



Intro to Public Finance

Week 1

Class Overview

- Introductions
- Syllabus and Blackboard
- Today's class
 - What is public finance and why study it?
 - Impact of government on modern economy.
 - Why government intervenes in the economy.

What Is Public Finance?



- The study of how and why government intervenes in the economy and the effects of its intervention.
- Examination of how government gets revenues and how it spends them.

Role of Government in the Economy

- Our everyday lives are affected by government.
 - Public schools
 - Social Security
 - Public highways
 - Government regulations
 - Taxes



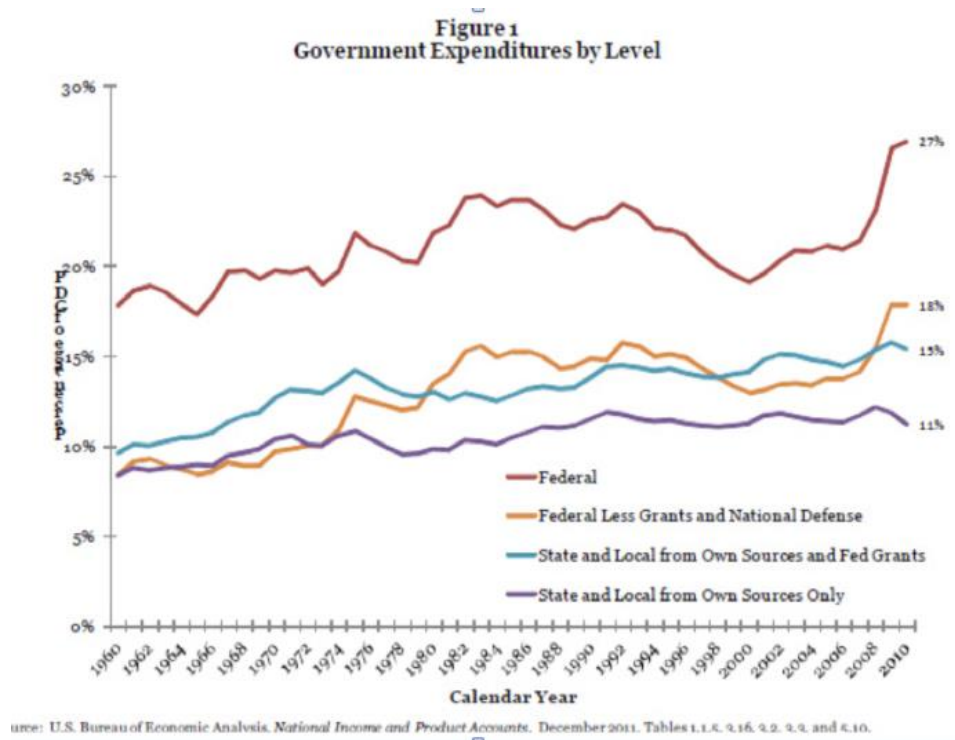
Mixed Economy

- ◉ Both private and public sectors play an important role in modern economy.
- ◉ All modern economies are mixed.
- ◉ Important reason for government intervention is existence of market failures.

The Size of Government

- Size of the government today is much larger than century ago.
 - Public expenditures as a share of GDP have grown rapidly.
 - Social Security, Medicare, and interest account for much of the increase.
 - The size of government relative to the economy is much smaller than in most European countries.

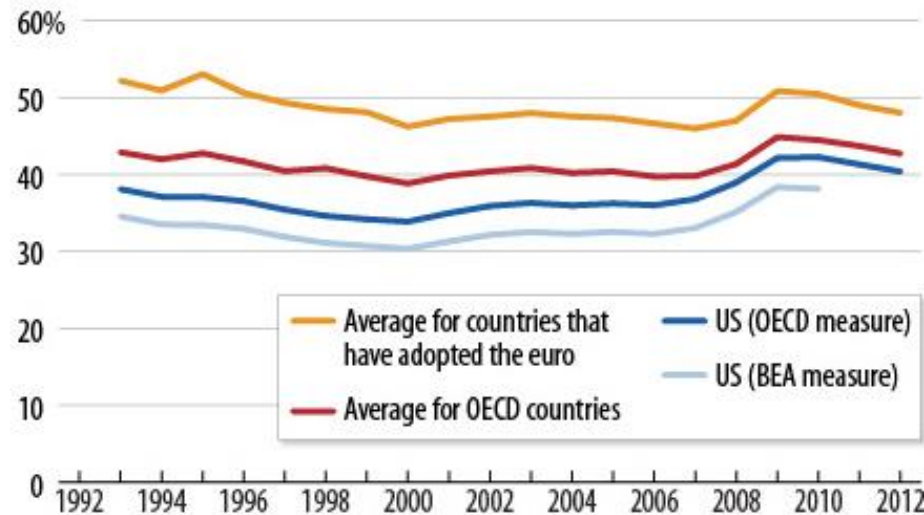
US Government Spending by Level



Comparative Spending: US vs Other Countries

U.S. Government Spends Less Than Most Other Developed Countries

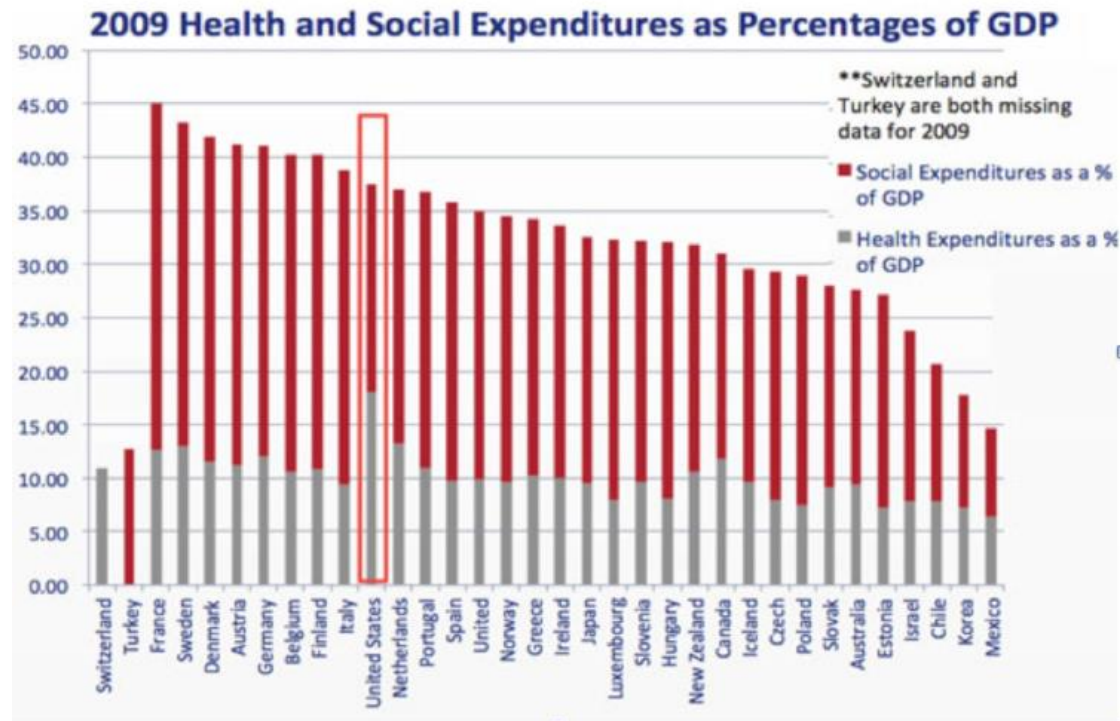
Government expenditures as a percent of GDP



Source: Bureau of Economic Analysis, Organisation for Economic Cooperation and Development

Center on Budget and Policy Priorities | cbpp.org

Welfare and Health Spending by Country



Defense Spending by Country

The Top 15 Countries For Military Expenditure in 2016

2016 military expenditure by country and share of global total



* Estimate
 @StatistaCharts Source: SIPRI

Forbes statista

Reasons for Intervention

- Efficiency of the economy
 - Markets sometimes fail to behave efficiently.
 - When this happens there are additional costs that are borne by society.
 - For example, unemployment.
 - What are the costs of unemployment for the economy?

Reasons for Intervening in the Economy

- Efficiency depends on several key assumptions:
 - Free entry & full market knowledge.
 - Competition.
 - Contracts and market arrangements enforced.
 - No externalities.

Reasons for Intervening in the Economy

- Additional reasons
 - Distribution (social values about equity).
 - Big issue in elections has been growing wealth inequality.
 - Stabilization (maintaining high employment, price stability, economic growth).
 - Leads to trade-offs.

Economic Analysis

- Economists study scarcity.
- Four central economic questions:
 - What is to be produced?
 - How is it to be produced?
 - For whom is it to be produced?
 - How are these decisions made?

Modes of Analysis

- ◉ Positive analysis uses social science to predict & evaluate the effects of policy on social behavior.
- ◉ Can't answer the question, should we do this?"
- ◉ Normative analysis uses values to answer the question, "should we do this?"

Key Questions

- What is produced?
 - Public or private goods?
- For whom should it be produced?
 - Taxes affect amount different individuals have to spend.
 - Different government programs benefit different groups.

Key Questions

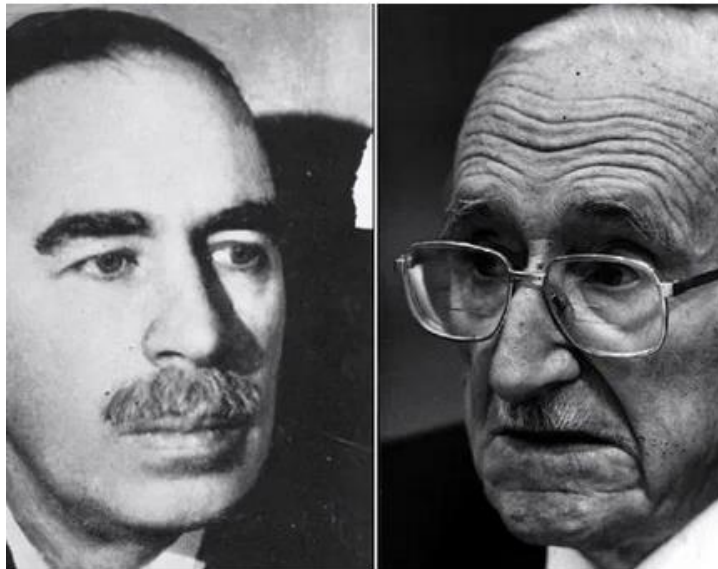
- How are these decisions made?
 - How are collective decisions, such as those concerning the supply of publicly provided goods and taxes, made?
- How is it to be produced?
 - By government or by private businesses?

Government Roles

- ◉ Establishes legal system—required if a market economy is to function.
- ◉ Assures fair competition.
- ◉ Produces goods—defense, education, mail, research, etc.
- ◉ Affects what firms produce, through subsidies, taxes, credits, and regulations.

Disagreements among Economists

Keynes vs von Hayek



The Fight Continues

- Conservative and liberal economists disagree over consequences of public policies and about values.
- What is the best model to describe the economy; whether the policy is desirable?

Economics and the 2008 Great Recession

- Intensified the debate between conservatives and liberals.
- Led to reexamining the role of government.
- Financial markets took on too much risk but why?



Government Activities

- Purchases goods and services from firms, and distributes them to private households.
- Redistributes income.
 - (Provides social safety net)