WI13  Economics 450: Public Finance—Government Spending

The Instructor: Who and Where
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The Course: What You Will Learn
You will be evaluated on how well you achieve three learning objectives.

- The significant facts about the spending programs of governments in the United States including spending on national defense, highways, environmental regulation, welfare, social security, health, and education.
- How to analyze the effects of these programs on the economy, including their effects on the level and distribution of economic well being.
- An understanding of the political and economic reasons why different spending programs exist, and an ability to evaluate such programs and their alternatives in terms of attaining economic and social objectives.

The Course: How Your Learning Will Be Assessed
Your course grade is based on two non-cumulative class tests (equally weighted), and periodic assignments and short quizzes (worth up to 20% of your grade). Your assignment and quiz grade will be used only to improve your grade, not to lower it. If you miss assignments and quizzes for any reason, your grade will depend wholly on the tests.

The first class test is on Wednesday February 13 and the second class test is on Wednesday March 13 (last day of class.) The tests must be taken on these days—I do not have the resources to offer make up tests.

Policy on Academic Integrity
My policy on academic integrity is to respect you, treat you as responsible adults and presume that you are honest. I ask that you return this respect by proving me right. If any academic dishonesty on quizzes or tests is discovered, I will follow the appropriate institutional procedures. Cooperative learning on assignments is permitted, even encouraged.
The Course: Lectures and Readings

- Lecture notes are available on the class page and links to some recommended internet readings. I will advise you what topic(s) and readings we will cover in the next class. Please read them before class and be prepared to discuss and ask questions. *The lecture notes and readings are not a perfect substitute for attending class.*


I  Role of Government in the Economy

A) **SIZING UP GOVERNMENT**: The "stylized facts" on government spending including how much the government spends, what it spends on, which level of government does the spending, and how these facts have changed over time.

   *Read* Topic 1 (Chapter 1 textbook), Reading 1.

B) **THE MARKET FAILURE THEORY OF GOVERNMENT**: When markets are efficient, when they are not, and how government programs can (in principle) can benefit all.

   *Read* Topic 2 (Chapter 2 textbook), Reading 2.

II. Public Goods

A) **PUBLIC GOODS AND ECONOMIC EFFICIENCY**: The concept of a public good (a good that is non-rival and non-excludable) is introduced. The conditions for the efficient production of a public good are explained.

   *Read*: Topic 3 (Chapter 3 textbook)

B) **PUBLIC GOODS AND MARKET FAILURE**: The reasons why market or voluntary contributions fail to provide adequate quantities of public goods is explained. Prisoner's Dilemma and Free Rider problems described. Why government coercion can make everyone better off.

   *Read*: Topic 4 (Chapter 3 textbook), Readings 3 and 4.

C) **CONGESTIBLE PUBLIC GOODS AND ROAD PRICING**: Many goods have a mixture of private and public qualities. An important case is a public good that is congestible, such as roads, tunnels and bridges. Such goods should be priced according to congestion.

   *Read*: Topic 5 (Chapter 3 textbook), Reading 5.
III. Market Externalities

A) EXTERNALITIES AND MARKET FAILURE: Externality as a generalized form of market failure. What is and what is not an externality. Why pollution is a market failure, not a crime. The Coase Theorem and the true nature of externalities.

Read: Topic 6 (Chapter 4 textbook)

B) GOVERNMENT POLICIES TO CORRECT FOR EXTERNALITIES: Governments intervene in markets to correct for externalities in several ways. We compare command and control regulations to market based policies like cap and trade and individual tradable quota in fisheries.

Read: Topic 7 (Chapter 4 textbook), Readings 6 and 7.

IV. The Government Decision-Making Process

A) THE THEORY OF GOVERNMENT DECISION-MAKING: How public choices are actually made through voting and other political actions. Main topics are the voter's paradox, the median voter theorem, and the theory of bureaucracy and "government failure".

Read: Topic 8 (Chapter 5 textbook), Readings 8 and 9.

B) VOTING AND ECONOMIC EFFICIENCY: When does voting lead to efficient public good outcomes? Condorcet's Paradox. Government failure and market failure.

Read: Topic 9 (Chapter 5 textbook)

V. Government and the Distribution of Economic Well-Being

A) GOVERNMENT AND THE DISTRIBUTION OF INCOME: The government redistributes income for several reasons, including charity as a public good, social insurance (safety net), distributional equity.

Read: Topic 10 (Chapter 7 textbook).

B) HOW INEQUALITY AND POVERTY ARE MEASURED: Methods of measuring inequality and poverty are described. Lorenz curve and Gini coefficient. Absolute and relative measures of poverty. Orshansky method.

Read: Topic 11 (Chapters 7, 8 textbook), Readings 10 to 15.

VI. Government Transfer Programs

A) TRANSFERS TO PERSONS WITH LIMITED INCOMES: What are the main means-tested (or welfare) programs? How much is spent and how the programs are structured.

Read: Topic 12 (Chapter 8 textbook)
B) THE EFFECTS OF WELFARE AND WELFARE REFORM: Main issues: How does means-testing affect the recipient’s behavior? Are transfers in cash better or worse than transfers in kind? If so, why is most welfare is in kind? What were the main elements of welfare reform, and what were the effects?

Read: Topic 13 (Chapter 8 textbook), Reading 16

C) SOCIAL INSURANCE AND SOCIAL SECURITY: Insurance market failure (because of moral hazard and adverse selection) and government social insurance type programs. How Social Security works in the US. Is there a solvency problem? What are the economic effects of Social Security.

Read: Topic 14 (Chapter 9 textbook), Readings 17 and 18.

D) GOVERNMENT HEALTH CARE PROGRAMS: What is the role of government in health care in the US? How does it compare to other countries? What health care reforms were legislated in 2010 and why?

Read: Topic 15 (Chapter 9 textbook), Reading 19

VII. State and Local Government Spending (Time permitting)

Topics: State and Local government spending, local public goods, inter-jurisdictional spillovers (a type of externality), the Tiebout hypothesis (the hypothesis that local government produces efficient quantities of local public goods when people can “vote with their feet”), fiscal federalism and government-to-government grants. Education, the largest category of state and local spending, is also covered

Read: Topic 16 (Chapter 18 textbook)