

Study Guide: EE 442: Public Finance – Expenditures midterm

### **Format of the Exam**

Answer 2 of 3, and 2 of 3

First 3 questions: Primarily identify/explain, in essay/graph format

My goal is NOT to trick you or confuse you, it is to see if you can repeat back the information to me, do the graphs, and explain the topic well.

Final 3 questions: Usually compare/contrast questions, or more technically difficult questions

My goal is for you to explain something in more than one way, and I am as interested in the problems of the argument as the argument itself. I am looking for deeper understanding; i.e. can you take the tools and apply them to other situations, and do you know the weaknesses of the tools.

### **Topics covered:**

**Chapter 1.** The Organic and Mechanistic view of the Government. The basic format of governments. Democracy vs. Liberty, positive and negative rights. Be able to explain what a Unitary Government, a Confederacy, and a Federation are – and what the tax implication (tax competition) are. Know the concept of limited government, the mixed economy (welfare state) – and the justifications for both.

**Chapter 2.** The importance of theory, and the problems of empirical study in Public Finance (no direct question on this chapter – but it will inform other questions)

**Chapter 3.** Pareto efficiency. PPF, and Edgeworth boxes. First and second theorems of welfare economics. When Pareto efficiency is not possible. The Social Welfare Function. When discussing Pareto efficiency, be sure to also know what has to hold in production market. (technical efficiency in the production side of economy and decreasing returns to scale).

**Chapter 4.** Public Goods. Defining them (this is important). Individual and market demand for public and private goods. Problems in the provision of public goods (free riders, tragedy of the commons, etc.) Privatization debate – (this comes up when talking about education).

**Chapter 5.** Externalities. What is (and is not) an externality. Graphical analysis of pollution. . Be able to explain ways of dealing with externalities. Pigouvian taxes (subsidies). The political problem of Pigouvian taxes. Command and control regulations (and the problems with). Emissions fees, Cap and Trade, Tradeable

permits – the problem they seek to solve, and the problems they have. The Coase theorem and “internalizing the externality”. Seriously know the Coase Theorem.

**Chapter 11.** Social Security. Know how the program is set up. Some key terms – the contribution, and “insurance” program, the 1929 crash and banking crisis, intergeneration transfer scheme, pay-as-you-go, worker-retiree ratio, demographics, demographic stages, birth-rate and death-rate, Total Fertility Rate, Baby boom, benefits, age of retirement, lifespans, the “trust fund”, Rate of Return, and the solutions to the problem, and the difficulties/problems with those solutions. I covered it in a way different from the book, but largely covered the same information. You are NOT responsible for the other changes in social security over the years (disability, survivor benefits, etc.).

**Chapter 7:** Education. Know the empirics of education. The justifications (private and public) for it, and the justifications for public education (schools?). I take a more skeptical take on it than the book, but you only need to know what the arguments are. Be sure to understand the graphs I did in class, I did them differently than the book. Be able to explain why we don’t see inexpensive private schools, how public education may lower or increase spending on education, public education as redistribution, etc. Know this chapter pretty well, since I was in a hurry when I taught this section. Be able to explain vouchers.

Also be able to explain **the theory of the clubs**. What will determine the size of clubs, and the diversity of the membership. When will you have competition between clubs, and when will you only have one?

