

Economics 517 / 389 -- Tax Policy in Emerging Markets
Spring 2011

Class meets: 2:35-3:50pm M, Th
CDE Classroom
Office hours: 1:30-3:30pm Tues.
and by appointment

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Course Description

Taxes are half of what government does. So if you are interested in what government policy can do to promote efficiency, equity, and economic development, you should be interested in tax policy. Governments must raise tax revenue to finance critical public goods, address other market failures and distributional issues, and to avoid problems with debt and inflation. Taxes typically take up anywhere from ten to fifty percent of a country's income, they profoundly affect the incentives to undertake all varieties of economic activity, and the government expenditures that they finance have potentially large consequences for human welfare. So the stakes involved in improving tax policy are quite large. All of these issues are of great importance in developing and transitional countries (also known as "emerging markets"), but in these nations taxation is especially challenging because of serious problems with tax evasion and administration, among other things. This class provides an in-depth exploration of tax policy, with an emphasis on the challenges and issues most relevant in emerging markets. Topics addressed in this class include: how basic economic principles can be applied to help one think about the efficiency and equity consequences of tax policies; how the value-added tax, taxes on land and property, personal income taxes, and corporate income taxes are designed and administered and how they influence the economy; how various elements of tax design affect incentives to save and invest; ideas for fundamental reforms of these taxes; the implications of global capital flows and corporate tax avoidance for the design of tax policy; tax holidays and other special tax incentives for investment; empirical evidence on the influence of taxes on economic growth, foreign direct investment, labor supply, and tax evasion; theory and evidence in the debate over progressive taxes versus "flat" taxes; case studies of efforts to reform tax administration and reduce tax evasion and corruption; presumptive taxation; and the "unofficial" economy and its implications for tax policy.

Course Materials

There will be a limited amount of reading from a textbook for the course, *Public Finance and Public Policy* by Jon Gruber (any edition is fine). CDE fellows already have this book from the fall semester. Undergrads can buy the textbook at Water Street Books; since we are using a relatively small portion of the textbook this semester, let me know if it is a financial hardship, as I have a limited number of old editions that I can lend out. All readings for the course except those from Gruber's textbook will be posted electronically on Glow and made available in printed course reading packets. The first reading packet is available now in the reading packet room in Hollander Hall.

Course Requirements

- **Class participation** (10% of the grade). You are expected to come to class having done the assigned readings in advance, and be prepared to discuss questions about the reading. I may call on particular people to ask you to contribute.
- Approximately **four homework assignments** before the midterm (10% of the grade).
- **Midterm exam** (40% of the grade). The midterm will be held outside of the regular class meeting time, in order to give everyone plenty of time to complete it. It is tentatively scheduled for the evening of Tuesday April 12. Undergrads with a schedule conflict can make arrangements with me to take it at an alternate time.
- **Two essays, approximately 7 pages each** (40% of the grade). These writing assignments will ask you to engage with the readings in the second half of the course, for example by making an argument for a particular side of a tax policy debate, comparing, contrasting and synthesizing arguments and evidence from multiple required readings; or by critically evaluating an assigned reading that performs an econometric analysis relevant to tax policy. One of the essays will be due during second half of the semester, and the other will be due during the exam period, in place of a final exam. Further details, including exact due dates, will be provided later in the term after CDE faculty have had a chance to coordinate scheduling.

There is no final exam for the course.

Course web page

The course web page is available through the site: <http://glow.williams.edu>

Honor code

All of the usual Williams honor code rules apply in this course. Your writing assignments should follow the Chicago author-date method of citation, and any words that are not your own must be enclosed in quotation marks and cited. For further details see:

http://www.williams.edu/resources/acad_resources/survival_guide/CitingDoc/CitingContents.php.

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 on your own, in your own words, and of course you must each turn in your own individual problem set. Turning in an identical problem set answer to a classmate is a violation of the honor code.

Teaching Assistant

The teaching assistant for the course is Andi Beqiraj <ab6@williams.edu>. He will grade your homework assignments, and will run a review session before each homework is due.

Schedule of Topics and Readings

	Date	Topic	Readings
1	Wed Feb 2	Tax incidence and economic efficiency: supply-demand analysis	<ul style="list-style-type: none"> • Gruber, Ch. 19, "The Equity Implications of Taxation: Tax Incidence," Sec. 19.1, first part of 19.2, and 19.3 (p. 559-570 and pp. 575-580 in 3rd ed., pp. 547-558 and 563-568 in 2nd ed., or pp. 519-530 and 534-539 in 1st ed.) • Gruber, Ch. 20, "Taxation and Economic Efficiency," Introduction and first 3 parts of Section 20.1 (p. 589-595 in 3rd ed., pp. 577-583 in 2nd ed., pp. 547-553 in 1st ed.). • Slemrod, Joel, and Jon Bakija. 2008. "Corporations Don't Pay Taxes, People Do" and "Do Workers Bear Taxes on Capital?" excerpted from <i>Taxing Ourselves</i>, 4th ed., Cambridge: MIT Press, pp. 78-81. • Sorenson, Peter Birch. 2007. "Taxing Capital Income: Some Basic Distinctions." Excerpted from "Can Capital Income Taxes Survive? And Should They?" <i>CESifo Economic Studies</i>, Vol. 53, No. 2 (June), pp. 173-177.
2	Mon Feb 7	Taxation and efficiency: indifference curve analysis	<ul style="list-style-type: none"> • Gruber Ch. 2, Sec. 2.1 (Review of indifference curves and income and substitution effects) • Gruber Ch. 21, Section 21.1 (Labor supply with indifference curves). • Rosen, Harvey S., and Ted Gayer. 2008. "Taxation and Efficiency." Excerpted from <i>Public Finance</i>, 8th ed. New York: McGraw-Hill Irwin, pp. 331-335, 337-340. • Bakija, Jon. 2011. "Notes on indifference curve analysis of the choice between leisure and labor, and the deadweight loss of taxation."
3	Thu Feb 10	Optimal taxation	<ul style="list-style-type: none"> • Gruber, Ch. 20, "Deadweight Loss and the Design of Efficient Tax Systems," "Optimal Commodity Taxation," and "Optimal Income Taxation" (bottom of p. 595 to top of p. 611 in 3rd edition, p. 584 – top of p. 597 in 2nd ed., bottom of p. 553 – 569 in 1st ed.). • Slemrod, Joel. 1990. "Optimal Taxation and Optimal Tax Systems." <i>Journal of Economic Perspectives</i>, Vol. 4, No. 1 [Excerpt, pp. 157-160]. (Note: this didn't make it into the first course packet, so it will be handed out in class.) • Weisbach, David. 2003. "Redistribution," from "Should Legal Rules be used to Redistribute Income?" <i>University of Chicago Law Review</i>. Vol. 70, pp. 440-446.
4	Mon Feb 14	The economics of tax evasion	<ul style="list-style-type: none"> • Gruber, Ch. 25, "Improving Tax Compliance" (pp. 739-743 in 3rd ed., pp. 726-730 in 2nd ed., pp. 692-695 in 1st ed.). • Slemrod, Joel. 2007. "Cheating Ourselves: The Economics of Tax Evasion." <i>Journal of Economic Perspectives</i>. Vol. 21, no. 1: 25-48. • Gordon, Roger, and Wei Li. 2009. "Tax Structures in Developing Countries: Many Puzzles and a Possible Explanation." <i>Journal of Public Economics</i>. Vol. 93, no. 7-8. [Excerpt, pp. 855-858 and 865.]

5	Thu Feb 17	Taxes on trade; taxes on land and property	<ul style="list-style-type: none"> • Mankiw, N. Gregory. 2004. "Application: International Trade" Chapter 9, pp. 175-185 of <i>Principles of Microeconomics</i>, 3rd edition. Thomson-Southwestern. • Skinner, Jonathan. 1991. "Prospects for Agricultural Land Taxation in Developing Countries." <i>World Bank Economic Review</i>. Vol. 5, No. 3. pp. 493-511.
6	Mon Feb 21	Value-added taxation 1	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. 2009. "How a Value Added Tax Works" from <i>Taxing Ourselves</i>, 4th edition. Cambridge MA: MIT Press. [Excerpt from Ch. 7, pp. 233-235]. • Ebrill, Liam, Michael Keen, Jean-Paul Bodin, and Victoria Summers. 2002. "The Allure of the Value-Added Tax" <i>Finance and Development</i>, June. • Bird, Richard M., and Pierre-Pascal Gendron. 2007. <i>The VAT in Developing and Transitional Countries</i>. Cambridge and New York: Cambridge University Press, pp. 28-43, 108-110, and 115-135.
7	Thu Feb 24	Value-added taxation 2	<ul style="list-style-type: none"> • Keen, Michael. 2007. "VAT Attacks!" <i>International Tax and Public Finance</i> Vol. 14, no. 4 [Excerpt, pp. 365-369 and 374-379]. • Ebril, Liam Ebril, Michael Keen, Jean-Paul Bodin, and Victoria Summers. 2001. "The Importance of Imports in Collecting VAT," excerpted from pp. 49-50 of <i>The Modern VAT</i>. Washington: International Monetary Fund. • Pomeranz, Dina. 2010. "No Taxation without Information: Deterrence and Self-Enforcement in the Value Added Tax." Working paper, Harvard University [Excerpt, pp. 1-5] http://www.people.fas.harvard.edu/~pomeranz/Pomeranz%20Job%20Market%20Paper.pdf.
8	Mon Feb 28	Income taxation 1	<ul style="list-style-type: none"> • Gruber Ch. 18, Section 18.3 ("Measuring the Fairness of Tax Systems") only. • Slemrod, Joel and Jon Bakija. 2009. <i>Taxing Ourselves</i>, 4th edition. Cambridge MA: MIT Press. [Excerpt from Ch. 2, pp. 28-46, 47-52]. • Gruber Ch. 22, Section 22.1 portion on "Inflation and the Taxation of Savings" only.
9	Thu Mar 3	Income taxation 2	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. 2009. <i>Taxing Ourselves</i>, 4th edition. Cambridge, MA: MIT Press. [Excerpt from Ch. 8, pp. 270-282] • Gruber, "Background: Present Discounted Value" (Ch. 4, pp. 103-104 in 3rd ed., pp. 102-103 in 2nd ed., p. 98 in 1st ed.). • Gruber Ch. 24, "Corporate Taxation." Introduction and sections 24.1, 24.2, and 24.5 only (pp. 703-713 and 722-729 in 3rd ed., pp. 689-700 and 709-716 in 2nd ed.; pp. 657-666 and 675-683, in 1st ed.).
10	Mon Mar 7	Income taxation in developing countries	<ul style="list-style-type: none"> • Tavernise, Sabrina, 2010. "Pakistan's Elite Pay Few Taxes, Widening Gap" <i>New York Times</i>, July 18, 2010. • Alm, James and Sally Wallace. 2006. "Can Developing Countries Impose an Individual Income Tax?" in <i>The Challenges of Tax Reform in a Global Economy</i>, James Alm, Jorge Martinez-Vazquez, and Mark Rider, eds., Springer, 2006, pp. 221-248.

11	Thu Mar 10	Taxes, saving, & investment	<ul style="list-style-type: none"> • Gruber, "Fairer Treatment of Savers and Less Distortion to Savings Decision" (Ch. 25, pp. 755-757 in 3rd ed., pp. 742-743 in 2nd ed., pp. 707-708 in 1st ed.) • Slemrod, Joel, and Jon Bakija. 2008. "A Consumption Base." Excerpted from <i>Taxing Ourselves</i>, 4th ed., Cambridge: MIT Press, pp. 194-216. • Bakija, Jon. 2010. "How Taxes Affect Incentives to Invest"
12	Mon Mar 14	Progressive consumption taxation 1	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. 2009. <i>Taxing Ourselves</i>, 4th edition. Cambridge MA: MIT Press. [Excerpt, pp. 235-239 and pp. 260-262.] • Bahl, Roy, and Sally Wallace. 2007. "From Income Tax to Consumption Tax? The Case of Jamaica." <i>FinanzArchiv</i> 63, no. 3: 396-414.
13	Thu Mar 17	Progressive consumption taxation 2	<ul style="list-style-type: none"> • Keen, Michael, and King, John. 2002. "The Croatian Profit Tax: An ACE in Practice." <i>Fiscal Studies</i>, September 2002, v. 23, iss. 3, pp. 401-18.
14	Mon Apr 4	International taxation 1: tax rules and evidence of avoidance	<ul style="list-style-type: none"> • Gruber, Ch. 24, Section 24.6, "Treatment of International Corporate Income" (pp. 730-734 in 3rd ed., pp. 717-721 in 2nd ed., pp. 683-686 in 1st ed.). • Hines, Jim. 1999. "International Taxation for Beginners," [excerpted from pp. 306-308 of "Lessons from Behavioral Responses to International Taxation," <i>National Tax Journal</i>, v. 52, iss. 2, pp. 305-22.] • Clausing, Kimberly. 2009. "Multinational Firm Tax Avoidance and Tax Policy." <i>National Tax Journal</i>, Vol. 62 No. 4 [Excerpt, pp. 703-717 only.]
15	Thu Apr 7	International taxation 2: theory and options for fundamental reform	<ul style="list-style-type: none"> • Sorenson, Peter Birch. 2007. "Why Do Source Based Capital Income Taxes Survive?" Excerpted from "Can Capital Income Taxes Survive? And Should They?" <i>CESifo Economic Studies</i>, Vol. 53, No. 2 (June), [Excerpt, pp. 181-186]. • Zodrow, George. 2006. "Capital Mobility and Source-Based Taxation of Capital Income in Small Open Economies," <i>International Tax and Public Finance</i>, Vol. 13, [Excerpt, pp. 275-286].
	Mon Apr 11	Optional review session for exam	(During our regular class meeting time, I will hold an optional review session where I will answer student questions).
	Tue Apr 12	Evening midterm exam	Time and place to be announced.
16	Thu Apr 14	International taxation 3: pros and cons of tax incentives for promoting foreign direct investment	<ul style="list-style-type: none"> • Margalioth, Yoram. 2003. "Tax Competition, Foreign Direct Investments, and Growth: Using the Tax System to Promote Developing Countries." <i>Virginia Tax Law Review</i>, Vol. 23 [Excerpt, pp. 175-191]. • McLure, Charles. 1999. "Tax Holidays and Investment Incentives: A Comparative Analysis." <i>Bulletin for International Fiscal Documentation</i>, Vol. 53, No. 8-9 (August-September 1999), pp. 326-39.

17	Mon Apr 18	International taxation 4: empirical evidence for developing countries	<ul style="list-style-type: none"> • Dharmapala, Dhammika, and James R., Jr. Hines. 2009. "Which Countries Become Tax Havens?" <i>Journal of Public Economics</i> Vol. 93, no. 9-10. [Excerpt, Sections 1, 2, and 5] • Van Parys, Stefan, and Sebastian James. 2010. "The Effectiveness of Tax Incentives in Attracting Investment: Panel Data Evidence from the CFA Franc Zone." <i>International Tax and Public Finance</i> Vol. 17, no. 4: pp. 400-429.
18	Thu Apr 21	Cross-country evidence on taxes and economic growth	<ul style="list-style-type: none"> • Slemrod, Joel. 1995. "What Do Cross-Country Studies Teach Us About Government Involvement, Prosperity, and Economic Growth?" <i>Brookings Papers on Economic Activity</i>, No. 2. [Excerpt, pp. 373-381]. • Lee, Young; Gordon, Roger H. "Tax Structure and Economic Growth" <i>Journal of Public Economics</i>, June 2005, v. 89, iss. 5-6, pp. 1027-43.
19	Mon Apr 25	Evidence on the response of labor supply to incentives	<ul style="list-style-type: none"> • Gruber, Ch. 21, Section 21.2 only ("Taxation and Labor Supply -- Evidence"). • Bakija, Jon. 2011. "Tax Rates and Labor Supply in OECD Countries." • Goldberg, Jessica. 2010. "Kwacha Gonna Do? Experimental Evidence about Labor Supply in Rural Malawi." Working paper, University of Michigan <http://www-personal.umich.edu/~jegoldbe/docs/goldberg_ganyu.pdf>. [Excerpt pp. 1-4 and 31-32].
20	Thu Apr 28	Evidence from the Russian "flat tax" reform	<ul style="list-style-type: none"> • Gorodnichenko, Yuriy, Jorge Martinez-Vazquez, and Klara Sabirianova Peter. 2009. "Myth and Reality of Flat Tax Reform: Micro Estimates of Tax Evasion Response and Welfare Effects in Russia." <i>Journal of Political Economy</i> 117, no. 3 [Excerpt, pp. 504-536, 542-544 and 546-547.] • Bakija, Jon. 2011. "If Tax Evasion Responds to Tax Rates, What Does That Imply About the Deadweight Loss from Taxation?" • Duncan, Denvil and Klara Sabirianova-Peter. 2010. "Does Labor Supply Respond to a Flat Tax? Evidence from the Russian Flat Tax Reform." <i>Economics of Transition</i>. Vol. 18, No. 2 [Excerpt, pp. 365-369.]
21	Mon May 2		
22	Thu May 5	Determinants of tax evasion: evidence from smuggling	<ul style="list-style-type: none"> • Fisman, Raymond and Edward Miguel. 2008. "The Smuggling Gap." Chapter 3 from <i>Economic Gangsters: Corruption, Violence, and the Poverty of Nations</i>. Princeton, NJ: Princeton University Press, [Excerpt, pp. 53-63 and 66-75] • Mishra, Prachi, Arvind Subramanian, and Petia Topalova. 2008. "Tariffs, Enforcement, and Customs Evasion: Evidence from India." <i>Journal of Public Economics</i> 92, no. 10-11: 1907-1925.

23	Mon May 9	Reforming tax administration and fighting corruption -- ideas, case studies, and evidence	<ul style="list-style-type: none"> • Chand, Sheetal K., and Karl O. Moene. "Controlling Fiscal Corruption." <i>World Development</i>, Vol. 27, No. 7, 1999. [Excerpt, pp. 1129-1130 and 1134-1140]. • Fjeldstad, Odd-Helge. 2003. "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority." <i>Public Administration and Development</i>, No. 23, 2003, pp. 165-175. • Yang, Dean. 2008. "Integrity for Hire: An Analysis of a Widespread Customs Reform." <i>Journal of Law and Economics</i> Vol. 51, no. 1. [Excerpt, pp. 25-29] • Di Tella, Rafael, and Ernesto Schargrotsky. 2003. "The Role of Wages and Auditing during a Crackdown on Corruption in the City of Buenos Aires." <i>Journal of Law and Economics</i> Vol. 46, no. 1 [Excerpt, pp. 269-272]. • McCarten, William. 2006. "The Role of Organizational Design in the Revenue Strategies of Developing Countries" from James Alm, Jorge Martinez-Vasquez, and Mark Rider, eds. <i>The Challenges of Tax Reform in a Global Economy</i>, New York: Springer. [Excerpt, portions of pp. 424-437]
24	Thu May 12	Taxing the informal sector; presumptive taxation	<ul style="list-style-type: none"> • Yitzhaki, Shlomo. 2007. "Cost Benefit Analysis of Presumptive Taxation." <i>FinanzArchiv</i> Vol. 63 no. 3, [Excerpt, pp. 311-323.] • La Porta, Rafael, and Andrei Shleifer. 2008. "The Unofficial Economy and Economic Development." <i>Brookings Papers on Economic Activity</i> (Fall). [Excerpt, pp. 275-318]