

Public Sector Economics

Bob McTeer, "The Dismal Science? Hardly!" *Wall Street Journal*, June 4, 2003
A candid introduction to the usefulness of economic logic in policy debates.

Neil King, Jr., "Errant Shot? So Far, Steel Tariffs Do Little of What President Envisioned," *Wall Street Journal*, Sept. 13, 2002
Tariffs designed to protect the U.S. Steel Industry from other countries who have cheaper products because "they pollute more" are still having trouble competing in the U.S. market. The culprit are U.S. mimi-mills that recycle scrap steel and use non-union labor. This article would be good for discussions on efficiency and subsidies.

Roger Thurow, "Bittersweet: How an Addiction to Sugar Hurts Development," *Wall Street Journal*, September 16, 2002
This article follows World Trade Organization talks shortly after the Johannesburg Round. The main talking point is the EU's sugar subsidies and the ripple effect that is being felt in sugar producing developing nations.

Dan Seligman, "Of Mice and Economics," *Forbes*, Aug. 24, 1998
Seligman discusses how humans don't always necessarily recognize sunk costs, and how new scientific evidence suggests that mice do.

Thomas Friedman, "It's A Flat World, After All," *New York Times Magazine*, April 3, 2005
Echoing sentiments from "The World is Flat", Friedman discusses India, technology, and a shrinking comparative advantage in the knowledge industry.

Marakon Associates, "Beyond Performance Measurement: The Use and Misuse of Economic Profit," August 1994
This article weighs the merits of measuring performance by Economic Profit vs. Economic Value Added.

Still Living Dangerously- *The Economist*, Oct 23, 2003.
This article discusses the difficulty Indonesia is having attracting foreign investors because of an inadequate legal system, government corruption, poor capital infrastructure and protectionism.

Just What the Professor Ordered- Ian Sayres, *New York Times*. Sept. 16, 2005
This article explores the monopoly enjoyed by college textbook manufacturers and possible remedies to the exorbitant amount that students pay each semester. Analogies are made with the prescription drug industry and allusions in both are to the economic concept of a moral hazard

Economic man, Cleaner Planet- *The Economist*, Sept. 27, 2001.
Command and Control regulation, or a system where the market and private property rights protects the environment? This article looks at the traditional, and the market oriented approach to saving the environment.

A Different Manifesto- the Economist, Sept. 29, 2001.

This article highlights weaknesses in the intellectual arguments of staunch anti-globalizers and pro-globalization politicians. Its main thrust is that globalization in mixed economies will likely have a positive environmental effect, raise people from poverty and empower developing countries, and if staunch anti-globalizers opened their minds to the idea of mixed capitalism, they may have a different opinion.

African Aid For American Farmers- Celia Dugger, New York Times, Oct. 12, 2004.

This article describes the US Food AID program and the variety of American organizations that have a stake in continuing the inefficient system of American farmers growing the food, with American shippers shipping it.

Marc Gunther, "Tree Huggers, Soy Lovers, and Profits," Fortune, June 23, 2003

As an advocate for social responsibility and DuPont's corporate vice president for safety, health, and environment, Paul Tebo is trying to help transform DuPont from an oil-and-chemicals company into an eco-friendly life-sciences firm. Its new goal is to own a collection of businesses that can go on forever without depleting natural resources. So, for example, the company spun off its massive Conoco oil-and-gas unit five years ago and used the proceeds to buy Pioneer Hi-Bred International, whose seeds produce not only food for people and livestock but renewable materials for commercial uses--turning corn into stretch T-shirts, for example. DuPont is at the cutting edge--and maybe over the edge--of the movement to make corporations more socially responsible. At DuPont, which got its start in 1802 making gunpowder, that now means producing soy protein, creating biodegradable material for plastic silverware, and hiring the former executive director of Greenpeace as a high-level consultant. But corporate social responsibility isn't simple. To the degree that business executives spend more money than they need to--for delivery vehicles with hybrid engines, or to pay higher wages in developing countries, or even to donate company funds to charity--they are spending shareholders' money to further their own agendas. The trouble is, none of this has paid off in a tangible way for investors, at least not yet.

Cait Murphy, "Hog Wild for Pollution Trading," Fortune, Sept. 2, 2002

Focuses on government-backed pollution-trading programs and environmental or emissions markets. Role of the U.S. Environmental Protection Agency in the sulphur dioxide cap-and trade system that created a value for what had been a free commodity; Discussion of markets for the pollutants, including nitrogen oxide, particulate matter, and volatile organic compounds, which have the goal of making emission-reduction units and certified emissions reductions readily tradable financial instruments.

In Praise of Cheap Labor- Paul Krugman, a "Dismal Science" piece for Slate available on Krugman's website at:

<http://web.mit.edu/krugman/www/smokey.html>

Krugman also talks about how the people who work in sweatshops are choosing to work there rather than the even worse alternatives. Krugman references the Smoky Mountain garbage scavengers in the Phillipines to Kristoff's (above) examples of loom workers, but the argument is essentially the same.

When Trust in an Expert is Unwise- David Leonhardt, New York Times, Nov. 7, 2007

This article discusses a study done by Cornell Professor where a rigged car was sent to body shops for diagnoses to determine if they would catch the intentional damage done to the car or if they would prescribe some expensive alternatives. The latter was true in this article that explores incomplete information and the economics of reputation.

Peter Huber, "Antitrust's Real Legacy," Wall Street Journal, December 26, 2002

Look at the adventures of telecom. The logic for breaking up the old Bell System in 1984 was to separate long-distance from local markets, to unleash competition on the long-distance side of the divide. Through the 1980s and into the '90s, however, federal regulators wouldn't let AT&T cut its long-distance prices, because the authorities feared -- correctly -- that AT&T could quickly wipe out at least one of its major competitors if it were free to do so. For good measure, regulators directed additional subsidies toward the upstarts by allowing them to pay much less than AT&T for their connections to local networks.

Mergers have often been the rational response to looming capacity excesses in network industries, because larger companies can sell, retire and downsize by attrition much more smoothly than smaller ones. United Airlines and US Airways tried that approach in 2001, but (as we know) the authorities effectively concluded that the traveling public would be better served if the two companies found their own, independent ways into bankruptcy instead. WorldCom tried to merge with Sprint in 1999, but Justice wouldn't hear of it. WorldCom is now in bankruptcy and Sprint probably would be too, but for the revenues it earns from the local phone and wireless companies that it also owns.

Since competitors in network industries must interconnect, hand off traffic, and share customers and facilities, these industries spawn private antitrust suits as well, and they too have had far-reaching impacts on market structures. Antitrust litigators helped fund the young MCI when they extracted about \$190 million in damages from AT&T and the Bell companies in 1985 -- the defendants had, once again, allegedly failed to grant MCI, their direct competitor, sufficiently ready access to their own networks. Covad is now suing Verizon and BellSouth, on exactly the same theory.

H. Courtney, "Games Managers Should Play," World Economic Affairs, Autumn 1997

This article examines Game Theory and its usefulness (to mostly private sector) managers. Price wars, industry capacity and other relevant issues are discussed.

Husted, T. and L. Kenny, 1997. The effect of the expansion of the voting franchise on the size of government. Journal of Political Economy 105, 54-82.

This paper examines the claim that expansion of the voting franchise has been an important factor in the growth of government. State government spending and state and local spending are explained using a panel of 46 states for 1950-88. Elimination of poll taxes and literacy tests led to higher turnout, particularly among the poor, and a poorer pivotal voter. As predicted, we find that these changes, a fall in the income of voters relative to state income, and the ouster of Republicans from

state government led to a sharp rise in welfare spending but no change in other spending.

Meltzer, A. and S. Richard, 1981. A rational theory of the size of government. *Journal of Political Economy* 89, 914-927.

In a general equilibrium model of a labor economy, the size of government, measured by the share of income redistributed, is determined by majority rule. Voters rationally anticipate the disincentive effects of taxation on the labor-leisure choices of their fellow citizens and take the effect into account when voting. The share of earned income redistributed depends on the voting rule and on the distribution of productivity in the economy. Under majority rule, the equilibrium tax share balances the budget and pays for the voters' choices. The principal reasons for increased size of government implied by the model are extensions of the franchise that change the position of the decisive voter in the income distribution and changes in relative productivity. An increase in mean income relative to the income of the decisive voter increases the size of government.

Gruber, J. and E. Saez, 2002. The elasticity of taxable income: evidence and implications. *Journal of Public Economics* 84, 1-32.

A central tax policy parameter that has recently received much attention, but about which there is substantial uncertainty, is the overall elasticity of taxable income. We provide new estimates of this elasticity which address identification problems with previous work, by exploiting a long panel of tax returns to study a series of tax reforms throughout the 1980s. This identification strategy also allows us to provide new evidence on both the income effects of tax changes on taxable income, and on variation in the elasticity of taxable income by income group. We find that the overall elasticity of taxable income is approximately 0.4; the elasticity of real income, not including tax preferences, is much lower. We also estimate small income effects on tax changes on reported income, implying that the compensated and uncompensated elasticities of taxable income are very similar. We estimate that this overall elasticity is primarily due to a very elastic response of taxable income for taxpayers who have incomes above \$100,000 per year, who have an elasticity of 0.57, while for those with incomes below \$100,000 per year the elasticity is less than one-third as large. Moreover, high income taxpayers who itemize are particularly responsive to taxation. We then derive optimal income tax structures using these elasticities. Our estimates suggest that the optimal system for most redistributive preferences consists of a large demogrant that is rapidly taxed away for low income taxpayers, with lower marginal rates at higher income levels.

Hausman, J., 1981. Exact consumers surplus and deadweight loss. *American Economic Review* 81, 622-676.

Barro, R., 1974. Are governments bonds net wealth. *Journal of Political Economy* 82, 1095-1117.

F. M. Bator (1957), "The Simple Analytics of Welfare Maximization", *The American Economic Review*, 47, 22-59.

F. M. Bator (1958), “The Anatomy of Market Failure”, *Quarterly Journal of Economics*, 72, 351-379.

Paul A. Samuelson (1954), “The Pure Theory of Public Expenditures”, *The Review of Economics and Statistics*, 36, 387-389.

Anthony Atkinson and Nicholas Stern (1974), “Pigou, Taxation and Public Goods”, *The Review of Economic Studies*, 119-28.

Charles L. Ballard and Don Fullerton (1992), “Distortionary Taxes and the Provision of Public Goods”, *Journal of Economic Perspectives*, 117-131.

When comparing marginal costs and benefits of a public project, most economists think in terms of adding together the marginal costs of production plus marginal costs of additional distortionary taxation. This paper clarifies how the “revenue effect” offsets the “distortionary effect.” For Cobb-Douglas utility with a marginal increase in a proportional wage tax, they exactly offset each other and the Samuelson rule is unaffected. Also, with a preexisting wage tax, an incremental lump-sum tax has only this “revenue effect:” it increases labor supply, increases tax revenue from the preexisting wage tax, and thus makes the project easier to fund. In our numerical example, the incremental lump-sum tax costs taxpayers only \$.77 per dollar raised.

Bird, “Why Tax Corporations?” Working Paper 96 – 2, Technical Committee on Business Taxation, Department of Finance, Canada (December 1996).

Popular opinion seems to be that, if anything, corporations do not pay enough in taxes. In contrast, although economists recognize that it is often convenient to utilize corporations as agents to collect taxes from customers (sales taxes), employees (payroll and personal income taxes) and owners (dividend and withholding taxes), they often see no good reason why corporations as such should pay any taxes, particularly since corporation income (and capital) taxes may impose significant economic costs on society. This paper discusses this apparent divergence of views, noting a number of reasons why corporations as such might properly be taxed.

Thomas Gaube (2000), “When Do Distortionary Taxes Reduce the Optimal Supply of Public Goods?” *Journal of Public Economics*, 151-180.

It is often argued that the optimal level of public good provision is below the first-best level as long as the government's expenditures have to be financed by distortionary taxes. I examine this hypothesis and show that it is correct in a representative consumer economy if (i) the public good is normal and (ii) private commodities are normal and gross substitutes. Otherwise, counterexamples can be constructed. These results hold also with heterogeneous households provided that equity considerations are ignored. In general, however, distributional objectives may lead to a higher level of public expenditures in second best than in first best.

James Andreoni and Theodore Bergstrom (1996), “Do Government Subsidies Increase the Private Supply of Public Goods?” *Public Choice*, 88, 295-308.

Can the government get people to contribute more to public goods by subsidizing voluntary contributions. In a general equilibrium model, answering this question is not a slam dunk, especially given the remarkable “neutrality theorems” in

the theory of voluntary contributions. But our model yields a surprisingly decisive comparative statics result. If public goods and private goods are both normal goods, then increases in the subsidy rate necessarily increase the equilibrium supply of public goods.

Theodore Bergstrom, Laurence Blume, and Hal Varian (1986), “On the Private Provision of Public Goods”, *Journal of Public Economics*, 29, 25-49.

This paper was stimulated by a paper by Peter Ware, who used calculus first-order conditions to show that a redistribution of income that does not change the set of voluntary contributors leaves the supply of public goods unchanged. In general, redistributions can change the set of contributors and also the supply of public goods. But we show that even in the general case there are some remarkably sharp comparative statics results.

C. Bliss and Barry Nalebuff (1984), “Dragon Slaying and Ballroom Dancing: The Private Supply of a Public Good”, *Journal of Public Economics*, 25, 1-12.

James Andreoni, James (1988), “Privately Provided Public Goods in a Large Economy: The Limits of Altruism”, *Journal of Public Economics*, 35, 57-73.

Dennis Epple and R.E. Romano (1998), “Competition between Private and Public Schools, Vouchers, and Peer-Group Effects”, *The American Economic Review*, 88 (1), 33-62.

A theoretical and computational model with tax-financed, tuition-free public schools and competitive, tuition-financed private schools is developed. Students differ by ability and income. Achievement depends on own ability and on peers' abilities. Equilibrium has a strict hierarchy of school qualities and two-dimensional student sorting with stratification by ability and income. In private schools, high-ability, low-income students receive tuition discounts, while low-ability, high-income students pay tuition premia. Tuition vouchers increase the relative size of the private sector and the extent of student sorting and benefit high-ability students relative to low-ability students. Copyright 1998 by American Economic Association.

Abigail Payne (1998), “Does the Government Crowd-Out Private Donations? New Evidence from a Sample of Non-Profit Firms”, *Journal of Public Economics*, 69 (3), 323-345.

During the 1980s, government grants to non-profit organizations declined dramatically and the price of private donations increased. Given there are different costs associated with government grants and private donations to non-profits, it is important to study the relationship between these two sources and determine whether government grants 'crowd-out' private donations. I take a fresh look at the issue of crowd-out and improve upon the literature by exploiting a panel data set that links private donations to non-profit firms with the government grants they received. I study 430 non-profit shelter, human services, and other similar types of organizations that were in operation between 1982 and 1992. I find private donations to these non-profits effectively do not change with changes in government grants after controlling for firm heterogeneity and political and economic factors under an OLS specification. In a 2SLS specification, after controlling for possible endogeneity of the government grants the estimated crowd-out is significantly different from zero and one dollar; on average, the estimated crowd-out is ~50 cents.

Gerard Marwell and Ruth Ames (1981), “Economists Free Ride - Does Anyone Else?” *Journal of Public Economics*, 295-310.

Steven T. Berry and Joel Waldfogel (1999), “Public Radio in the United States: Does it Correct Market Failure or Cannibalize Commercial Stations?” *Journal of Public Economics*, 71,189-211.

Radio signals are pure public goods whose total value to society is the sum of their value to advertisers and listeners. Because broadcasters can capture only part of the value of their product as revenue, there is the potential for a classic problem of underprovision. Small markets have much less commercial program variety than larger markets, suggesting a possible underprovision problem. Public funding of radio broadcasting targets programming in three formats - news, classical music, and jazz - with at least some commercial competition. Whether public support corrects a market failure depends on whether the market would have provided similar services in the absence of public broadcasting. To examine this we ask whether public and commercial classical stations compete for listening share and revenue. We then directly examine whether public stations crowd out commercial stations. We find evidence consistent with the view that public broadcasting crowds out commercial programming in large markets, particularly in classical music and to a lesser extent in jazz. Although the majority of government subsidies to radio broadcasting are allocated to stations without commercial competition in their format (thereby possibly correcting inefficient market underprovision), roughly a quarter of subsidies support direct competition with existing commercial stations.

Alesina and Tabellini (1990), “A Positive Theory of Fiscal Deficits and Government Debt”, *The Review of Economics Studies*, 57, 403-414.

This paper considers an economy in which policymakers with different preferences alternate in office as a result of elections. Government debt is used strategically by each policymaker to influence the choices of his successors. If different policymakers disagree about the desired composition of government spending between two public goods, the economy exhibits a deficits bias; that is, debt accumulation is higher than it would be with a social planner. The equilibrium level of debt is larger the larger the degree of polarization between alternative governments and the less likely it is that the current government will be reelected.

W. Hanemann (1991), “Willingness to Pay and Willingness to Accept: How Much Can They Differ?”, *The American Economic Review*, 81, 635-647.

S. A. Marglin (1963), “The Social Rate of Discount and the Optimal Rate of Investment”, *Quarterly Journal of Economics*, 77, 95-112.

S. A. Marglin (1963), “The Opportunity Costs of Public Investment”, *Quarterly Journal of Economics*, 77, 274-289.

A. Lans Bovenberg and Lawrence H. Goulder (1996), “Optimal Environmental Taxation in the Presence of Other Taxes: General Equilibrium Analyses”, *The American Economic Review*, September 1996, 985— 1000.

This paper employs analytical and numerical general equilibrium models to examine the optimal setting of environmental taxes in the presence of pre-existing distortionary taxes. Both models indicate, contrary to what several analysts have suggested, that the optimal environmental tax rate in this setting is less than the rate implied by the "Pigovian principle," which would equate the tax to the marginal environmental damage from pollution. Numerical results show that previous studies may have seriously overstated the size of the optimal carbon tax by disregarding pre-existing taxes, and that the optimal carbon tax can be negative when revenues from the tax are recycled in a lump-sum fashion.

Robert Hahn (1989), "Economic Prescriptions for Environmental Problems: How the Patient Followed the Doctors Orders", *Journal of Economic Perspectives*, 95-114.

James Poterba (1993), "Global Warming Policy: A Public Finance Perspective", *Journal of Economic Perspectives*, 7, 47-63.

The Intergovernmental Panel on Climate Change (IPCC) recently published its second scientific assessment of climate change. Central to the findings of this study is the statement that "the balance of evidence suggests a discernible human influence on global climate". This statement arose from recent studies which compared the observational record over the last century with the results from numerical modelling simulations of the climatic response to increasing greenhouse gases and anthropogenic sulphate aerosols. It has profound implications for policy makers as it is the first time that IPCC has stated that global warming has been detected in the observational record. Recent modelling studies reported in the IPCC second assessment also suggest "best estimates" of 2°C warming and 50cm sea level rise by the year 2100, relative to 1990, with amplification of the warming at high latitudes and over the interior of continents. Similar IPCC "best estimates" of emission scenarios suggest that the atmospheric concentration of carbon dioxide will continue to increase over the next few centuries. Stabilization of atmospheric carbon dioxide levels, even as high as three times the present, require emission levels significantly below those of 1990. In this paper, the observational record is briefly reviewed as are the recent modelling results which have led to the statements above. Particular emphasis is given to the role of the oceans in climate change and climate variability. By appealing to the paleoclimatic record for analogies of a climate warmed through anthropogenic greenhouse gases, a discussion of potential climatic swings and regime changes is presented. The policy implications of this work are also addressed.

Diamond, P., 1965. National debt in a neoclassical growth model. *American Economic Review* 55, 1125-1150.

Alesina, A. and R. Perotti, 1996. *Budget Deficits and Budget Institutions*. NBER WP 5556.

By discussing the available theoretical and empirical literature, this paper argues that budget procedures and budget institutions do influence budget outcomes. Budget institutions include both procedural rules and balanced budget laws. We critically assess theoretical contributions in this area and suggest several open and unresolved issues. We also examine the empirical evidence drawn from studies on samples of OECD countries, Latin American countries and US states.

Alesina, A. and G. Tabellini, 1990. A positive theory of fiscal deficits and

government debt. *Review of Economic Studies* 57, 403-414.

This paper considers an economy in which policymakers with different preferences alternate in office as a result of elections. Government debt is used strategically by each policymaker to influence the choices of his successors. If different policymakers disagree about the desired composition of government spending between two public goods, the economy exhibits a deficits bias; that is, debt accumulation is higher than it would be with a social planner. The equilibrium level of debt is larger the larger the degree of polarization between alternative governments and the less likely it is that the current government will be reelected.

Lizzeri, A., 1999. Budget deficits and redistributive politics. *Review of Economic Studies* 66, 909-928.

This paper proposes a new view of the forces in the political process that cause governments to accumulate debt. The analysis builds on a model of redistributive politics that, contrary to median voter models, does not restrict the set of policies that politicians can propose. I show that deficits occur even in an environment where voters (and periods) are homogeneous. This is an environment where previous political theories of debt would predict budget balance. In the model deficits are a way for candidates to better target promises to voters and are therefore used as tools of redistributive politics. The main contribution of the analysis is to show that the same forces that push candidates to redistribute resources across voters to pursue political advantage are forces that generate budget deficits. Copyright 1999 by The Review of Economic Studies Limited.