ECON0050: The Economics of Public Sector

# Lecturer

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# Why study the Economics of the Public Sector?

When individuals live in groups or societies, like we all do, they take collective decisions, the so-called social choices. These choices are implemented by governments through public policies. As such, the actions of governments affect everyone in a country.

One fundamental reason to study public policy is for understanding whether we need government intervention in the economy or not. Weren’t we told that the competitive market equilibrium is Pareto efficient?

Our daily-life experience is that government policies are prominent in political debates as well as in the news. For example, governments provide goods that the public wants. The public is willing to pay for health, education and pensions. But, as Evan Davis said, why is Sainsbury’s so much better at selling food than most of our schools are at teaching children? Hence, another reason to study public economics, is analysing weather governments are efficient. And, if not, why.

Further, government policies can contribute to social equity, in the sense that the less fortunate are helped and supported by the society as a whole. Then, why the gap between and the rich remain high? Or, put in other terms, are redistributive policies effective? Another good reason!

Last but not the least, in these unprecedented times, governments all over the world are rapidly and substantially increasing public spending with the aim of stabilizing their economies after they have been harshly hit by the global pandemic. However, is accumulating debt good? Is that fair for future generations? Would it be better to raise taxes today?

These questions have been in the air for years…centuries, actually. In this module we will hone deeply on each of these questions, using economic analysis.

# What will you learn about?

This module will provide you with an understanding of the economics of public goods, public expenditure and public services. You will explore some fundamental questions about the aims and tools of public policy. You will develop the ability to analyse and understand key issues in this field using standard tools of theoretic and empirical economic analysis, corresponding to the level taught in core second- year economics modules.

At the end of the module, you should

* have a knowledge of the dimensions and functions of the public sector in at least one country, and an appreciation of the normative arguments which might define the economic borders of the state;
* have a clear understanding of the economic theory of public goods, and of the problems which arise in making efficient decisions about public goods provision;
* have a clear understanding of the role of redistribution and of incentive problems that arise as a result of redistributive policy;
* understand the economic issues concerning various aspects of the role of the public sector in the provision of education and other public services.

# What will you know (better) by the end of the course?

By the end of the course, you will be able to use your economic knowledge to independently critique problems and policy solutions in the public sector, understanding the implications for the wider economy.

The desired learning outcomes are that on completion of the course you are able to:

* 1. Explain, using economic tools and empirical evidence, why we do have government intervention in the economy, developing the ability to evaluate claims and counterclaims;
  2. Independently investigate and critically comment on a range of current debates relating to public policy;
  3. Consolidate and deepen your critical thinking abilities, creativity, communication, team working and time management skills via video- making;
  4. Write clear and well-structured economic essays for a non-expert audience and critically assess the writing of others.
  5. Confidently discuss economic ideas with your peers.

When marking the 3-minute video, the assessed essay and exam answers we will be looking for evidence that students have reached outcomes 1 to 4 in particular. You will meet Outcome 5 if you engage with discussions in lectures and tutorials.

# How do you learn on this course?

The course is taught using a mix of lectures and tutorials. Students are expected to work independently outside the classroom for an average of 8-10 hours per week. Reading Week is a perfect opportunity to catch-up with literature and to prepare homework for later weeks.

# Learning

Your learning will be articulated into both live sessions, such as lectures and tutorials, as well as around activities you are free to take at the time that suits you the most. In both cases, we have set weekly activities so that you have to complete the activities on-time and, thus, your degrees of freedom are not infinite, right? More details below.

# Assessment

TBC

# Independent study

Students need to read lecture notes and readings weekly to ensure they keep on top of the course material.

During the course we will practice short answer questions, similar in style to short answer questions in the exam. The intention is to provide students with a vehicle to check their understanding of the main facts and concepts of the course and to provide useful practice for the short answer questions on the exam paper.

# Readings

The reading list provides suggestions of textbook chapters that cover the subjects discussed in each of the lectures. You are expected to read the textbook chapters as well as the suggested papers that discuss applied policy research or case studies. Further, you might want to expand your readings independently, starting from the references of the recommended readings and the suggested homework readings.

**Demonstrating a beyond the textbook knowledge** as well as the ability to build a well articulated and solid argument drawing from different sources is essential for a high grade in the exam.

The **principal textbook** for the course is:

* Jean Hindriks and Gareth D Myles "Intermediate Public Economics", MIT Press.

**Other textbooks** that you may find useful are:

* Sara Connolly and Alistair Munro "Economics of the Public Sector", Prentice Hall Europe
* Joseph E Stiglitz and Jay K. Rosengard "Economics of the Public Sector", 4th Edition, International Student Edition, Norton.
* Le Grand, Propper, Smith, Propper, Carol, & Smith, Sarah. (2008). The economics of social problems (4th ed. / Julian Le Grand, Carol Propper and Sarah Smith ed.). Basingstoke: Palgrave Macmillan. **Notes:** interesting real world examples, UK focused.
* Gruber, J. (2019). Public finance and public policy / Jonathan Gruber. (Sixth ed.). **Notes:** e-book available via UCL library, US focused but very good complement to the main textbook.

# Textbook chapters and other readings for each of the lecture topics

Please note that you are not requested to read all the resources here listed. I suggest you to read the chapters from the main textbook and to complement them with one or two readings amongst the ones listed.

*Lecture 1. Introduction and overview*

* Hindriks and Myles chapter 5, "Theories of the public sector".
* Stiglitz and Rosengard chapter 1, "The public sector in a mixed economy", chapter 3, "Market efficiency", chapter 4, "Market failure", chapter 10, "The analysis of expenditure policy".
* Connolly and Munro chapter 1 "Introduction" and chapter 2 "Economic

rationales for the state".

* Le Grand et al. chapter 1 “Social Objectives and the Allocation of Resources” and chapter 10 “The market and the Government”
* Gruber, J chapter 1 “Why study public finance” and chapter 2 “Theoretical tools of public finance”.
* Thomas A. Garrett and Russell M. Rhine (2006), " On the Size and Growth of Government", *Federal Reserve Bank of St. Louis Review*, January/February 2006, 88(1), pp.13-30.

<http://research.stlouisfed.org/publications/review/article/5018>

*Lecture 2: Fiscal Policy and Stabilisation*

* Stiglitz and Rosengard chapter 28, “Fiscal Deficits and Government Debt”
* Gruber, J chapter 4 “Budget Analysis and Deficit Financing”.
* Richard Baldwin, Beatrice Weder di Mauro 18 March 2020, *Mitigating the COVID Economic Crisis: Act Fast and Do Whatever It Takes,* full text available: [https://voxeu.org/content/mitigating-covid-economic-crisis-](https://voxeu.org/content/mitigating-covid-economic-crisis-act-fast-and-do-whatever-it-takes) [act-fast-and-do-whatever-it-takes](https://voxeu.org/content/mitigating-covid-economic-crisis-act-fast-and-do-whatever-it-takes)
* Giavazzi, Francesco, 2014. Notes on Fiscal Policy. MIT OCW [https://ocw.mit.edu/courses/economics/14-02-principles-of-](https://ocw.mit.edu/courses/economics/14-02-principles-of-macroeconomics-spring-2014/lecture-notes/MIT14_02S14_Fiscal_Policy.pdf) [macroeconomics-spring-2014/lecture-notes/MIT14\_02S14\_Fiscal\_Policy.pdf](https://ocw.mit.edu/courses/economics/14-02-principles-of-macroeconomics-spring-2014/lecture-notes/MIT14_02S14_Fiscal_Policy.pdf)

Other optional readings on Lecture 2 can be found in ECON0050 Moodle page

*Lecture 3. Voting as a mechanism for collective choice*

* Hindriks and Myles chapter 11, “Voting”
* Stiglitz and Rosengard chapter 7, “Public choice”
* Connolly and Munro chapter 8 "Public choice" and chapter 9 "Government failure"
* Gruber, J chapter 9 “Political Economy”
* Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice*, McGraw Hill. Chapter 6 "Public choice and fiscal politics"

*Lecture 4. Public goods, preference revelation*

* Hindriks and Myles chapter 6, "Public goods".
* Stiglitz and Rosengard chapter 5, "Public goods and publicly provided private goods".
* Connolly and Munro chapter 4, "Public goods".
* Le Grand et al. chapter 7 “Road conjestion”.
* Gruber, J chapter 7 "Public goods".

*Lecture 5. Externalities and the regulatory role of government*

* Hindriks and Myles chapter 8, "Externalities".
* Stiglitz and Rosengard chapter 6, "Externalities and the environment".
* Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice*, McGraw Hill. Chapter 35 "Public pricing and environmental policy".
* Le Grand et al. chapter 8 “Climate change”.
* Gruber, J chapter 5 "Externalities: Problems and Solutions" and chapter 6 "Externalities in action: environmental and health externalities.

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Other suggested readings for Lecture 5:

* Carson, R., (1962) “Silent spring". Houghton Mifflin Harcourt.

[http://library.uniteddiversity.coop/More\_Books\_and\_Reports/Silent\_Spring](http://library.uniteddiversity.coop/More_Books_and_Reports/Silent_Spring-Rachel_Carson-1962.pdf)

[-Rachel\_Carson-1962.pdf](http://library.uniteddiversity.coop/More_Books_and_Reports/Silent_Spring-Rachel_Carson-1962.pdf)

* Heller, W.P. and Starrett, D.A., 1976. “On the nature of externalities”. In *Theory and measurement of economic externalities* (pp. 9-27). Ed.: STE- VEN A. Y. LIN. NY: Academic Press, 1976, pp. 9- 22.
* Meade, J.E. (1952) External Economies and Diseconomies in a Competitive Situation. *Economic Journal*. 62: 54-6

*Lecture 6. Imperfect information, insurance and risk: an application to health care.*

* Hindriks and Myles chapter 10, "Asymmetric information”
* Connolly and Munro chapter 6, "Asymmetric information".
* Le Grand et al. chapter 2 “Health care”.
* Gruber, J chapter 12 “Social Insurance: the new function of government” and chapter 15 “Health Insurance I: health economics and private health insurance”.

*Lecture 7. Equity and the public sector: poverty and inequality*

* Hindriks and Myles chapter 14, "Inequality and poverty".
* Stiglitz and Rosengard chapter 7, "Efficiency and equity"
* Connolly and Munro chapter 14, "Income inequality" and Chapter 15, "Poverty".
* Le Grand et al. chapter 9 “Poverty and Welfare”.
* Gruber, J chapter 17 “Income distribution and welfare programs” Other suggested readings for Lecture 6:

O’Dea, C. and Preston (2010): “The distributional impact of public spending in the UK”, IFS Working Paper W12/06.

<https://www.ifs.org.uk/wps/wp1206.pdf>

*Lecture 8. Equity and public policy.*

* Hindriks and Myles chapter 23, "Social security".
* Stiglitz and Rosengard chapter 16, "Social insurance".
* Connolly and Munro chapter 16 "Social insurance and the welfare state", Chapter 17, "Social policy", and Chapter 18, "Pensions and ageing".
* Le Grand et al. chapter 4 “Pensions”.
* Gruber, J chapter 13 “Social Security”

Other suggested readings for Lecture 8:

IFS Green Budget, different years. Available at [www.ifs.org.uk](http://www.ifs.org.uk/)

*Lecture9. Decentralisation in government.*

* Hindriks and Myles chapters 7, "Local public goods" and 19, "Fiscal federalism".
* Stiglitz and Rosengard chapters 26, "Fiscal federalism" and 27, "State and local taxes and expenditures".
* Gruber, J chapter 10 “State and Local Government Expenditures”

*Lecture 10. Revenue issues.*

* Connolly and Munro chapter 11, "Tax incidence and efficiency".
* Richard A Musgrave and Peggy B Musgrave, *Public Finance in Theory and Practice*, McGraw Hill. Chapter 14 "Excess burden and efficiency".
* Gruber, J Part IV “Taxation in theory and practice”. You can skim through chapters 18, 19, 20 and 21. Bear in mind that we are dedicating just one lecture to taxation so that you do not need to read everything, unless you are really interested.