

## **Public Finance Doctoral Examination**

### **Ground Rules:**

- 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.

### **Answer one of the following two questions:**

1. Sustainability has become a focus of discussion in many areas, including environment, politics, economics, and finance. In recognition of that all-encompassing concern, please define fiscal sustainability and explain how and why this is an important concern for public finance scholars as well as for people. Identify and explain any current threats to fiscal sustainability in the United States, being quite specific about each identified threat. How might the threats in the United States differ from those faced by, for instance, Greece or Ireland? What does the public finance and budgeting literature say about the sources of the threats, their magnitude, and how they might be mitigated? What data are available to allow an assessment of the severity of these threats?
2. In the FY 2013 budget, the Obama administration proposed to allow some of the EGTRRA and JGTRRA tax cuts (popularly known as the "Bush tax cuts") to sunset for those with income in excess of \$250,000 for joint filers, and \$200,000 for single filers. Consider one portion of this sunset, which would increase marginal tax rates from 33 and 35 percent to 36 and 39.6 percent.

First, discuss the impact that these rate increases would have on a taxpayer's budget constraint in a simple static model, using equations or diagrams where necessary. Then, discuss the expected impact that this increase would have on labor force participation, labor supply, and taxable incomes given the current state of the literature. Finally, discuss how one

might estimate the impact of these changes if they were passed. In doing so, describe the method that could be used, and the assumptions and data required.

**Answer one of the following two questions:**

3. While popular, some of the predictions of the Allingham and Sandmo (AS) tax evasion model are at odds with reality, especially in the United States. Discuss. Your discussion should follow the outline below.
  - a) Write down the Allingham and Sandmo 1972 tax evasion model and derive its main predictions.
  - b) How do the theoretical predictions compare with empirical evidence?
  - c) Discuss three developments in the tax evasion literature, since the AS 1972 piece, aimed at addressing the shortcomings for the AS model. These may be marginal extensions of the original AS model or completely different models.
4. The benchmark that public finance economists use for defining income is the Haig-Simons comprehensive income definition. First, explain this concept for defining the tax base, and give examples of expenditures that would be exempt from taxable income under the H-S rationale. Secondly, local taxes (including those on real property) are deducted from federal taxable income under current tax law. Discuss whether or not this is appropriate within the context of the property tax incidence debate. In other words, discuss the appropriateness of the deduction of property taxes by comparing the Hamilton/Tiebout Benefit View against the New/Capital Tax View in the Haig-Simons rational. A very good answer will provide a detailed description of the two views.

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

5. Discuss performance budgeting from the literature on the evolution of budgetary reform. What are the perceived challenges in the implementation performance budgeting? Why and what adjustments should be made in performance measures according to the literature and your view?
6. Budgeting for stability in both revenue and expenditure represents an important goal for sub-national governments for many reasons.
  - a) Justify stability as a theoretical and practical goal.
  - b) Sub-national governments are often facing multiple and conflicting fiscal objectives (i.e., adequacy, equity, efficiency,

- etc.). How should trade-offs between stability and these other objectives be made?
- c) Explore the possible approaches that help to achieve budget stability.
  - d) Discuss the pros and cons associated with each approach you identified in part (c).

**DEBT: Answer one of the following two questions:**

7. The efficiency and incidence of the tax-exemption of most municipal bonds has been viewed differently by the scholarly community over the years. One aspect of the debate focuses on the relationship between taxes and yields on tax-exempt and taxable bonds. Peter Fortune highlighted one segment of the debate with the title of his article: “Municipal Bond Yields: Whose Tax Rates Matters?”

Sketch the contours of the theoretical arguments and empirical findings in the research literature in this area starting back in the 1970s up to the present. Use diagrams and/or equations as needed. Finally, using your understanding of the literature, analyze the likely impact on tax-exempt and taxable municipal yields from a tax policy change that lowers the current federal corporate income tax rate to zero.

8. The American Recovery and Reinvestment Act of 2009 (ARRA) enacted the Build America Bond (BAB) program. The BAB program was a response to the global financial crisis and was intended to expand capital investment by “unfreezing” capital markets and lowering the cost of borrowing to state and local governments. Over the decades, however, several authors have argued that the tax preferred treatment of interest earned on state and local debt from personal income tax liability results in a misallocation of resources and an overinvestment in public infrastructure.

Write an essay that analytically contrasts BAB-type debt instruments and traditional municipal debt. Begin your essay by providing a thorough description and analysis of the BABs program to date. Then, contrast the BABs program with traditional tax-exempt financing in terms of market supply, investor demand, transaction costs and yields. Next, discuss whether or not a program structured similar to the BABs program is likely to lead to an over (or under) investment of sub-national, public investment compared to traditional tax-exempt financing. Finally, discuss the pricing, tax arbitrage and tax expenditure implications of establishing

a BABs-type debt instrument as a permanent and majority segment of the municipal securities market.