

**Centre for International Trade and Development
School of International Studies**

Course (MA/PhD): MA

Course Title: Public Economics – IE522

Course Type (Core/Optional): Optional

Course Teacher: Sushama Murty and Bharatee Bhusana Dash

Credits: 4

Contact Hours: 4 per week

Course Objectives

- To impart knowledge and training of basic public economic theory and its uses in real life design and implementation of governmental policies.
- To prepare students for undertaking advanced research work and a PhD programme in the area of Public Economics.
- To train students to be independent researchers, and prepare them as professional economists for faculty positions in the universities, in government and nongovernment organizations, research organizations, and the corporate world.

Learning Outcomes

- Students should be able to apply basic tenets of public economic theory such as optimal taxation theory to analyse and critically evaluate real-life policies.
- Student should be able to formulate appropriate economic models and conduct analysis for the design of various governmental expenditure and tax policies
- Students should be able to distinguish between various (often conflicting) objectives of government policies such as growth, efficiency, revenue generation, equity/redistribution, externality correction, public good provision etc
- Students should be able to read and comprehend state of the art literature on public economic theory
- Students should be able to understand and analyse the normative and positive motives of public sector spendings.
- Students should be able to rationalise and distinguish the fiscal role and responsibility of the national and subnational governments in a federation.

Evaluation Methods:

- Mid semester closed book examination: 50%
- End semester closed book examination: 50%

Course Content:

Taxation: Redistributive and Externality Correction:

1. Basics of general equilibrium and welfare economics, fundamental theorems of welfare economics, role of government in a market economy, first-best versus second-best economies

2. Ramsey taxation (Diamond and Mirrlees 1971 model); optimal tax rules – inverse elasticity rule, many-person Ramsey rule, second-best production efficiency; value added taxation
3. Non-linear income (direct) taxation – information constraints, marginal and average tax rates, characterising optimal non-linear income tax schedule (Mirrlees 1971 model), using elasticities to derive optimal income tax rates (Saez 2001 approach)
4. Optimal commodity and income tax mix.
5. Second-best corrective taxation for environmental externalities – violation of production efficiency, decomposition into many person Ramsey rule and Pigouvian components, non-uniqueness of optimal tax mix
6. Value added taxation in an open economy – border tax adjustments, destination and origin-based principles, neutrality under uniform VAT, tax competition and equivalence of tax regimes.

Public Goods, Political Economy and the Public Sector, and Fiscal Federalism:

1. Public goods and market failure: characteristics of publicly provided goods, optimal provision of public good, Lindahl equilibrium, free riding equilibrium, mechanism design and preference revelation; optimal provision of clubs and local public goods.
2. Political economy and public sector: public sector decision making through majority rule, alternatives to majority rule; competitive politics and public expenditure; rent-seeking models of politics; bureaucracy and budgeting in the public sector.
3. Fiscal federalism and fiscal competition: logic of federalism, Tiebout hypothesis and decentralization, federalism and (hard and soft) budget constraints, determinants of decentralization, intergovernmental grants under federalism; competition among subnational governments and fiscal outcomes.

Readings:

1. Mirrlees, J. A., “An Exploration in the Theory of Optimum Income Taxation,” *Review of Economic Studies*, Vol. 38, No. 2, pp. 175-208, April 1971
2. Diamond, P. A., and Mirrlees, J. A., “Optimal Taxation and Public Production I: Production Efficiency” and “Optimal Taxation and Public Production II: Tax Rules” *American Economic Review*, Vols 61 pp. 8-27 and pp. 261-278
3. Atkinson, A., and J. Stiglitz., *Lectures on Public Economics*. McGraw--Hill, 1980 and updated edition by Princeton University Press 2015.
4. Auerbach, A., and M. Feldstein. *Handbook of Public Economics*. Vol 1, 2, 3, 4, North Holland, 1985, 1987, 2002, 2002, 2013.
5. Guesnerie, R., *A contribution to the pure theory of taxation*. Cambridge University Press, 1998.
6. Institute for Fiscal Studies, *The Mirrlees Review*, Oxford University Press, 2010.
7. Myles, G., *Public Economics*. Cambridge University Press, 1995.
8. Saez, E., Using Elasticities to Derive Optimal Income Tax Rates, *Review of Economic Studies*, 68, 2001, 205--229.
9. Salanie, B., *Economics of Taxation*. MIT Press, 2011.
10. Tuomala M., *Optimal Redistributive Taxation*, Oxford University Press, 2016
11. Weymark, J., *Redistributive nonlinear income taxation*. Unpublished Lecture notes, 2012.

12. Murty, M. N., and S. Murty, Fiscal Policy Reforms for Environmental Management in India, Chapter 7, *Three Pillars of Government, Market, and Communities for Environment Management*, Edited by M. N. Murty and Surrender Kumar, Academic Press, New Delhi, 2023
13. Murty S., "Some principles for corrective taxation of externalities in a second-best world with commodity taxes" CITD Discussion Paper Series, DP1801, 2018
14. Murty, S., "Some results from the theory of optimal taxation and their relevance for increasing the progressiveness of Indian tax structure," *Indian Economic Review*, Springer, vol. 54(1), pages 19-50, June 2019.
15. Levell P., O'Connell, M.I and Smith K., "Excise Duties", Chapter 9, IFS Green Budget 2016 - Institute For Fiscal Studies, 2016
16. Dennis C. Mueller (2003). *Public Choice III*. Cambridge University Press.
17. Jean Hindriks and Gareth D. Myles (2013). *Intermediate Public Economics*. MIT Press.
18. Jonathan Levin and Barry Nalebuff (1995). An Introduction to Vote-Counting Schemes. *Journal of Economic Perspective* 9: 3-26.
19. Lucie Gadenne and Monica Singhal (2014). Decentralization in Developing Economies. *Annual Review of Economics* 6: 581-604.
20. Richard Cornes and Todd Sandier (1996). *The Theory of Externalities, Public Goods, and Club Goods*. Cambridge University Press.
21. Wallace Oates (1999). An Essay on Fiscal Federalism. *Journal of Economic Literature* 37: 1120-1149.