

Università di Roma Tor Vergata - Dipartimento DEF

European Public Choice & Public Economics (2016/2017)

Availability

Compulsory for MSc European Economy and Business Law.

Lecturers

Module 1

Berardino Cesi

Room P1 S Ex 24, 1st floor

Email: berardino.cesi@uniroma2.it

Web: <http://berardinocesi.jimdo.com>

Office Hours:

During the course: Wednesday
16.00-18.00

Outside the course: by
appointment

Module 2

Stefano Gagliarducci

Room B2 13, 1st floor

Email: stefano.gagliarducci@uniroma2.it

Web: sites.google.com/site/stefanogagliarducci

Office Hours:

During the course: Tuesday
9.00-11.00

Outside the course: by
appointment

Content

This course is composed of two parts:

Module 1

- **European Public Economics:** public good and common resources, the principles of optimal taxation on income and commodities, provision of public good (equity and efficiency).

Module 2

- **European Public Choice:** public policy formation, political processes and political institutions from a rational choice perspective

Attendance

Not compulsory, but strongly recommended. Active class participation is very much appreciated.

Course prerequisites

You need to have covered the material of a good undergraduate economics program: a good working knowledge of intermediate microeconomics (we will make almost no use of macroeconomics) some literacy in mathematics and some knowledge of game theory is

necessary, as is a basic understanding of econometrics, at least through multiple regression (you should understand how to interpret regression coefficients and be aware of the possible pitfalls in their use). The first class is devoted to review some of these tools. An introductory course in public finance is useful but not necessary. In the second module the main tool of analysis will be the revelation principle, and students are advised to study it beforehand

Final Exam

The final exam is a three-hours written test consisting of six questions, as follows. Three questions from Module 1 (2 mathematical exercises, similar but easier than those carried out during the course, and the discussion of an article chosen among those presented in class), and three questions from Module 2 (2 mathematical exercises, and the discussion of an article chosen among those presented in class). Within each question there might be a choice of "subquestions". To pass the exam it is necessary to obtain a mark of 18 in at least four questions. The mark for the written exam is given by the average mark of the six questions. In each question the scale of marks goes from 0 to 34, so students can obtain a final mark of 30 even without answering perfectly all the questions.

In addition students can volunteer to give presentations and have their mark added to the mark of the exam. Each presentation will be given a mark from -2 to +3, which is added to the mark of the first exam session after the course only, and rounded to the nearest integer to determine the final mark of the students. Withdrawals from scheduled presentations will be marked with -2.

NB 1: There is one exam per session, plus an additional exam in the session that follows the course (but students can only sit for one of the two).

Module 1

Content

Detailed understanding of the provision of public good and its implications in terms of efficiency and equity. Principles of optimal income and commodity taxation in competitive market and under market power. The course also focuses on the role and use of common resources.

It is expected that the students will learn an analytical approach to the economic issues. This first module will help strengthen and ease the analysis of the second cycle of courses and make students able to develop and/or implement original ideas, potentially with original research in mind.

Course schedule

Please note that the dates on which material will be covered are approximate. Total 10 classes for a total of 36 hours. Classes will begin promptly; there will be a break of approximately 10-15 minutes, at an appropriate point towards the mid-point of the class.

Beginning: Monday **22-Feb**

End: Wednesday **23-Mar**

Material

The program of the course is divided into 3 main parts:

- **An introduction to the basics of taxation**
 - Basic models of taxation (on demand and supply)
- **Public provision of public goods.**
 - Samuelson's Rule and Lindhal prices.
 - Median income theorem.
 - Vickrey-Clarke-Groves Mechanism
- **Tax Models**
 - Optimal commodity taxation.
 - a. Commodity taxation in competitive market. Ramsey' rule.
 - b. Commodity taxation with market power.
 - Optimal income taxation.
- **Exploitation and use of common resources**
 - Externalities
 - Free riding problem and overexploitation of common resources
 - Tragedy of commons

Main references

The main text books are in general good enough to cover this part of the program (Gruber, Myles-Hindricks, Myles, Rosen e Gayer). The course basically follows *Intermediate Public Economics* (2006).

Public provision of public goods

Intermediate public Economics (2006), Hindriks & Myles (Ch. 5 1st edition or Ch. 6 2nd edition)

Advanced Microeconomic Theory Jehle, Reny (more challenging)
The Economics of Taxation, Salanie, B. (2002), MIT Press

Further readings:

Samuelson, Paul A. 1954, "The Pure Theory of Public Expenditure," *Review of Economics and Statistics*, 36, 4: 387-389.

Samuelson, Paul A., 1955, "Diagrammatic Exposition of a Theory of Public Expenditure," *Review of Economics and Statistics*, 37, 4: 350-35

Tax Models – Optimal commodity/income taxation.

Intermediate Public Economics (2006), Hindriks & Myles (Ch. 14-15 first-edition or 15-16 2nd edition)

Salanie, B. (2002), *The Economics of Taxation*, MIT Press: there are several simple model of taxation in increasingly less simple set-ups). Commodity (indirect) taxation in Chapter 3. (useful reading)

The model are highly simplified (but with all the original message intact) versions of the original difficult contribution, Diamond and Mirrlees (AER 1971).

Further readings:

- Matthew, Weinzierl, and Yagan (2009) "Optimal Taxation in Theory and Practice" *Journal of Economic Perspective*.
- Mirrlees, J.A., (1971), "An Exploration in the Theory of Optimum Income Taxation", *Review of Economic Studies*, p.175-208
- Mirrlees, J.A. (1976) "Optimal tax theory", *Journal of Public Economics*, 6, pp.327-358
- Diamond, Peter A., and James A. Mirrlees, 1971, "Optimal Taxation and Public Production I: Production Efficiency," *American Economic Review*, 61, 1: 8-27.
- Diamond, Peter A., and James A. Mirrlees, 1971, "Optimal Taxation and Public Production II: Tax Rules," *American Economic Review*, 61, 3: 261-278.

- Seade, J. (1982) "On the Sign of the Optimum Marginal Income Tax", *Review of Economic Studies*, 49, pp.637-643
- Tuomala, M. (1984) "On the Optimal Income Taxation", *Journal of Public Economics*, 23, pp.351-366
- Tuomala, M. (1985) "Simplified formulae for optimal linear income taxation", *Scandinavian Journal of Economics*, 87, pp.668-72
- Ebert, U. (1992) "A Reexamination of the Optimal Nonlinear Income Tax", *Journal of Public Economics*, 49, pp.47-73
- Auerbach, Alan J., and James R. Hines, Jr., 2002, "Taxation and Economic Efficiency," Chapter 21, in *Handbook of Public Economics*, volume 3, edited by Alan J. Auerbach and Martin Feldstein (Amsterdam: Elsevier): 1360-1383
- Slemrod, Joel, 1990, "Optimal Taxation and Optimal Tax Systems," *Journal of Economic Perspectives*, 4, 1: 157-178.

Common resources

Microeconomics and Behavior, Robert H. Frank Gregory, McGraw-Hill Irwin

Course Web Page

The material for this course (syllabus, notes, announcements, materials) will be posted online. It is essential to consult this link, as all information regarding this course will be available there.

Exercises

Exercises will be assigned in advance and analysed during the lessons in the classroom with the active participation of students. Exercises questions will be downloaded from the course webpage. Some examples of the right answers will be provided on the course webpage, after each lesson. The day for the exercise section will be decide during the course according to the covered material.

Students' presentations

These will be assessed and the student will be allowed to choose whether to have them included as an element of the final evaluation of the course.

The aim of the presentation is to transfer and communicate new knowledge to a group of people who have a general knowledge of economics or finance, but not necessarily in possession of complete familiarity with all aspects of that topic.

A skill that will be evaluated in the presentation is the ability to choose what needs to be explained and what you can assume that the public knows. "Wasting" time in explaining topics that the students of the master already know is not a good use of one's time.

The presentations will be held in the last week of the course.

The teacher will provide a list of articles (available on the web), and each student must choose an article from those.

In general, however, there will be wide choice regarding the topics to which students might be examined in each session.

The presentation in PowerPoint (or Beamer pdf) must be sent to the teacher's email address by the deadline communicated during the course.

The presentation will last no more than 15 minutes. This limit may be reduced at 13 minutes depending on the number of presentations

Written and verbal suggestions on presentation techniques will be given during the course.

Each presentation will receive a detailed individual comment from the teacher

Module 2

Content

This course examines public policy formation, political processes and political institutions from a rational choice perspective. A one-term course cannot offer a comprehensive treatment of the complex working of political systems. The emphasis is on introducing some key formal models to simplify and analyze broad classes of situations. At the same time, rigorous empirical testing of formal models will be a central component. We will focus on the literature on voting, elections, partisan politics and political agency.

Required Text and Readings

No single textbook covers all the material presented in this course. A number of the recommended readings will consist of journal articles. I will also distribute the slides of each class. The books that will be used more frequently are the following:

- Besley, "Principled Agents?", Oxford University Press, 2006 (henceforth: Besley)
- Mueller, "Public Choice III", Cambridge University Press, 2003 (henceforth: Mueller)
- Persson and Tabellini, "Political Economics", MIT Press, 2000 (henceforth: PT)

All readings are available through the *Biblioteca Vilfredo Pareto*, located in the building B. Class notes, as well as any other additional material/reading, will be available on the course web page.

Location

Classes will be held in room P10, 2nd floor, building A. Any eventual change will be posted on the course web page.

Course Web Page

The material for this course (syllabus, notes, announcements, materials) will be posted on the course webpage.

Outline of the course

- **Foundations and review:** individual rationality, game theory, econometrics
- **Preference aggregation:** Arrow's impossibility theorem, median voter model
- **Voting:** multidimensionality, agenda setting, strategic voting, the paradox of voting

- **Electoral competition:** Downsian model, probabilistic voting, partisan candidates, citizen-candidate model
- **Political agency:** accountability, term limit, incumbency advantage
- **Legislative organization:** presidential vs. parliamentary, committees, electoral rules, coalition governments
- **Bureaucracy:** budget maximizing bureau, congressional dominance
- **Special interest politics:** interest groups, rent-seeking

Material

In the following pages you will find the detailed reading list for each topic. This list is indicative, and can be subject to some changes. In particular, further readings may be provided during the lectures. Readings marked with a * represent compulsory reading, all other readings are just suggestions.

1. Review: Individual rationality, Nash equilibrium, Causality in econometrics

Mueller: 1 *

Besley: 1 *

PT: 1 *

Varian, (1992), "Microeconomic Analysis", 94-102

Turocy and von Stengel (2001), "Game Theory"

Ichino (2007), "The Problem of Causality"

2. Preference aggregation

PT: 2

Ferreira and Gyourko (2009), "Do Political Parties matter? Evidence from U.S. Cities", *Quarterly Journal of Economics*, 399-422 *

Pettersson-Lidbom (2008), "Do Parties Matter for Economic Outcomes: A Regression-Discontinuity Approach", *Journal of the European Economic Association*, 1037-1056

3. Voting

Mueller: 5.1, 5.2, 5.3, 5.4, 14

Merlo: 2

Larcinese, Puglisi and Snyder (2011), "Partisan Bias in Economic News: Evidence on the Agenda Setting Behavior of U.S. Newspapers", *Journal of Public Economics*, 1178-1189 *

Bernheim, Rangel and Rayo (2006), "The Power of the Last Word in Legislative Policy Making", *Econometrica*, 1161-1190

Degan and Merlo (2009), "Do Voters Vote Ideologically?", *The Journal of Economic Theory*, 1868-1894

Gentzkow, Shapiro and Sinkinson (2011), "The Effect of Newspaper Entry and Exit on Electoral Politics", *American Economic Review*, 2980-3018 *

Funk (2010), "Social Incentives and Voter Turnout: Evidence from the Swiss Mail Ballot System", *Journal of the European Economic Association*, 1077-1103

4. Electoral competition

PT: 3.1, 3.2, 3.3, 3.4, 5.1, 5.2, 5.3

Mueller: 11, 12, 21

Persson and Tabellini (1994), "Is Inequality Harmful for Growth?", *American Economic Review*, 600-621

Alesina and Rodrik (1994), "Distributive Politics and Economic Growth", *Quarterly Journal of Economics*, 465-90

Perotti (1996). "Growth, Income Distribution, and Democracy: What the Data Say", *Journal of Economic Growth*, 149-187

Lee, Moretti and Butler (2004), "Do Voters Affect or Elect Policies? Evidence from the U.S. House", *Quarterly Journal of Economics*, 807-859

Jones and Olken (2005), "Do Leaders Matter? National Leadership and Growth Since World War II", *Quarterly Journal of Economics*, 835-864

Chattopadhyay and Duflo (2004) "Women as Policy Makers: Evidence from a Randomized Policy Experiment in India", *Econometrica*, 1409-1443 *

Alesina (1988), "Credibility and Policy Convergence in a Two-Party System with Rational Voters", *American Economic Review*, 796-805

Besley and Coate (1997), "An Economic Model of Representative Democracy", *Quarterly Journal of Economics*, 85-114

Caselli and Morelli (2004), "Bad Politicians", *Journal of Public Economics*, 759-782

Meltzer and Richard (1981), "A Rational Theory of the Size of Government", *Journal of Political Economy*, 914-927

Hinnerich and Pettersson-Lidbom (2012), "Democracy, Redistribution, and Political Participation: Evidence from Sweden 1919-1938", mimeo *

Agranov and Palfrey (2013), "Equilibrium Tax Rates and Income Redistribution: A Laboratory Study", mimeo *

Dal Bò, Finan, Folke, Persson and Rickne (2016), "Who Becomes a Politician?", mimeo

5. Political agency

Besley: 3

Mueller: 16, 17

Ferraz and Finan (2011a), "Electoral Accountability and Corruption: Evidence from the Audits of Local Governments", *American Economic Review*, 1274-1311 *

Besley and Case (1995), "Does Electoral Accountability Affect Economic Policy Choices? Evidence from Gubernatorial Term Limits", *Quarterly Journal of Economics*, 769-98 *

Ferraz and Finan (2008), "Exposing Corrupt Politicians: The Effects of Brazil's Publicly Released Audits on Electoral Outcomes", *Quarterly Journal of Economics*, 703-745

Ferraz and Finan (2011b), "Motivating Politicians: The Impacts of Monetary Incentives on Quality and Performance", mimeo

Gagliarducci and Nannicini (2013), "Do Better Paid Politicians Perform Better? Disentangling Incentives from Selection", *Journal of the European Economic Association*, 369-398 *

Gagliarducci, Nannicini and Naticchioni (2010), "Moonlighting Politicians", *Journal of Public Economics*, 688-699

Mattozzi and Merlo (2009), "Mediocracy", mimeo
Diermeier, Keane and Merlo (2005), "A Political Economy Model of Congressional Careers", *American Economic Review*, 347-373
Mattozzi and Merlo (2008), "Political Careers or Career Politicians?", *Journal of Public Economics*, 597-608
Dal Bò, Dal Bò and Snyder (2009), "Political Dynasties", *Review of Economic Studies*, 115-142
List and Sturm (2006), "How Elections Matter: Theory and Evidence from Environmental Policy", *Quarterly Journal of Economics*, 1249-1281
Bagues and Esteve-Volart (2011), "Politicians' Luck of the Draw: Evidence from the Spanish Christmas Lottery", mimeo
Fisman, Harmon, Kamenica and Munk (2015), "Labor Supply of Politicians", *Journal of the European Economic Association*
Fisman, Schulz and Vig (2015), "The Private Returns to Public Office", *Journal of Political Economy*

6. Legislative organization

Mueller: 17

PT: 10

Merlo: 5

Gagliarducci, Nannicini and Naticchioni (2011), "Electoral Rules and Politicians' Behavior: A Micro Test", *American Economic Journal: Economic Policy*, 144-174 *
Gagliarducci and Paserman (2011), "Gender Differences in Hierarchical Environments: Evidence from the Political Arena", *Review of Economic Studies*, 1021-1052
Diermeier, Eraslan and Merlo (2003), "A Structural Model of Government Formation", *Econometrica*, 27-70
Myerson (1995), "Analysis of Democratic Institutions: Structure, Conduct and Performance", *Journal of Economic Perspectives*, 77-89

7. Bureaucracy

Mueller: 16

Pettersson-Lidbom (2012), "Does the Size of the Legislature Affect the Size of Government: Evidence from Two Natural Experiments", *Journal of Public Economics* 269-278

Alesina and Tabellini (2007), "Bureaucrats or Politicians? Part I: A Single Policy Task", *American Economic Review*, 169-179

Alesina and Tabellini (2008), "Bureaucrats or Politicians? Part II: Multiple Policy Tasks", *Journal of Public Economics*, 426-447

Dal Bò, Finan and Rossi (2013), "Strengthening State Capabilities: The Role of Financial Incentives in the Call to Public Service", *Quarterly Journal of Economics*, 1169-1218 *

8. Special interest politics

Mueller: 15, 20

PT: 3.5

Coate and Morris (1995), "On the Form of Transfers in Special Interests", *Journal of Political Economy*, 1210-35 *

Hall and Deardoff (2006), "Lobbying as Legislative Subsidy", *American Political Science Review*, 69-84

Mitchell and Munger (1991), "Economic Models of Interest Groups: An Introductory Survey", *American Journal of Political Science*, 512-546