

Winter 2016
Stanford University
Department of Economics

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ECON 241: PUBLIC FINANCE AND TAXATION I

This course covers topics in the optimal design of tax and transfer policy, income and wealth inequality and its policy implications, the empirical effect of taxes on earnings and savings, fiscal and debt policy, social mobility and the dynamics of taxation, public finance issues in developing countries, and the political economy of inequality and tax policy. It also aims at familiarizing you with the frontier theoretical, empirical and computational tools that are currently used to address economic policy questions.

Lectures are on Tuesdays and Thursdays 9:30-11:20AM in Landau 218. Office hours are by appointment in SIEPR 222 (Best) and Landau 341 (Scheuer).

Problem sets, a referee report, and class presentations are an important part of this course. We will have 2 problem sets that will help you to deepen your understanding of the theoretical concepts introduced in the lectures. You will also write one referee report on a paper to be assigned. You are encouraged to work on them in groups but must turn in your own individual work. Some lectures will be devoted to the problem sets and related material. Finally, in each of the empirical lectures, the final 40 minutes will be set aside for a student presentation of one of the key papers (each week's paper is marked with a ☐ below). The final grade will be based on the problem sets, referee report, class presentations, and class participation.

Reading List (📖 = indispensable) (☐ = class presentation paper)

TOPIC 1: EFFICIENCY COSTS OF TAXATION, TAX INCIDENCE, COMMODITY TAXATION

1.1 Efficiency Costs of Taxation

📖 Auerbach, A. and Hines, J., Taxation and Economic Efficiency, *Handbook of Public Economics* 2002

Diamond, P. and McFadden, D., Some Uses of the Expenditure Function in Public Finance, *Journal of Public Economics* 1974

Hausman, J., Exact Consumer Surplus and Deadweight Loss, *American Economic Review* 1981

1.2 Tax Incidence

Theory

📖 Fullerton, D. and Metcalf, G., Tax Incidence, *Handbook of Public Economics* 2002

- Goulder, L. and Williams, R. The Substantial Bias from Ignoring General Equilibrium Effects in Estimating Excess Burden, and a Practical Solution, *Journal of Political Economy* 2003
- Harberger, A., The Incidence of the Corporation Income Tax, *Journal of Political Economy* 1962

Empirics

- Chetty, R., Friedman, J. N., and Saez, E. Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings. *American Economic Review*, 2013, 103(7), 2683-2721
- 📖 Chetty, R, Looney, A, and Kroft, K, Salience and Taxation: Theory and Evidence, *American Economic Review*, 2009, 99(4) 1145-1177
- Rothstein, J. Is the EITC as Good as an NIT? Conditional Cash Transfers and Tax Incidence, *American Economic Journal: Economic Policy*, 2010, 2(1) 177-208
- Saez, E., Matsaganis, M., and Tsakloglou, P. Earnings Determination and Taxes: Evidence From a Cohort-Based Payroll Tax Reform in Greece, *Quarterly Journal of Economics*, 2012, 127, 493-533
- Suárez Serrato, J. C., and Zidar, O. Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms. Working Paper, U. Chicago Booth

1.3 Optimal Commodity Taxation

- 📖 Chari, V. and Kehoe, P., Optimal Fiscal and Monetary Policy, *Handbook of Macroeconomics* 1999
- Diamond, P. and Mirrlees, J., Optimal Taxation and Public Production II: Tax Rules, *American Economic Review* 1971
- 📖 Diamond, P., A Many-Person Ramsey Tax Rule, *Journal of Public Economics* 1975

1.4 Externalities and Corrective Taxation

Theory

- 📖 Bovenberg, L. and Goulder, L., Environmental Taxation and Regulation, *Handbook of Public Economics* 2002
- Diamond, P., Consumption Externalities and Imperfect Corrective Pricing, *Bell Journal of Economics* 1973
- Rothschild, C. and Scheuer, F., A Theory of Income Taxation under Multidimensional Skill Heterogeneity, NBER working paper 2014
- Rothschild, C. and Scheuer, F., Optimal Taxation with Rent-Seeking, forthcoming, *Review of Economic Studies*

Empirics

- Anderson, M. and Auffhammer, M., Pounds That Kill: The External Costs of Vehicle Weight, *Review of Economic Studies*, 2014, 81, 535-571
- 📖 Linden, L. and Rockoff, J. Estimates of the Impact of Crime Risk on Property Values from Megan's Laws, *American Economic Review*, 2008, 98(3), 1103-1127

Case Study: Gasoline Taxes and Fuel Economy

- Aghion, P., Dechezleprêtre, A., Hemous, D., Martin, R. and van Reenen, J. Carbon Taxes, Path Dependency and Directed Technical Change: Evidence from the Auto Industry, *Journal of Political Economy*, forthcoming.
- Anderson, S.T., & Sallee, J., Using Loopholes to Reveal the Marginal Cost of Regulation: The Case of Fuel-Economy Standards, *American Economic Review*, 2011, 101, 1375-1409
- Coglianesse, J., Davis, L., Kilian, L., & Stock, J.H., Anticipation, Tax Avoidance, and the Price Elasticity of Gasoline Demand, 2015, Working paper, Harvard University.
- Davis, L. & Kilian, L., Estimating the Effect of a Gasoline Tax on Carbon Emissions, *Journal of Applied Econometrics*, 2011, 26, 1187-1214
- Ito, K. & Sallee, J., The Economics of Attribute-Based Regulation: Theory and Evidence from Fuel-Economy Standards, 2015, Working Paper, University of Chicago.
- Jacobsen, M.R. & van Benthem, A.A., Vehicle Scrappage and Gasoline Policy, *American Economic Review*, 2015, 105(3), 1312-1338
- Li, S. Linn, J. & Muehlegger, E., Gasoline Taxes and Consumer Behavior, *American Economic Journal: Economic Policy*, 2014, 6(4), 302-342

TOPIC 2: INCOME TAXATION, LABOR SUPPLY AND THE ELASTICITY OF TAXABLE INCOME

2.1 Optimal Income Taxation

- Diamond, P., Optimal Income Taxation: An example with a U-shaped Pattern of Optimal Marginal Tax Rates, *American Economic Review* 1998
- Mirrlees, J., An Exploration into the Theory of Optimum Income Taxation, *Review of Economic Studies* 1971
- 📖 Saez, E., Using Elasticities to Derive Optimal Income Tax Rates, *Review of Economic Studies* 2001
- 📖 Scheuer, F. and Werning, I., Mirrlees meets Diamond-Mirrlees, NBER working paper 2016
- 📖 Werning, I., Pareto Efficient Income Taxation, MIT working paper 2007

2.2 Taxation and Labor Supply

- Beffy, M., Blundell, R., Bozio, A., Laroque, G., & To, M. Labour Supply and Taxation with Restricted Choices, 2014, IFS Working Paper.
- Bitler, M., Gelbach, J.B., & Hoynes, H.W. What Mean Impacts Miss: Distributional Effects of Welfare Reform Experiments, *American Economic Review*, 2006, 96(4), 988-1012.
- Blau, F.D. and Kahn, L.M. Changes in the Labor Supply Behavior of Married Women: 1980-2000, 2007, *Journal of Labor Economics*, 25(3), 393-438
- Blundell, R., Bozio, A. & Laroque, G. Labour Supply and the Extensive Margin, *American Economic Review, Papers & Proceedings*, 2011, 101(3).

- ❑ Blundell, R., Bozio, A. & Laroque, G. Labour Supply Responses and the Extensive Margin: The US, UK and France, 2011, IFS Working Paper.
- Blundell, R., Costa Dias, M., Meghir, C., & Shaw, J. Female Labor Supply, Human Capital and Welfare Reform. 2015, Working Paper, UCL.
- 📖 Blundell, R., Duncan, A. & Meghir, C. Estimating Labor Supply Responses Using Tax Reforms, *Econometrica*, 1998, 66, 827-862
- Blundell, R. & Macurdy, T. Labor Supply: A Review of Alternative Approaches, in *Handbook of Labor Economics*, 1999, volume 3A. O. Ashenfelter and D. Card eds.
- 📖 Eissa, N. Taxation and Labor Supply of Married Women: The Tax Reform Act of 1986 as a Natural Experiment, 1995, NBER Working Paper 5023
- Eissa, N. & Hoynes, H. Taxes and the Labor Market Participation of Married Couples: The Earned Income Tax Credit, *Journal of Public Economics*, 2004, 88(9-10), 1931-1958
- 📖 Eissa, N & Liebman, J. Labor Supply Response to the Earned Income Tax Credit, *Quarterly Journal of Economics*, 1996, 111, 605-637

2.3 Tax Rates and Taxable Income

- 📖 Chetty, R. Is the Taxable Income Elasticity Sufficient to Calculate Deadweight Loss? The Implications of Evasion and Avoidance. *American Economic Journal: Economic Policy*, 2009, 1(2), 31-52.
- Chetty, R. Sufficient Statistics for Welfare Analysis: A Bridge Between Structural and Reduced-Form Methods, *Annual Review of Economics*, 2009, 1(1), 451-487.
- Chetty, R. Bounds on Elasticities with Optimization Frictions: A Reconciliation of Micro and Macro Labor Supply Elasticities, *Econometrica*, 2012, 80(3), 969-1018.
- ❑ Chetty, R. Friedman, J., Olsen, T. Pistaferri, L. Adjustment Costs, Firm Responses, and Micro vs. Macro Labor Supply Elasticities: Evidence from Danish Tax Records, *Quarterly Journal of Economics*, 2011, 126(2), 749-804.
- ❑ Chetty, R., Friedman, J. N., and Saez, E. Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings. *American Economic Review*, 2013, 103(7), 2683-2721
- Chetty, R. Guren, A. Manoli, D. & Weber, A. Are Micro and Macro Labor Supply Elasticities Consistent? A Review of Evidence on the Intensive and Extensive Margins, *American Economic Review Papers and Proceedings*, 2011, 101, 471-475
- 📖 Feldstein, M. Tax Avoidance and the Deadweight Loss of the Income Tax. *Review of Economics and Statistics*, 1999, 81(4), 674-680.
- Gruber, J. & Saez, E. The Elasticity of Taxable Income: Evidence and Implications, *Journal of Public Economics*, 2002, 84(1), 1-32.
- Kleven, H. & Waseem, M. Using Notches to Uncover Optimization Frictions and Structural Elasticities: Theory and Evidence from Pakistan, *Quarterly Journal of Economics*, 2013, 669-723.
- Saez, E. Do Taxpayers Bunch at Kink Points?, *American Economic Journal: Economic Policy*, 2010, 2(3), 180-212.
- 📖 Saez, E. Slemrod, J. & Giertz, S. The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review, *Journal of Economic Literature*, 2012, 50(1), 3-50.

2.4 Income Inequality

- Alvaredo, F. Atkinson, A., Piketty, T., & Saez, E. The Top 1 Percent in International and Historical Perspective, *Journal of Economic Perspectives*, 2013, 27(3), 3-20.
- Atkinson, A., Piketty, T. & Saez, E. Top Incomes in the Long Run of History, *Journal of Economic Literature*, 2011, 49(1), 3-71.
- Piketty, T. & Qian, N. Income Inequality and Progressive Income Taxation in China and India, 1986-2010, *American Economic Journal: Applied Economics*, 2009, 1(1), 53-63.
- Piketty, T. & Saez, E. Income Inequality in the United States, 1913-1998, *Quarterly Journal of Economics*, 2003, 118(1), 1-39.

2.5 Optimal Income Taxation—Extensions: Extensive Margin, Multidimensional Heterogeneity, and General Equilibrium

- Ales, L., Kurnaz, M. and Sleet, C., Technical Change, Wage Inequality, and Taxes, *American Economic Review* 2015
- Chone, P. and Laroque, G., Negative Marginal Tax Rates and Heterogeneity, *American Economic Review* 2010
- Kleven, H., Kreiner, C. and Saez, E., The Optimal Income Taxation of Couples, *Econometrica* 2009
- 📖 Rothschild, C. and Scheuer, F., Redistributive Taxation in the Roy Model, *Quarterly Journal of Economics* 2013
- Rothschild, C. and Scheuer, F., A Theory of Income Taxation under Multidimensional Skill Heterogeneity, NBER working paper 2014
- Saez, E., Optimal Income Transfer Programs: Intensive versus Extensive Labor Supply Responses, *Quarterly Journal of Economics* 2002
- Scheuer, F., Entrepreneurial Taxation with Endogenous Entry, *American Economic Journal: Economic Policy* 2014
- 📖 Scheuer, F. and Werning, I. Mirrlees meets Diamond-Mirrlees, NBER working paper 2016
- 📖 Stiglitz, J., Self-Selection and Pareto Efficient Taxation, *Journal of Public Economics* 1982

2.6 The Taxation of Top Incomes

Theory

- Ales, L. and Sleet, C., Taxing the Top, Carnegie Mellon working paper 2015
- Lockwood, B., Nathanson, C. and Weyl, G., Taxation and the Allocation of Talent, University of Chicago working paper 2013
- 📖 Piketty, T., Saez, E. and Stantcheva, S., Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities, *American Economic Journal: Economic Policy* 2014
- 📖 Rothschild, C. and Scheuer, F., Optimal Taxation with Rent-Seeking, *forthcoming, Review of Economic Studies*
- 📖 Scheuer, F. and Werning, I., The Taxation of Superstars, NBER working paper 2015

Empirics

- ☐ Akcigit, U., Baslandze & Stantcheva, S. Taxation and the International Mobility of Inventors, 2014, NBER Working Paper 21024.
- Kleven, H., Landais, C. & Saez, E. Taxation and the International Mobility of Superstars: Evidence from the European Football Market, *American Economic Review*, 2013, 103(5) 1892-1924.
- Moretti, E. & Wilson, D. The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists, 2015, Mimeo: UC Berkeley

TOPIC 3: PRODUCTION EFFICIENCY AND MIXED TAXATION

Theory

- 📖 Atkinson, A. and Stiglitz, J., The Design of Tax Structure: Direct versus Indirect Taxation, *Journal of Public Economics* 1976
- Diamond, P. and Mirrlees, J., Optimal Taxation and Public Production, *American Economic Review* 1971
- Naito, H., A Reexamination of Uniform Commodity Taxes under a Nonlinear Income Tax System and Its Implication for Production Efficiency, *Journal of Public Economics* 1999

Empirics

- Best, M.C. Brockmeyer, A. Kleven, H.J., Spinnewijn, J. & Waseem, M., Production versus Revenue Efficiency with Limited Tax Capacity: Theory and Evidence From Pakistan, *Journal of Political Economy*, forthcoming
- Kopczuk, W. & Slemrod, J. The Optimal Elasticity of Taxable Income, *Journal of Public Economics*, 2002, 84(1) 91-112
- ☐ Kopczuk, W. Tax Bases, Tax Rates and the Elasticity of Reported Income, *Journal of Public Economics*, 2005, 89(11-12), 2093-2119.

TOPIC 4: CAPITAL AND BEQUEST TAXATION, SAVINGS, AND WEALTH INEQUALITY

4.1 Optimal Linear Capital Taxation

- Chamley, C., Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives, *Econometrica* 1986
- Diamond, P. and Spinnewijn, J., Capital Income Taxes with Heterogeneous Discount Rates, *American Economic Journal: Economic Policy* 2011
- 📖 Judd, K., Redistributive Taxation in a Simple Perfect Foresight Model, *Journal of Public Economics* 1985
- Straub, L. and Werning, I., Positive Long-Run Capital Taxation: Chamley-Judd Revisited, MIT working paper 2014

4.2 Taxation and Savings: Empirics

- Attanasio, O.P. & Weber, G., Consumption and Saving: Models of Intertemporal Allocation and Their Implications for Public Policy, *Journal of Economic Literature*, 2010, 48, 693-751.
- Banks, J., Blundell, R. & Tanner, S. Is There a Retirement-Savings Puzzle? *American Economic Review*, 1998, 88(4), 769-88
- Bernheim, B.D., Skinner, J. & Weinberg, S. What Accounts for the Variation in Retirement Wealth among U.S. Households? *American Economic Review*, 2001, 91(4) 832-857.
- 📖 Bernheim, B.D. Taxation and Saving, in *Handbook of Public Economics*, Volume 3, ch 18. 2002.
- 📖 Chetty, R. Friedman, J., Leth-Petersen, S. & Nielsen, T. Active vs. Passive Decisions and Crowd-out in Retirement Savings: Evidence from Denmark, *Quarterly Journal of Economics*, 2014, 129(3), 1141-1219.
- Duflo, E. Gale, W. Liebman, J., Orszag, P. & Saez, E. Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block, *Quarterly Journal of Economics*, 2006, 121(4), 1311-1346.
- Madrian, B. & Shea, D. The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior, *Quarterly Journal of Economics*, 2001, 116(4), 1149-1187.
- Parker, J. The Reaction of Household Consumption to Predictable Changes in Social Security Taxes, *American Economic Review*, 1999, 89(4), 959-973.
- Souleles, N., The Response of Household Consumption to Income Tax Refunds, *American Economic Review*, 1999, 89(4), 947-958.

4.3 Taxation over the Life Cycle

- Erosa, A. and Gervais, M., Optimal Taxation in Life-Cycle Economies, *Journal of Economic Theory* 2002
- 📖 Farhi, E. and Werning, I., Insurance and Taxation over the Life Cycle, *Review of Economic Studies* 2013
- Stantcheva, S., Optimal Taxation and Human Capital Policies over the Life Cycle, MIT working paper 2014
- 📖 Weinzierl, M., The Surprising Power of Age-Dependent Taxation, *Review of Economic Studies* 2011

4.4 Taxation of Intergenerational Transfers: Theory

- Cremer, H. and Pestieau, P., Wealth and Wealth Transfer Taxation: A Survey, IDEI working paper 2009
- Farhi, E. and Werning, I., Inequality and Social Discounting, *Journal of Political Economy* 2007
- 📖 Farhi, E. and Werning, I., Progressive Estate Taxation, *Quarterly Journal of Economics* 2009
- 📖 Piketty, T. and Saez, E., A Theory of Optimal Inheritance Taxation, *Econometrica* 2013

4.5 Bequests, Wealth Inequality, and Intergenerational Mobility: Empirics

- Boserup, S., Kopczuk, W. & Kreiner, C. Stability and Persistence of Intergenerational Wealth Formation: Evidence from Danish Wealth Records of Three Generations, 2014, Mimeo: Columbia University
- 📖 Chetty, R., Hendren, N., Kline, P., & Saez, E. Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States. *Quarterly Journal of Economics*, 2014, 129(4), 1553-1623.
- Chetty, R. & Hendren, N. The Effects of Neighborhoods on Intergenerational Mobility: Childhood Exposure Effects and County Level Estimates. 2015. Mimeo: Harvard University.
- Kopczuk, W., Saez, E., & Song, J. Earnings Inequality and Mobility in the United States: Evidence from Social Security Data since 1937, *Quarterly Journal of Economics*, 2010, 125(1), 91-128.
- 📖 Saez, E. & Zucman, G. Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data, *Quarterly Journal of Economics*, forthcoming.
- Kopczuk, W. The Trick is to Live: Is the Estate Tax Social Security for the Rich? *Journal of Political Economy*, 2003, 111(6), 1318-1341.
- 📖 Kopczuk, W., Bequest and Tax Planning: Evidence from Estate Tax Returns, *Quarterly Journal of Economics*, 2007, 122(4), 1801-1854.
- 📖 Kopczuk, W., What Do We Know About the Evolution of Top Wealth Shares in the United States? *Journal of Economic Perspectives*, 2015, 29(1), 47-66

4.6 Fiscal Policy with Business Cycle Shocks

- Aiyagari, R., Optimal Capital Income Taxation with Incomplete Markets, Borrowing Constraints and Constant Discounting, *Journal of Political Economy* 1995
- Aiyagari, R., A. Marcet, T. Sargent and J. Seppala, Optimal Taxation Without State-Contingent Debt, *Journal of Political Economy* 2002
- Barro, R., On the Determination of Public Debt, *Journal of Political Economy* 1979
- Christiano, L., V. V. Chari and P. Kehoe, Optimal Fiscal Policy in a Business Cycle Model, *Journal of Political Economy* 1994
- Farhi, E., Capital Taxation and Ownership when Markets are Incomplete, *Journal of Political Economy* 2010
- 📖 Lucas, R. and Stokey, N., Optimal Fiscal and Monetary Policy in an Economy without Capital, *Journal of Monetary Economics* 1983
- 📖 Werning, I., Optimal Fiscal Policy with Redistribution, *Quarterly Journal of Economics* 2007

4.7 Nonlinear Capital Taxation

- Albanesi, S. and Sleet, C., Dynamic Optimal Taxation with Private Information, *Review of Economic Studies* 2006
- 📖 Farhi, E. and Werning, I., Capital Taxation: Quantitative Explorations of the Inverse Euler Equation, *Journal of Political Economy* 2012

- 📖 Golosov, M., Kocherlakota, N. and Tsyvinski, A., Optimal Indirect and Capital Taxation, *Review of Economic Studies* 2003
- Golosov, M., Tsyvinski, A. and Werning, I., New Dynamic Public Finance: A User's Guide, *NBER Macroeconomics Annual* 2006
- 📖 Kocherlakota, N., Zero Expected Wealth Taxes: A Mirrlees Approach to Dynamic Optimal Taxation, *Econometrica* 2005
- Saez, E., Optimal Progressive Capital Income Taxation in the Infinite Horizon Model, *Journal of Public Economics* 2013
- Werning, I., Nonlinear Capital Taxation, MIT working paper 2010

4.8 Political Economy of Capital Taxation and Wealth Inequality

- Acemoglu, D., Golosov, M. and Tsyvinski, A., Political Economy of Mechanisms, *Econometrica* 2008
- Benhabib, J. and Rusticchini, A., Optimal Taxes Without Commitment, *Journal of Economic Theory* 1997
- 📖 Farhi, E., Sleet, C., Werning, I. and Yeltekin, S., Nonlinear Capital Taxation without Commitment, *Review of Economic Studies* 2012
- Phelan, C. and Stacchetti, E., Sequential Equilibria in a Ramsey Tax Model, *Econometrica* 2001
- 📖 Scheuer, F. and Wolitzky, A., Capital Taxation under Political Constraints, *forthcoming, American Economic Review*