
Public Finance

90-736

Syllabus, Lecture Notes, and Readings

Volume I

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

Carnegie-Mellon University

Fall 2004

**Professor Robert P. Strauss
RS9F@Andrew.CMU.Edu
www.heinz.cmu.edu/~rs9f**

90-736 Public Finance

Professor Robert P. Strauss

RS9F@andrew.cmu.edu

<http://www.heinz.cmu.edu/~rs9f>

Fall 2004

Mon-Wed: 10:30-12:00

Friday: 11:30-12:50

Office Hours: 12:00-1:30 Monday and Wednesday and by appointment

Hamburg Hall 1003

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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*.

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'¹ 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 economic, financial and fiscal events, especially in this election year. 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 contain complementary, empirical material. The lecture 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.

We will be using Blackboard for a variety of purposes. The up to date syllabus is under **Course Information**, the lecture outlines are under **Course Documents**, and the problem sets and associated data are under **Assignments**.

I am available after class Monday and Wednesday from 12:00-1:30 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 the last 4 digits of

¹ See www.heinz.cmu.edu/~rs9f/pf02.html

his/her Social Security Number.² 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 3%.

Finally, a few reminders about *decorum, classroom procedures and suggested attire*: (1) the class begins at 10:30 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 10:30 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, water 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 clothing worn by young men and women in *Public Finance*, according to comments and complaints made by several students, left nothing to their imagination. Further, both young men and women, 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 dress professionally and refrain from dressing provocatively in *Public Finance*.

Lecture	Date	Topic	Required Reading
	Aug 30 (M)	Overview of Course, Distribution of Strauss Bucks	
1	Sep 1 (W)	The Public Sector: Functions and Institutions	MM 1-3, 8, see tables in notes *
	Sep 6 (M)	NO CLASS: LABOR DAY	
2	Sep 8 (W)	Public Goods	MM 4, 5
	Sep 10 (F)	SAS Tutorial 1	A103
3	Sep 13 (M)	Public Choice Mechanisms and Dilemmas	MM 7
4	Sep 15 (W)	Introduction to Taxation: Equity and Efficiency	MM 6, 12-14
	Sep 17 (F)	SAS Tutorial 2	A103
5	Sep 20 (M)	Tax Incidence and Excess Burden I	MM 15-16, see graphs in notes *
6	Sep 22 (W)	Tax Incidence and Excess Burden II	MM 16-17
	Sep 24 (F)	SAS Tutorial 3 (if needed) & Mathematica Tutorial 1	A103
7	Sep 27 (M)	Taxation of Individual Income I	MM 19-20, article in notes *
8	Sep 29 (W)	Taxation of Individual Income II	MM 19-20, see tables in notes *
9	Oct 4 (M)	Sales and Gross Receipts Taxation I	MM 23
	Oct 6 (W)	Review	
	Oct 11 (M)	1st EXAM: 10 ESSAY QUESTIONS (20%) 1.5 HOURS	
10	Oct 13 (W)	Business Taxation I: Rationale, Classical System	MM 21-22
11	Oct 18 (M)	Business Taxation II: Federal and State Issues	MM21-22, article in notes *
12	Oct 20 (W)	Foreign Tax Issues	MM 33
13	Oct 25 (M)	Gift and Estate Taxation	MM 25
14	Oct 27 (W)	Property Taxation I	MM 24, article in notes *

² This means you are **NOT** to put your name on any problem set answer or examination.

Lecture	Date	Topic	Required Reading
15	Nov 1 (M)	Property Taxation II	MM 24
16	Nov 3 (W)	Social Insurance and the Payroll Tax	MM 26
17	Nov 8 (M)	Other Transfer Programs	MM 11, see tables in notes *
18	Nov 10 (W)	Fiscal Federalism: Revenue Sharing Formula Design	MM 28-29, article in notes *
19	Nov 15 (M)	Fiscal Federalism: Revenue Sharing Civil Rights	Article in notes *
	Nov 17 (W)	Review	
	Nov 22 (M)	2nd EXAM: 10 ESSAY QUESTIONS (20%) 1.5 HOURS	
	Nov 26 (W)	NO CLASS: THANKSGIVING	
20	Nov 29 (M)	Tax Administration and Simplification	Articles in notes *
21	Dec 1 (W)	Stabilization Policy I	MM 30-32
	Dec 3 (F)	Fair Model Tutorial in Cluster	
22	Dec 6 (M)	Stabilization Policy II	MM 30-32
23	Dec 8 (W)	Stabilization Policy III, IV	MM 30-32
	Dec 10 (F)	Review	
	Dec 13 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 for Defense: Maintaining Today's Forces</i> (Chapter 1-3)
2	Japanese Reform: <i>Sinking, not Flying</i>
3	N/A
4	JCT 2004 Tax Expenditure Study
5	Berliant & Strauss, Excerpt from Working Paper
6	Supply & Demand Diagram from Musgrave & Musgrave
7	1. <i>A Handy Summary of the Capital Gains Arguments</i> by Walter J. Blum 2. 2003 Tax Forms 1040, Schedule A/B, Schedule C, Tax Rate Schedules, AMT (6251) 3. (Optional) Tax Analysts' Guide to the Economic Growth and Tax Relief Act of 2001
8	1. Earned Income Tax Table for 2003 2. A CBO Study: <i>For Better or for Worse: Marriage and the Federal Income Tax</i> 3. 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 & 11	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. (optional) 1996 Depreciation Guide featuring MACRS 4. Canellos & Kleinbard, <i>Disclosing Book-Tax Differences</i> 5. Knott & Rosenfield, <i>Book and Tax: A Selective Exploration of Two Parallel Universes</i> 6. Mills, Newberry & Trautman, <i>Trends in Book-Tax Income and Balance Sheet Differences</i>
11	See readings for Lecture 10

Lectures	Required Readings in the Notes
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. State Education Finance Communications: <i>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 P. Strauss 4. Pa. State Tax Equalization Board Common Level Ratios: 1982-2003 5. <i>Restoring the Public Trust in Allegheny County's Real Estate Assessment</i> by Robert P. Strauss 6. Robert P. Strauss & David A. Strauss, <i>Residential Real Estate Fairness in Four Urban Counties</i>
16	1. Policy in Perspective: <i>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. Statement of Edward M. Gramlich: Testimony and Hearing
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. The Wall Street Journal: <i>Dole as Reagan's Heir</i> by Robert L. Bartley 3. <i>Wage and Price Controls: 25 Years Later</i> by Herbert Stein

Problem	Out/Due	Nature of Problem Set	ESTIMATED TIME
Prob 1 4%	Out: 9/1 Due: 9/8	SimCity 2000: Understanding the Budget Constraint NOTE: SimCity 2000 is available in the Heinz Clusters (Group Problem Set)	3-6 hours
Prob 2 4%	Out: 9/15 Due: 9/20	Reading and Interpreting the Internal Revenue Code	5-10 hours
Prob 3 4%	Out: 9/20 Due 9/27	Sacrifice Theory, Excess Burden and Efficient Taxes	5-10 hours
Prob 4 4%	Out: 9/27 Due: 10/6	Individual Taxation with SAS (Group Problem Set)	5-15 hours
Prob 5 4%	Out: 10/13 Due: 10/20	Business Depreciation Policy, Warp Depreciation	5-10 hours
Prob 6 4%	Out: 10/27 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: 12/10	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)

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Back -- Homework # **Graded** and Handed Back to Class On or Before Date

Month	Monday	Wednesday	Friday
<u>August</u>	30 Intro to Course	1 [1-3, 8], # 1 Out	3 NO CLASS
<u>September</u>	6 LABOR DAY 13 7] 20 [15-16] # 2 Due, # 3 Out 27 [19-20] # 3Due;#4 Out	8 [4, 5], # 1Due 15 [6,12-14] # 2 Out; #1 Back 22 [16-17] # 2 Back 29 [19-20]	5 SAS # 1 12 SAS # 2 19 SAS # 3 1 NO CLASS
<u>October</u>	4 [23] 11 EXAM I , 20% 18 [21-22] 25 [25]	6 Review # 4 Due 13 [21-22], # 4 Back, # 5 Out 20 [33] # 5 Due 27 [24, article in notes] # 6 Out	8 NO CLASS 15 NO CLASS 12 NO CLASS 29 NO CLASS
<u>November</u>	1[24] 8 [11] # 6 Due 15[article in notes] 22 EXAM II , 20%	3 [26] # 6Due 10 [28-29, article in notes] 17 Review # 6 Back 24 Thanksgiving No Class	5 NO CLASS 12 NO CLASS 14 NO CLASS # 7 Out 26 NO CLASS
<u>December</u>	29 #7 5 [30-32] 13 FINAL EXAM (3 hours) 30% # 7 Back	1 [30-32] 8 [30-32]	28 NO CLASS 10 Review # 7 DUE