Economics 504: Public Economics for Developing and Transitional Countries
Fall 2012

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Office hours:
Tues. 1:30-3:30PM,
and by appointment

Class meets 11am-12:15pm MW
CDE Classroom

Course description
Public economics (also known as “public finance”) is the branch of economics concerned with government expenditure and taxation, focusing primarily on microeconomic aspects of these activities. In this class, we will mainly consider the expenditure side of public economics. An in-depth exploration of tax policy, the other half of public economics, is offered in Econ 514 in the spring semester. Because it is a CDE course, Econ 504 is tailored to the interests of policymakers and policy analysts from developing and transition economies. It applies the tools of public economics to the microeconomic policy problems that are most pertinent in these countries, and includes much coverage of the institutional details of policies and empirical evidence in these types of countries. Econ 504 is a survey course providing brief introductions to many different microeconomic concepts and public policy issues that we think it is important for every CDE fellow to understand. Spring elective courses at the CDE provide you with the opportunity to investigate some of these particular issues in greater depth.

This semester’s course begins by laying out a general theoretical and empirical framework for thinking about public economics issues. Among the questions we address in this part of the course include: what should the goals of government be? What do “economic efficiency,” “equity,” and “social welfare” mean, how can these concepts help us think clearly about policy issues, and what are the philosophical disputes over these concepts? Why is it so challenging to find convincing empirical evidence on questions of public policy, and how can one learn to think critically about empirical evidence and to begin to distinguish more convincing evidence from less convincing evidence?

With that as background, we delve into the market failures that provide efficiency rationales for government intervention in the market, including externalities, public goods, imperfect competition, and asymmetric information. We also consider ways that human behavior might deviate from perfect rationality, and what that might imply for policy. Along the way, we apply these concepts to various examples of policy issues, including, among other things, the environment, education, health care, infrastructure, security, social insurance, and transfers to the poor. In each case we will think about the efficiency, equity, and other rationales for government involvement, and the pros and cons of different ways of designing policies to address the problems.

Next, we turn to the general question of how to make the government work better, addressing questions such as the following. What are the incentives of politicians and government employees, and how does the design of political institutions affect the degree to which they serve the public interest? How should responsibilities be divided up between the central government and local governments, and what are the advantages and disadvantages of
“decentralization?” What practical steps can be taken to improve the delivery of basic services? For example, how might one address problems of absenteeism and corruption?

After that, we’ll consider government policy towards education in greater depth, applying the full array of theoretical and empirical tools we’ve built up throughout the course. We then end the course by addressing the following question: when is it better to have the government own and produce things, and when is it better to privatize? We consider the examples of government-financed vouchers for privately-provided education, and privatization of state-owned enterprises such as water utilities, as case studies.

Throughout the course, we consider examples of empirical research, and to facilitate this, we will occasionally introduce empirical tools that are particularly useful for microeconomic policy evaluation.

Course materials
There is one required text for the course: Public Finance and Public Policy, by Jonathan Gruber (3rd edition, Worth Publishers, 2011), which can be purchased at Water Street Books or online. The 1st and 2nd editions are acceptable substitutes (the reading list below includes page references for all three editions of Gruber’s book). Additional required readings, with many applications to policy issues in developing and transitional countries, will be made available in course reading packets. The initial course reading packet is available now for you to pick up in the course packet room in the basement of Hollander Hall (room #026). Another course reading packet will be made available a little later in the term, once the initial rush at office services is over and we have a better idea of the enrollment in the class. All of the readings aside from Gruber will also be available in electronic format on the class “Glow” web site.

Students are expected to read the textbook selections and assigned articles from the reading packet before class and be prepared to discuss them on the days indicated in the syllabus. Each week I will e-mail you a guide to the next week’s readings, including a set of discussion questions to help you prepare for class. Depending on how things go, as the semester progresses, I may modify when we cover certain readings, or skip some, or tell you to emphasize some parts of the reading and skim others -- I will make this clear in the weekly e-mail guides. All readings represent testable material; my e-mail guides to the readings and what I cover in class will be good guides to what you need to know about the readings for the exam. I will not expect you to memorize names of authors or to address points in the reading that were never mentioned in class.

Class meeting time
Class meets 11:00am – 12:15pm in the CDE classroom. During the first week of classes, we will meet on Friday. After that, class normally meets Mondays and Wednesdays.
Course requirements
Your grade will be determined according to the following grading formula:

<table>
<thead>
<tr>
<th></th>
<th>CDE fellows</th>
<th>Undergraduates</th>
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</thead>
<tbody>
<tr>
<td>CDE orientation exam and homework</td>
<td>10%</td>
<td>-</td>
</tr>
<tr>
<td>Econ 504 writing assignment, due Mon. Dec. 10</td>
<td>-</td>
<td>10%</td>
</tr>
<tr>
<td>Econ 504 homework assignments (about 5)</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Econ 504 class participation</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Econ 504 midterm exam, 7pm Thu. Oct. 18</td>
<td>35%</td>
<td>35%</td>
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<tr>
<td>Econ 504 final exam, 9:30am Mon. Dec. 17</td>
<td>35%</td>
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- For CDE fellows, scores on the CDE orientation exam and homework on microeconomics, regression, and writing together account for 10% of the Econ 504 grade.

- **Writing Assignment for Undergraduates.** In lieu of the CDE orientation, undergraduates will be required to submit a writing assignment of approximately seven pages, due Monday, December 10th at 4:00pm. It will count for 10% of the final grade. (For CDE fellows, that 10% of the grade will come from the CDE orientation instead). Further information on the writing assignment will be provided later in the term.

- There will also be approximately five homework assignments which together count for 15 percent of your grade. Due dates for these will be announced as the semester progresses. Homework assignments will be graded by the teaching assistant for the class (Tejesh Pradhan). Working on the homework assignments in groups is encouraged. However, if you work out an answer as part of a study group, be sure you understand exactly how to arrive at the answer. You must write up the answer to the problem completely on your own, in your own words, and of course you must each turn in your own individual homework. Turning in an identical homework assignment as a classmate is a violation of the honor code. Late homework assignments will not be accepted, because I will be making the answers available shortly after they are handed in. I will drop the lowest homework grade from your grade calculation, which should take care of legitimate excuses. Unless otherwise specified, you may hand-write your homework if you want, it is not necessary to type it.

- **Class participation** counts for 5 percent of your grade. You should attend class regularly, come to class having done the assigned readings, and be prepared to discuss the questions about the reading that I pose to you in advance by e-mail. I reserve the right to call on people to provide their thoughts on the e-mailed discussion questions. **It is also important that you not be distracted by electronic equipment. Students may use a computer to take notes if they like, but must use the computer for that purpose only. Smart phones and other electronic devices must be turned off and stowed.**
• The midterm exam counts for 35 percent of your grade. **The midterm is scheduled for Thursday October 18th from 7:00pm to 9:30pm**, location to be announced. The exam will be in the evening so that you can have extra time. In exchange, one regular class meeting (tentatively Wednesday October 17th) will be canceled and replaced with an optional review session for the exam. In the event of schedule conflict, undergraduates are welcome to re-schedule for an alternate date and time – please talk with me if that is the case.

• The final exam counts for 35 percent of your grade. It is **tentatively scheduled for Monday December 17th from 9:30am to Noon**, location to be announced.

**Teaching Assistant**
Tejesh Pradhan <Tejesh.M.Pradhan@williams.edu> is the teaching assistant for this course. He is a senior at Williams College majoring in economics and math, has taken my CDE tax policy course and also took year-long courses in public economics and development economics at London School of Economics. He is writing an economics honors thesis providing evidence on the social and economic consequences of inadequate insurance against drought in Nepal. Tejesh will grade most of your homework, and will run a review session before each homework is due. In addition, the CDE teaching assistants, Daniel Jenya <Daniel.Jenya@williams.edu>, and Pablo Evia <Pablo.E.Evia.Salas@williams.edu>, are available by appointment to provide extra help.

**Course web page**
The course web page is available through the site: [http://glow.williams.edu/](http://glow.williams.edu/)
All readings (except for the textbook), assignments, handouts, etc., will be posted there (in some cases gradually as the semester progresses).
Course schedule and reading assignments

The schedule below lists the topics and reading assignments for Economics 504. Some readings come from the textbook for the course: *Public Finance and Public Policy* by Jonathan Gruber. These readings are listed as "Gruber." I have provided page references for the 1st, 2nd, and 3rd editions. Other readings will be made available in printed reading packets, and in electronic format on the class “Glow” web page. You should do the assigned reading before the date that we cover the topic in class, and come to class prepared to discuss the questions about the readings that I will pose to you by e-mail.

1. **Friday, September 7.**  
   **Introduction; Efficiency, Equity, and Social Welfare, Part I**  
   
   (27 pages)  
   - Gruber, Ch. 1, "The Four Questions of Public Finance" (pp. 3-10 in 3rd ed., pp. 3-11 in 2nd ed., pp. 2-9 in 1st ed.)  

2. **Monday, September 10.**  
   **Efficiency, Equity, and Social Welfare, Part II**  
   
   (35 pages)  

3. **Wednesday, September 12.**  
   **Empirical Tools of Public Economics**  
   
   (34 pages)  
   - Gruber, Ch. 3, "Empirical Tools of Public Finance" (including appendix)  

4. **Monday, September 17.**  
   **Externalities and Public Goods I**  
   
   (25 pages)  
   - Gruber, “Externalities: Problems and Solutions,” Ch. 5, Sections 5.1 to 5.3 only. (pp. 121-137 in 3rd ed., pp. 120-138 in 2nd ed., pp. 115-132 in 1st ed.).  
5. **Wednesday, September 19.**  
**Externalities and Public Goods II**  
{28 pages}  
- Bakija, Jon. 2012. “Trust as a Public Good or Externality Problem”  

6. **Monday, September 24.**  
**Imperfect Competition**  
{13 pages}  

7. **Wednesday, September 26.**  
**Insurance and Asymmetric Information**  
{36 pages}  
8. Monday, October 1.

Insurance (or Lack Thereof) in Developing Countries

(31 pages)


9. Wednesday, October 3.

Credit Market Failure due to Asymmetric Information

(17 pages)


No class on Monday, October 8 (Fall Reading Period)

10. Wednesday, October 10.

Can Transfers to the Poor Improve Economic Efficiency?

(17 pages)

11. Monday, October 15.

Behavioral Economics and Public Policy

(30 pages)

- Gruber, "The Economics of Smoking," Ch. 6, Section 6.3 (pp. 165-172 in 3rd ed., pp. 163-171 in 2nd ed., pp. 156-164 in 1st ed.).

Wednesday, October 17. -- Optional review session for midterm.

Thursday, October 18. Evening midterm exam, 7:00pm – 9:30pm, room to be announced

12. Monday, October 22

Health Care Policy in Developing Countries

(30 pages)


13. Wednesday, October 24.

Issues in the Design of Transfers to the Poor I

(19 pages)


Issues in the Design of Transfers to the Poor II

(25 pages)

• Hanlon, Joseph, Armando Barrientos, and David Hulme. 2010. “Cash Transfers are Practical in Poor Countries.” Excerpted from pp. 143-155 of Just Give Money to the Poor, Kumarian Press.

15. Wednesday, October 31.
Political Economy I
{29 pages}
• Gruber, Ch. 9, "Political Economy,” Sections 9.1 – 9.3 only (pp. 227-248 in 3rd ed., pp. 223-244 in 2nd ed., pp. 215-237 in 1st ed.).

Political Economy II
{20 pages}

17. Wednesday, November 7.
Fiscal Federalism and Decentralization
{28 pages}
• Gruber, "Optimal Fiscal Federalism” Ch. 10, Section 10.2 only (pp. 267-275 in 3rd ed., pp. 262-270 in 2nd ed., pp. 251-258 in 1st ed.).

18. Monday, November 12
Making Government Work Better I: Addressing Corruption
{29 pages}
19. Wednesday, November 14
Making Government Work Better II: Addressing Absence
(15 pages)

Education I
(24 pages)
- Bakija, Jon. “Unemployment Rate by Highest Level of Educational Attainment,” based on data from World Bank, World Development Indicators 2011.

Wednesday November 23: No class (Thanksgiving Break)

Education II
(42 pages)
22. Wednesday, November 28.

Government vs. Private Ownership and Production: Introduction

(24 pages)


23. Monday, December 3.

Government vs. Private Ownership and Production: Evidence, Part 1 – School Vouchers

(22 pages)


24. Wednesday, December 5.

Government vs. Private Ownership and Production: Evidence, Part II – Privatization of State Owned Enterprises

(17 pages)