

The purpose of the final paper is to provide the student with the opportunity to write a substantial research paper in the field of public economics using the tools developed in lecture. The most natural topics for this class are public choice or rational choice politics explanations of particular public policies, which is to say papers on the positive theory of public policy formation. However, other papers topics are also possible. The purpose of the paper is to show case your understanding of the tools developed in this class. Other things being equal, the more public economics and public choice tools that are applied to the topic chosen and more original and sophisticated is the analysis, the higher the grade will be.

The papers can be theoretical, empirical, or combine elements of both methodologies. However, the theory-conceptual part of the paper is likely to be most important for the purposes of this class. The paper should include a short literature review, if an academic literature exists in the area written about, but not be entirely devoted to such a review.

Style counts, because good reasoning is best demonstrated by clear, well-organized prose. All papers should be typed *double* spaced, fifteen to twenty two pages in length, with 12 pt or 13 pt fonts and 1 inch margins. Complete references should appear in a bibliography at the end of the paper. (The papers can be longer if necessary. A standard journal article runs 28-30 pages in manuscript form.)

The papers will be submitted via email to me at roger.congleton@mail.wvu.edu with a header "Public Econ Final Paper" and title EC741\_lastname\_title. Papers should be in "doc or docx form, although pdf are acceptable.

*Some possible applications of the tools developed in class include:*

1. **The Political Economy of Public Policy**
  - Choose some local, state, national or international government service or regulation and discuss the reasons why a democratic or authoritarian regime might provide such services or impose such regulations. If the problem has already been addressed through regulations or taxation, analyze whether the policy has solved the problem or not. If not, explain why not? Ignorance or interest groups? Can your analysis be subjected to empirical tests? If so, how. If not, why not?
  - Choose a government service (roads, education, social insurance, defense, etc.) and analyze the distribution of benefits and costs associated with those programs. To what extent can that distribution of benefits and costs explain the extent of the political support for and opposition to those services? Now suppose that a technological breakthrough or change in the tax code alters that distribution. How will services change if your analysis is correct? Is there a result that would confirm or completely refute your analysis?
  - The manner in which political pressures (elections, interest groups, the bureaucracy etc.) produce policies is partly a consequence of the manner in which institutions account for and/or allow those pressures to influence policy decisions. Choose a specific government service and analyze how political institutions of various kinds (dictatorship vs. democracy, PR vs. single member districts, prime ministerial vs. presidential) affect the level and efficiency of that public service. Discuss briefly how your analysis can be tested statistically.

- Are some types of public services likely to be affected by institutions than others? If so why? Explain why some types of services are more likely affected by institutions than others. How could you use statistical inference to demonstrate this effect? What date would be ideal for this type of analysis?

## 2. Public Goods and Externalities

- Choose some local, state, national or international public good, commons, or coordination problem and discuss the nature of the problem and possible method(s) that a democratic (or authoritarian) polity would use to “solve” these problems. If the problem has already been addressed through regulations or taxation, analyze whether the policy has solved the problem or not. If not, explain why not? Ignorance or interest groups? Can your analysis be subjected to empirical tests? If so, how. If not, why not?
- Analyze how solutions to an externality, public good, or coordination problem vary with the politics through which it is addressed. Contrast, for example, the solutions that would be adopted by the median voter with those that would be adopted by an interest group that is either very “pro” or very “anti” regulation. Consider also the Peltzman/Becker analysis in which interest groups pressure relevant decision makers and the result. For the case of interest, is it possible to empirically distinguish between these models? If so how? If not why not?
- Contrast politically feasible or likely solutions to a local, state, national, or international public goods problems with Pareto efficient or ideal utilitarian solutions. Explain why political solutions are normally less than ideal from the perspective of such normative theories. Are some “solutions” worse than the problems addressed?

## 3. Rational Ignorance and Fiscal Illusion

- Downs argued that rational ignorance induces types of fiscal illusion that tends to induce voters to demand fewer government services than which actually maximizes their net benefits. Tullock argues that rational ignorance induces types of fiscal illusion that tends to induce voters to demand more services than which actually maximizes their net benefits. Discuss the logic of their arguments. Is it possible that both are right and that some services are under provided and others over provided? Provide examples and discuss how one could test both these specific forms of the fiscal illusion hypotheses and others that you can think of.
- Alternatively, discuss the fiscal illusion hypothesis and also policies that might serve to reduce fiscal illusion. To what extent might politicians attempt to use fiscal illusion to promote their own interest? Discuss how your analysis might be tested in a particular area of public policy at the local, state, or national level. What kind of data would you need, and what kinds of tests and results would reveal clear support for the fiscal illusion hypothesis.
- Discuss why rational ignorance is the root-cause of interest group politics in otherwise well functioning democracies with competitive elections. Explain why voter ignorance facilitates “horse trading” between interest groups and both elected officials and candidates for office. Explain how one could test your analysis in a particular area of public policy. Is it possible to determine how important it is that voters are unable to completely monitor the

Congress, President, and the bureaucracy?

- The Condorcet jury theorem implies that if voters have sufficient information to make unbiased estimates of the costs and benefits of government services and regulations, that the results of median voter outcome will be far less error prone than rational ignorance implies. Summarize that argument and explain why various political institutions and private information sources can facilitate that theorem by reducing information costs. How might one go about testing Condorcet's idea? Statistically? Experimentally? Are there natural experiments that might provide suitable evidence of the joint effect of different degrees and types of rational ignorance and the implications of the jury theorem?

#### 4. Tax, Expenditure, and Regulatory Incidence

- Choose some real or hypothetical tax or expenditure program and carefully analysis of the incidence of the costs or benefits of the program. Note any spillover effects on other markets or individuals. Are their secondary markets or markets for raw materials that are affected by the tax or expenditure being analyzed?

Discuss briefly the politics behind the program. [Examples of taxes include: income taxes, value added taxes, property taxes, food stamps, along with variations in tax preferences. Examples of expenditures include: social security, farm subsidies, property taxes, energy taxes, highway construction, defense expenditures, etc.]

- Consider a specific externality problem in which a Pigovian tax can solve the problem—int the utilitarian, Paretian, or social net benefit maximizing sense. Pigovian taxes do not have an excess burden unless they are imposed at too high a level. Given their economic efficiency, why are they so rarely used? Think of three or four possible explanations. Next consider how your explanation can be tested.

#### 5. Tax Reform

Presidents routinely create blue ribbon commissions to recommend reforms of the US tax code. President Bush/Obama/Trump's recommended reducing tax preferences generally and lowering tax rates. One common suggestion is that a cap be placed on the deductability of mortgage payments.

Analyze the merits and/or politics of such a cap (which, recently has been adopted in the US if I remember correctly). In what ways would a cap on mortgage deductions change the burden of taxation and pattern of expenditures on housing? Which groups would lobby in favor of such a reform and which would tend to oppose it. Is there any evidence that such groups have been actively engaged in such campaigns? (Consider, for example, the donations of persons from such groups to candidates and lobbying groups. Do these groups give donations to, for example, the chairmen and chair women of congressional committees that have some direct influence over such deductions?

- A few years ago, Senator Ted Cruz of Texas proposed replacing the present income tax system with a 10% flat income tax (with a personal exemption) and a corporate income tax

of 16%.

Consider the impact of such a reform and analyze which groups would benefit and lose if it were adopted. Briefly survey the literature on such reforms and determine if your theoretical/intuitive analysis is supported by that literature. Are there states or countries that have adopted such reforms? If so, why were these reforms adopted in such places but not others?

- Social security and public medicine programs are seriously under funded in the US at present. Most of the states have under-funded their government pension programs. How might such future deficits generated by those programs be addressed? Are other democratic countries in a similar situation? Could such deficits become a financial crisis? Explain why or why not.

How would you test your conclusions? For example, Sweden had a financial crisis in the early 1990s in part because of the expansion of its social insurance programs. How did they solve the crisis? What were the consequences of reforms to its social insurance programs and budget process on for example economic growth rates, average income, the distribution of income, interests rates, unemployment etc.?

## 6. Risk, Uncertainty, and the Welfare State

- Analyze the role that perceived risks and/or crisis play in changes in the size or scope of a particular public program (defense spending, unemployment insurance, flood insurance, highway construction, building codes, etc.). For example, does an international military or terrorism crisis lead to large defense budgets? Does a flood lead to more spending on flood insurance and dikes? etceteras.

Does the program of interest tend to reduce or increase risks or simply reduce or increase losses from risks? That is to say, is there an moral hazard problem associated with the program of interest? For example, does unemployment insurance or bankruptcy law encourage taking up more risky careers? Does subsidized flood insurance induce more building near rivers and the oceans? Do “bailouts” of private firms encourage more risky investments? etceteras.

Is it possible to develop and estimate a statistical model that shows the above effects? If so collect the data to do so.

## 7. Fiscal Federalism

- [Positive Analysis] Analyze the effects of some particular example of fiscal or regulatory decentralization, as for example, alternative division of funding for highways, schools or Medicaid expenditures among local, state and national governments. If service levels are ultimately determined locally, how would increases in such intergovernmental grants affect service levels. Who would benefit from such programs? Who would be disadvantaged? Is there any evidence that these effects have induced lobbying efforts to favor (or oppose) the expansion of such intergovernmental grants? Give examples.
- [Positive] How does “yard stick” competition affect the tax and regulatory policies of

nearby governments? Can spatial econometrics be used to show the effects of yardstick competition in a particular policy area, either within a single country, or within a group of countries that are linked in some way.

Analyze how international variations in federal institutions affect the size and/or efficiency of government services.

- [Normative Analysis.] Try to characterize the optimal degree of centralization for a particular service (education, trash collection, highway construction, defense, etc.) or regulatory authority (building codes, antitrust regulation, environmental protection, etc.).

Is it possible to show that yardstick competition increases the efficiency of public service provision in the area of interest?

Is it possible to show that yardstick competition increases the efficiency of public service provision in the area of interest?

## 10. **OTHER TOPICS.**

- Any public economics topic can be tackled, but to be sure that your project is feasible in the time available and that analyzing it can be undertaken with a subset of the tools developed in class.
- (Other topics might, for example, be found in the “worth more attention” comments on your one pagers and in the news.)
- But please discuss and clear your topics with me before going too far. You can do so by simply writing up a short paragraph that explains what you plan (hope) to do.