

Economics 514 -- Tax Policy in Emerging Markets
Spring 2014 [With suggested revisions for next edition of class]

Class meets: 1:10-2:25pm M, Th
CDE Classroom
Office hours:
2:35-3:35pm Mon & 1:10-2:10pm Tue
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; evidence on economic inequality and the degree to which tax and transfer policies affect it; 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 tax administration reform; the "informal sector" and its implications for tax policy; presumptive taxation; and taxation of natural resource wealth.

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.

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.
- **Three or four homework assignments** before the midterm (*10% of the grade*). I will drop the lowest homework grade from your grade calculation. Late homework will not be accepted.
- **Midterm exam** (*40% of the grade*). The midterm exam will be held on Tuesday April 15th from 7:00pm to 9:30pm in Hopkins 001, to make sure you have plenty of time to complete the exam. Undergrads with a schedule conflict should contact me as soon as possible so that you can make arrangements with me to take the exam at an alternate time.
- **Two essays, approximately 8 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. The first of these essays will be due Friday May 2 at 4:00pm. The due date for the second essay is during exam period, on Thursday May 22 at 4:00pm. Further information on the writing assignments will be provided later in the term.
- 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://web.williams.edu/wp-etc/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 Carson Eisenach <carson.m.eisenach@williams.edu>, a senior who took this course two years ago. 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 5	Tax incidence and economic efficiency: review of supply-demand analysis	<ul style="list-style-type: none"> • Gruber, Ch. 19, "The Equity Implications of Taxation: Tax Incidence," Sec. 19.1, 19.2 (skip parts on imperfect competition and balanced budget incidence), and 19.3 (pp. 557-571 and 574-579 and in 4th ed., pp. 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 (pp. 589-595 in 4th ed., pp. 589-595 in 3rd ed., pp. 577-583 in 2nd ed., pp. 547-553 in 1st ed.). • Slemrod, Joel, and Jon Bakija. Forthcoming 2014. "Corporations Don't Pay Taxes, People Do" and "Do Workers Bear Taxes on Capital?" excerpted from <i>Taxing Ourselves</i>, 5th ed., Cambridge: MIT Press. • 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), portions of pp. 173-177.
2	Mon Feb 10	Taxation and efficiency: indifference curve analysis	<ul style="list-style-type: none"> • Gruber Ch. 2, Section 2.1, "Constrained Utility Maximization." • Gruber Ch. 21, Section 21.1, "Taxation and Labor Supply – Theory." • 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 13	Optimal commodity taxation, and the "principle of the second best"	<ul style="list-style-type: none"> • Gruber, Ch. 20, "Deadweight Loss and the Design of Efficient Tax Systems," and "Optimal Commodity Taxation," (p. 596 to middle of p. 607 in 4th ed., bottom of p. 595 to top of p. 601 in 3rd edition, p. 584 – bottom of p. 592 in 2nd ed., bottom of p. 553 – top half of p. 565 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].
4	Mon Feb 17	Optimal income taxation, and the tradeoff between equity and efficiency	<ul style="list-style-type: none"> • Bakija, Jon. 2013. "Social Welfare, the Tradeoff between Equity and Efficiency, and the Theory of Optimal Income Taxation." • Gruber, Ch. 20, Section 20.3 "Optimal Income Taxes" (pp. 607-611 in 4th edition; pp. 607-611 in 3rd edition, bottom of p. 592 to top of p. 597 in 2nd ed., bottom half of p. 565 – p. 569 in 1st ed.). • Slemrod, Joel, and Shlomo Yitzhaki. 2002. "The Marginal Efficiency Cost of Funds." excerpted from "Tax Avoidance, Evasion, and Administration," in A. J. Auerbach and M. Feldstein, eds. <i>Handbook of Public Economics</i>. Elsevier, pp. 1459-1463.

5	Thu Feb 20	Economic inequality and evidence on distribution of taxes and transfers	<ul style="list-style-type: none"> • “Measurement of Income Inequality,” excerpted from <i>Leading Issues in Economic Development</i>, 8th ed., by Gerald M. Meier and James E. Rauch, New York: Oxford University Press, pp. 437-438. • Milanovic, Branko. 2011. “More or Less.” <i>Finance and Development</i>. September. pp. 6-11. • Goni, Edwin, J. Humberto Lopez, and Luis Serven. 2011. “Fiscal Redistribution and Income Inequality in Latin America.” <i>World Development</i> Vol. 39, No. 9: 1558-1569. • Slemrod, Joel and Jon Bakija. Forthcoming 2014. “Who Bears the Burden of U.S. Federal Taxes?” excerpted from <i>Taxing Ourselves</i>, 5th edition, Cambridge MIT Press.
6	Mon Feb 24	The economics of tax evasion	<ul style="list-style-type: none"> • Gruber, Ch. 25, “Improving Tax Compliance” (middle of p. 741 to middle of p. 746 in 4th ed., 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.]
7	Thu Feb 27	Taxes on international 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.
8	Mon Mar 3	Value-added taxation 1: introduction	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. Forthcoming. “How a Value Added Tax Works” excerpted from Ch. 7 of <i>Taxing Ourselves</i>, 5th edition. Cambridge MA: MIT Press. • 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.
9	Thu Mar 6	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. Forthcoming. “Income Taxation” excerpted from Ch. 2 of <i>Taxing Ourselves</i>, 5th edition. Cambridge MA: MIT Press. • Gruber Ch. 22, Section 22.1 portion on “Inflation and the Taxation of Savings” only. • Gruber, “Background: Present Discounted Value” (Ch. 4, p. 104 in 4th ed., pp. 103-104 in 3rd ed., pp. 102-103 in 2nd ed., p. 98 in 1st ed.).

10	Mon Mar 10	Income taxation 2	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. Forthcoming. "Integration: Addressing the Double Taxation of Corporate Income," "Corporate Welfare," and "Capital Gains," excerpted from Ch. 6 of <i>Taxing Ourselves</i>, 5th edition. Cambridge, MA: MIT Press. • Gruber Ch. 24, "Corporate Taxation." Introduction and sections 24.1, 24.2, and 24.5 only. • Barreix, Alberto, Carlos Garcimartin, and Fernando Velayos. 2013. "Personal Income Tax: An Empty Shell" from Ana Corbacho, Vicente Fretes Ciblis, and Eduardo Lora, eds. <i>More than Revenue: Taxation as a Development Tool</i>. New York: Palgrave Macmillan, pp. 115-123.
11	Thu Mar 13	Consumption taxes vs. income taxes	<ul style="list-style-type: none"> • Gruber, "Fairer Treatment of Savers and Less Distortion to Savings Decision" (Ch. 25, pp. 758-759 in 4th ed., pp. 755-757 in 3rd ed., pp. 742-743 in 2nd ed., pp. 707-708 in 1st ed.) • Slemrod, Joel, and Jon Bakija. Forthcoming. "A Consumption Base," excerpted from Ch. 6 of <i>Taxing Ourselves</i>, 5th ed., Cambridge: MIT Press. • Slemrod, Joel. 1990. "Optimal Taxation and Optimal Tax Systems." <i>Journal of Economic Perspectives</i>, Vol. 4, No. 1 [Excerpt, pp. 157-160]. • Gruber, "Differences between Savers and Non-Savers." (Ch. 25, pp. 760-761 in 4th ed.; not present in earlier editions, so a copy is included in the printed reading packet).
12	Mon Mar 17	How taxes affect incentives to invest	<ul style="list-style-type: none"> • Bakija, Jon. 2011. "How Taxes Affect Incentives to Invest"
13	Thu Mar 20	Progressive consumption taxation	<ul style="list-style-type: none"> • Slemrod, Joel and Jon Bakija. Forthcoming. "How the Hall-Rabushka Flat Tax and the X-Tax Work" and "Distributional Consequences of an X-Tax," excerpted from Ch. 7 of <i>Taxing Ourselves</i>, 5th edition. Cambridge MA: MIT Press.
14	Mon Apr 7	Taxation of multinational corporations: tax rules and avoidance schemes	<ul style="list-style-type: none"> • Gruber, Ch. 24, Section 24.6, "Treatment of International Corporate Income." • 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.] • Slemrod, Joel and Jon Bakija. Forthcoming. "Corporate Tax Evasion and Avoidance," excerpted from Ch. 5 of <i>Taxing Ourselves</i>, 5th edition. Cambridge MA: MIT Press. • 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 10	Should we tax internationally mobile capital, and if so how?	<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, portions of pp. 176-177 and 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].
Sunday April 13, 11:00am, CDE Classroom			Optional review session for midterm exam
16	Mon Apr 14	Tax incentives to attract foreign 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.
	Tue Apr 15	Evening midterm exam	7:00pm – 9:30pm, Hopkins 001. [Undergrads with a schedule conflict should contact me as soon as possible to schedule an alternative time to take the exam.]
17	Thu Apr 17	Evidence on the effects of corporate income tax on investment	<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] • Djankov, Simeon, Tim Ganser, Caralee McLiesh, Rita Ramalho, and Andrei Shleifer. 2010. "The Effect of Corporate Taxes on Investment and Entrepreneurship." <i>American Economic Journal: Macroeconomics</i>. Vol. 2, No. 3, pp. 31-64. • Gravelle, Jane. 2014. "Cross-Country Investment Estimates: The Djankov Study" excerpted from "Corporate Tax Reform: Issues for Congress." <i>Congressional Research Service</i>. January 6, pp. 13-15.
18	Mon Apr 21	Evidence on the effects of taxes on economic growth	<ul style="list-style-type: none"> • Lee, Young; Gordon, Roger H. "Tax Structure and Economic Growth." <i>Journal of Public Economics</i>, June 2005, Vol. 89, iss. 5-6, pp. 1027-43.
19	Thu Apr 24	Taxation of natural resource wealth	<ul style="list-style-type: none"> • Collier, Paul. 2010. "Capturing Natural Assets" Ch. 5 from <i>The Plundered Planet</i>. Oxford University Press. • Boadway, Robin and Michael Keen. 2010. "Theoretical Perspectives on Resource Tax Design," in P. Daniel, M. Keen and C. McPherson, eds., <i>The Taxation of Petroleum and Minerals: Principles, Problems and Practice</i>, Routledge Press. [Excerpt, portions of pp. 13, 14, 15, 16-19, 25, 27-37, and 62-63]. <p>Moss, Todd. 2011. "Oil to Cash: Fighting the Resource Curse through Cash Transfers." Center for Global Development Working Paper 237, January.</p>

20	Mon Apr 28	The elasticity of taxable income; evidence from the Russian "flat tax" reform	<ul style="list-style-type: none"> • Bakija, Jon. 2014. "The Elasticity of Taxable Income and the Implications of Tax Evasion for Deadweight Loss." • 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.] • 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	Thu May 1	Value-added taxation 2: challenges and empirical evidence	<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]. • Pomeranz, Dina. 2013. "No Taxation without Information: Deterrence and Self-Enforcement in the Value Added Tax." NBER Working Paper No. 19199, July. • Naritomi, Joan. 2013. "Incentivizing Consumers against Tax Evasion." <i>Development Impact Blog</i>. Dec. 16. http://blogs.worldbank.org/impactevaluations/print/incentivizing-consumers-against-tax-evasion-guest-post-joana-naritomi
Fri May 2		4:00 pm: Essay #1 due	
22	Mon May 5	Reforming tax administration and fighting corruption: ideas, case studies, and evidence	<ul style="list-style-type: none"> • Bird, Richard. 2010. "Smart Tax Administration," <i>Economic Premise</i>, No. 156, The World Bank. • The World Bank. 2012. "Strengthening Tax Collection," Ch. 3 from <i>Fighting Corruption in Public Services: Chronicling Georgia's Reforms</i>. (Excerpt. pp. 25-35). • Moore, Mick. 2013. "Revenue Reform and Statebuilding in Anglophone Africa." IDS Working Paper Volume 2013 No. 428, July. • Kloeden, David. 2011. "Revenue Administration Reforms in Anglophone Africa since the Early 1990s." IMF Working Paper No. 11/162, July. [Excerpt, pp. 6-8 and 25-27]
23	Thu May 8	Taxes and the informal sector; presumptive taxation	<ul style="list-style-type: none"> • Keen, Michael. 2013. "Informality is not the Issue." Excerpted from "Taxation and Development – Again." in Clemens Fuest and George R. Zodrow, eds., <i>Critical Issues in Taxation and Development</i>. Cambridge MA: MIT Press, pp. 25-29. • Yitzhaki, Shlomo. 2007. "Cost Benefit Analysis of Presumptive Taxation." <i>FinanzArchiv</i> Vol. 63 no. 3, pp. 311-326. • Duncan, Denvil, and Klara Sabirianova Peter. 2014. "Switching on the Lights: Do Higher Income Taxes Push Economic Activity into the Shade?" <i>National Tax Journal</i>, Vol. 67, No. 2, pp. 321-350.

24	Mon May 12	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. [Excerpt, pp. 1907-1910 and 1912-1920, and 1923-1925.]
	Thu May 15	Class cancelled in exchange for evening midterm exam back on April 15th	
	Thu May 22	4:00pm: Essay #2 due	