
Public Finance

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90-736

Syllabus, Lecture Notes, and Readings

**The H. John Heinz III. School
of Public Policy and Management**

Carnegie-Mellon University

Fall 2003

Professor Robert P. Strauss

90-736 Public Finance

<http://www.cmu.edu/blackboard>

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Fall 2003

Mon-Wed: 11:00-12:20

Friday: 11:00-12:20

Office Hours: 12:30-2 Monday and Wednesday and by appointment

Hamburg Hall 2503

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Hamburg Hall A120B

The purpose of this course is to provide an introduction to the theory and practice of how government finances itself from both positive and normative points of view. To accomplish this, the course reviews rationales for government intervention in the market place, analyzes methods of resolving conflicts over the size of the public sector budget, extensively analyzes the rationales and issues of various sources of public revenue, and reviews the effects of public sector spending and taxes on the aggregate economy.

Because the subject matter of public spending and revenues can easily consume an entire academic year of study, *Public Finance* focuses mainly on the revenue side of the public budget. Two courses offered in the spring build on *Public Finance*. *Public Expenditure Analysis* (90-774) deals with techniques for evaluating private and public expenditure decisions. *State and Local Finance* (90-790) deals in-depth with issues surrounding multi-level government finance from US and international perspectives. *State and Local Finance* presumes the material covered in *Public Finance*; students interested in taking *State and Local Finance* should take *Public Finance*. It is suggested that students interested in *Public Expenditure Analysis* take *Public Finance*.

There are three items that you must obtain and two (*) that you must purchase to take this course:

- 1) The textbook*;
- 2) The bound lecture notes and additional required readings; and,
- 3) Tax Analyst's *One Disc* CD of the Internal Revenue Code (IRC), IRC Regulations, and Supreme Court Decisions*.

To make these purchases, please give a check to anybody in Hamburg 1505 willing to exchange the above for your payment.

The required text for the course is Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice*, New York: McGraw Hill Book Company, 5th edition (1989) which went out of print, but is still a classic. Fortunately, through an arrangement with the publisher, we are able to duplicate and sell it to you at less than its retail price. It will cost about \$30.00. Problem Set 2 requires each student to read and interpret a portion of the Internal Revenue Code. Tax Analysts, the publishers of *Tax Notes*, *State Tax Notes*, and *International Tax Notes*, of Arlington, Virginia, are offering a *Student Edition* of *OneDisc* for \$19.95. It is a CD-ROM containing a search engine, the Internal Revenue Code (IRC) and Regulations (final, temporary and proposed), IRS Documents (rulings, notes, letter rulings and tax information) and various Federal Court Opinions (summaries of all decisions 1942 to present, and key decisions in full text), and Federal Tax Resources. Normally this sells for \$199.00.

Students in *Public Finance* are expected to read and annotate my lecture outlines and required reading materials, and *bring them to class* each session. Also please bring your 'CMUs' to each session as well.

In addition, it is strongly recommended that you subscribe to *The Wall Street Journal* in order to keep abreast of fiscal events. A subscription form will be circulated in class.

The format of the course is lecture/discussion. The Musgrave and Musgrave text (MM) is self-explanatory but extremely terse; the text *and* footnotes require close reading. Lectures will typically involve elaboration of key points in the text, and will contain complementary material, which is designed to bring together the world of theory and the world of actual public financial practice. Students are required to have read the assigned material *prior* to lecture, and will be asked questions about the assigned material. Student answers will be graded.

The teaching assistant for the course is Dave Stickers who is a PHD candidate in the Department of Engineering and Public Policy. Not only did he take this course several years ago, he also is a graduate student of the Heinz School. Dave can be contacted at des3@andrew.cmu.edu.

The initial course roster as of August 19, 2003 has been enrolled in the course. Login in with your Andrew user-id and password. The syllabus is under *Course Information*, the lecture outlines are under *Course Documents*, and the problem sets are under Assignments.

I am available after class Monday and Wednesday from 12:30-2 and by appointment. You may wish to communicate with me via electronic mail (rs9f@andrew.cmu.edu) as I am usually logged in from somewhere.

Evaluation of student performance is based on written essay examinations, problem sets, and class participation. Identification of each student on problem sets and examinations is solely through his/her Social Security Number.¹ Answers to problem sets must be typed or word-processed, and must contain explanations of all numerical results. **Problem sets 2-7 are to be turned in paper form. Handwritten answers to problem sets will not be accepted. Problem sets 2, 3, 5, and 6 are to be worked on and answered separately and independently by each student.**

Problem Sets 1, 4, and 7 may be completed in groups.

The penalty for disobeying these rules (which is construed as cheating) will at a minimum entail a failing grade on the problem set, and may include a recommendation to the Dean that you be expelled from the Heinz School.

There will be three examinations: at six weeks, at twelve weeks, and at the end of the semester worth 20%, 20%, and 30% respectively. The final examination will cover the entire course, while the two mid-term exams will cover the material in the immediately preceding six weeks. There are seven problem sets, each worth 4%. Class participation is worth 10%.

Finally, a few reminders about *decorum, classroom procedures and suggested attire*: (1) the class begins at 11:00 AM Eastern Standard Time. Students are expected to be in the classroom, ready for the class **on or before** the appointed time. The room will be closed upon the beginning of class, and students who are not in the room on or before 11:00 AM will not be allowed into the room. Students who leave the classroom after the class begins will not be permitted back in. Punctuality and planning are important professional skills, and it is suggested that if you need to use the lavatory, do so before the start of class. (2) Portable or cellular telephones, beepers, pagers, televisions, radios, hand-held video games, and CD and radio headsets are **not** permitted. They are to be turned off and are not for use in the classroom. Laptops, only for note taking, are permitted. (3) Students are **not** permitted to eat food in class (coffee and sodas only). While attendance is not required, students are graded on their class participation. (4) Students who do not answer questions in class because they are not in class will receive zero scores. (This relates of course to (1) above). (5) In recent years textile technology has radically advanced to the point that certain jerseys worn by young women in *Public Finance* last year, according to comments and complaints made by several young men, left nothing to their imagination. Further, the young men who made these comments stated that such attire became a constant distraction from the intellectual activities of the class. Freedom of expression is a valued American principle, and one's choice of attire arguably is a constitutionally protected right, both for women and men. On balance, I suggest that both men and women refrain from dressing provocatively in *Public Finance*.

Lecture	Date	Topic	Required Reading
	Aug 25 (M)	Overview of Course, Distribution of Strauss Bucks	
1	Aug 27 (W)	The Public Sector: Functions and Institutions	MM 1-3, 8, see tables in notes *
	Sep 1 (M)	NO CLASS: LABOR DAY	
2	Sep 3 (W)	Public Goods	MM 4, 5
	Sep 5 (F)	SAS Tutorial 1	A103
3	Sep 8 (M)	Public Choice Mechanisms and Dilemmas	MM 7
4	Sep 10 (W)	Introduction to Taxation: Equity and Efficiency	MM 6, 12-14
	Sep 12 (F)	SAS Tutorial 2	A103
5	Sep 15 (M)	Tax Incidence and Excess Burden I	MM 15-16, see graphs in notes *
6	Sep 17 (W)	Tax Incidence and Excess Burden II	MM 16-17
	Sep 19 (F)	SAS Tutorial 3 (if needed) & Mathematica Tutorial 1	A103
7	Sep 22 (M)	Taxation of Individual Income I	MM 19-20, article in notes *
8	Sep 24 (W)	Taxation of Individual Income II	MM 19-20, see tables in notes *
Lecture	Date	Topic	Required Reading ?

¹ This means you are **NOT** to put your name on any problem set answer or examination.

9	Sep 29 (M)	Sales and Gross Receipts Taxation I	MM 23
	Oct 1 (W)	Review	
	Oct 6 (M)	1st EXAM: 10 ESSAY QUESTIONS (20%) 1.5 HOURS	
10	Oct 8 (W)	Business Taxation: Rationale, Classical System	MM 21-22
11	Oct 13 (M)	State Business Taxation: Issues	MM21-22, article in notes *
12	Oct 17 (W)	Foreign Tax Issues	MM 33
13	Oct 20 (M)	Gift and Estate Taxation	MM 25
14	Oct 22 (W)	Property Taxation I	MM 24, article in notes *
15	Oct 27 (M)	Property Taxation II	MM 24
16	Oct 29 (W)	Social Insurance and the Payroll Tax	MM 26
17	Nov 3 (M)	Other Transfer Programs	MM 11, see tables in notes *
18	Nov 5 (W)	Fiscal Federalism: Revenue Sharing Formula Design	MM 28-29, article in notes *
19	Nov 10 (M)	Fiscal Federalism: Revenue Sharing Civil Rights	Article in notes *
	Nov 12 (W)	Review	
	Nov 17 (M)	2nd EXAM: 10 ESSAY QUESTIONS (20%) 1.5 HOURS	
20	Nov 19 (W)	Tax Administration and Simplification	Articles in notes *
	Nov 21 (F)	Fair Model Tutorial in Cluster	
21	Nov 24 (M)	Stabilization Policy I	MM 30-32
	Nov 26 (W)	NO CLASS: THANKSGIVING	
22	Dec 1 (M)	Stabilization Policy II	MM 30-32
23	Dec 3 (W)	Stabilization Policy III, IV	MM 30-32
	Dec 5 (F)	Review	
	Dec TBA	FINAL EXAM 15 ESSAY QUESTIONS (30%) 3 HOURS	

* The titles of the required and elective readings are listed in the table below

Lectures	Required Readings in the Notes
1	A CBO Study: 1. <i>Forecasting</i> by Rudolph G. Penner 2. <i>Budgeting fore Defense: Maintaining Today's Forces</i> (Chapter 1-3)
2	Japanese Reform: <i>Sinking, not Flying</i>
3	N/A
4	N/A
5	N/A
6	N/A
7	1. <i>Why Can't America Get The Capital Gains Tax Right?</i> (Chapter 1) 2. <i>Basic Statistics on Capital Gains</i> by Allen D. Manvell 3. <i>A Handy Summary of the Capital Gains Arguments</i> by Walter J. Blum
8	1. A CBO Study: <i>For Better or for Worse: Marriage and the Federal Income Tax</i> 2. Special Report: <i>The Earned Income Tax Credit and the Child Tax Credit Under the Tax Act of 2001</i> by Laurence S. Seidman and Saul D. Hoffman
9	1. Special Report/Viewpoint: <i>The Effects of a Flat Federal Consumption Tax on the States</i> by Robert P. Strauss 2. <i>A Primer on Changing Information Technology and the FISC</i> by Jon M. Peha & Robert P. Strauss
10	1 <i>Federal Tax Policy and the Market for Corporate Control: Relationships and Consequences</i> by Robert P. Strauss 2. <i>Statement of Robert S. McIntyre Director, Citizens for Tax Justice Concerning the Alternative Minimum Tax Before the Senate Finance Committee</i> 3. 1996 Depreciation Guide featuring MACRS

11	N/A
12	N/A
13	1. <i>The Curious Story of Erehwemos (With Apologies to Samuel Butler)</i> by Harold Pepperell 2. <i>The Prospect: How the Pie is Sliced: America's Growing Concentration of Wealth</i> by Edward N. Wolff
14 & 15	1. <i>Property Taxation in the United States Today</i> 2. <i>State Education Finance Communications: Why Call for Property Tax Relief?</i> by Robert Strauss 3. <i>The Assessment of Residential Property in Allegheny County - Report 2: Sources of State Variations in Assessment Quality</i> by Robert Strauss 4. <i>Restoring the Public Trust in Allegheny County's Real Estate Assessment</i> by Robert P. Strauss
16	1. <i>Policy in Perspective: An Overview of the Major Proposed U.S. Reforms</i> 2. 1994-1996 Advisory Council on Social Security: <i>Findings, Recommendations and Statements</i> 3. <i>Statement of Edward M. Gramlich: Testimony and Hearing</i>
17	Special report/Viewpoint: <i>Revising the Medicaid Reimbursement Formula in an Era of Fiscal Austerity</i> by Robert P. Strauss
18	<i>State and Local Fiscal Assistance Amendments of 1976</i>
19	<i>General Revenue Sharing: How Well Is It Working?</i> by Robert P. Strauss
20	1. <i>III. Effects of Complexity on the Present-Law Federal Tax System</i> 2. <i>IV. Efforts of Foreign Countries to Simplify Their Tax Laws</i>
21	N/A
22 & 23	1. <i>Opening Up the Growth Debate</i> by Robert Eisner 2. <i>The Wall Street Journal: Dole as Reagan's Heir</i> by Robert L. Bartley 3. <i>Wage and Price Controls: 25 Years Later</i> by Herbert Stein 4. <i>Public Pricing and Environmental Policy</i>

Problem	Out/Due	Nature of Problem Set	ESTIMATED TIME
Prob 1 4%	Out: 8/27 Due: 9/5	SimCity 2000: Understanding the Budget Constraint NOTE: SimCity 2000 is available in A003.	3-6 hours
Prob 2 4%	Out: 9/10 Due: 9/11	Reading and Interpreting the Internal Revenue Code	5-10 hours
Prob 3 4%	Out: 9/17 Due 9/24	Sacrifice Theory, Excess Burden and Efficient Taxes	5-10 hours
Prob 4 4%	Out: 9/24 Due: 10/3	Individual Taxation	5-15 hours
Prob 5 4%	Out: 10/8 Due: 10/22	Business Depreciation Policy, Warp Depreciation	5-10 hours
Prob 6 4%	Out: 10/24 Due: 11/3	Property Taxation: Equity and Appraisal Analysis of Residential Properties in Allegheny County	7-15 hours
Prob 7 4%	Out: 11/14 Due: 12/3	Macro-Public Finance: Stabilizing the US Economy with FairModel (Group Problem Set)	10-20 hours

Course Calendar

Musgrave and Musgrave chapter readings [] and articles in bound notes completed by date
Out -- Homework # handed **Out** to Class
Due -- Homework # **Due** to Professor Strauss by End of Class (5 PM EST)
 * **Back** -- Homework # **Graded** and Handed Back to Class On or Before Date

<u>Month</u>	<u>Monday</u>	<u>Wednesday</u>	<u>Friday</u>
<u>August</u>	25 Intro to Course	27 [1-3, 8], # 1 Out	29 NO CLASS
<u>September</u>	1 LABOR DAY 8 [7] 15 [15-16] 22 [19-20] 29 [23]	3 [4, 5] 10 [6,12-14] # 2 Out; #1 Back 17 [16-17] # 2 Due; # 3 Out 24 [19-20] # 2 Back; #3Due; #4 Out	5 SAS # 1, # 1 12 SAS # 2 19 SAS # 3 26 NO CLASS
<u>October</u>	6 EXAM I , 20% 13 [21-22] 20 [25] 27 [24]	1 Review, # 3 Back 8 [21-22], # 4 Back, # 5 Out 15 [33] 22 [24, article in notes], # 5 Due 29 [26]	3 NO CLASS # 4 Due 10 NO CLASS 17 NO CLASS 24 NO CLASS # 6 Out 31 NO CLASS
<u>November</u>	3 [11] # 6 Due 10[article in notes] 17 EXAM II , 20% 24 [30-32]	5 [28-29, article in notes] 12 Review, # 6 Back 19 [article in notes] 25 NO CLASS	7 NO CLASS 14 NO CLASS # 7 Out 21 NO CLASS 28 NO CLASS
<u>December</u>	1 [30-32] 8 Finals Period FINAL EXAM (3 hours) 30% # 7 Back	3 Stabilization III, IV [30-32] # 7 DUE 10 Finals Period	5 Review