

Optimal Policy

RED, November-December 2021

Prof. Facundo Piguillem

facundo.piguillem@gmail.com

Syllabus

Course Description

This class will provide the basic tools to analyze problems involving policy interventions. In this sense, it is like a toolkit that should allow the students to deepen their knowledge with more specific problems.

There are two types of problems and two types of approaches to study optimal taxation. The problems are in general divided between 1) finding the optimal way to finance a given level of government spending and 2) determining the level of taxation that balances the trade-off between efficiency and redistribution.

These problems can be analyzed using the Classical Public Finance approach, where the government is endowed with restricted set of instruments; or the New Public Finance approach, which endows the policy makers with an unrestricted set of instruments, but models underlying frictions that impede the application of the first welfare theorem.

Lecture's plan.

Week 1: Basics on taxation. Setting up a problem and initial results.

Lecture 1 A static problem. Writing down a "Ramsey Problem."

Lecture 2: Elasticities and taxation.

Lecture 3: Taxation of intermediate goods, the case of money holdings.

Week 2: Optimal taxation in the Neoclassical growth model.

Lecture 1: Capital and labor taxation.

Lecture 2: Zero capital taxation in the long run.

Lecture 3: Optimal taxation and government debt.

Week 3: Redistribution and the Mirrlees approach.

Lecture 1: Redistribution with an unrestricted set of instruments.

Lecture 2: An analytical framework to study progressivity.

Lecture 3: Taxing the upper tail of the labor income distribution.

References (some, not of all them)

Aiyagari, S Rao, 1995. "[Optimal Capital Income Taxation with Incomplete Markets, Borrowing Constraints, and Constant Discounting](#)," *Journal of Political Economy*, University of Chicago Press, vol. 103(6), pages 1158-1175, December.

Aiyagari, S Rao & Albert Marcet & Thomas J. Sargent & Juha Seppala, 2002. "[Optimal Taxation without State-Contingent Debt](#)," *Journal of Political Economy*, University of Chicago Press, vol. 110(6), pages 1220-1254, December.

Bhandari, Anmol & David Evans & Mikhail Golosov & Thomas J. Sargent, 2018. "[Inequality, Business Cycles, and Monetary-Fiscal Policy](#)," *NBER Working Papers* 24710, National Bureau of Economic Research, Inc.

Chari, V.V. & Kehoe, Patrick J., 1999. "[Optimal fiscal and monetary policy](#)," *Handbook of Macroeconomics*, in: J. B. Taylor & M. Woodford (ed.), *Handbook of Macroeconomics*, edition 1, volume 1, chapter 26, pages 1671-1745, Elsevier.

Heathcote, Jonathan & Kjetil Storesletten & Giovanni L. Violante, 2017. "[Optimal Tax Progressivity: An Analytical Framework](#)," *The Quarterly Journal of Economics*, Oxford University Press, vol. 132(4), pages 1693-1754.

Ljungqvist, Lars and Thomas Sargent. *Recursive Macroeconomics Theory*. Third Edition. 2004.

Saez, Emmanuel, 2001. "[Using Elasticities to Derive Optimal Income Tax Rates](#)," *Review of Economic Studies*, Oxford University Press, vol. 68(1), pages 205-229.

Straub, Ludwig & Iván Werning, 2020. "[Positive Long-Run Capital Taxation: Chamley-Judd Revisited](#)," *American Economic Review*, American Economic Association, vol. 110(1), pages 86-119, January.