Instructor's Manual to accompany
Public Finance, Ninth Edition, by Harvey S. Rosen and Ted Gayer

Suggested Answers to End-of-Chapter Discussion Questions

Some of the questions have no single "correct" answer – reasonable people can go off in different directions. In such cases, the answers provided here sketch only a few possibilities.

Chapter 1 - Introduction

1.

   a. McCain's statement is consistent with an organic conception of government. Individuals and their goals are less important than the state.

   b. Locke makes a clear statement of the mechanistic view of the state in which individual liberty is of paramount importance.

   c. Chavez's statement is consistent with an organic view of government. The individual has significance only as part of society as a whole.

2. Libertarians believe in a very limited government and are skeptical about the ability of government to improve social welfare. Social democrats believe that substantial government intervention is required for the good of individuals. Someone with an organic conception of the state believes that the goals of society are set by the state and individuals are valued only by their contribution to the realization of social goals.

   a. A law prohibiting receiving compensation for organ donation would be opposed by libertarians, as they would want the market to decide who buys and who sells organs and at what price the organs would be sold. Social democrats also might oppose the law if they consider that such a law would prevent organ donation from happening as frequently. However, they are likely to support the law on the grounds that paying for organ donation would coerce financially desperate people to sell their organs. The law would protect the individual from making a poor decision. The organic view might also oppose the law because the society might become healthier if more individuals received transplants, although they would believe that individuals should donate for the good of society, rather than for compensation.

   b. Libertarians oppose the law mandating helmet use for motorcyclists, arguing that individuals can best decide whether or not to use helmets without government coercion. Social democrats take the position that the mandate saves lives and ultimately benefits individuals. The organic view would probably lead to favoring the mandate on the grounds that reduced health care costs caused by fewer injuries benefit society.

c. Libertarians oppose the law mandating child safety seats, arguing that individuals can best decide whether or not to use child safety seats without government coercion. Social democrats take the position that the mandate saves lives and ultimately benefits individuals. The organic view would probably lead to favoring the mandate on the grounds that reduced health care costs caused by fewer accidents benefit society.

d. Libertarians would probably oppose a law prohibiting prostitution, while social democrats would likely favor such a law. The organic view depends on the type of society policymakers are attempting to achieve. The law would probably be favored on moral grounds.

e. Libertarians would probably oppose a law prohibiting polygamy, while social democrats would likely favor such a law. The organic view depends on the type of society policymakers are attempting to achieve. The law would probably be favored on moral grounds.

f. Libertarians would likely oppose the ban on trans fats in restaurants, believing that consumers will demand restaurants remove trans fats if they believe that is important. Social democrats would probably support the ban because consumers might not understand how bad trans fats are for their health. Those with an organic view would probably favor the ban because the scientific literature suggests that people who avoid trans fats are healthier, therefore the ban would reduce health care costs.

3. The mechanistic view of government says that the government is a contrivance created by individuals to better achieve their individual goals. Within the mechanistic tradition, people could disagree on the obesity tax. Libertarians would say that people can decide what is best for themselves - whether to consume high calorie food - and do not need prodding from the government. In contrast, social democrats might argue that people are too short sighted to know what is good for them, so that government-provided inducements are appropriate.

4.

a. If the size of government is measured by direct expenditures, the mandate does not directly increase it. Costs of compliance, however, may be high and would appear as an increase in a "regulatory budget."

b. This ban would not increase government expenditures, but the high costs of compliance would increase the regulatory budget.

c. It's hard to say whether this represents an increase or decrease in the size of government. One possibility is that GDP stayed the same, and government purchases of goods and services fell. Another is that government purchases of goods and services grew, but at a slower rate than the GDP. One must also consider coincident federal credit and regulatory activities and state and local budgets.

d. The federal budget would decrease if grants-in-aid were reduced. However, if state and local governments offset this by increasing taxes, the size of the government sector as a whole would not go down as much as one would have guessed.

5. The inflation erodes the real value of the debt by 0.021 x £502 billion or £10.54 billion. The fact that inflation reduces the real debt obligation means that this figure should be included as revenue to the government.

6. The federal government grew by $1.17 billion. However, because the price level went up by 34 percent, in terms of 2007 dollars this amounted to a real increase of $640 billion (=$2.73 trillion - 1.34*$1.56 trillion=$2.73 trillion-$2.09 trillion). As a proportion of GDP, federal spending in 1996 was 19.9 percent ($1.56 trillion/$7.82 trillion) and in 2005 it was 19.8 percent ($2.73 trillion/$13.78 trillion). Hence, the size of government grew in absolute terms and fell slightly in relative terms. To get a more complete answer, one would want data on the population (to compute real spending per capita). Also, it would be useful to add in expenditures by state and local governments, to see if the *total* size of government fell. Also, although it would be harder to measure, one would want to try to gain some sense of how the regulatory burden on the economy grew during this time period.

7. Relative to GDP, defense spending grew from 4.9 percent of GDP in 1981 to 5.8 percent of GDP in 1985 and then grew from 2.9 percent of GDP in 2001 to 3.8 percent of GDP in 2005. The increase from 2001 to 2005 was proportionally larger, but both increases were the same in terms of the percentage point increase.

8.

a. For the years 1993 to 1997, the absolute change in federal expenditures was $191.6 billion *[$1,601.2 billion - $1,409.6 billion]*, the change in federal expenditures in real terms (1997 dollars) was $79.43 billion *[inflation rate = (95.414-88.381)/88.381=7.96%, $1,601.2 billion – $1,409.6(1+0.0796)=$79.43 billion]*, the change in real government expenditures per capita was $19.87 *[real government expenditures per capita in 1993 (1997 dollars): $1,409.6*(1+1.0796)/0.260255 = $5,847.23; real government expenditures per capita in 1997 (1997 dollars): $1,601.2/0.272912 billion = $5,867.09; $5,867.09-$5,847.23=$19.87], and the change in expenditures per GDP is -$0.0189 billion [$1,409.6/$6,657.4 – $1,601.2/$8,304.3]*.

   For the years 2001 to 2005, the absolute change in federal expenditures was $608.7 billion *[$2,472.1 billion - $1,863.4 billion]*, the change in federal expenditures in real terms (2005 dollars) was $415.79 billion *[inflation rate = (113.000-102.399)/102.399=10.35%, $2,472.1 billion – $1,863.4(1+0.1035) = $415.79 billion]*, the change in real government expenditures per capita was $1,121.6 *[real government expenditures per capita in 2001 (2005 dollars): $1,863.4*(1+1.1035)/0.2854 = $7,203.65; real government expenditures per capita in 2005 (2005 dollars): $2,472.1/0.29694 billion = $8,3257.25;*

$8,3257.25-$7,203.65=$1,121.6], and the change in expenditures per GDP is -$0.0034 billion $1,863.4 /$10,128.0 – $2,472.1/$13,194.7].

b. Relative to GDP, the only increase in expenditure was for Medicare in the years 1993 to 1997. These years saw the largest relative decrease in expenditures on "other" and on income security. In the years 2001 to 2005, the largest increases in expenditures relative to GDP were in defense and health expenditures. These years saw the largest decreases in net interest payments and social security.

9.

a. The 1993 to 1997 absolute change in federal tax revenues was $425.0 billion *(=$1579.5-$1154.5)*, while from 2001 to 2005 the same change was $162.6 billion *(=$2153.8-$1991.2)*. In real terms, the 1993 to 1997 change in federal tax revenues was $333.13 *(inflation over period 7.96%, real change =$1579.5-$1154.5*1.0796)*. For 2001 to 2005, the change in federal tax revenues was $-43.54 *(inflation over period 10.35%, real change = $2153.8-$1991.2*1.1035)*. The change in real tax revenues per capita for 1993 to 1997 was $588.03 *(=($737.5/.260255-$509.7*(1.0796)/0.2729))* and for 2001 to 2005 was $-720.54 *(=($927.2/.2855-$994.1*(1.1035)/0.2969))*. The change in the tax revenues per GDP from 1993 to 1997 was 0.258 *(=$1579.5/8304.3-$1154.5/6657.4)* and from 2001 to 2005 was 0.0530 *(=$2153.8/13194.7-$1991.2/10128.0)*.

b. From 1993 to 1997 and 2001 to 2005, corporate taxes had the largest relative increase. From 1993 to 1997, social insurance revenue had the largest relative decrease, while from 2001 to 2005 the largest relative decrease was in individual income tax.