

he also indirectly discussed efficiency concerns by talking about the importance of cutting health care costs. Nancy Pelosi was focused primarily on redistribution/equity, viewing health insurance as a “right and not a privilege.”

John Boehner seemed concerned about efficiency, taking the opposing view of President Obama that the law would increase costs and reduce efficiency.

Finally, Ron Paul’s concerns were centrally about fairness and redistribution, but unlike President Obama and Nancy Pelosi, he took an opposing moral view that redistribution is unconstitutional and against the will of the people.

4. Some goods and services are provided directly by the government, while others are funded publicly but provided privately. What is the difference between these two mechanisms of public financing? Why do you think the same government would use one approach sometimes and the other approach at other times?

Direct public provision of a good or service occurs when the government itself produces the good or service. Police forces and the military are examples of direct provision. Public financing of private provision of goods and services occurs when the government wishes to increase the provision of a good or service, but it does not want to directly involve itself in its provision. An example is when the government hires private companies to build or repair roads, or when the government purchases military aircraft from private companies instead of building them itself.

Public funding for private provision is appealing relative to direct public provision whenever the private market can produce the goods or services more efficiently than the government. This is likely to be the case where there is an existing market or industry for the good or service, especially when that market is competitive. When there is no existing market for a good or service provided by the government, or when that market is characterized by an imperfectly competitive industry, there may be a stronger case for direct provision (although it is important to recognize that direct provision can also suffer from efficiency failures). There may be national security concerns related to private provision of certain goods and services, especially those performed by the military and police forces. The government is more likely to provide these goods and services directly.

5. Why does redistribution cause efficiency losses? Why might society choose to redistribute resources from one group to another when doing so reduces the overall size of the economic pie?

Redistribution can cause efficiency losses if there are behavioral responses to the redistribution system. The government might raise money to fund redistribution by imposing a tax on labor income, and this might cause a reduction in the labor supply. Similarly, generous unemployment benefits might induce some who are out of work to remain unemployed. Despite these possible efficiency losses, we (collectively) choose to redistribute wealth. Some reasons for redistribution are that people have a taste or preference for a certain degree of economic equity; that the existence of a large or visible underclass is somewhat discomfiting or threatening; that people are risk averse and so are willing to pay for a “safety net” in case they or their families ever need assistance; and that humans are naturally empathetic. In a country with many very poor people, redistribution from the few rich to the many poor may make the majority of people better off, even if it reduces the overall size of the pie. A democratic process may therefore lead to the occurrence of this sort of redistribution.

6. Consider the four basic questions of public finance listed in the chapter. Which of these questions are positive—that is, questions that can be proved or disproved—and which are normative—that is, questions of opinion? Explain your answer.

The four basic questions of public finance:

1. *When should the government intervene in the economy?* The word “should” suggests that this is a question about which opinion will vary, so it is normative.
2. *How might the government intervene?* This question is positive. It asks: How does the government actually intervene now, and how might it intervene in the future? One can check whether a government might intervene in a particular way directly by examining the behavior of existing and future governments.
3. *What is the effect of those interventions on economic outcomes?* Economic effects can be measured and thus are not a matter of opinion, so this question is positive.
4. *Why do governments choose to intervene in the way that they do?* This is a factual (positive) question. It may be difficult to directly observe the answer, but one can potentially learn about the motivations behind a government’s interventions by looking at patterns of behavior over time.

7. One rationale for imposing taxes on alcohol consumption is that people who drink alcohol impose negative spillovers on the rest of society—for example, through loud and unruly behavior or intoxicated driving. If this rationale is correct, in the absence of governmental taxation, will people tend to consume too much, too little, or the right amount of alcohol?

People demand goods primarily on the basis of their own enjoyment of that good. They tend to underweight the impact of their consumption on the well-being of others. In the absence of taxes on alcohol, people will tend to consume too much of it. That is, they will tend to consume more than they would if they took the harm they cause others into account.

8. What is the role of the Congressional Budget Office (CBO)? Why is independence and impartiality important when conducting empirical analyses?

The CBO provides economic analyses of proposed legislation, particularly estimates of the cost of proposed projects. To do this accurately and to provide the best possible advice to Congress, the CBO must carefully consider all the economic effects of a proposal. A politically motivated CBO might be tempted to understate some costs or overstate others in order to influence legislation.

9. U.S. law prohibits hospitals from denying patients care in an emergency, even if they are unable to pay. Historically, the cost of covering these uninsured patients has been passed on to insured patients and the government. Explain how a law like the Affordable Care Act, which reduces the number of uninsured patients, thus alleviates a market failure.

Uninsured patients do not need to take into account the full costs that their decision to remain uninsured impose on society, because in an emergency they cannot be denied care. Thus, they may impose a *negative externality* on society, by receiving costly emergency care for which they are not ultimately financially responsible. A law that reduces the number of uninsured alleviates this market failure.

10. In 2017, partial repeal of the Affordable Care Act was enacted by Congress as a part of a larger tax reform package that made many substantial changes to the tax code. Why does the manner in

which it was passed complicate efforts to evaluate the effect of ACA repeal on health care costs, coverage, and the overall economy?

Partial repeal of the ACA did not happen in a vacuum. The economy was growing at a rapid clip in the years surrounding the 2017 repeal, and an entire package of tax cuts passed at the same time as partial ACA repeal. The evolving economic outlook and the other changes to the tax code makes it hard to definitively detangle whether any changes observed before and after 2017 in health care costs, coverage, or overall economic outlook are attributable to ACA repeal, the tax cuts, a booming and evolving economy, or all of these factors in combination.

For example, of particular concern to policy makers is understanding the effects of partial ACA repeal on the number of uninsured Americans. All other things equal, ACA repeal would be expected to increase the number of uninsured Americans, but the booming economy and decreasing unemployment rates might offset that effect, as increasing numbers of Americans become employed and can obtain jobs with insurance. However, policy makers might care about the impact of ACA repeal under other economic circumstances; if a recession occurs and many Americans lose their jobs, the number of uninsured Americans might be higher than would otherwise be the case if ACA repeal had not been enacted.

ADVANCED QUESTIONS

11. In the United States, the federal government pays for a considerably larger share of social welfare spending (that is, spending on social insurance programs to help low-income, disabled, or elderly people) than it does for K–12 education spending. Similarly, state and local governments provide a larger share of education spending and a smaller share of welfare spending. Is this a coincidence, or can you think of a reason for why this might be so?

Local control is often considered more important for education than for other services because there may be regional variations in curriculum preferences—whether to teach the theory of evolution, for example. There may be fewer regional variations in preferences related to social programs, however, so people may be more willing to give up local control over these programs. Another possible explanation for federal control of social welfare programs is jurisdiction “shopping.” If social insurance benefits varied substantially among states, people might move from one to another to avail themselves of more generous benefits.

12. Americans are split on the subject of school vouchers, and the controversy especially affects communities with disproportionate numbers of poor families. Some leaders in these communities strongly support the voucher system and the increased school competition it brings, while others oppose it. Why do you think this split exists?

In communities containing a disproportionate number of poor families, many students attend substandard schools. Proponents of the voucher system may believe that it will allow them to send their children to better schools or that competition will encourage their local schools to improve in order to retain students who would have a choice of schools under the voucher system. Opponents may view it as a threat to neighborhood schools, fearing that if students take their vouchers and leave, inner-city schools may become even more impoverished. Philosophically, some proponents believe that market competition can solve a wide variety of problems, while some opponents are suspicious of the market system—at least as applied in the context of education—possibly viewing it as an institution that favors those with more money to spend in the marketplace.

13. Many states have constitutional requirements that their budgets be in balance (or in surplus) in any given year, but this is not true for the U.S. federal government. Why might it make sense to allow for the federal government to have deficits in some years and surpluses in others?

Time-series graphs illustrate one striking reason to allow for deficits: during World War II the federal government spent far more than it took in. Like a family, a government sometimes faces unforeseen emergencies that require it to borrow. Had the United States been constrained by a balanced budget requirement at the time of World War II, the outcome of the war might have been very different. The family metaphor is relevant for a second reason: borrowing allows an entity to pay over time for a durable good that is being consumed over time. It makes sense for most families to take out a mortgage to purchase a home, because that purchase delivers benefits over many years. Similarly, many government investments yield long-term benefits. Surpluses and deficits may also have beneficial macroeconomic effects, such as helping to stabilize a volatile economy.

14. Proper hygiene, such as regular hand-washing, can greatly limit the spread of many diseases. How might this suggest a role for public interventions? What kinds of public interventions might be possible? Suggest three distinct types of possible intervention.

Individuals tend to ignore the external costs they impose on others by failing to wash their hands frequently enough (or by failing to employ other sorts of hygienic practices).

This suggests that they tend to wash their hands less than optimally and that there may therefore be a role for public interventions. One possible intervention would be a requirement that individuals wash their hands after using restrooms. (Such regulations are imposed for employees at businesses, for example.) A second possible intervention is public provision of hand-washing facilities. This would reduce the cost of hand-washing, thereby encouraging individuals to engage in that activity more frequently. A third possibility would be an advertising campaign to encourage hand-washing.