

South Asian University
MA in Development Economics
Public Economics (PE)

Course Outline and Readings

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Course Objectives: In this course we explore the classical reasons why markets fail to be efficient, and whether and how intervention measures like regulation, public expenditure and taxation policies may improve upon the allocation of resources. We start by examining the case of public goods' allocation, a classic example of market failure, both generally and also as a special case, to the context of medical care in a developmental context.

Turning to taxation, we apply modern economic analysis to understand how taxes and subsidies affect economic behaviour. Pivotal to this task is the idea of the excess burden (or *dead-weight loss*, DWL) of public policies. Finally, we take up the issue of tax design and reform such that the relevant excess burden can be minimised. Here we focus on both personal and commodity taxation. In the context of the latter, the evolving GST reform in India will be focused on and in that context related reforms in the entire SAARC region will be examined.

Prerequisites: (i) Advanced Undergrad Microeconomics and (ii) University Level Calculus

Texts and Readings:

Atkinson & Stiglitz (AS), *Lectures on Public Economics* (McGraw-Hill, 1980)

Myles, Gareth (1995), *Public Economics*, Cambridge University Press, 1995.

Two UG texts may also prove valuable as providing the needed background:

J. E. Stiglitz, *Economics of the Public Sector*, Norton, latest edition.

H. S. Rosen, *Public Finance*, McGraw-Hill, latest Edition.

Evaluation: The course will be evaluated as follows.

- a) Class Project/Assignments: 20%
- b) Mid-Term Test: 30%
- c) Final Examination: 50 %

The class project can be a 10-page report on 'Tax Reform Measures in South Asia', though other thought-out suggestions from class will receive consideration. More will follow in due course.

Topics

1. Government & Markets: Institutional, Allocative & Redistributive Perspectives
[Market Failure and the Scope of Public Policy]

Lecture Notes by Ahsan_PE1

*Arrow, K.J. "The Organization of Economic Activity", in *Public Expenditure and Policy Analysis*, eds., Haveman and Margolis (Markham, 1970)

Atkinson-Stiglitz (AS), Lecture 1

2. Criteria for Public Interventions & the Measurement of Excess Burden

[Efficiency, Equity & Tax progressivity]

Lecture Notes by Ahsan_PE2

Rosen, H, Ch. 12 & 13.

3. Public Good Allocation: Pricing, Preference Revelation & Free Riding

Lecture Notes by Ahsan_PE3

Samuelson, P. A. (1954), "The Pure Theory of Public Expenditure", *Review of Economics & Statistics*, 387-389.

Samuelson, P. A. (1955), "Diagrammatic Exposition of a Theory of Public Expenditure", *Review of Economics & Statistics*, 350-356.

Rosen, ch 4.

Stiglitz, J. E. (2000), Chapter 6, *Economics of the Public Sector*, 3rd ed., Norton.

4. Personal Taxation and Household Behaviour [Definition of the Individual Income Tax base, Effects on Labour Supply, Saving, Wealth and Asset holding.]

Lecture Notes by Ahsan_PE4

Atkinson-Stiglitz (AS), Chapters 2 & 3.

Rosen, Ch. 15 & 16.

Stiglitz, op cit, pp.542-47.

Kotlikoff, L (1984), "Taxation and Savings", *J of Economic Literature*, 22, Dec (esp. pp1598-1604).

Laura, M & A. Guillermo (2012), "Welfare Programs and Labour Supply in Developing Countries: Experimental Evidence from Latin America, IZA DP No. 6959 October.

5. Tax Incidence [Incidence in Partial and General Equilibrium, The Harberger Analysis, and Developing Country Applications]

Lecture Notes by Ahsan_PE5

Atkinson-Stiglitz (AS), Chapter 6.

Rosen, H, Chapter 15.

L. Kotlikoff and L. Summers. "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, 1043-1092. Required reading: Sections 0, 1, 2, 3.1, and 4.4.

L. Kotlikoff and L. Summers. "Tax Incidence," in A. Auerbach and M. Feldstein, Volume 2, Sections 2.2.1-2.2.3 and 2.3.

J. Whalley (1984), "Regression or Progression: The Taxing Question of Incidence Analysis", *CJE* 17 (4): 654-82.

6. Optimal Indirect Taxation

Lecture Notes by Ahsan_PE6

Rosen, Ch 14

Siglitz, Chapter 16, pp 322-27.

A.J.Auerbach and J.R.Hines, (2002), "Taxation and Economic Efficiency", in Auerbach & Feldstein, *Handbook of Public Economics*, Vol. 3, Ch. 21, Secs.1 - 3.

A. Sandmo (1976), "Optimal taxation: An Introduction to the literature", *JPubE*.

Stern, N.H. (1984), "Optimum Taxation and Tax Policy", *IMF Staff Papers* 31(2), 339-378.

Auerbach, A. (1985), "The Theory of Excess Burden and Optimal Taxation," in A. Auerbach and M. Feldstein, *Handbook of Public Economics*, Volume 1, 61-127, Section 5.

7. Optimal Income Tax & Redistribution

Lecture Notes by Ahsan_PE7

Stiglitz, JE, UG book, Chapter 20.

A.J.Auerbach and J.R.Hines, "Taxation and Economic Efficiency", *AF*, Vol. 3, Ch. 21, 2002, Secs. 4 and 6.

Dahlby, B. (1998), "Progressive Taxation and the Social Marginal Cost of Public Funds", *JPubE*, 67: 105-22, January.

Diamond, Peter and Emmanuel Saez (2011), "The Case for a Progressive Tax: From Basic Research to Policy Recommendations", CESifo Working Paper # 3548 (August), www.cesifo.org/wp.

E. Saez (2001), "Using Elasticities to Derive Optimal Income Tax Rates," *Review of Economics Studies*, 68, 2001, 205-229, Sections 1-3 and 5.

Myles, Ch 5.

Stern, N.H., (1984) op cit.

8. Tax Reform in South Asia

Ahsan, Syed M., (1995a), "Tax Reform in Bangladesh: Some Theoretical and Practical Issues", in Salim Rashid, ed., *Bangladesh Economy: Evaluation and a Research Agenda*, (Dhaka: University Press Ltd, 1995), 194-221.

Ahsan, Syed M., (1995b), "Tax Evasion: The Developing Country Perspective", *Asian Development Review*, vol. 13(1), 1995, 78-126.

Cnossen, S (2013), "Preparing the Way for a Modern GST in India", *International Tax & Public Finance*.

Gordon, Roger & Wei Li (2009), "The Structures of Taxation in Developing Countries: Many Puzzles and a Possible Explanation", *J of Public Economics*, 93, 855-866.

Piketty, Thomas and Nancy Qian (2009), "Income Inequality and Progressive Income Taxation in China and India, 1986-2015", *AEJPP*.

Rao, M. Govinda (2005), "Tax System Reform In India: Achievements & Challenges Ahead", *Journal of Asian Economics* 16, 993-1011.