

0. Introduction and road map

Public Economics

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INTRODUCTION

What is public economics?

Public economics is the study of the role of government policy

Government intervenes in virtually every aspect of economic life:

1. **Regulation:** antitrust, banking regulation, environmental standards, minimum wages
2. **Taxes:** modern governments collect 30-50% of national income in taxes (personal and corporate income taxes, social security, commodity taxes, property taxes)
3. **Expenditures:** tax revenue funds traditional *public goods* (infrastructure, public order and safety, defense), *welfare state* (education, retirement benefits, health care, income support)
4. **Macroeconomic stabilization:** central bank's monetary policy (interest rate, QE), fiscal stimulus, bailout policies, capital controls

Stylized facts on rich nations' public sectors

This course focuses predominantly on **taxes and expenditures** (for regulation, see IO; for stabilization, see macro).

In the 20th century, all OECD countries saw government expenditures and tax revenue increase strongly until around 1980.

While there is a substantial divergence between public sector sizes across OECD countries, the modern public sector is everywhere a dominant economic force.

Size of government ranges from 30-40% of GDP in Switzerland, Australia, United States; to 50-60% in France, Belgium, Sweden.

Government expenditures, % share of GDP

Country	1920	1960	1980	2006	2013
Australia	19.3	21.2	34.1	33.3	36.6
Austria	14.7	35.7	48.1	49.1	50.9
Belgium	22.1	30.3	57.8	48.6	54.5
Canada	16.7	28.6	38.8	39.2	40.7
France	27.6	34.6	46.1	53.0	57.1
Germany	25.0	32.4	47.9	45.3	44.3
Ireland	18.8	28.0	48.9	34.2	40.7
Italy	30.1	30.1	42.1	48.5	50.9
Japan	14.8	25.4	32.0	36.2	42.3
Netherlands	13.5	33.7	55.8	45.5	46.8
Spain	8.3	18.8	32.2	38.4	44.3
Sweden	10.9	31.0	60.1	52.7	53.3
Switzerland	17.0	17.2	32.8	33.5	33.5
U. Kingdom	26.2	32.2	43.0	44.2	45.5
United States	12.1	27.0	31.4	36.0	38.7
Average	18.7	28.4	43.1	42.2	45.3

Source: Tanzi and Schuknecht (2000); OECD *Government at a Glance 2015*.

Normative vs positive public economics

Given the economic importance of the public sector, public economics contributes to our understanding in two ways:

Normative public economics is concerned with the theoretical question: what policies should government set?

Positive public economics is concerned with the empirical question: what are the effects of government policies?

This course mainly focuses on the first question, but second question provides essential input in order to answer the first (e.g., how large are the behavioral responses to different types of taxes?).

To be distinguished from **political economics**, which analyzes how the political process shapes actual government policy.

Types of questions covered by this course

This course will be focused on answering and discussing the following types of questions.

1. What are the distortive effects of taxation?
2. What are the redistributive effects of taxation?
3. How should the government set commodity taxes?
4. Should VAT rates be uniform or differentiated? If differentiated, how?
5. How high should the labor income tax be set?
6. Should marginal income taxes vary across the income distribution? If so, how?
7. How high should the tax rate on top income earners be?
8. Should the government tax the personal income from savings and investments? Even if the savings themselves were already taxed when earned?
9. How can government fight tax evasion?
10. How do taxes affect individual behavior under risk?
11. Should the government set a minimum wage if it can redistribute with taxes?
12. ...

ROAD MAP AND PRACTICAL DETAILS FOR THIS COURSE

Course outline

The course consists of at least 6 Lectures, among which:

- L1. (Recap of) Some essential economics concepts
- L2. The deadweight loss of taxation
- L3. Tax incidence
- L4. Optimal commodity taxation
- L5. Optimal linear income taxation
- L6. Optimal nonlinear income taxation
- L7. Optimal capital taxation
- L8. Welfare effects of the minimum wage
- L9. Taxation and risk
- L10. Tax evasion

Lectures

Lecturer: Laurent Simula, Professor of Economics, ENS Lyon
(laurent.simula@ens-lyon.fr)

- Office hours: appointments by e-mail

Further notes:

- Don't miss any classes: Lectures and slides are important parts of the course material!
- Please let me know if you spot any mistakes in the slides
- Advised to read complementary material

Further reading

In the lecture slides you will find many reference to further reading material. If interested in more textbook treatments of the economics of taxation, I can recommend the following material.

Graduate level books:

- Atkinson, A.B. and J. Stiglitz (1980). *Lectures on Public Economics*. McGraw Hill.
- Kaplow, L. (2008). *The Theory of Taxation and Public Economics*. Princeton University Press.
- Mirrlees, J. *et al.* (2010). *Dimensions of Tax Design: The Mirrlees Review*. Oxford University Press.
- Myles, G.D. (1995). *Public Economics*. Cambridge University Press.
- Salanié, B. (2011). *The Economics of Taxation*. MIT Press.
- Slemrod, J. and C. Gillitzer (2014). *Tax Systems*. MIT Press.

Undergraduate level books:

- Myles, G.D. and J. Hindriks (2006). *Intermediate Public Economics*. MIT Press.
- Rosen, H. (2005). *Public Finance, 7th Edition*. McGraw Hill.
- Stiglitz, J. (1999). *Economics of the Public Sector, 3rd Edition*. Norton.

More lecture slides:

- Raj Chetty:
<http://www.rajchetty.com/index.php/lecture-videos>
- Emmanuel Saez:
<http://eml.berkeley.edu/~saez/course/course.html>
- Guy Laroque:
<http://econ.sciences-po.fr/staff/guy-laroque>

REFERENCES

References

OECD (2015). *Government at a Glance 2015*. OECD Publishing.

Piketty, T. (2014). *Capital in the Twenty-First Century*. Harvard University Press.

Tanzi, Vito and Ludger Schuknecht (2000). *Public Spending in the 20th Century*. Cambridge University Press.