief issues of fundamental concern to students of public budgeting.

*Write a tightly-argued essay that addresses in comprehensive fashion either one of the following two related issues*

- a. In a meeting with President George W. Bush, former Vice President Dick Cheney once famously quipped to then Treasury Secretary Paul O'Neill: "Reagan proved that deficits don't matter." The notion that chronic federal budget deficits violate the basics principles of sound finance has a long history in U.S. public finance. Historically, economists have associated chronic deficits with lower national savings rates, reduced long-run economic growth, and a weak dollar. Write an essay that explores the historical development of the norm of federal budgetary balance. If budgetary balance is defunct as a norm at the federal level, is there any effective upper limit on the federal government's ability to spend? In your essay, cite the relevant literature.
- b. Some economists and other experts have expressed their concerns that the growth of the national debt represents an increasing burden on future generations of Americans who must bear the burden of repaying the debt. Write an essay that explores both sides of the issue of the intergenerational burden of the national debt (i.e., that it is a burden on future generations, and that it is not a burden on the future). What does the recent literature on intergenerational equity say about this matter?

**[Debt] Answer one of the following two questions:**

7. Over the past forty-six years there has been much discussion in the public finance literature over the role and impact of the tax exemption of municipal debt. One major aspect of the debate focuses on the efficiency of the federal subsidy. Craft an essay that carefully lays out the contours of the theoretical and empirical aspects of this debate. Use your analysis of

the literature to analyze the issues of supply and demand, capital investment, and the general pros and cons (benefits and costs) of tax-exempt municipal debt.

Finally, U.S. Treasury officials appear to support a proposal to replace tax-exempt securities with AMT and taxable municipal bonds. Carefully analyze the pros and cons of such a proposal within a fiscal federalist framework, employing the principles of modern financial economics, and demonstrating a sophisticated understanding of the public finance principles used to analyze changes in tax policy.

8. Financial markets are designed to meet the needs of both suppliers (buyers) and demanders (issuers) of funds, allocating risk and return across time and between parties. The traditional general obligation debt instrument has been the “gold” standard municipal debt contract since reportedly being issued in 1774. Similarly, the basic cash flow structure, with fixed debt service and a final maturity date, has been the standard cash flow structure in the municipal securities market. The city of Detroit bankruptcy workout, however, may represent a fundamental change in the way the market views different repayment pledges, cash flow structures, and other competing municipal long-term obligations.

Clearly, the nature and variety of repayment pledges backing municipal securities has changed over the last thirty or so years with the advent of appropriation-backed securities and a variety of revenue debt; the cash flow structures have become more complex as well, with the advent of derivative securities like interest rate swaps. Analyze how these changes have, and prospective changes will likely in the future, influence primary market credit quality, interest rate spreads and bond contracts (indentures). Also, using your understanding of the nature and characteristics of the secondary market based on the theoretical and empirical research literature, analyze how future changes might affect or be translated through the secondary market.