

Prof. Bryan Caplan

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Econ 849

Public Finance Syllabus

Course Focus:

The course provides a survey of public finance, or as I prefer to call it, "public economics." Over the past four decades, public economics has grown from a narrow focus on taxation to the comprehensive economic analysis of the public sector. In the first part of the course, we will study the fundamentals of public economics: efficiency analysis, public goods, taxation, voting, interest groups, political competition, and political collusion. After the midterm, we will turn to a variety of what I think of as "cutting edge" topics: empirical public opinion research, ideology, Wittman's critique of the political failure literature, Brennan and Lomasky's expressive voting model, the economics of anarchy, and my own theoretical and empirical work on voter irrationality.

Prerequisites:

I assume that you are familiar with graduate microeconomics and basic calculus and econometrics.

Texts:

Most of the course material will consist in detailed notes that will be handed out in class. There are six required texts:

Robert Cooter, *The Strategic Constitution*

A (free) online version of Cooter is available at:

<http://www.law.berkeley.edu/faculty/cooterr/PDFpapers/stratcon.PDF>

Steven Landsburg, *The Armchair Economist*

Steven Landsburg, *Fair Play*

Geoffrey Brennan and Loren Lomasky, *Democracy and Decision*

Donald Wittman, *The Myth of Democratic Failure*

Bryan Caplan, *The Myth of the Rational Voter*

My papers are available on my webpage at:

<http://www.gmu.edu/departments/economics/bcaplan/econ.html>

Readings marked with a + are available on Jstor (www.jstor.org)

Finally, I will hand out miscellaneous readings, marked with a *, in class.

Grading and Exams:

There will be one midterm and a final exam - essentially, an exam for each Part of the course. The midterm counts 30%; the final exam is 50%; homework counts for the remaining 20%.

These weights are fixed - improvement on later exams will not retroactively raise your grades on earlier exams.

There is no formal grade for participation, but if you are one of the students who (in my judgment) contributes most to the quality of class discussion you will be "bumped up" a fractional grade (e.g. B- to B).

Homework:

There will be approximately four homework assignments during the semester. Depending upon how good a job you do, your homework will receive a check-plus (4 points), a check (3 points), or a check-minus (2 points) if you turn it in; otherwise you receive 0 points. Late homework loses one point. *Late homework is no longer accepted after I pass out my suggested answers for a given assignment.*

Office Hours

The best way to contact me is by email at bcaplan@gmu.edu. Many questions and requests can be satisfied by going to my homepage at <http://www.gmu.edu/departments/economics/bcaplan>. My office is in 8 Carow Hall; my office number is 3-2324. My official office hours are MTh 1:30-3:00, but you can also schedule an appointment or just drop by and see if I'm available.

Tentative Schedule:

My proposed schedule for the semester follows. If it proves too ambitious, I will try to *simply say less about each topic* rather than cut the topics for the final weeks.

PART I: Basics of Public Economics

Week 1: Efficiency

- The many meanings of efficiency
- Pareto efficiency
- Kaldor-Hicks efficiency and deadweight costs
- K-H efficiency versus utilitarianism
- Allocative inefficiency, productive inefficiency, and lobbying inefficiency
- The comparative institutions approach and "second best"
- Moral philosophy and efficiency

Readings:

Landsburg, *The Armchair Economist*, pp.60-82, 95-105

Week 2: Public Goods and the Logic of Collective Action

- Private versus social benefits and costs
- Negative externalities and "public bads"
- Positive externalities and "public goods"
- The irrelevance of non-rivalry
- Normative versus positive public goods theory
- Bad but popular examples; good but unpopular examples

- Externalities, efficiency, and fairness
- Productive inefficiency of non-profit supply
- Coase, property rights, and externalities
- Demsetz and privatization
- Fallacies of group action
- Individual impact: probability and magnitude
- Calculating the probability of electoral decisiveness
- Empirical evidence on collective action problems
- The paradox of public good provision

Readings:

Brennan and Lomasky, pp.54-65

Week 3: Taxation: Incidence, Efficiency, and Equity

- The concept of incidence
- Incidence and elasticity
- Deadweight costs of taxation
- Deadweight costs and elasticity
- The Laffer curve
- The Ramsey rule
- Normative optimal taxation versus positive optimal taxation
- Landsburg's Perfect Tax
- Egalitarianism, Rawls, and tax equity

- Landsburg, Rothbard, and tax equity

Readings:

* Frederic Bastiat, "What Is Seen and What Is Not Seen"

Landsburg, *Fair Play*, pp.76-85, 98-128, 136-142

* Rothbard, *Power and Market*, pp.135-162

Week 4: Voting, I: The Basics

- Rational, instrumental voting
- Single-peaked preferences
- Two-party, winner-take all elections
- Political competition and platform convergence
- Voter participation and franchise restrictions
- The effect of fringe parties
- Multi-peaked preferences
- Individual and social intransitivity
- Multiple voting dimensions

Readings:

Cooter, chapter 2

Week 5: Voting, II: Information and Bargaining

- The economics of imperfect information
- Political knowledge and rational ignorance
- Empirical evidence on political knowledge
- Informed voting as a public good
- Education and voter ignorance
- Other group differences in political knowledge
- Voter ignorance, principal-agent problems, and optimal punishment
- The principle of aggregation
- Voter ignorance and the "miracle of aggregation"
- Uncertainty and platform convergence
- Divergence between median and mean preferences on a single dimension
- Log-rolling, bargaining, and the Coase theorem
- Bargaining to efficiency on one dimension
- Bargaining to efficiency on multiple dimensions
- Bargaining around intransitivity
- Pork barrel politics
- Supermajority rules

Readings:

* Delli Carpini and Keeter, *What Americans Know About Politics and Why It Matters*, pp.68-95, 142-147, 154-161, 188-209

Cooter, chapter 3

Week 6: Redistribution, Divided Government, Interest Groups, and Rent-Seeking

- Normative redistribution: return on investment, insurance, and egalitarianism as return on investment
- Redistribution in practice: the elderly, the poor, and more
- Redistribution in reverse: immigration restrictions
- Principal-agent problems, multiple agents, and overlapping principals
- Division of powers and minimum winning coalitions
- Bicameralism
- Presidential veto
- The role of the judiciary
- Special interests and the median voter model
- Campaign contributions, political advertising, and rational ignorance
- Concentrated benefits, diffuse costs, and asymmetric information
- Lobbying in equilibrium: rent-seeking, rent dissipation, and efficiency

Readings:

Cooter, chapter 9

Landsburg, *Fair Play*, pp.12-23

Week 7: Political Competition and Political Collusion

- Restrictions on political competition: term limits and spending limits
- Pure versus local public goods
- Tiebout and inter-governmental competition
- Some perverse incentives of non-profit competition
- Federalism: for and against
- Federal grants and the "race to the bottom"

Readings:

Cooter, chapter 6

MIDTERM

PART I: Topics in Public Economics

Week 9: Voter Motivation and the SIVH

- Is the median voter model correct?
- The self-interested voter hypothesis (SIVH)
- Empirical evidence on the SIVH

- Sociotropic voting
- Group-interested voting
- The SIVH versus the logic of collective action

Readings:

+ Meltzer, Allan, and Scott Richard. 1981. "A Rational Theory of the Size of Government." *Journal of Political Economy* 89, pp.914-27.

+ Peltzman, Sam. 1985. "An Economic Interpretation of the History of Congressional Voting in the Twentieth Century." *American Economic Review* 75, pp.656-75.

* David Sears and Carolyn Funk, "Self-Interest in Americans' Political Opinions"

+ Green, Donald, and Ann Gerken. 1989. "Self-Interest and Public Opinion Toward Smoking Restrictions and Cigarette Taxes." *Public Opinion Quarterly* 53, pp.1-16.

Week 10: Ideology

- The dimensionality of U.S. political opinion
- Ideological voting
- Education, ideology, income, and opinion
- Case study: the determinants of party identification
- Case study: the determinants of economic beliefs
- The ideology*education interaction
- Mainstream and polarization effects

Readings:

+ Keith Poole, Howard Rosenthal. 1991. "Patterns of Congressional Voting." *American Journal of Political Science* 35, No. 1, pp. 228-278.

+ Steven Levitt. 1996. "How Do Senators Vote? Disentangling the Role of Voter Preferences, Party Affiliation, and Senator Ideology." *American Economic Review* 86, pp.425-41.

* Delli Carpini and Keeter, *What Americans Know About Politics and Why It Matters*, pp.242-258.

* Zaller, *The Nature and Origins of Mass Opinion*, pp.97-113

Week 11: Wittman and Democratic Failure

- Critiques of the economic approach
- Wittman's challenge to orthodox public choice
- "Extreme voter stupidity"
- "Serious lack of competition"
- "Excessively high transactions costs"
- The effect of asymmetric political information
- Wittman's sampler: Responses to diverse political failures
- Validity versus soundness

Readings:

Wittman, chapters 1-4, 6-8, 11-14

Week 12: Expressive Voting

- The instrumental voting assumption
- Instrumental versus expressive value
- Decisiveness revisited
- Decisiveness and the relative prices of instrumental and expressive voting
- Expressive voting as political pollution
- Inefficient unanimity
- Application: Environmentalism
- Answering Wittman, I

Readings:

Brennan and Lomasky, chapters 1-3, 5-7

Week 13: Ignorance, Irrationality, and Aggregation: Theory and Evidence

- Return to the "miracle of aggregation"
- Ignorance, irrationality, and systematic error
- Rational ignorance versus rational irrationality
- Irrationality as political pollution
- Inefficient unanimity again
- Systematically biased beliefs about economics
- Group differences in economic beliefs
- Application: Protectionism
- Answering Wittman, II

- The interaction of voter motivation and cognition
- Availability cascades

Readings:

Caplan, chapters 1-3, 5, 6

Week 14: The Economics of Anarchy

- The comparative institutions approach revisited
- Some political economy of dictatorship
- Constitutional reform and endogenous institutions
- Are the functions of the night watchman state really public goods?
- Dispute resolution as a private good
- Rule formation as a private good
- Enforcement as a private good
- Moderate versus radical privatization
- Main objections to radical privatization
- Cowen, anarchism, and collusion

Readings:

* Murray Rothbard, *For a New Liberty*, pp.215-241

* David Friedman, *The Machinery of Freedom*, pp.114-163.

* Tyler Cowen. 1992. "Law as a Public Good." *Economics and Philosophy* 8, pp.249-267.

Bryan Caplan and Edward Stringham. 2003. "Networks, Law, and the Paradox of Cooperation." *Review of Austrian Economics* 16(4), pp.309-26.

FINAL EXAM