

THE UNIVERSITY OF THE WEST INDIES, MONA  
**ECON3016: Public Finance**

Semester I, 2013-14

**Pre-requisites: ECON2000 and ECON 2001**

**Lecturer: Georgia McLeod**

**Lecture Time: Thursday 7:00 p.m. – 9:00 p.m. (SR4)**

**Office Hours: Ms. Georgia McLeod (Room 17 Department of Economics)**

Wednesdays 3p.m. - 5p.m; Thursdays 4 p.m. - 6 p.m.

## **Description**

The purpose of this course is to give students a technical and critical understanding of the theoretical economic foundations that should inform the management of public expenditure and its financing through taxation and public debt accumulation. The course is more microeconomic than macroeconomic in its orientation focusing on the rationale for and impact of alternative taxation and expenditure choices rather than the macroeconomic impact of total tax revenue and total expenditure. Institutional, social and political reality, along with theoretical diversity, may mean even in developed countries, that policy is not always applied in consistency with the theoretical foundations of this course. Accordingly, students will be challenged to make and justify recommendations on current policy issues and to critically evaluate contemporary policy initiatives relative to the theoretical content of the course.

## **Learning Outcomes**

Upon successful completion of the course, the student should be able to:

1. Explain the central importance of public finance in a modern economy.
2. Explain and critically evaluate neo-classical concepts of equity and efficiency as a basis for decision making in taxation and public expenditure.
3. Identify and assess and critically compare the relevance of market failure and government failure.
4. Distinguish between public goods, goods produced by the public sector and goods provided by the private sector.
5. Identify positive and negative impacts that are generated outside of market transactions and evaluate the relative merits of various private and public sector interventions to resolve the attendant problems.
6. Use net present value as a basis for project selection and to differentiate between social and private cost benefit analysis.
7. Explain how and why taxation may have other effects than those explicitly intended.
8. Explain the impact of alternative forms of taxation on economic efficiency and explain the considerations relevant to designing an optimal system of taxation in balancing equity and economic efficiency.

9. Identify the difference between tax avoidance and tax evasion and articulate the considerations relevant to designing policy to minimize tax evasion.
10. Critically evaluate systems of taxation and proposals for tax reform.
11. Analyze the basis for the accumulation of public debt and weigh options for the correction of chronic indebtedness.

## **Modes of Delivery**

The course will be taught in a lecture/tutorial format (2 lecture hours plus one tutorial hour per week) supplemented by examination of specific case studies, internet references, audio-visual and handout materials. Lectures will be augmented with guest speakers where possible. Extensive use of websites of various Governmental policy implementation agencies as well as those of multilateral financial institutions will be required.

## **Assessment**

Three MCQ tests (15% each, summing to 45% in total) and a comprehensive final examination (55%).

## **Syllabus**

### **The Evolution and Critical Importance of Public finance.**

- Social organization and the role of government
- Organic vs. mechanistic state
- Positive and normative views of the role of government.
- Command, free market and mixed economies
- Global expansion and economic dependence
- Paying for government; taxation, grants and debt
- The ideal characteristics of a system of taxation.

### **Review of Partial and General Equilibrium and Welfare Economics**

- Rationality, divisibility, continuity and market perfection.
- Maximizing consumer satisfaction and entrepreneurial returns.
- Short vs. long run profit maximization
- The Edgeworth box in pure exchange and production economy.
- General equilibrium
- Welfare economics and Pareto Optimality

### **Market failure and Government failure**

- Violations of theoretical foundations of market perfection.

- Introduction of information asymmetries, externalities, public goods and natural monopoly.
- Pareto optimality and equity vs. efficiency.
- Government information deficiencies.
- Government market intervention and disequilibrium outcomes.
- Government production vs. government provision.
- Natural monopoly, regulation and paying for losses.

### **Public Goods**

- Definition as non-rival and non-excludable in consumption.
- Public goods vs. “social entitlements”
- Market demand and equilibrium: public vs. private goods.
- Market failure and the free rider problem.
- Public production vs. public provision
- User fees and under-consumption

### **Externalities**

- Definition of externalities (positive and negative).
- Identification of the importance of property rights and enforcement.
- Symmetric and non-normative nature of externalities.
- Efficiency costs of externalities.
- Private responses to externalities
- Market based public policy for socially efficient output and pollution.
- Regulatory (non-market) public policy.
- Input vs. output standards.

### **Private and Social Cost-Benefit Analysis**

- Net Present Value vs. Internal Rate of Return vs. Benefit-Cost as criteria for project selection.
- The impact of inflation and taxation on project selection
- Social vs. private benefits and costs and discount rate
- The appropriate rate of discount for inter-generational projects.
- Market prices vs. shadow prices
- Valuing non-pecuniary benefits and costs
- Distributional issues and the appropriate social welfare function.

### **The Incidence of Taxation**

- Definition of tax incidence: who pays?
- Forward and backward incidence.
- The impact of demand and supply elasticities.
- Short run vs. long run incidence.
- Incidence in factor markets.

- The incidence of subsidies.
- Incidence in monopoly with linear demand curves
- Incidence with constant elasticity of substitution demand curves.
- Incidence in general equilibrium.

### **Balancing Economic Efficiency and Economic Equity in Taxation Policy**

- Definition of efficiency as the avoidance of distortion of expenditure patterns.
- Explanation of all taxes except lump sum taxes as distortionary.
- Measurement of impact of distortion as deadweight loss or excess burden
- Derivation and analysis of formula for excess burden
- Analysis of excess burden of subsidies and factor market taxes.
- Optimal taxation as balancing efficiency and equity subject to a welfare function.
- Proportional vs. progressive income tax systems.
- Non-linear tax systems: efficient progressive taxation?
- The Ramsey, Inverse Elasticity and Corlett-Hague rules.
- Natural monopoly, regulation ownership and user fees.

### **Tax avoidance and tax evasion**

- Tax avoidance within the law and tax evasion outside.
- The facilitation of tax avoidance by public policy.
- The role of transnational business structures and the role of double-taxation agreements.
- The incentives for tax evasion in high rates and low probability of being apprehended and prosecuted.
- Policy to moderate tax evasion through reformed tax structures, enhanced administration and more effective judicial processes.

### **Tax Reform**

- The ideal characteristics of a system of taxation.
- The imperative for revenue and growth enhancement in heavily indebted developing countries.
- Characteristics of legacy tax systems in Jamaica and the Caribbean
- Proposals for and implementation of tax reform.
- Critical evaluation of tax reform.

### **Fiscal Deficits and Public Debt**

- The structure of the Government budget
- The processes of public sector financial management.
- Structural underpinnings of chronic fiscal deficit and debt in the Caribbean
- The nexus between chronic fiscal deficit and intractable public debt.
- Approaches to resolving fiscal deficit problems.
- Options for easing the burden of public debt
- Social, institutional and political constraints.

### **Prescribed P) and Recommended (R) Books:**

**Stiglitz, Joseph E:** Economics of the Public Sector (Norton) 3<sup>rd</sup> Ed (2000) (P)

**Rosen and Gayer:** Public Finance (Mc. Graw Hill – Irwin) 9<sup>th</sup> Ed (2010) (P)

**Howard Michael:** Public sector Economics for Developing Countries (UWI Press) 2001 (P)

**Joseph Matalon, (Chairman)** Final report of the Tax Policy Reform Committee to Government of Jamaica , (2004), (P)

**Hillman, Arye L:** Public Finance and Public Policy: Responsibilities and Limitations of Government (Cambridge) 2003 (R)

**Tanzi, Vito:** Fiscal Policies in Economies in Transition (IMF) 1992 (R)

**Tanzi Vito and Scuknecht:** Public Spending in the 20th Century: A Global Perspective (Cambridge) 2000 (R)

**David N. Hyman (2008), Public Finance:** A Contemporary Application of Theory to Policy with Applications, 9th Edition (New York: Thomson South-Western). (R)

**Bahl and Wallace;** (2007) Tax Reform and Economic Development: The Jamaican Experience, **Planning Institute of Jamaica** (R)