

Study Guide: Public Finance – Expenditures midterm

Format of the Exam

Answer 3 of 4, and 2 of 3

First 4 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

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. Freedom, positive and negative rights. Also, the tax analysis.

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, Edgeworth boxes. First and second theorems of welfare economics. When Pareto efficiency is not possible.

Also, exchange and the provision of a public and private good (the eye graph). Why does the cost of exchange go DOWN for private goods when exchanging goods privately, but it could go DOWN OR UP when exchanging a basket of private and public goods.

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. The theory of the club.

Chapter 5. Externalities. What is (and is not) an externality. Graphical analysis of pollution. Pigovian taxes (subsidies). The Coase Theorem (important). Why emissions fees instead of pigovian taxes. The political problem of pigovian taxes and emissions fees. Cap and Trade.

Empirical Applications: Social Security in the U.S (chapter 11), Insurance plans (general)

Empirical Applications: Education (chapter 7).

Empirical Application: The Thai Rice Scheme and the 2014 Coup.

Study guide for Final Exam

Format of the Final Exam

Answer 5 of 6, and 2 of 3

First 6 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 4 questions: Usually compare/contrast 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.

Chapter 6: Political Economy and Public Choice Economics

Note: I way expanded on this chapter, see the notes passed out in class. Topics covered included:

The Median Voter Model

(empirical application – Thailand’s shift to a two party system)

Vote cycling

Multi-peaked preferences

Two goods, three voters

Agenda Setters

Log-rolling

Different voting systems

Rational/Expressive Voting

Why voting is irrational as an instrumental act

Rent Seeking

The structure of Government and Federalism (before Midterm

The Niskanen Bureaucrat

The Lazy Bureaucrat

The Growth of Government

Chapter 12 and 13

Income Redistribution – Especially measurement problems

Absolute and Relative Poverty

AFDC and TANF

Welfare Reform

“corner problems, implicit Taxes”

Sample Questions

The Median Voter Theorem

Q. What is the weak version of the Median Voter Theorem?

Q. What is the Strong version of the Median Voter Theorem?

Q. What is Alienation? How would alienation change the results of the Theorem?

Q. Can you demonstrate with the Median Voter Theorem how changes in how much a person cares about an issue (intensity of voter preference) can have no impact on who the median voter is?

Q. How could strategic voting change the results of the Median Voter Theorem?

Q. What does the Median Voter Theorem assume about how we can arrange voter preferences?

Q. How would/could a law requiring people to vote change the expected results of the Median Voter Theorem?

Vote Cycling

Q. “economic questions lend themselves to a simple left-right continuum, but questions of values or culture often don’t. Why? (Hint: absolutes, multi-peaked preferences)”

Q. Why you start mixing multiple economic goods together, there is more opportunity for cycling. Explain.

Q. Why does there appear to be so little vote cycling.

Q. Explain what we mean by “multi-peaked preferences”. Why would we think them less common for economic issues than value issues.

Q. Condorcet Voting is really just rock-paper-scissor. Explain.

The Agenda Setter

Q. Explain what an Agenda Setter is.

Q. Agenda setters rely on two things, power and uncertainty. Explain why an Agenda setter needs both to manipulate/arrange things to benefit themselves.

Q. How can an agenda setter control the outcome when in a situation of vote cycling?

Q. Can you model the three-voter, 2 issue agenda setter using indifference curves and bliss-points?

Q. An agenda setter can be thwarted when others engage in strategic voting. Explain.

Alternative Voting systems.

Explain winner-take-all (first past the post) vote systems. Why do they often lead to plurality, as opposed to majority, victories?

Explain proportional representation (party list) voting, and why winning parties are usually smaller.

Explain voting with a runoff election.

Explain the Condorcet criteria – and why it can lead to vote cycling or no victory.

Explain the Hare system, and the Combs (Veto) system of voting.

Explain approval voting.

Explain the Borda count.

When would you want a Hare system of voting, and when would want a combs system? In other words, what advantages and disadvantages does each create?

The Optimal Majority

Q. What is the advantage of having committees making decisions, even though they are small. Should a committee be composed of people representative of the population as a whole, or should they be composed of a better-informed subset of the population.

Q. Why are plurality decisions intrinsically less decisive than majority decisions?

Q. The graph of this is composed of the sum of two costs - the cost of a harmful decision, which goes down as the % of voters necessary to agree to a decision increases, and the cost of arriving at (agreeing to) a decision, which goes up as the % of voters necessary to agree to a decision increases. Explain in detail each of these costs.

Q. Sometimes you want a majority. Sometimes you want a minority, or even a dictatorship. And sometimes, you want a supermajority. Give an example of each, and explain why.

Q. Why is our graph kinked at $n/2+1$?

Q. Markets are a special example of voting behavior - one where every vote taken is one that requires unanimity. Explain.

Why do people vote?

Q. What are the potential benefits of voting, and what are the costs of voting?

Q. Under what circumstances would it be rational to vote, and under what circumstances is it not rational to vote? Explain this as if voting was an example of instrumental behavior, i.e. we vote because we expect it to change the outcome of something in a way we approve.

*Q. "the best argument against democracy is a five-minute conversation with the average voter" https://www.brainyquote.com/authors/winston_churchill
Explain. Is the average voter stupid, or rationally ignorant?*

*Q. "getting laid, Mr. Kennedy, is a rational reason to vote". Gordon Tullock.
Explain (you may skip this if you were not in class that day)*

Q. What do we mean by "expressive voting"?

Q. Empirically, what are some of the things that can be used to predict why people as they do.

Q. Economists and other social scientists often complain about how voters are acting, and about how politicians sell themselves to the voters. Politicians continue to sell themselves in ways social scientists dis-approve of. Who understands the voters better, and why?

Q. Do people vote their narrow self-interest? Can most people identify what their self interest is when voting? Why or why not. (hint: compare the act of voting to the act of buying a car).

Rent Seeking

Q. What is the definition of Rent Seeking?

Q. Explain the problem with “Transitory gains from Rent-seeking”.

Q. Why does Rent Seeking lower an economies rate of growth, and over-all wealth?

Q. Is rent seeking created by politicians or bureaucrats who create the rents to auction off to businessmen, or by entrepreneurial businessmen who seek to influence the government to create the rents? Explain.

Q. Explain how much the entrepreneurial businessman will spend to capture the rents (the equation given in class). Under what circumstances will the profits of rent-seeking exceed the costs, and when will the profits be less than the costs expended to create or capture the rents.

Q. The great problem of monopoly isn't natural monopolies, it is government created monopolies. Explain.

Q. What is the measurement problem associated with Rent Seeking?

Q. Explain the logic of the early salt monopolies.

Q. Do taxi drivers in NYC who spent \$1,000,000 for a taxi medallion in 2014 have a “right” to the expected revenue stream the medallion would create, or do uber drivers who are not part of the system have right to offer their services outside of the system? (there is no wrong or right answer to this, just explain to me what the costs/benefits to each, and to consumers and the government, is).

Bureaucracy

Q. Who is the most important government official in most of your lives?

Q. Model the revenue maximizing Niskanen bureaucrat, and show how they can provide more of a good than the public wants. Can they actually provide so much of the good that the public values the marginal good negatively?

Q. Model the lazy bureaucrat. Explain how this bureaucrat provides less of the public good than the public wants, and the public overpays for what it gets.

Q. What sorts of goods will be overprovided, and what sorts will be underprovided. Explain this from the perspective of the bureaucrats – what sorts of goods will make them power-hungry, and what sorts will make them lazy?

Q. What is power? How is it different from wealth?

Q. explain why, in a perfect bureaucracy, nobody would have any power.

Q. A bureaucrat's power is a function of information asymmetries, and of discretionary decision making. Explain.

The Growth of Government

Q. Explain the statistical equation $G = P_G + Y + T + \dot{\alpha}$

Q. What relationship does taste have to the growth of government, and why?

Q. What are the basic empirics of the growth of government since 1900?

Q. What is the “ratchet effect”?

Q. What relationship does income have to the growth of government, and why?

Q. What relationship does the price of Government (relative or absolute) have to the growth of government, and why?

Q. What is Baumol's cost disease?

Q. What is Buchanan's false casualty argument against the Baumol effect as the source of government growth?

Q. What are the three demand-side (we, though who the we are can differ) arguments for the growth of government?

Q. What are the three supply-side (the government, though who/what part of it can differ) arguments for the growth of government?

Q. What are

**Income Redistribution
and
Redistribution and anti-poverty programs**

Q. What is the difference between absolute poverty, and relative poverty?

Q. How does the U.S. measure absolute poverty?

Q. What does Engel's law imply about how we measure absolute poverty?

Q. What has happened to the absolute poverty rate in the U.S. since the 1960s?

Q. What is the standard demographic unit of measurement used in calculating the poverty rate, and why do we use that unit?

Q. "Poverty in Thailand is often an economic problem in Thailand, related to a lack of human capital, economic opportunity, or generalized low(er) development. Poverty in the U.S. is rarely an economic problem in the U.S., it is a spiritual or behavioral problem." Ajarn Kennedy. Explain.

Q. What is the difference between a direct monetary payment, and commodity support, as ways to combat poverty. Why do most economists believe in direct monetary payments, but most taxpayers believe in commodity support?

Q. Give some examples of commodity support, and how they do, (and often don't) work in practice. Be sure to specify both the intended, and unintended, effects.

Q. Specifically talk about housing support (the projects) and how they worked poorly.

Q. How did AFDC work?

Q. What was the problem with it over time (hint: the role of stigma)?

Q. What is welfare dependency?

Q. What are "implicit taxes", and can you graph them?

Q. Before the midterm, we modeled public schools as a legitimate public expenditure on the basis that they created positive externalities. Explain how they could also be considered as an example of a commodity transfer.

Q. How did TANF change AFDC?

Q. How did the concept of federalism differ when applied to AFDC and TANF? In other words, how did the role of the states change between the two, and why?

Q. States in a federal system encompass two roles, as “Laboratories of Democracy”, and as “differing bundles of public goods and obligations”. Explain how each of these were reflected in the design of TANF.

Q. What was the budgeting problem in AFDC?

Q. How did the work requirements change between AFDC and TANF?

Q. What was the fear about a “race to the bottom” by the states with introduction of TANF? Did a large shifting of the poor population between states actually happen?

Q. What were the empirical results of Welfare Reform? In other words, what parts seemed to work, what parts did not.