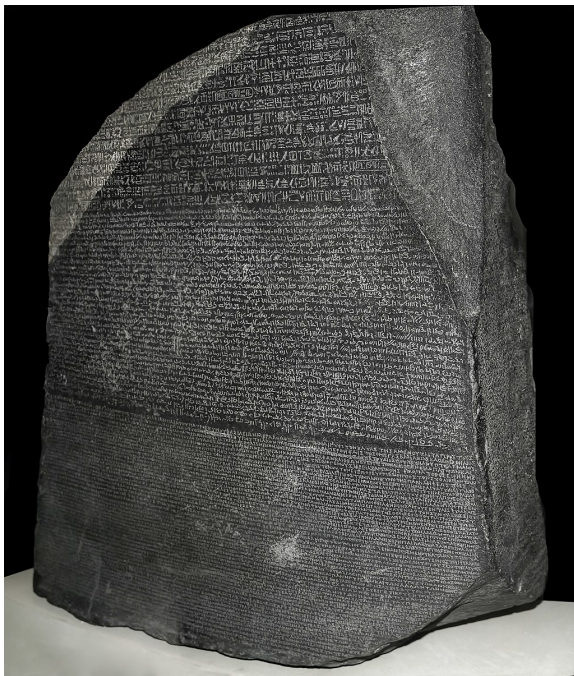


# EC2106 PUBLIC ECONOMICS

David Seim

Fall 2022



# Course Logistics I

Lecture environment:

- Interactions.
- Ask during breaks.
- Contact: david.seim@su.se
- Material:
  - Gruber: “Public Finance and Public Policy”, 4th edition or later.
  - Selected **research articles**.
  - Lecture notes posted on **Athena**.
- Why many research articles?

# Examination: Two Options

- Option 1:

- A. Final exam (0 - 100 points).

- B. Quizzes with 5 multiple choice questions.

- Open a couple of minutes during the lecture.

- 3+ correct gives 2 points for exam.

- Maximum:  $2 \times 10 = 20$  credits.

- Two goals:

- (i) Incentive for you.; (ii) Feedback for me.

- Drawbacks: i. Stress (?); ii. Not possible to make up for missed credit.

- Option 2: Option 1, but without the quiz credits.

- Grade only determined by exam.

- [www.menti.com](http://www.menti.com)

# Overview of Today's Lecture

1. Talk about Public Economics on a broad level. Where is the government present?
  2. Lay out four questions that are the core of public finance.
- **Goal of the lecture:**
    - i. To provide an orientation of the role of the government and what this field is about.
    - ii. Motivate why the field is interesting.
  - Based on Gruber's Chapter 1 and research articles.

# What do You Think?

Introduction to Public Finance / Public Economics

What do you associate with **Public Economics**?

Go to [www.menti.com](http://www.menti.com)

# What is Public Economics?

**Public Economics** (or **Public Finance**) = Study of the role of government in the economy

Government present in everyday economic life.

- **Taxes:** Governments collect 30-45 % of GDP in taxes in developed countries.
- **Expenditures:**
  - Public goods (defense, infrastructure, safety, education), welfare programs (health insurance, unemployment insurance, income support, retirement benefits).
  - local and federal governments account for 1/3 of national employment in Sweden.
- **Regulation:** Minimum wages, labor laws, environment, trade agreements.
  - Sweden's Labor laws (LAS) reformed on October 1 2022.
- **Macro-economic stabilization:** Central bank policies (Riksbank's inflation target: around 2 %), fiscal stimulus.

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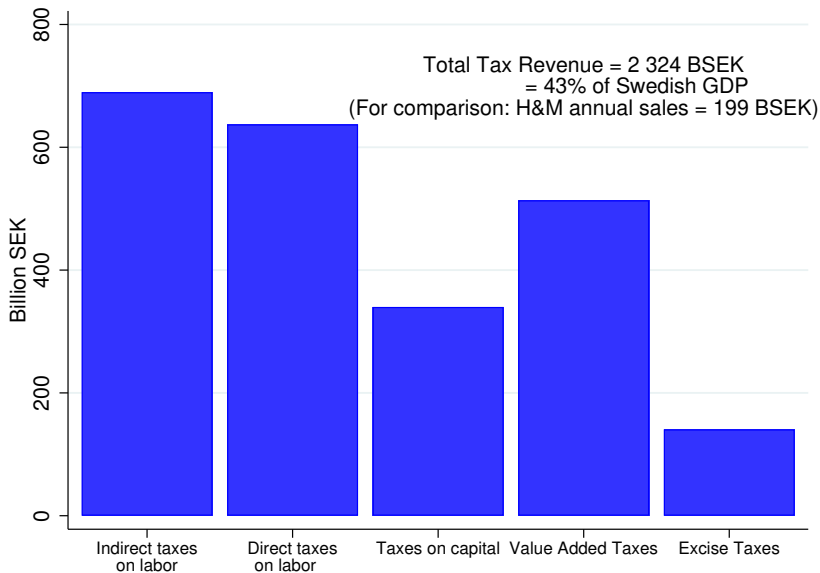
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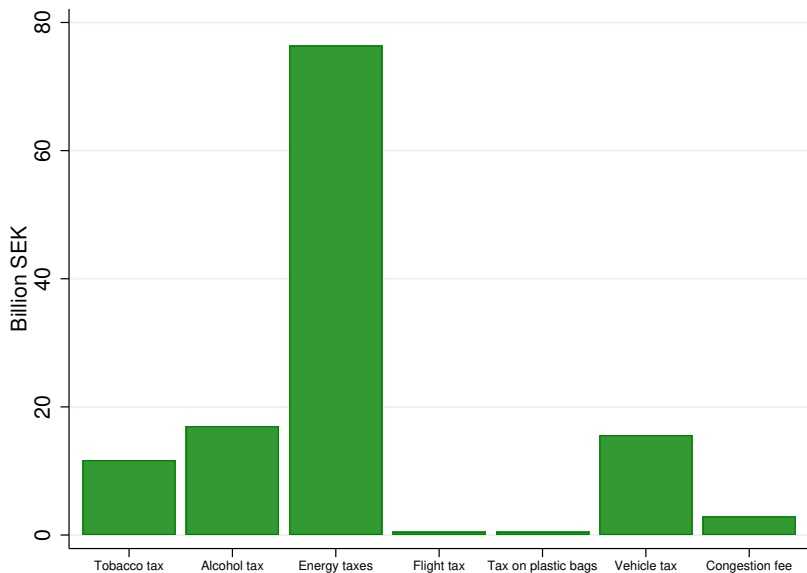
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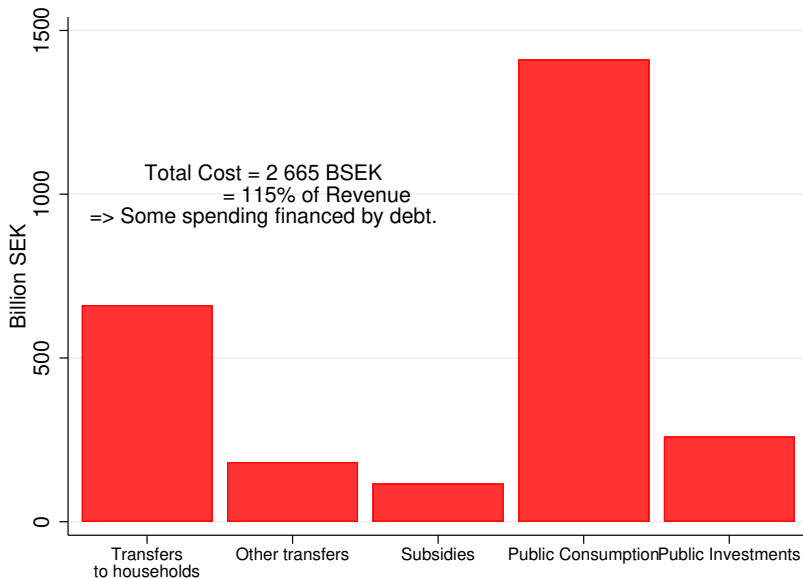
# Government Revenue in Sweden 2021



# Excise Taxes in Sweden 2021



# Government Spending in Sweden 2021



# Why Study Public Economics?

## 1. STAKES ARE HIGH.

- Size of government huge in relation to the economy in developed countries. Gov't revenue amounts to 30-45% of GDP.

## 2. SCIENCE NEEDED.

- Injecting science to controversial political debates has a high value.
  - Swedish example 1: Contentious debate about **benefits** and **costs** of immigration. See Joakim Ruist.
  - Swedish example 2: How to shield citizens from surging energy costs?

## 3. MAKE THE WORLD A BETTER PLACE.

- Interest in improving the world → Interest in Public Economics.

## 4. METHODS ARE INTERESTING.

- Public Economics is undergoing an exciting methodological transformation.

## DEBATT

Vad var / Ämnet

## 4. Rubrik 18 p på två fina rader ruggrikt

I Notis ut 2000 den inkubative ingreppen.  
Non expel maximpores uti quibhus ibusapi  
tivet rui, int. eum arum quatinis. I. Notis ut  
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int. eum arum quatinis.  
SvD.se/debatt

» InGäst

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SvD.se/debatt

» InGäst

## Slopa dyra reformen och få mer för pengarna

Fortsatta stödlösningar för sysselsättningen behövs och dessa måste få kosta. Men det finns effektivare åtgärder än sänkningen av arbetsgivaravgifterna för unga.

I regeringskansliet, som föreslår att sänka arbetsgivaravgifterna för unga, är det en utmaning att hitta en lösning som inte innebär att sänka arbetsgivaravgifterna för unga. Även om det är en utmaning att hitta en lösning som inte innebär att sänka arbetsgivaravgifterna för unga, är det en utmaning att hitta en lösning som inte innebär att sänka arbetsgivaravgifterna för unga.

Det finns många aspekter på ungdomsarbetslöshet. Det är naturligt att arbetslösheten bland unga som trösklar in på arbetsmarknaden, och kanske måste göras ett steg från på olika jobb, är högre än bland äldre och mer etablerade. Dagens arbetsmarknad har 15-24-åringar på över 20 procent betydligt inte än mer än var femte ungdom är arbetslös, eftersom arbetslösheten minskar i förhållande till dem som är i arbetsdragen, vilket bara är en del av bilden i lärandeprocessen. Däremot sätter många unga arbetslösa endast deltidjobb som komplement till sina studier.

Samtidigt stiger arbetslösheten alltid mer bland unga än äldre i en konjunkturavregning. Medan arbetslösheten för hela arbetsmarknaden i augusti var knappt 7 procent, var arbetslösheten för unga 11 procent. Detta är en del av bilden i lärandeprocessen. Däremot sätter många unga arbetslösa endast deltidjobb som komplement till sina studier.

Särskilt Centerpartiet tycks i alla lägen vara en stark förespråkare för sänkta arbetsgivaravgifter som metod att öka sysselsättningen. Samtidigt finns en allmän känsla om att denna åtgärd bland dem som är i arbetsdragen, vilket bara är en del av bilden i lärandeprocessen. Däremot sätter många unga arbetslösa endast deltidjobb som komplement till sina studier.

I en senare studie – som är en del av den (David Seitz) varit medförfattare till och bekräftar i en rapport från SNS Analys 2019 – utvärderar alliansregeringens arbetsgivaravgiftssänkningar för unga på nytt. Rapporten har skrivits av Anne-Li Löfdal och Centerpartiet har skrivit på för sänkta arbetsgivaravgifter för unga. Foto: Carola Rydbeck/Almida/TT

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En billigare och bättre metod är förstärkt anställningsstöd som bara subventionerar nyanställningar.

Det nya med den senaste analysen är att den stora positiva effekten på lösting med unga som anställda i företag. I företagen, både större och mindre, är lösting med unga som anställda i företag. I företagen, både större och mindre, är lösting med unga som anställda i företag. I företagen, både större och mindre, är lösting med unga som anställda i företag.

Enligt att tolka resultaten är att sänkta arbetsgivaravgifter för unga kanske inte



Anne-Li Löfdal och Centerpartiet har skrivit på för sänkta arbetsgivaravgifter för unga. Foto: Carola Rydbeck/Almida/TT



Stämman och debattören Lars Calén och David Seitz. Foto: Tjernerbild

främst ska ses som ett stöd för dessa sysselsättningar utan som ett stöd till branschen som sysselsätter många unga. Hotell, restauranger och hotellier har generellt, vilka alla drabbats hårt av coronakrisen, är sådana verksamheter.

Det kan i svårare läge kunna skilja för selektiva stöd till särskilda utvalda branscher. Men lägre arbetsgivaravgifter för unga är inte ett effektivt sätt att lösa problemen det dels subventionerar men också verksamheter med många anställda ungdomar som inte drabbats av pandemin (till exempel livsmedelsbranschen), dels när man inte verksamheter som drabbats men som inte sysselsätter ungdomar i särskild hög grad (till exempel kulturverksamhet). Arbetsgivaravgifter för unga är helt enkelt inte tillräckliga branscher.

Grundproblemet med sänkta arbetsgivaravgifter i syfte att öka ungdomsarbetslösheten är att de ärver alla unga som jobbat eller med subventionerna många arbetslösa som ändå skulle finnas. Det är därför avgörande för de billigare och bättre metoder för förstärkt anställningsstöd som bara subventionerar nyanställningar. Alliansen i bredd 2007 är så kallad styrningsplan som riktar sig mot dem som står långt från arbetsmarknaden, sätter främst läroplaner för läroplaner i utbildningsstöd som bara subventionerar nyanställningar.

Även i svårare situation med stor arbetslöshet om att fortsätta stöd för sysselsättningen behövs och dessa måste få kosta. Ät det viktigt med noggranna övervakningen om olika åtgärds effektivitet. Effektivitet blir inte sänkningen av arbetsgivaravgifterna för unga genomförelse.

Lars Calén  
professor emeritus i internationell ekonomi vid Uppsala universitet  
David Seitz  
professor i nationalekonomi vid Uppsala universitet och tidigare

# Four Questions of Public Economics

1. **When** should the government intervene in the economy?
2. **How** might the government intervene?
3. **What** is the effect of those interventions on economic outcomes?
4. **Why** do governments choose to intervene in the way that they do?

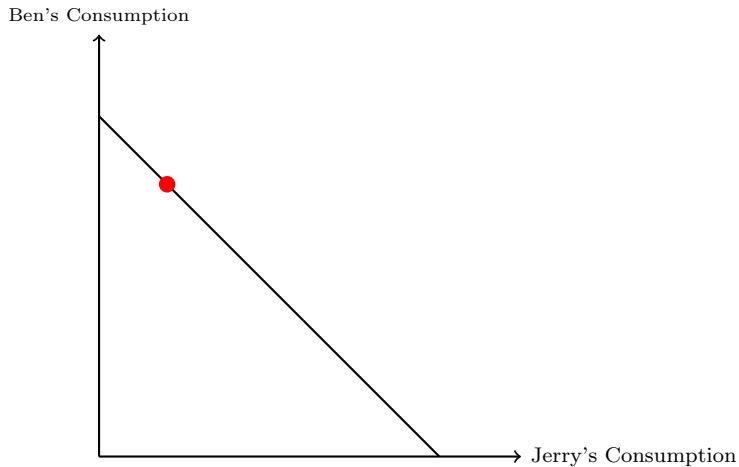


1. **When** should the government intervene in the economy?

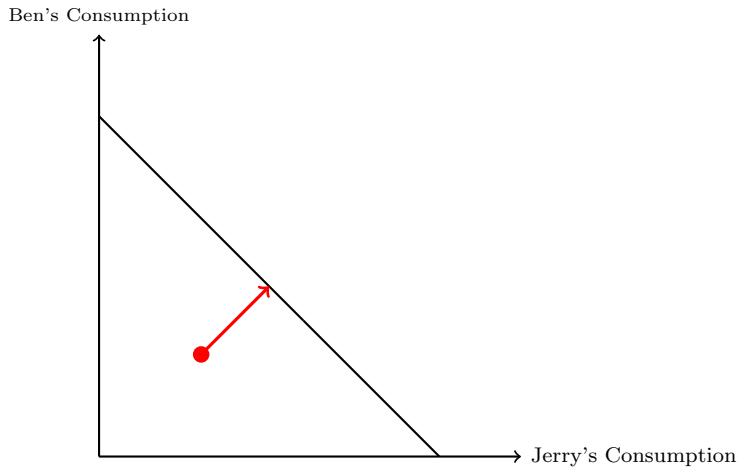
1. **Market failure:** Market economy delivers an outcome which is inefficient.

Government intervention  $\Rightarrow$  improve the situation.

# When Private Market Allocation is Efficient



# First Role of Government: Improve Efficiency



# Main Market Failures

# Main Market Failures

- **Externalities** - Greenhouse gases - regulation of emissions and/or pigouvian taxes / subsidies. Mandatory health insurance.
- **Imperfect competition** - Monopolies or oligopolies (small number of sellers) brings prices up too high.
- **Imperfect and asymmetric information** - Example: Mandatory health and unemployment insurance.
- **Individual failures** - People are not always rational. Example: people do not save enough for retirement, people do not care about their health.

# Paternalism and Individual Failures

Why do people choose actions which are seemingly unrational?

- **Libertarian View:** Individuals always do what they think is right for them. Govt acts **paternalistically** if it distorts individuals' choices.
- **Behavioral Economics View:** Individuals have self-control problems which the govt should correct.

Example: Sin taxes - taxes on fat and sugar. Should they be present?

1. **When** should the government intervene in the economy?

1. **Market failure**: Market economy delivers an outcome which is **inefficient**.

Government intervention  $\Rightarrow$  improve the situation.

2. **Redistribution**: Market economy delivers an **efficient** but highly **unequal outcome**.

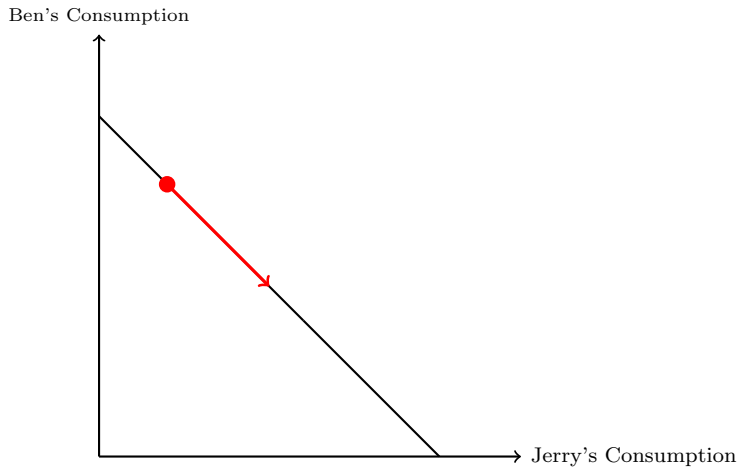
Government intervention  $\Rightarrow$  reduce inequality through redistribution.

# Inequality and Redistribution

- Market outcome may be **Pareto efficient**, but there could still be room for government intervention if the distribution of resources is very unequal.



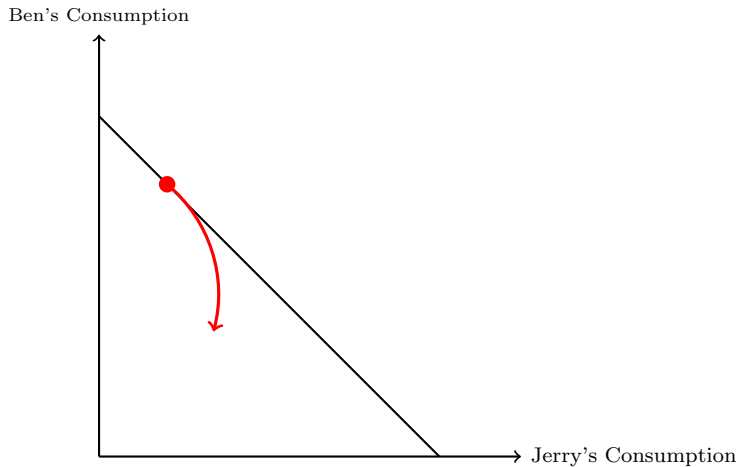
## Second Role of Government: Improve Distribution



# Inequality and Redistribution

- Market outcome may be **Pareto efficient**, may want government intervention if the distribution of resources is very unequal.
- Redistribution creates a **trade-off** between **equity** (a more equal distribution of the pie) and **efficiency** (redistribution achieved through taxes and subsidies that lowers incentives to work).

# Equity-Efficiency Trade-Off



# Example: Importance of redistribution argument

At present, there is a **highly contentious debate** in the US about inequality of resources and policy responses.

- *Rising inequality is the narrative of our time*  
⇒ *More redistribution.*

**Academically:** What is the level of inequality today? How has it changed over time?

**Input 1:** Inequality concepts.

Inequality of income or wealth?

**Input 2:** Data.

Where do we get data? And what type of data do we use?

Survey data or Administrative data.

**Policy:** Elizabeth Warren's wealth tax proposal to combat inequality. (Answers the 2nd question of Public Finance: How might the gov't intervene?)

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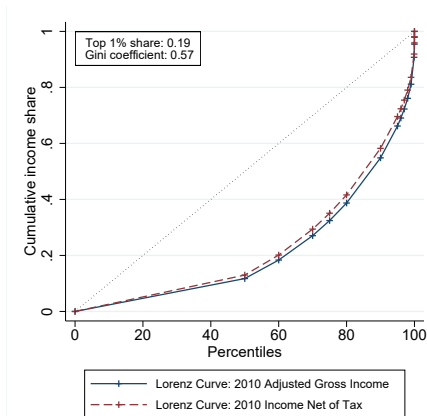
# Inequality concepts



# Inequality concepts

- **Lorenz** curve  $L(p)$  at percentile  $p$  is the share of total income earned by individuals below percentile  $p$ .

$$0 \leq L(p) \leq p.$$



# Common inequality concepts

1. **Gini** coefficient measures the area between perfect equality and Lorenz curve.

Gini=0: perfect equality. Gini=1: complete inequality (top earner earns everything).

2. **Income quantile shares** measure the share of total income going to given quantile  $[p_1, p_2]$  from percentile  $p_1$  to  $p_2$ .

Examples: top 1% income share is around 20%  $\Leftrightarrow$  Top 1% incomes are 20 times larger than the average.

3. **Percentile ratios** (Kuznets ratios) are  $z_{p_2}/z_{p_1}$ .

4. **Poverty rate** is the fraction of population below  $z^*$ .

NB! Not constructed with Lorenz-curve.

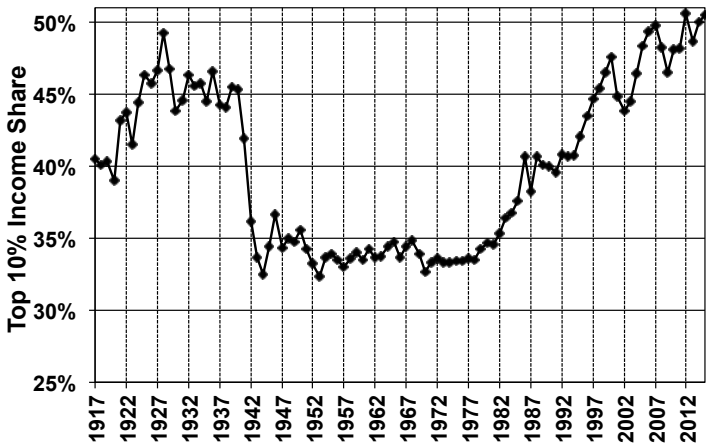
# Essential preliminaries

1. Inequality of what: **income**, **consumption** or **wealth**?
2. Time-period: measure outcome quarterly, annually or over the life-cycle?
3. Unit of observation: **individual** or **household**.
4. Data sources:
  - i. Survey data, e.g. LNU – survey data administered at Stockholm U.
  - ii. Administrative data, e.g. Income Tax Registers.



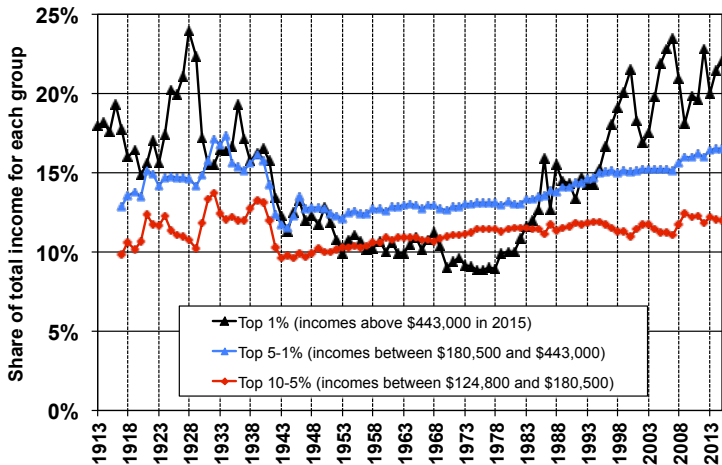
# Inequality in the US

Top 10% Pre-tax Income Share in the US, 1917-2015



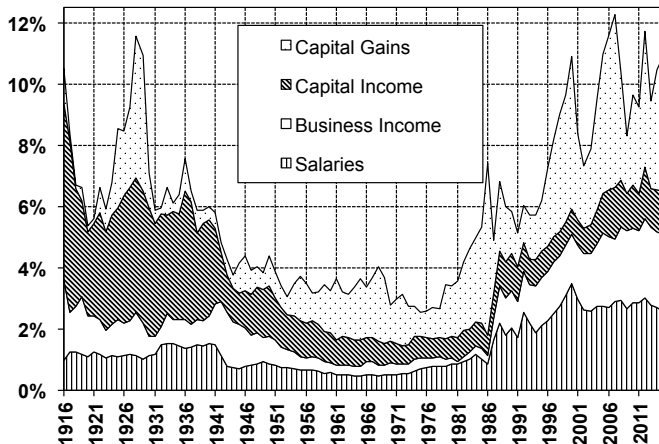
Source: Piketty and Saez, 2003 updated to 2015. Series based on pre-tax cash market income including realized capital gains and excluding government transfers.

## Decomposing Top 10% into 3 Groups, 1913-2015



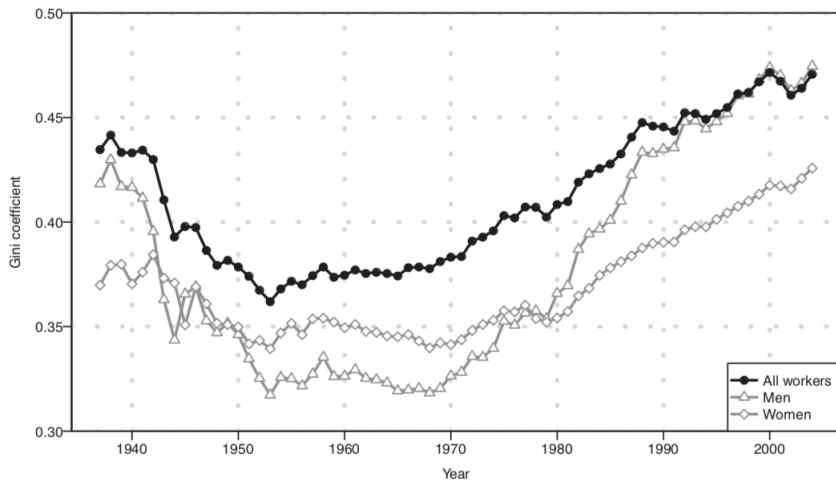
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## US Top 0.1% Pre-Tax Income Share and Composition



Source: Piketty and Saez, 2003 updated to 2015. Series based on pre-tax cash market income including or excluding realized capital gains, and always excluding government transfers.

Until 1998: “Working rich have overtaken coupon-clipping rentiers.”



Source: Kopczuk, Saez and Song, 2010, QJE.



# Piketty, Saez and Zucman (2018)

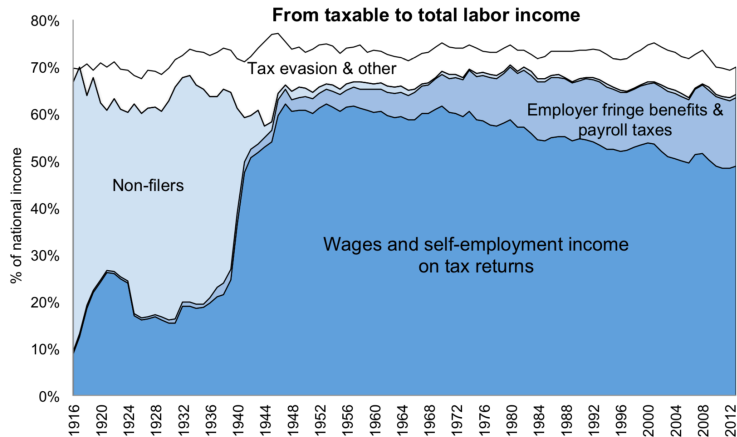
**Gap** between

- **macro-measurements** of growth and
- **micro-measurements** of inequality.
- How much of total economic growth accrued to the bottom 50% or the top 10%?
- How does government revenue/spending affect the distribution of growth?

Innovation:

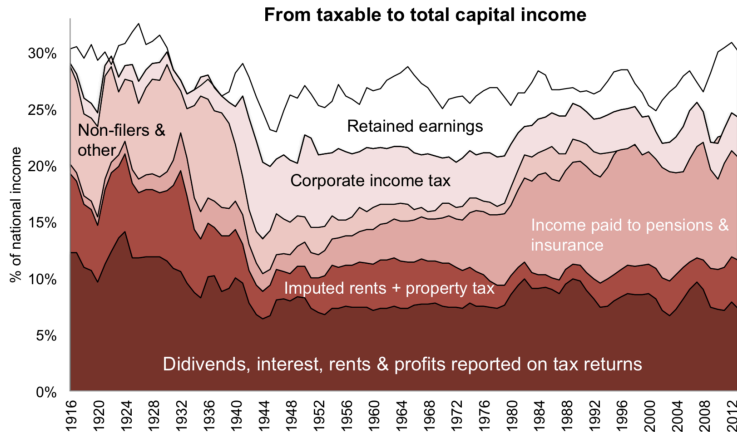
- Bridge the gap by distributing **national income** to the citizens.
- Use tax returns, surveys and assumptions to allocate these income.

# How much labor income is missing?



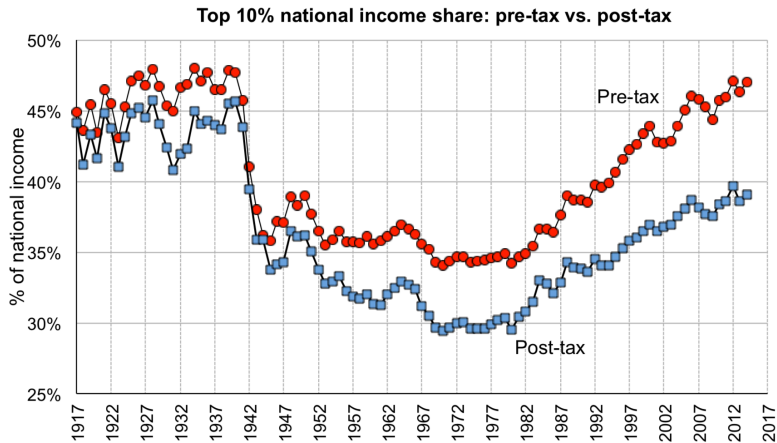
Source: Piketty, Saez and Zucman (2018).

# How much capital income is missing?



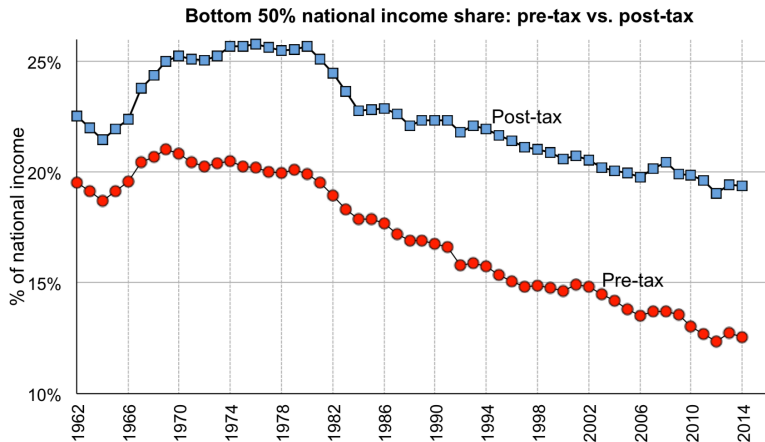
Source: Piketty, Saez and Zucman (2018).

# New series confirm tax-data picture



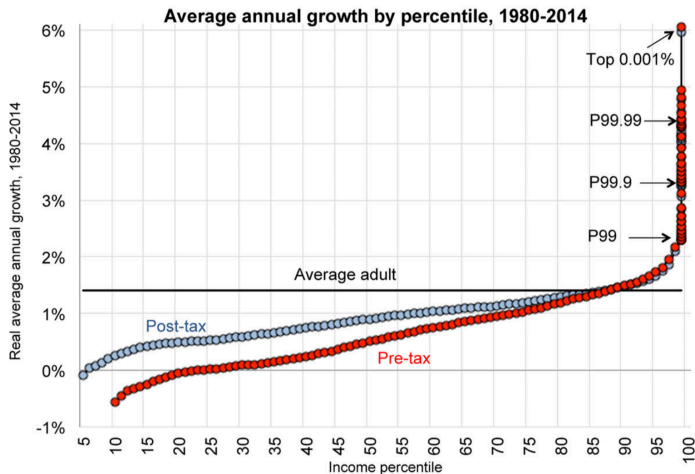
Source: Piketty, Saez and Zucman (2018).

# Collapse of the bottom 50 %



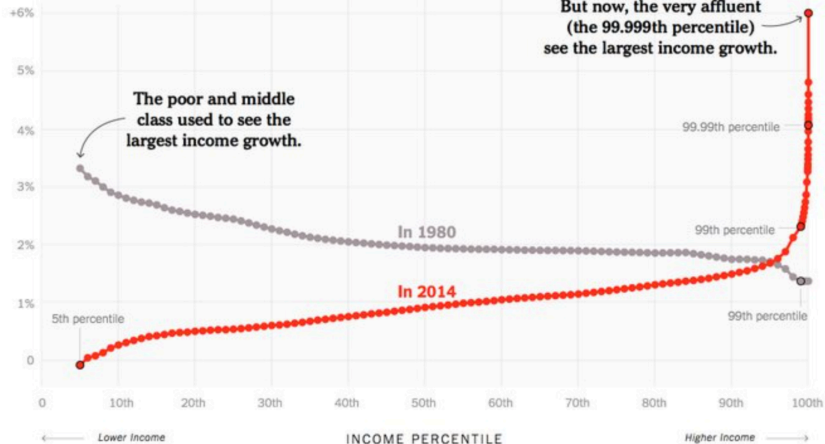
Source: Piketty, Saez and Zucman (2018).

# How is economic growth distributed?



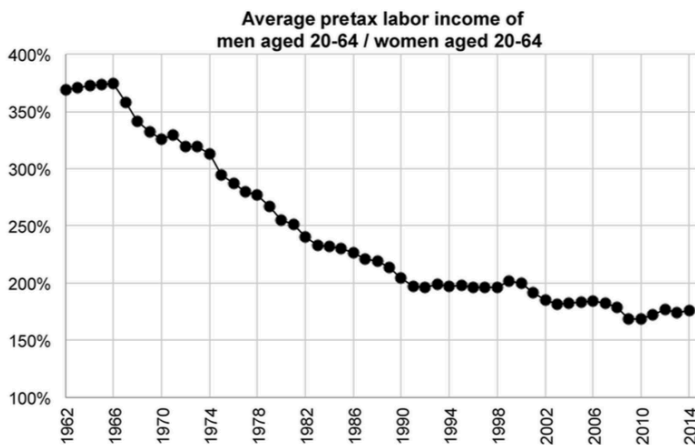
Source: Piketty, Saez and Zucman (2018).

**INCOME GROWTH**  
Over previous 34 years



Source: Piketty, Saez and Zucman (2018) on request from NYTimes.

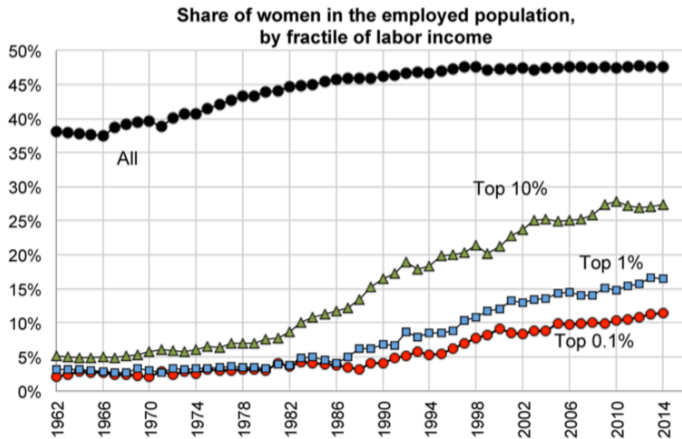
# Gender inequality



Source: Piketty, Saez and Zucman (2018).

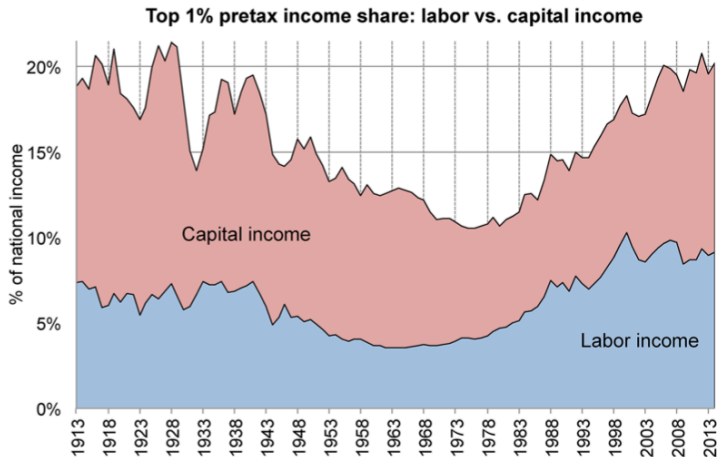


# Gender inequality



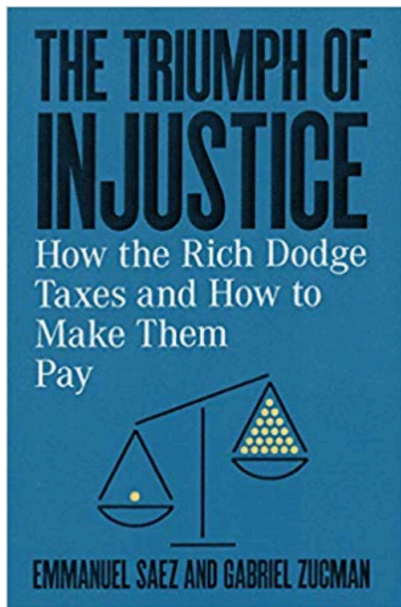
Source: Piketty, Saez and Zucman (2018).

# Capital and labor shares



Source: Piketty, Saez and Zucman (2018).

## Recommended reading



# Criticism: Auten and Splinter (2022)

Rising income inequality is partly an artefact of measurement changes.

- (i) 40 % of the increase in top share from 1960 to 2015 due to Tax Reform Act (TRA) in 1986.

Reform:

- lowered top statutory taxes,

- firm owners **choose** to report firm profits as wage income.

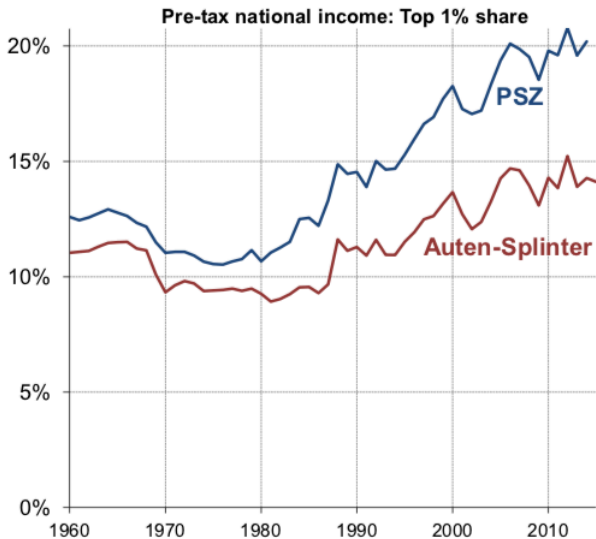
- broadened tax base,

- more income had to be reported in tax files.

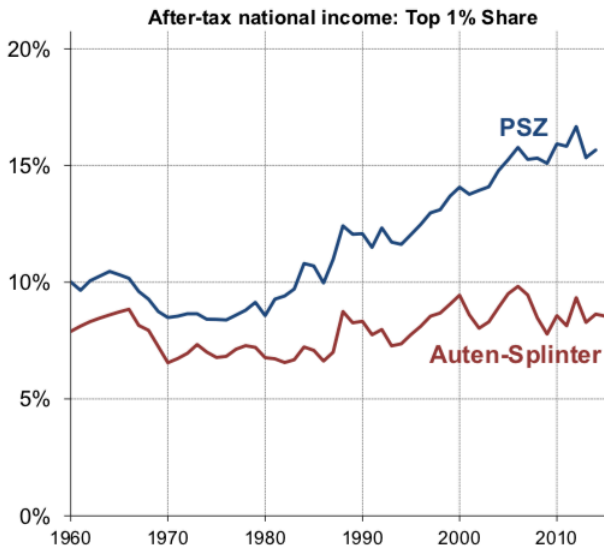
- increased dependent filers.

- nr of low-income filers  $\uparrow$  → threshold for top  $X$  %  $\downarrow$

- (ii) Declining marriage rates in the lower part of the distribution.

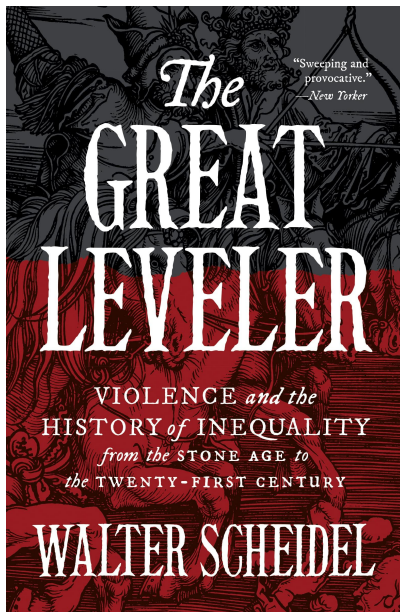


Source: Auten and Splinter (2022).



Source: Auten and Splinter (2022).

How can we affect the trends?



# How can we affect the trends?

- Can the government do anything?
- Walter Scheidel, *“The great Leveler”*:
  - Questions the **2nd question of Public Economics**.

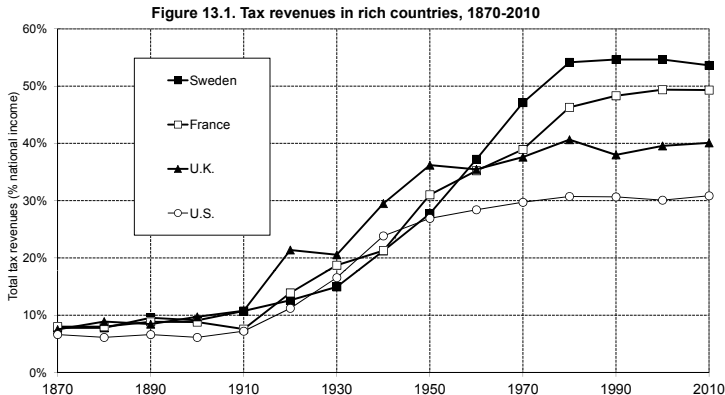
1. Large wars
2. Revolution
3. State collapse
4. Natural disasters



# Government the fifth leveler?

- i. Expansion of the public sector during 20th century.
- ii. Post-tax inequality much lower than pre-tax (cf. Aaberge et al, 2010).
- iii. External shocks (which Scheidel describes) triggered policy reforms.
- iv. Policy changes have long-lasting influences.

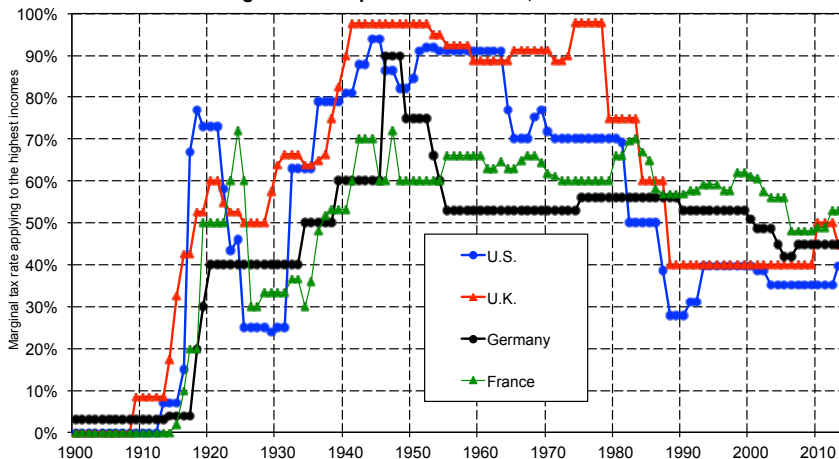
# Argument i. Size of gov't $\uparrow$



Total tax revenues were less than 10% of national income in rich countries until 1900-1910; they represent between 30% and 55% of national income in 2000-2010. Sources and series: see [piketty.pse.ens.fr/capital21c](http://piketty.pse.ens.fr/capital21c).

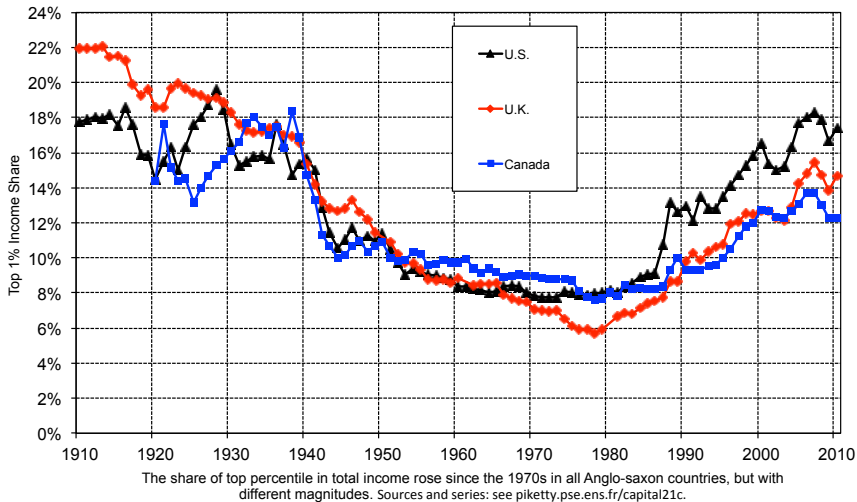
## Argument ii. Progressive taxes

Figure 14.1. Top income tax rates, 1900-2013

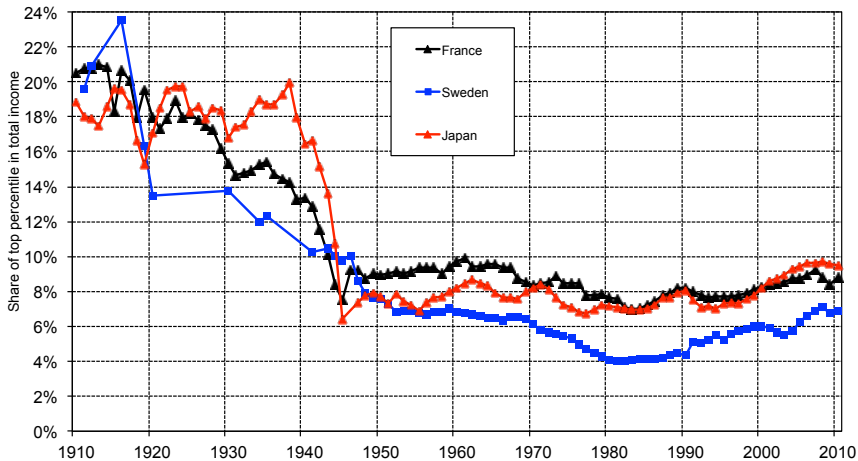


The top marginal tax rate of the income tax (applying to the highest incomes) in the U.S. dropped from 70% in 1980 to 28% in 1988. Sources and series: see [piketty.pse.ens.fr/capital21c](http://piketty.pse.ens.fr/capital21c).

Figure 9.2. Income inequality in Anglo-saxon countries, 1910-2010



**Figure 9.3. Income inequality: Continental Europe and Japan, 1910-2010**



As compared to Anglo-saxon countries, the share of top percentile barely increased since the 1970s in Continental Europe and Japan. Sources and series: see [piketty.pse.ens.fr/capital21c](http://piketty.pse.ens.fr/capital21c).

# Conclusion

Q: Should the government intervene by redistributing resources from rich to poor?

- Question **also depends on the efficiency-costs** of intervening.
- Not clear there is a **trade-off** b/w equity and efficiency.
  - Some evidence suggests **rent-seeking** important at the top of the distribution.

## 2. **How** might the government intervene?

### 1. **Tax / Subsidize Sales or Purchases:**

- Use government policy to change the price of goods.
- Taxation, ex: labor income taxes, fuel taxes, alcohol taxes.
- Elizabeth Warren: **Tax wealth!**
- Subsidies, ex: food stamps, flu shots.

## 2. **How** might the government intervene?

2. **Quotas and Mandates:** Restrict sales of goods that are overproduced (quotas). **Ex: import quotas.** Require purchases of goods that are underproduced (mandates). **Ex: auto insurance.**
3. **Public Provision:** Government provides the good directly. **Ex: defense.**
4. **Public Financing of Private Provision:** Government pays, private companies provide the good.



### 3. **What** are the effects of interventions on economic outcomes?

1. **Direct Effects / Mechanical effects:** The predicted effects if individuals do not change their behavior.
  - Example: Raise taxes by 10 percentage points (from 20% to 30%). If average income is 300,000 SEK, this effect amounts to  $30\% \times 300,000 - 20\% \times 300,000 = 30,000$ .
2. **Indirect effects / Behavioral effects:** The effects that arise only because individuals change their behavior (also called **unintended effects**).
  - Suppose individuals change behavior and work less with higher taxes. Average income is 250,000 after reform. Then revenue effect  $30\% \times 250,000 - 20\% \times 300,000 = 15,000$ .  
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#### 4. **Why** do governments do what they do?

**Political Economy:** The theory of how the political process produces decisions that affect individuals and the economy.

Example: How is the level of taxes and spending affected through voting and voters' preferences?

# Normative versus Positive Questions

- **Normative analysis** - How should things be? How should policies be designed optimally?
  - When should the government intervene in the economy?
  - How Might the Government Intervene?
- **Positive analysis** - How are things? Do income taxes influence labor supply? How do governments choose policies?
  - What are the Effects of Interventions on Economic Outcomes?
  - Why Do Governments Do What They Do?
- **Positive analysis** is mainly empirical and **normative analysis** is mainly theoretical.

# My Research

- Within Public Economics
  - Available on my webpage.
- 1) Analyses of the effects of taxes, transfers and social insurance schemes on individuals' and firms' behavior.
  - 2) Determinants of inequality.
  - 3) Political economy: How are individuals' political preferences shaped?

Some of my work will appear in the course.

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