ECO-4504
Public Economics
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Introduction
What is Public Economics?

• Public economics (or public finance) is the branch of economic that studies the role of the government in the economy
Four Fundamental Questions of Public Economics

1. Why should the government intervene in the economy?
2. How might the government intervene?
3. What are the effects of those interventions on economic outcomes?
4. Why do the governments intervene in the way they do?
Why should the government intervene in the economy?

1. Market Failures

   - Problem that causes the market economy to deliver an outcome that does not maximize efficiency.
   - Example: externalities
Why should the government intervene in the economy?

• Market Failures-Example

  – Measles vaccine introduced in 1960’s
  – Huge increase in measles cases between 1989 and 1991
Why should the government intervene in the economy?

- Market Failures-Example
  
  - Negative externality: children from low-income families who could not afford the vaccination increased the measles cases on those whose immunizations may have worn off
Why should the government intervene in the economy?

- Market Failures - Example
  - The federal government corrected this market failure by
    1. Increasing awareness among low-income families.
    2. Subsidizing low-income families by paying for the vaccination
  - Result: The immunization rate increased to 90% in 2005.
Why should the government intervene in the economy?

2. Redistribution

   The shifting of resources from one group in society to another.
Why should the government intervene in the economy?

2. Redistribution
   - Example: private school vouchers
   - Public school assignment are typically determined by the household’s residence.
   - Low-income families who cannot afford to live in neighborhoods with high-achieving schools are usually stuck with their low-achieving neighborhood school.
Why should the government intervene in the economy?

2. Redistribution
   - Example: private school vouchers
   - Florida’s A+ plan:
     - Public schools are assigned grades based on the students’ math and reading test scores.
     - All students in schools which fail three years in a row become eligible to receive vouchers to attend private schools.
Why should the government intervene in the economy?

2. Redistribution
   – Florida’s A+ plan:
     • Since 1999, public schools are assigned grades based on the students’ math and reading test scores.
     • All students in schools which fail three years in a row become eligible to receive vouchers to attend private schools.
Why should the government intervene in the economy?

2. Redistribution

   - How is this redistribution?
     
     • Private school vouchers are mostly financed thru property taxes, which are proportional to the value of the property for each household.
     
     • Low income families with lower property values contribute less to the vouchers.
     
     • In other words, with this policy, high-income families ‘help’ disadvantaged students go to better schools.
How might the government intervene in the economy?

1. By changing the prices of the goods

   a. Thru taxes: increase the price of goods that are overproduced (voucher example)
   b. Thru subsidies: decrease the price of goods that are under-produced (measles epidemic example)
How might the government intervene in the economy?

2. By changing the quantity of the good produced or purchased
   
a. Restrict the private sale or purchase of an over-produced good by placing quotas
   
b. Mandate the private sale or purchase of an under-produced good
How might the government intervene in the economy?

2. By changing the quantity of the good produced or purchased

   c. Public provision of the good: produce the good directly to maximize social efficiency.
   d. Public financing of private provision: Finance the private sector to produced or not produce the good.
What are the effects of alternative interventions?

1. Direct effects: The impact of the intervention if individuals do not change their behavior as a result of the intervention.

2. Indirect effects: The effects of the interventions only because individuals change their behaviors.
What are the effects of alternative interventions?

• Example- Measles epidemic:
  1. Direct effects: The impact of the subsidy on children health outcomes if parents do not change their behaviors after the subsidy.
  2. Indirect effects: The effects of the subsidy on children health outcomes if parents change their behavior such as paying less attention to children’s health after the change.
What are the effects of alternative interventions?

• Example- Measles epidemic:
  
  • Other than experimental settings, we can typically only observe the overall impact of the policy (direct + indirect) even though what we care about might be the direct effect.
Why do governments intervene in the ways they do?

- Topic of public choice and political economy.
- Basically, each ‘elected’ government acts in ways that would maximize its vote share.