

**University of Ottawa**  
**Department of Economics**

**ECO 6130**  
**Public Economics: Expenditures**

Winter 2006

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**Course Objectives**

This course will explore the different rationales for government intervention in the economy and will examine the appropriate form of public policies to address market failures of various types. A range of topics will be discussed including the nature of externalities and potential corrective policies, the conditions defining the optimal provision of public goods and the consequences of the free-rider problem, incentive mechanisms for the provision of public goods, local public goods and fiscal federalism, the potential justifications for the public provision of private goods and market failures arising from problems of asymmetric information.

**Evaluation**

There will be a mid-term exam and a final exam, each worth 35% of the final grade. The mid-term exam will be held on February 16<sup>th</sup>. The date of the final exam will be determined by the University. The final exam will cover only the second half of the course. A term paper, worth 30% of the final grade, will be due on April 7<sup>th</sup>. The requirements of the term paper will be discussed in class.

**Textbooks**

There is no required textbook for this course. However, listed below are some textbooks that contain relevant material. Some of these books will be on reserve at Morrisset Library.

Atkinson, A. and J. Stiglitz (1980), *Lectures on Public Economics*, McGraw-Hill, New-York.

Boadway, R. and N. Bruce (1984), *Welfare Economics*, Basil Blackwell, Oxford.

Cornes, R. and T. Sandler (1996), *The Theory of Externalities, Public Goods, and Club Goods*, Second Edition, Cambridge University Press, Cambridge.

Myles, G. (1995), *Public Economics*, Cambridge University Press, Cambridge.

Jha, R. (1998), *Modern Public Economics*, Routledge, London.

## **Course Outline and Reading List**

You are not required to read all the items listed below. However, you should read the articles and book chapters that will be discussed in class.

### **1- The Foundations of Welfare Economics**

Atkinson and Stiglitz, Lecture 11.

Boadway and Bruce, Chapters 3 and 4.

Cornes and Sandler, Chapters 1 and 2.

Myles, Chapter 2.

Boadway, R. (1997), 'Public Economics and the Theory of Public Policy', *Canadian Journal of Economics* 30: 753-772.

### **2- Externalities**

Cornes and Sandler, Chapters 3 and 4.

Myles, Chapter 10.

Varian, H. (1994), 'A Solution to the Problem of Externalities When Agents Are Well-Informed', *American Economic Review* 84: 1278-1293.

### **3- Public Goods**

Atkinson and Stiglitz, Lecture 16.

Cornes and Sandler, Chapters 5 and 7.

Myles, Chapter 9.

Samuelson, P. (1954), 'The Pure Theory of Public Expenditures', *Review of Economics and Statistics* 36: 387-389.

- Samuelson, P. (1955), 'Diagrammatic Exposition of a Theory of Public Expenditures', *Review of Economics and Statistics* 37: 350-356.
- Atkinson, A. and N. Stern (1974), 'Pigou, Taxes, and Public Goods', *Review of Economic Studies* 41: 119-128.
- Hirshleifer, J. (1983), 'From Weakest-Link to Best-Shot: The Voluntary Provision of Public Goods', *Public Choice* 41: 371-386
- Warr, P. (1983), 'The Private Provision of Public Goods is Independent of the Distribution of Income', *Economics Letters* 13: 207-211.
- Sugden, R. (1984), 'Reciprocity: The Supply of Public Goods through Voluntary Contributions', *Economic Journal* 94: 772-87.
- Cornes, R. and T. Sandler, (1985), 'The Simple Analytics of Pure Public Goods Provision', *Economica* 52: 103-116.
- Bergstrom, T., L. Blume and H. Varian (1986), 'On the Private Provision of Public Goods', *Journal of Public Economics* 29: 25-49.
- Andreoni, J. (1990), 'Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving', *Economic Journal* 100: 464-77.
- Bordignon, M. (1990), 'Was Kant Right? Voluntary Provision of Public Goods under the Principle of Unconditional Commitment', *Economic Notes* 3: 342-72.
- Vicary, S. (1990), 'Transfers and the Weakest-Link: An Extension of Hirshleifer's Analysis', *Journal of Public Economics* 43: 375-394.
- Ballard, C. and D. Fullerton (1992), 'Distortionary Taxes and the Provision of Public Goods', *Journal of Economic Perspectives* 6: 117-131.
- Boadway, R. and M. Keen (1993), 'Public Goods, Self-Selection, and Optimal Income Taxation', *International Economic Review* 34: 463-478.
- Kaplow, L. (1996), 'The Optimal Supply of Public Goods and the Distortionary Cost of Taxation', *National Tax Journal* 49: 513-533.
- Boadway, R. and M. Hayashi (1999), 'Country Size and the Voluntary Provision of International Public Goods', *European Journal of Political Economy* 15: 619-638.
- Boadway, R., I. Horiba and R. Jha (1999), 'The Provision of Public Services by Government Funded Decentralized Agencies', *Public Choice* 100: 157-184.

Gaube, T. (2000), 'When Do Distortionary Taxes Reduce the Optimal Supply of Public Goods', *Journal of Public Economics* 76: 151-180.

Arce, D. (2001), 'Leadership and the Aggregation of International Collective Action', *Oxford Economic Papers* 53: 114-137.

Rossi De Oliveira, A., J. Faria and D. Arce, (2005), 'Leading by Example in International Collective Action', *Journal of Public Economic Theory* 7: 51-63.

#### **4- Mechanisms for the Provision of Public Goods**

Cornes and Sandler' Chapter 6.

Groves, T. and J. Ledyard, (1977), 'Optimal Allocations of Public Goods: A Solution to the Free-Rider Problem', *Econometrica* 45: 783-809.

Guttman, J. (1978), 'Understanding Collective Action: Matching Behavior', *American Economic Review* 68: 251-55.

Bliss, C. and B. Nalebuff (1984), 'Dragon-Slaying and Ballroom Dancing: The Private Supply of a Public Good', *Journal of Public Economics* 25: 1-12.

Danziger, L. and A. Schnytzer, (1991), 'Implementing the Lindahl Voluntary-Exchange Mechanism', *European Journal of Political Economy* 7: 55-64.

Jackson, M. and H. Moulin, (1992), 'Implementing a Public Project and Distributing its Costs', *Journal of Economic Theory* 57: 125-140.

Moulin, H. (1994), 'Serial Cost Sharing of Excludable Public Goods', *Review of Economic Studies* 61: 305-325.

Varian, H. (1994), 'Sequential Contributions to Public Goods', *Journal of Public Economics* 53: 165-186.

Ghosh, S., A. Karaivanov, and M. Oak (2005), 'A Case for Bundling Public Goods Contributions', working paper, Simon Fraser University.

#### **5- Local Public Goods**

Cornes and Sandler, Chapters 10 and 11.

Atkinson and Stiglitz, Lecture 17.

Tiebout, C. (1956), 'A Pure Theory of Local Expenditures', *Journal of Political Economy* 64: 416-424.

Bewley, T. F. (1981), 'A Critique of Tiebout's Theory of Local Public Expenditures', *Econometrica* 49: 713-740.

Mieszkowski, P. and G. Zodrow (1989), 'Taxation and the Tiebout Model', *Journal of Economic Literature*, 1098-1146.

Lim, C. (2003), 'Public Good Contributions Between Communities', *Journal of Public Economic Theory* 5: 541-548.

Clark, S. and R. Kanbur (2004), 'Stable Partnerships, Matching and Local Public Goods', *European Economic Review* 48: 905-925.

## **6- Fiscal Externalities and Intergovernmental Transfers**

Flatters, F., V. Henderson and P. Mieszkowski (1974), 'Public Goods, Efficiency, and Regional Fiscal Equalization', *Journal of Public Economics* 3: 99-112.

Boadway, R. and F. Flatters (1982), 'Efficiency and Equalization Payments in a Federal System of Government: A Synthesis and Extension of Recent Results', *Canadian Journal of Economics* 15: 613-633.

Zodrow, G and P. Mieszkowski (1986), 'Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods', *Journal of Urban Economics* 19: 356-370.

Myers, G. (1990), 'Optimality, Free Mobility and Regional Authority in a Federation', *Journal of Public Economics* 43: 107-121.

Dahlby, B. (1996), 'Fiscal Externalities and the Design of Intergovernmental Grants', *International Tax and Public Finance* 3: 397-411.

Edwards, J. and M. Keen (1996), 'Tax Competition and Leviathan', *European Economic Review* 40: 113-134.

Keen, M. and M. Marchand (1997), 'Fiscal Competition and the Pattern of Public Spending', *Journal of Public Economics* 66: 33-53.

Boadway, R., M. Marchand and M. Vigneault (1998), 'The Consequences of Overlapping Tax Bases for Redistribution and Public Spending in a Federation', *Journal of Public Economics* 68: 453-478.

Oates, W. (1999), 'An Essay on Fiscal Federalism', *Journal of Economic Literature* 37: 1120-1149.

## **7- Public Provision of Private Goods**

- Usher, D. (1977), 'The Welfare Economics of the Socialization of Commodities', *Journal of Public Economics* 8: 151-168.
- Nichols, A. and R. Zeckhauser (1982), 'Targeting Transfers Through Restrictions on Recipients', *American Economic Review* 72: 372-377.
- Blackorby, C. and D. Donaldson (1988), 'Cash Versus Kind, Self-Selection and Efficient Transfers', *American Economic Review* 78: 691-700.
- Besley, T and S. Coate (1991), 'Public Provision of Private Goods and the Redistribution of Income', *American Economic Review* 81: 979-984.
- Bruce, N. and M. Waldman (1991), 'Transfers In-Kind: Why They Can Be Efficient and Non-Paternalistic', *American Economic Review* 81: 1345-1351.
- Coate, S., S. Johnson and R. Zeckhauser (1994), 'Pecuniary Redistribution Through In-Kind Programs', *Journal of Public Economics* 55: 19-40.
- Boadway, R. and M. Marchand (1995), 'The Use of Public Expenditures for Redistributive Purposes', *Oxford Economic Papers* 47: 45-59.
- Coate, S. (1995), 'Altruism, the Samaritan's Dilemma, and Government Transfer Policy', *American Economic Review* 85: 46-57.
- Epple, D. and R. Romano (1996), 'Public Provision of Private Goods', *Journal of Political Economy* 104: 57-84.
- Epple, D. and R. Romano (1996), 'Ends against the Middle: Determining Public Service Provision when there are Private Alternatives', *Journal of Public Economics* 62: 297-325.
- Gouveia, M. (1997), 'Majority Rule and the Public Provision of a Private Good', *Public Choice* 93: 221-244.

## **8- Asymmetric Information and Market Failure**

### **Insurance market:**

- Akerlof, G. (1970), 'The Market for 'Lemons': Quality Uncertainty and the Market Mechanism', *Quarterly Journal of Economics* 84: 488-500.

Rothschild, M. and J. Stiglitz (1976), 'Equilibrium in Competitive Insurance Markets', *Quarterly Journal of Economics* 90: 629-650.

Wilson, C. (1977), 'A Model of Insurance Markets with Incomplete Information', *Journal of Economic Theory* 16: 167-207.

Dahlby, B. (1981), 'Adverse Selection and Pareto Improvements through Compulsory Insurance', *Public Choice* 37: 547-558.

### **Credit market:**

Stiglitz, J.E. and A. Weiss (1981), 'Credit Rationing in Markets with Imperfect Information,' *American Economic Review* 71, 393-410.

De Meza, D. and D.C. Webb (1987), 'Too Much Investment: A Problem of Asymmetric Information,' *Quarterly Journal of Economics* 102, 281-92.

Williamson, S. (1987), 'Costly Monitoring, Loan Contracts, and Equilibrium Credit Rationing', *Quarterly Journal of Economics*, 135-145.

Black, J.M. and D. De Meza (1994), 'The Nature of Credit Market Failure', *Economics Letters* 46: 243-249.

De Meza, D. and D.C. Webb (1999), 'Wealth, Enterprise and Credit Policy', *The Economic Journal* 109: 153-163.

Boadway, R. and M. Keen (2003), 'Financing New Investments Under Asymmetric Information: A General Approach', mimeo.

### **Labor market:**

Weiss, A. (1980), 'Job Queues and Layoffs in Labor Markets with Flexible Wages', *Journal of Political Economy* 88: 526-538.

Shapiro, C. and J. Stiglitz (1984), 'Equilibrium Unemployment as a Worker Discipline Device', *American Economic Review* 74: 433-444.

Chang, C. and Y. Wang (1996), 'Human Capital Investment under Asymmetric Information: The Pigouvian Conjecture Revisited', *Journal of Labor Economics* 16: 505-519.

Acemoglu, D. (1997), 'Training and Innovation in an Imperfect Labor Market', *Review of Economic Studies* 64: 445-464.

Acemoglu, D. and J.S Pischke (1999), 'The Structure of Wages and Investment in General Training', *Journal of Political Economy* 107-3: 539-572.