Economics 750
Public Economics

Hanming Fang and Andrew Postlewaite

Fall, 2011

- This is a graduate course in public economics. Economics 701 and 703 are prerequisites; you cannot take the course for credit if you have not taken these courses. 750A is taught by Professor Andrew Postlewaite and 750B is taught by Professor Hanming Fang. The class will meet Tuesdays and Thursdays 1:30 - 3:00 in McNeil 285. There will be an additional meeting scheduled for student presentations.

- Requirements:
  - Students will present an empirical or theoretical research paper. At the end of this syllabus, there is a list of papers that you can choose from to present. Presentations will be by pairs of students with presentations being approximately 1 hour. Students are expected to attend all presentations. More details will be given the first class.
  - You are required to write a short research paper. For the paper, you are expected to pursue a topic covered in class or other related issues (subject to the approval of the instructors). The paper may consist of an empirical and/or theoretical analysis, but should contain original work. Before the end of the semester, you are to complete a two-page research proposal. The paper will be due in the beginning of the Spring semester. Please speak to us if you have difficulty developing a topic, and we will work on it together. The goal is to get you started on your first research project that can potentially be turned into the third-year paper later.
Part I

Econ 750A Postlewaite

- Room 456 McNeil building, phone: 898-7350, office hours: Friday 1:30-2:30 or by appointment

- There will be several problem sets for 750A.

- The topics we will cover are listed below in more or less the order in which we will cover them.

- Much of the reading will be journal articles. There are also notes on Blackboard mostly due to Hanming Fang.

- The following books contain material that is useful background for some topics and may be referred to.


  Required reading is marked as (R).
  My papers can be downloaded from my webpage.
  Papers marked with (B) can be downloaded from the Blackboard site for this course.

1. Public Goods

  Reading:
  Public Economics Notes, Sections 1-3
  (MWG) Chapter 11.C and example 16.G.3
2. Implementation and Mechanism Design

In our first look at public goods, we discussed the problems with relying entirely on markets for decisions within society. In this section we develop tools that are useful in analyzing how well societies can determine public decisions according to fixed criteria.

2.1. Implementation with Complete Information

Reading:
(S) Chapter 4

Hurwicz, L., E. Maskin and A. Postlewaite, “Feasible Implementation of Social Choice Correspondences by Nash Equilibria,” in *Essays in Honor of Stanley Reiter*, Kluwer Academic Publishers, 1995; pp 367-433. This paper deals primarily with questions of feasibility when the set of alternatives is not presumed to be known at the time the mechanism is chosen.

2.2. Implementation with Incomplete Information

Reading:
(R) MWG, Chapter 23.
(R)(B) Jackson, M. “Mechanism Theory”.


3. Positive Models of Public Good Provision

3.1. Positive Models of Private Provision of Public Goods

3.1.1. Static Models of Private Provision

Public Goods Notes, Section 4.1


3.1.2. Dynamic Models of Voluntary Provision


3.2. Provision of Public Goods with Private Information

Public Goods Notes Section 5
(R) Mailath, G. and A. Postlewaite, “Asymmetric Information Bargaining Problems with Many Agents,” *Review of Economic Studies*, 1990. (I list this as required but the notes cover nearly all the relevant material.)

3.3. Voting

MWG, Chapter 21D. This section deals with the median voter model and it’s limitations.

(R)(B) Jackson, M. “Mechanism Theory” Sections 1, 2 and 3.4.

4. Social Arrangements


(B) Corneo, G. and Olivier Jeanne "Conspicuous consumption, snobbism and conformism," *Journal of Public Economics* Volume 66, Issue 1, October 1997,
Pages 55-71. This paper presents a model generating conspicuous consumption similar to the model in Cole et al. in the Quarterly Review listed above.

(B) Corneo, G. and Olivier Jeanne "Status, the Distribution of Wealth, and Growth," Scand. J. of Economics 103(2), 283-293, 2001. This paper takes a fairly standard endogenous growth model and incorporates relative wealth concerns.

(B) Corneo, G. and Hans Gruner, "Social Limits to Redistribution," American Economic Review, Vol. 90, No. 5. (Dec., 2000), pp. 1491-1507. This is a nice application of a model in which a concern for relative ranking is taken to data.

(B) DellaVigna, Stefano, “Psychology and Economics: Evidence from the Field,” Journal of Economic Literature 47:2, 315-372, 2009. This is a nice survey of behavioral economics that discusses deviations from standard models in the preferences, beliefs and decision making process employed by individuals.

(B) Dufwenberg, M., P. Heidhues, G. Kirchsteiger, F. Riedel and J. Sobel, “Other-Regarding Preferences in General Equilibrium,” mimeo, 2008. This is a recent paper that incorporates preferences that take into account other people’s welfare (other-regarding preferences) and addresses the question of when one can identify other-regarding preferences from market behavior, and when the conclusion of the First Welfare Theorem continues to be true.

(B) Heller, D. "Insuring Against Risk through Social Assets", mimeo, undated. A variant of the Social Asset paper we discussed in class.


(B) Hopkins, E. and Tatiana Kornienko, "Inequality and Growth in the Presence of Competition for Status," Economics Letters 93 (2006) 291-296. This is a short note that integrates a concern for relative position into a simple endogenous growth model. The authors show that redistribution to reduce inequality may increase inefficient conspicuous consumption.


(B) Sobel, J. "Interdependent Preferences and Reciprocity," *JEL 93*, 2005, pp 392-436. This is a very nice survey of work that aims at understanding the limits of the joint assumptions of rationality and individual greed in economics models.

4.1. Applications

4.1.1. Labor Supply


4.1.2. Investment


5. Discrimination


6. Public Choice

6.1. Models of Political Competition

Reading:

(R) MWG Chapter 21

(R) Notes, Part III Public Choice


Part II
Econ 750B Fang

In this part of the course, we will mainly cover two topics:

1. (Section 7) Economics of Discrimination and Affirmative Action: Theory and Empirical Methods;


Requirements:
There will be two problem sets in this part of the course, one for each topic.

Office Hours: Friday, 1:00-2:30pm and by appointment

7. Economics of Statistical Discrimination and Affirmative Action

Section 7.1 overlaps with Andy’s Section on Discrimination. We will go directly to Section 7.2 if Andy has covered most of the theory papers in I.A.

7.1. Theory


7.2. Empiric Methods to Distinguish Prejudice from Statistical Discrimination


8. Selected Issues on Social Insurance: Theory and Evidence

8.1. Asymmetric Information: Theory, Tests and Welfare Analysis

The key reason for the government to be involved in providing insurance is the potential market failure as a result of asymmetric information. Here we review the basic theory of how asymmetric information may lead to market failure; and the tests for asymmetric information that are derived from the theory; and finally some recent empirical methods to examine the welfare effects of asymmetric information. Recently there have been some work emphasizing potential private information in other dimensions, such as risk aversion.

8.1.1. Theory:


8.1.2. Empirical Tests of Asymmetric Information

The most well-known empirical tests of asymmetric information is known as the “positive association property” test, first applied in Chiappori and Salanie (2000) for automobile and Chiappori, Jullien, Salanie and Salanie (2005) showed the robustness of this test. Other applications include Cawley & Philipson (1999) for life insurance market, Finkelstein & McGarry (2006) for Long Term Care insurance market, Fang, Keane & Silverman (2008) for Medigap insurance market.


However, “positive correlation property” is not the unique implication from the presence of asymmetric information. The following papers use different angles to examine the presence of asymmetric information.


8.1.3. Welfare Effects of Asymmetric Information

The frontier of this research area lies in welfare analysis of asymmetric information in insurance context. The following list is almost exhaustive about the existing literature.


Health care reform is one of the most important policy issues in the US. There are numerous angles from which one can examine the issues related to the health care system. I will touch upon only two issues, reclassification risk insurance, and dynamic externalities.
8.2.1. Reclassification Risk: Theory and Evidence

Reclassification risk is the risk that consumers face in future insurance premiums. There is no long-term health insurance currently in the U.S. This could lead to significant welfare loss.


8.2.2. Dynamic Externalities

Health insurance in the US is mostly tied to employment. There is neither universal, nor single-payer, health insurance in the US and this leads to dynamic inefficiencies.


8.2.3. Demand and Supply of Medical Care, Interacting with Health Insurance


8.2.4. Health Insurance and Labor Market Outcomes


8.3. Unemployment Insurance: Theory and Evidence

For the institutional background related to the unemployment insurance system in the US, see:


8.3.1. Theory and Evidence of Optimal Unemployment Insurance (Static Models)

The static models for optimal unemployment insurance are Baily (1978), extended further by Chetty (2006). Theoretical results on the optimal unemployment insurance are useful only if one has reliable estimates regarding the effect of UI benefit on unemployment duration, and the consumption smoothing from UI. Meyer (1990) and Gruber (1995) are classical studies on these two issues. Meyer (1995) summarizes.


8.3.2. Theory of Optimal Unemployment Insurance (Dynamic Models)

Dynamic theory of optimal timing and level of unemployment insurance started with Shavell and Weiss (1979). There is also a growing literature dubbed “dynamic public finance” that addresses the mechanism design issues related to unemployment insurance, as well as disability insurance, dynamic optimal taxation etc.


8.3.3. Some New Empirical Studies and Empirical Methods for Welfare Analysis


Part III
Student Presentations

- Presentations will be by pairs. So find another student to be your presentation partner.
- Each pair should pick two papers, one from the theory list and one from the empirical list. Indicate your preference about which of the two papers you prefer to present.
- If you are planning to use this course to satisfy the empirical course requirement, you should indicate this, and you are more likely to be asked to present an empirical paper.
- We will try to accommodate the preference but depending on the overall choices you may not be assigned your first choice.

Theory

- Bhaskar, V., (2011), "Sex Selection and Gender Balance", *AEJ: Micro*, pp 214-244. (See also the corrigendum.)


**Empirical**


