

Econ G 6222
Advanced Macro Analysis II
SPRING 2006

Version: January 20, 2006.

Instructor: Prof. Stefania Albanesi, Columbia University, e-mail: sa2310@columbia.edu.

Time and Location: M 2.10-4 PM, IAB 1101.

Office Hours: By appointment.

Reference Textbook:

(LS) T. Sargent and L. Ljungqvist, 2001, *Recursive macroeconomic theory* (MIT Press).
B. Salanié, *Economics of Taxation* (Cambridge: MIT Press, 2002).

Additional Material: A number of research papers are required reading for the course, as well as several handouts. They will be made available electronically on the course website if possible, or distributed in print.

Course website: <http://www.columbia.edu/~sa2310/Columbia-PhD/phdcourse.htm>

Grading: Grades will be based on five assignments and a final as follows:

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|-------------|------|
| Assignments | 30% |
| Final | 70%. |

Assignment Policies: You are encouraged to work in groups on the assignments, however, you must turn in an *individual* solution. Late assignments are unacceptable and will not be graded. Your lowest scoring assignment will not be counted towards the final grade.

Exams: The final exam will be on TBA.

Description of the Course

This course will review topics in optimal taxation. We will first briefly discuss the Ramsey approach to optimal taxation. We will focus on long run or steady state properties of optimal taxes and mostly abstract from the stochastic properties of optimal taxes. We will then discuss the dynamic Mirrlees approach to optimal taxation, which will be the main focus of the course. We will review results on the taxation of labor earnings and asset income, as well estate taxation. The last part of the course will focus on the implications of lack of commitment in the setting of government policies. We will first briefly analyze the time inconsistency problem in Ramsey policies. We will then discuss some deeper issues with commitment and review example of credible policies with private information.

The derivation of these results relies heavily on recursive contracting with private information. The required notions will be presented in the course. However, we will not have time to cover proofs and technical issues in great detail. Students are strongly encouraged to take or audit course ECON G6219, Advanced Microeconomic Analysis, II.

Detailed Topics and Tentative Lecture Plan.

- Optimal fiscal policy with commitment
 - Ramsey Approach, LS Ch. 15, Chari and Kehoe 2000.
 - * Primal Approach
 - * Optimal Indirect and Capital Taxation
 - New Dynamic Public Finance Approach

- * Wedges, Golosov, Kocherlakota and Tsyvinski (2003)
 - Optimal Indirect and Capital Taxation
- * Wedges and taxes, Albanesi and Sleet (2006), Kocherlakota (2005a), Kocherlakota (2005b).
- * Complementarity between optimal taxes and private contracts, Golosov and Tsyvinski (2005).
- * Taxation, inequality and overlapping generations, Phelan (2004), Farhi and Werning (2005).

Background reading: LS Ch. 19, "Social Insurance" contribution.

- Optimal fiscal policies with no commitment.
 - The basic problem with commitment (1 lecture). Readings: Chari (1989).
 - A deeper notion of commitment, Bassetto (2003), Bassetto and Phelan (2005).
 - Credibility and private information, Phelan (2003) and Sleet and Yeltekin (2005 a and b).

Required Readings

Stefania Albanesi. 2005. Social Insurance. Contribution to the *New Palgrave Dictionary of Economics and Law*, forthcoming.

Stefania Albanesi and Christopher Sleet. 2006. Dynamic Optimal Taxation with Private Information. Forthcoming, *The Review of Economic Studies*.

Andrew Atkeson, V.V. Chari and Patrick Kehoe. 1999. Taxing Capital Income: A Bad Idea. Federal reserve Bank of Minneapolis QR Vol. 23, No. 3.

Marco Bassetto. 2003. Equilibrium and Government Commitment. Forthcoming *Journal of Economic Theory*.

Marco Bassetto and Christopher Phelan. 2005. Tax Riots, Federal Reserve Bank of Minneapolis WP.

V.V. Chari. 1989. Time Consistency and Optimal policy Design. Federal reserve Bank of Minneapolis, Quarterly Review, Vol. 12, No.4.

V. V. Chari and Patrick J. Kehoe. 2000. Optimal Fiscal and Monetary Policy. Federal Reserve Bank of Minneapolis, Staff Report 251 (also in Handbook of Macroeconomics, Elsevier, 2000).

Emmanuel Farhi and Ivan Werning. 2005. Inequality, Social Discounting and Estate Taxation. NBER WP.

Michael Golosov, Narayana Kocherlakota, and Aleh Tsyvinski. 2003. Optimal Indirect and Capital Taxation. *The Review of Economic Studies*.

Narayana Kocherlakota. 2005a. Advances in Dynamic Optimal Taxation. Article prepared for the World Congress of the Econometric Society, London.

Narayana Kocherlakota. 2005b. Zero Expected Wealth Taxes: A Mirrlees Approach to Dynamic Optimal Taxation. *Econometrica*.

Narayana Kocherlakota. 2004. Wedges and Taxes. *AER Papers and Proceedings*.

Christopher Phelan. 2005. Opportunity and Social Mobility. Forthcoming, *The Review of Economic Studies*.

Related Readings

Stefania Albanesi. 2005. Optimal Taxation of Entrepreneurial Capital with Private Information. Manuscript, Columbia University.

Lawrence J. Christiano, V.V. Chari, Patrick Kehoe, "Optimal Fiscal Policy in a Business Cycle Model", *The Journal of Political Economy*, Vol. 102, No. 4. (Aug., 1994), pp. 617-652.

Carlos da Costa and Ivan Werning, 2005, "On the Optimality of the Friedman Rule with Heterogeneous Agents and Nonlinear Income Taxation," manuscript, MIT.

Golosov, M., and Tsyvinski, A., 2004, "Designing Optimal Disability Insurance: A Case For Asset-Testing," NBER working paper.

Kapicka, M., 2004, "Optimal Taxation with Human Capital Accumulation," manuscript, University of California-Santa Barbara.

Robert E. Lucas and Nancy Stokey, "Optimal Fiscal and Monetary Policy in Economies without Capital", *Journal of Monetary Economics*, 1983.

Christopher Phelan, 2003, "Public Trust and Government Betrayal", forthcoming, *Journal of Economic Theory*.

Christopher Sleet, 2003, "Optimal Taxation with Private Government Information," *The Review of Economic Studies*, 71:1217-1239.

Christopher Sleet and Sevin Yeltekin, 2005a, "Optimal Taxation with Endogenously Incomplete Markets", *Journal of Economic Theory*.

Christopher Sleet and Sevin Yeltekin, 2005b, "Credible Social Insurance", manuscript, Carnegie-Mellon University.