

## **Public Finance Doctoral Examination**

### **Ground Rules:**

- Answer at least one (1) question from each of the three sections, plus one (1) more question from any section of your choosing. This means you will have answered four (4) questions in total.
- You should not identify yourself in the exam, so as to assist in making this a double-blind grading process.
- You are not to discuss the questions with your colleagues as you prepare your answers.
- Your answers are to be turned in by 5:00 PM.

You should have sufficient time for the examination. Before you begin to write, it would be helpful for you to spend some time on reflection and on organizing your thoughts.

### **Taxation:**

1. In recent years, housing prices and rental rates have risen well above the rate of inflation and prices of other assets. Platform sites like Airbnb have made it possible for people to rent out spare rooms or their entire property. Fairly or not, some affordable housing advocates blame the rise of short-term rental property owners. Cities have sought from their respective states the right to pass “Airbnb taxes” that apply to these transactions.

Write an essay that explains the different possible dimensions of the efficiency of a selective tax on Airbnb transactions. You can assume your professors are the audience and are expecting you to write in terms of social science models and figures. However, we will assume you know nothing about possible relevant topics (e.g. excess burden, social welfare functions, externalities, optimal taxation, behavioral economics, fiscal federalism, tax administration, special interest group theory, etc.) unless you explicitly teach them to us with good technical sophistication inside the essay.

2. In most of the United States, local police departments can seize property (real examples include cash, a gold watch, a hotel, a car) they are suspicious might have been involved in a drug related crime, even if they have no evidence of a crime or human suspects. This is called “Civil Asset Forfeiture.” The owners of these properties must then go through the time and expense of the legal system to try and get their

property back, and with high failure rates many just don't bother. The proceeds from selling these seized assets has become a substantive form of revenue for many local governments and their police departments. Some state/local governments encourage it with favorable rates for sharing the proceeds with the police departments as part of "The War on Drugs." In response to prominent abuses of this power and stories of police focusing on "profitable" crimes over other more mundane policing activities, some states have tried to discourage it by mandating that no police departments receive a share of the proceeds. State laws like the latter though can be undermined by the federal Department of Justice, which will similarly share about half of the revenue if the police seize the property and accuse it under federal (rather than state or local) law. Some states have begun floating the idea of a "federal revenue forfeiture tax" on city budgets when police do this, which would involve the withholding of state grants to local governments in amounts proportional to what the local police receive from the Department of Justice forfeiture program.

Your task:

Offer and discuss 2 hypotheses based on the issue of civil asset forfeiture policies that could be publishable in a public finance journal. Be extremely clear in terms of the theoretical set-up of these hypotheses. For example, if you were going to test a tax compliance or tax competition hypothesis, then you'd set up an objective & constraint for the relevant actor(s) with their first order conditions. Contextualize the hypotheses in relevant public finance literature, and explain the relevance of the hypothesis to policy, our understanding of social order, or both. Do not spend time on the econometrics or data.

### **Budgeting:**

3. Human beings appear naturally drawn to "rational" (i.e., logical, means-ends oriented) decision making processes. It seems to be the predominant way that we explain ourselves to others, and that extends to accounting for budget proposals. That is, budget justifications are recommended to be clear, logical, free of jargon, and containing a coherent rationale in terms of the expected outcomes. Comprehensiveness appears to be the underlying principle in budgeting. Yet, it has been pretty well understood for some 75 years that there are limits, or "boundaries", to human rationality (cf. H. Simon, various citations). Limited as to attention spans, information, time, political will, and sheer calculating capacity, humans operate more in a mode of "bounded rationality." While they may be

intendedly-rational, actually, they are boundedly-rational. Bounded rationality argues for a pragmatic approach to budgeting, one that focuses on annual incremental changes. Rather than concentrate on justifying and building budgets from "the ground up" each fiscal year, political authorities and administrators focus on the annual change; mainly, this is to economize on their scarce resources (attention spans, information, time, political will, and sheer calculating capacity).

Other research (Jones & Baumgartner, Ryu, among others) has revealed that there tends to be a great deal of inertia in various elements of both federal and state budgets over time. In "normal" periods, budget elements grow apace, more-or-less in line with overall budgetary growth. But there are noticeable, and significant, "lurches:" thresholds are crossed where certain elements of budgets will change rapidly for a limited time, the return to a more normal growth path. This pattern of budgetary change has been termed "punctuated equilibrium," after the evolutionary theory that also bears that name.

Which theory appears to better describe budgetary change: incrementalism or punctuated equilibrium? Are the two competing theories, or are they actually complementary to one another? Cite the appropriate literature in support of your response.

4. On July 24, 2019, the Co-chairs of the Washington, DC based Committee for a Responsible Federal Budget released a statement that is provided in Attachment 1 at the end of this exam. Please read the statement.

These statements are reflective of mainstream economic thought: that the growth of the national debt is unsustainable, will burden future generations with higher taxes and debt repayments, and that the federal government already may be, technically, "bankrupt." These views are based on neoclassical economics notions of the budget as a "household checkbook," the public debt as a future burden which must be repaid, and the scarcity of funds available for investment purposes (the so-called "loanable funds" doctrine).

An alternative view which has been gaining adherents in academe, the financial community, and among certain political leaders, holds that the public debt is private wealth in the hands of those who hold it, that government debt is different than private debts, and that the limits of debt affordability actually are more elastic than the mainstream view would have it.

Prepare arguments for both sides of the issue of national debt sustainability. Make every attempt to provide the best rationale for the two points of view. Cite appropriate literature in support.

**Debt:**

5. The COVID-19 pandemic and national shutdown placed great stress on the intergovernmental fiscal system and financial markets in the United States in 2020. The pandemic-related shocks to the fiscal and financial systems are similar in many ways to that of the financial crisis and Great Recession shocks in 2007-2009, but they are also very different in many ways as well.

In response to the crises, governments have used both old and new fiscal and monetary policies and tools; some of the strategies across crises have been the same, others have varied merely by degree, while still others are fundamentally different.

Using rigorous public finance and financial economic theories as your analytical framework, analyze the fiscal and monetary policies and tools implemented in response to both the COVID-19 pandemic and national shutdown in 2020 and the financial crisis and Great Recession of 2007-2009.

- a. What are the major fiscal and monetary policies and tools (acts, programs, funds, facilities, etc.) that have been implemented?
- b. What are the important public finance and financial economic theories that have been used to understand on-going events and craft fiscal and monetary policies and tools? Explain in detail whether the policies and tools are consistent with such theories?
- c. What has been the impact of the major fiscal and monetary policies and tools that have been implemented? Specifically, what has been their effect on macroeconomic aggregates; on financial markets, especially the municipal securities market; and the intergovernmental financial system and intergovernmental relations?
- d. In your reasoned and informed opinion, what are the major lessons learned for government policymakers and research scholars facing the next fiscal, financial markets, and intergovernmental financial system shocks?