

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

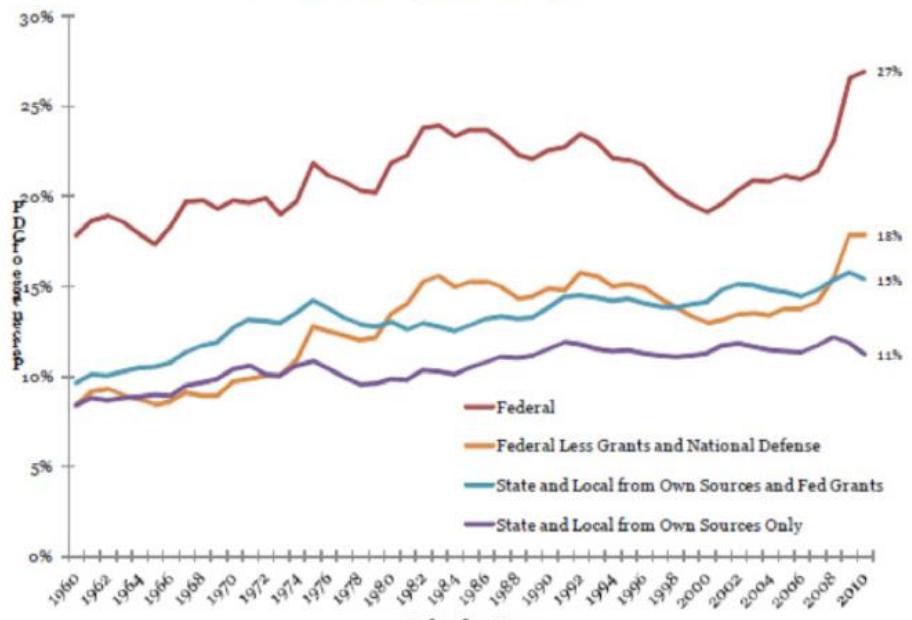
- Both private and public sectors play an important role in modern economy.
- All modern economies are mixed.
- Important reason for government intervention is existence of market failures.

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.

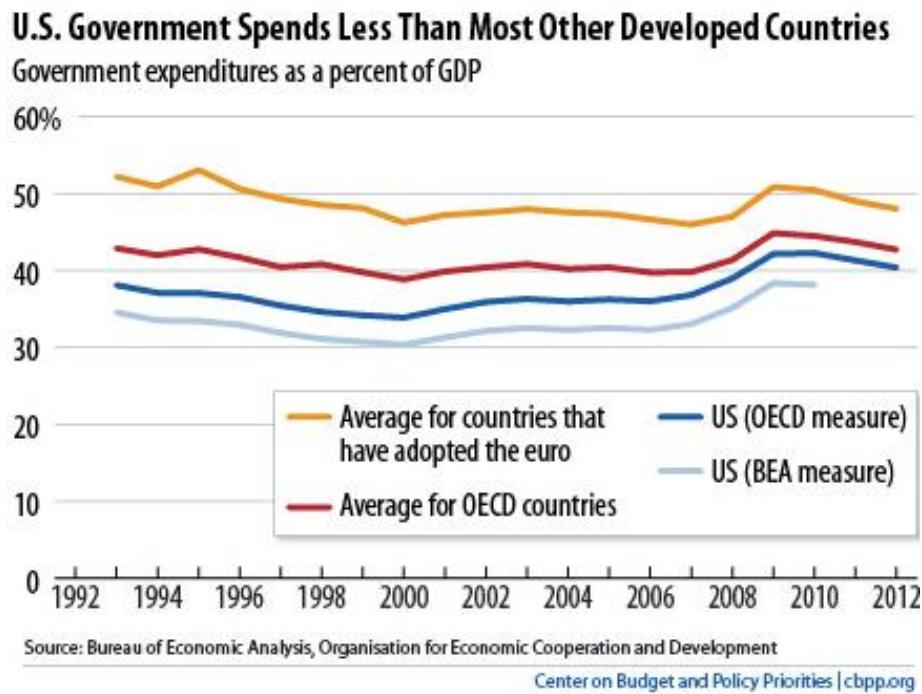
US Government Spending by Level

Figure 1
Government Expenditures by Level

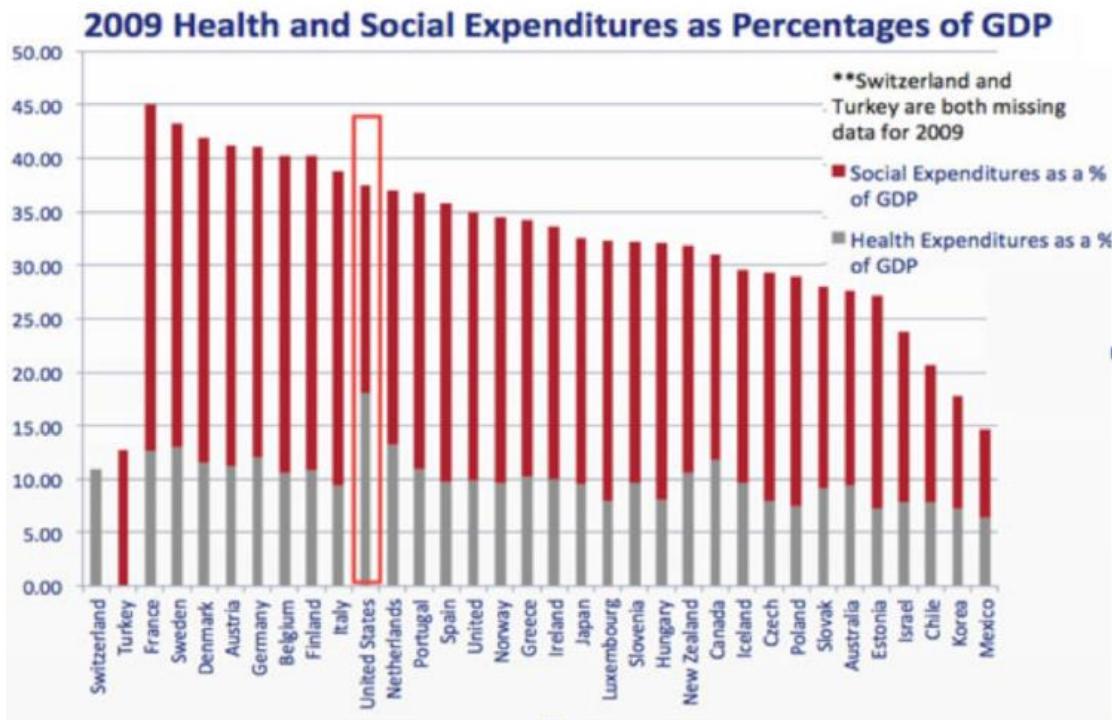


source: U.S. Bureau of Economic Analysis, *National Income and Product Accounts*, December 2011, Tables 1.1.R, 2.16, 2.2, 9.9, and 6.10.

Comparative Spending: US vs Other Countries



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



@StatistaCharts

* Estimate

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

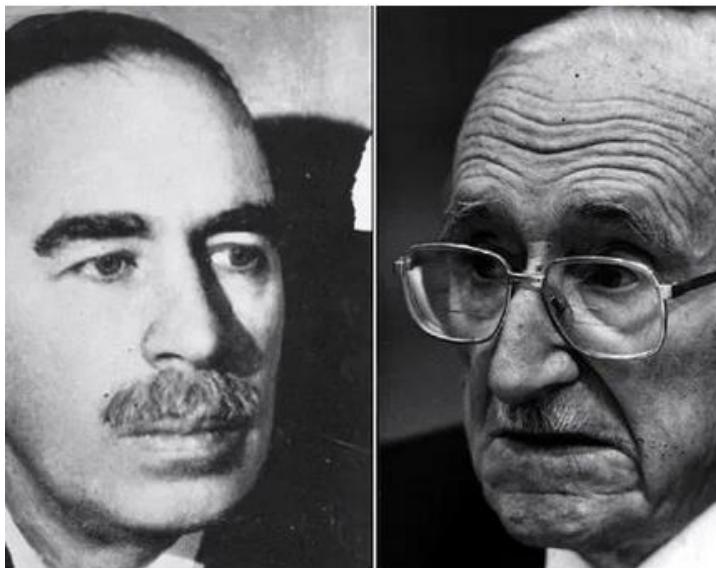
- How are these decisions made?
 - How are collective decisions, such as those concerning the supply of publicly provided goods and taxes, made?
- How is it to be produced?
 - By government or by private businesses?

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)