

**INSTRUCTOR'S MANUAL AND TEST BANK
TO ACCOMPANY
HYMAN, PUBLIC FINANCE 10E**

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PREFACE

This instructor's manual has been designed to complement classroom use of *Public Finance: A Contemporary Application of Theory to Policy*, tenth edition. The manual concisely states the instructional objectives of each chapter and provides an outline of each chapter. The major points are summarized, and suggestions for lectures are provided. I have tried to point out areas of possible confusion for students, based on my own teaching experience. My goal has been to give instructors who do not have time to read all the material in the text a capsule discussion of important topics and their reason for inclusion in each chapter. Each chapter of this instructor's manual has a brief section that describes the chapter revisions that were made since the ninth edition of the text.

This instructor's manual also includes a test bank to be used as an aid when making up examinations. I have tried to include questions that require students to use theory to arrive at an answer. Supplied in this manual are true/false questions, multiple choice questions, and essay questions for each chapter. Answers to the problems that appear at the end of each chapter in the text are also included.

Public Finance: A Contemporary Application of Theory to Policy has been designed as a teaching tool that integrates theory and policy. I hope that this manual makes it easier for instructors to assist their students in mastering the theory and in understanding the relevance of the factual material provided in the text.

Thanks to Kevin Balsam and Tom Arnold for their assistance in authoring this manual.

David N. Hyman
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CHAPTER 1

Individuals and Government

INSTRUCTIONAL OBJECTIVES

Chapter 1 is a general introduction to the field of public finance, emphasizing the relationship between individuals and government. The functions of government are outlined, and the importance of taxes in household budgets is highlighted. The chapter seeks to develop an understanding of the economic role of government as a supplier of useful goods and services. Students are also expected to digest data on the actual extent of government activity in the United States and other nations. They should know the current structure of government expenditures and revenues in the United States, how government has grown since 1920, and how the structure of federal government spending has changed since 1960.

In addition, the chapter seeks to demonstrate that the problem of scarcity implies that an increase in resources devoted to government goods and services decreases availability of resources for nongovernment uses. It is also made clear to students how government provision of goods and services differs from market provision of goods and services.

CHANGES IN THIS EDITION

Chapter 1 has a new introduction that discusses the growth in government spending, the impact of the recession on public finance on the federal, state and local government levels, and health care issues. All data on government spending and revenues have been updated to 2008 or the latest available year. Public expenditure data have been revised using the latest NIPA data for government consumption and investment documenting the rise in the share of the public sector to 35 percent of GDP since 2001. The data now include all years from 1929 to 2008 based on latest NIPA revisions. The *International View* on government spending has been revised and updated with the latest empirical data. Graphs have been redone to reflect the latest available observations. The discussion of the mix between transfer payments and government consumption has been revised to reflect changes in NIPA accounting. The growth in health care spending by the government has been documented showing that it is now the largest category and fastest growing category of federal government expenditure. More analysis of state government spending is provided in the revised *Public Policy Perspective* entitled “The State of State Finances 2009-2010: Impact of a Recession”. The impact of the recession on revenues and spending is discussed along with provisions of the *American recovery and Reinvestment Act of 2009*, the affecting state governments and the federal government mandates that influence state spending. The analysis of the implications of aging populations for public finance has been updated based on empirical analysis of the latest U.N. projections of changing world demographics.

CHAPTER OUTLINE

Individuals, Society, and Government

Governments and Political Institutions

The Allocation of Resource between Government and Private Use
How Government Goods and Services Are Distributed

The Mixed Economy, Markets, and Politics
Circular Flow in the Mixed Economy

International View: How Much Government? The Share of Government Expenditure in Modern Economies

Government Expenditures in the United States
Growth of Government Expenditures
Structure of Federal Government Expenditure

The Structure of State and Local Government Expenditure

Financing Government Expenditure in the United States

Public Policy Perspective: The State of State Government Finances 2009-2010: Impact of a Recession

Market Failure and the Functions of Government: How Much Government is Enough?

Aging Populations: Implications for Public Finance

MAJOR POINTS AND LECTURE SUGGESTIONS

1. My objective in the first lecture is to make it clear to students how economic analysis of the functions and activities of governments fits in with their other courses. Since most students have already had at least one course in microeconomics, I point out how governments can be thought of as agents for supplying goods and services whose quantities have been determined through political, as opposed to market, interaction. The role of government in the mixed economy is schematically illustrated with a modified circular flow diagram. Figure 1.2 represents a useful starting point for illustrating how the economic analysis of government fits in with previous analyses of markets to which most students will have already been exposed. I usually draw the diagram on the board and show how both households and business firms have economic relations with governments.
2. The tradeoff between government goods and services, and private goods and services is illustrated with the production possibility curve. Figure 1.1 is familiar to most students, and its application to analysis of government goods and services usually captures their attention. It helps to use the graph in class to discuss reallocation of resources from military to nonmilitary uses. Another interesting use of the graph is to show how increased environmental quality improvement services supplied by government will require the sacrifice of material goods and services, as the prices of such products as fuel, electricity, and automobiles rise.
3. Emphasize that government goods and services are usually made available through nonprice rationing: