

ECO 7525
Fall 2021
MAT 14
M-W, 4:05 – 6:00 pm

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Welfare Economics and the Second Best

This is the first half-semester mod in the sequence on the economics of the public sector. This course covers several topics in optimal taxation. A second mod in the spring semester will cover other topics in optimal tax theory. The focus is to prepare you to do research in public economics.

Requirements

Problem sets: They are important for learning the material, but do not count heavily toward your grade. Some problem sets extend a lecture presentation, while others include detailed examples. You may discuss these problems with other students, but you must turn in your own answers. Unless stated otherwise, they must be handed in for grading.

Exam: There is one exam for the course which will largely determine your grade. The exam will be on (or due on) Tuesday, October 12.

I. Externalities and Corrective Taxes

Baumol and Oates, *The Theory of Environmental Policy*, 2nd edition, Cambridge University Press, 1988.

Baumol, "On Taxation and the Control of Externalities," *American Economic Review* 62: 307–322, 1972.

Baumol and Bradford, "Detrimental Externalities and Nonconvexities of the Production Set," *Economica* 39: 160–176, 1972.

Starrett and Zeckhauser, "Treating External Diseconomies—Markets or Taxes," in Pratt (ed.) *Statistical and Mathematical Aspects of Pollution Problems*, Dekker, 1974.

Weitzman, "Prices vs. Quantities," *Review of Economic Studies* 41: 477–491, 1974.

Hamilton, Sheshinski, and Slutsky, "Production Externalities and Long-run Equilibria: Bargaining and Pigovian Taxation," *Economic Inquiry* 27: 453–471, 1989.

Slutsky, "Personal Action Altruism, Externalities, and Corrective Taxes," working paper.

II. Second Best Analysis

Lipsey, R. G., and Kelvin Lancaster, "The General Theory of Second Best," *Review of Economic Studies* 24, 11–32, 1956.

Friedman, "The "Welfare" Effects of an Income Tax and an Excise Tax," in *Essays in Positive Economics*, University of Chicago Press. 100 – 113.

Deepak, Unel, and Slutsky, "Optimal Public Housing Policy in the Presence of Homelessness," working paper.

III. Optimal Commodity Taxation

Diamond and Mirrlees, "Optimal Taxation and Public Production, I and II," *American Economic Review* 61: 8-27 and 261-278, 1971.

Ebrill and Slutsky, "Production Efficiency and Optimal Pricing in Intermediate Good Regulated Industries," *International Journal of Industrial Organization* 8: 417-442, 1990.

Stiglitz and Dasgupta, "Differential Taxation, Public Goods and Economic Efficiency," *Review of Economic Studies* 38: 151-174, 1971.

Atkinson and Stern, "Pigou, Taxation, and Public Goods," *Review of Economic Studies* 41: 119-128, 1974.

Gaube, "When Do Distortionary Taxes Reduce the Optimal Supply of Public Goods?" *Journal of Public Economics* 76, 151-180, 2000.

Ballard and Fullerton, "Distortionary Taxes and the Provision of Public Goods," *Journal of Economic Perspectives* 6: 117-131, 1992.

Cremer, Gahvari, and Ladoux, "Second-Best Pollution Taxes and the Structure of Preferences," *Southern Economic Journal* 68: 258- 280, 2001.