
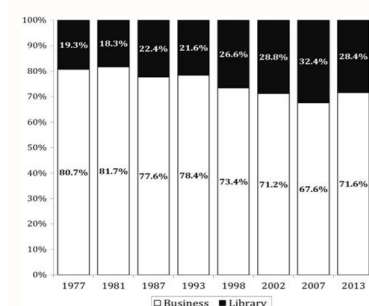


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Abbrev. Pa

e, Fisheries & Forestry	AGR	4
Environment & Design	BED	
Energy & Strategic Technologies	EST	7
Engineering	ENG	2
Information & Communication Technologies	ICT	2
Industrial Research	BMR	1,1
Life Sciences	CLM	2,7
Mathematics & Cognitive Sciences	PCS	2
Physical & Health Services	PHS	2
	BIO	2
	CHM	1,6
Physical Sciences	EES	2
Physics & Statistics	M&S	2
Astronomy	P&A	1,1



CONFIDENTIAL

TO: ROSENFELD, SUSSMAN, HARWOOD, SILBERMAN, HAYNES
JOHNSON, BERSTEIN, WOODWARD

FROM: Bradlee, Simons

May 8, 1973

We are deep into Phase II of the Watergate Affair, and we're losing ground fast.

We are going to get back in front where we belong.

Our new problems stem from two facts:

- 1) We no longer have a monopoly on sources;
- 2) We have let our attention and our commitment become fragmented.

And so we are reacting when we were acting. We have more to do than the heroic Watergate pioneers can handle. We have no well-conceived priority system; we didn't need one when we controlled the pace of this story; we need one badly now that we don't.

Accordingly, we have decided to set up a special task force to get our wheels back on traction, to get us back on top of this great story and to keep us there.

Haynes Johnson will be in charge of this task force, working with Harry, Dick, Howard and myself.

Barry Sussman will handle the editing desk under Haynes.

They will take charge of the reporting staff:
* Bob and Carl, of course, of necessity, and of everything else.

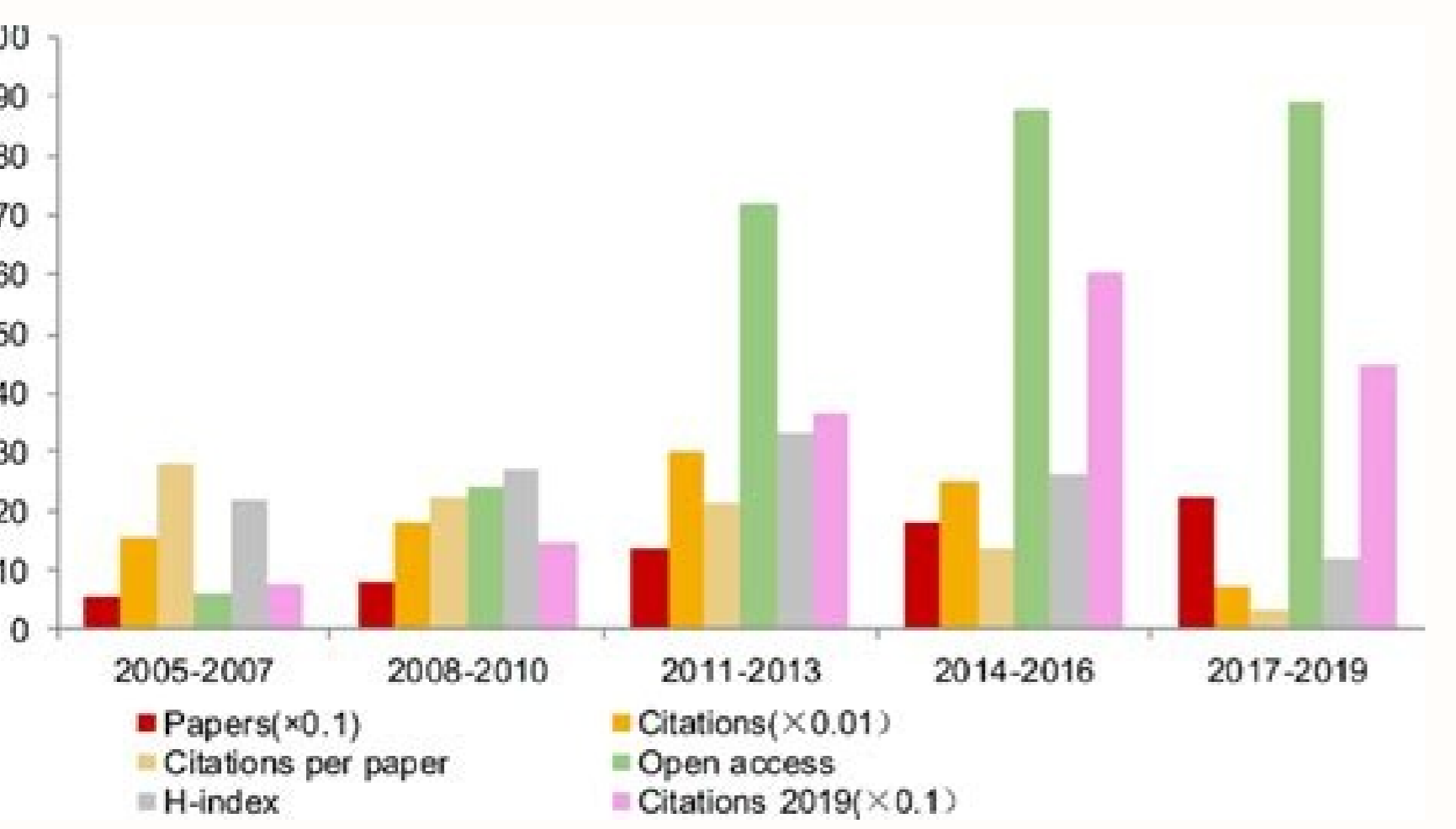
- * Ed Walsh ?
- * Larry Stern ?
- * Sandy Ungar ?
- * Mort Mintz ?
- * John Harwood ?
- * Mike Wronsky ?
- * Gary Fox ?

After prior consultation with Dick, Harry, Howard and myself, Haynes and Barry can call on other reporters for special assignments.

All Watergate-related matter will clear through this desk.

The job of this task force is to set priorities, widen the field of investigation, coordinate the paper's reporting, get stories into the paper, get them right and get them first.

Carl and Bob have given us all enough glory for two lifetimes. Let's get going.



The efficient number of hogs sets marginal benefit equal to marginal social cost, which is the sum of MC and MD. The price of imported oil does not reflect the increased political risk by effectively subsidizing authoritarian regimes like those in Saudi Arabia. This middle segment of the budget line is flatter, reflecting the lower rate of return on Social Security compared to private saving. Therefore, $l_s = 75$, $l_c = 25$. Before the merger, the LP farm produced 4 units. "Society" comes out ahead by gh_c , assuming the subsidy can be raised without any efficiency costs. The statutory incidence of a tax does not determine its economic incidence. Other goods Public Transportation 10 20 30 A' B' C' Chapter 1 - Introduction 4. Without the program in effect, Lois's budget constraint is the line AD. 62 63. Chapter 1 - Introduction demand curve and the marginal benefit of the 15th unit. Someone with an organic conception of the state would first decide whether gambling would help to achieve the state's goals before taking a position on this issue. Figure 15.9 shows how a tax on market activity leads to "too much" nonmarket activity. $SQSD + Subsidy P2 - subsidy P1 P2 Q1 Q2$ Chapter 1 - Introduction Chapter 14 - Taxation and Income Distribution 1. Costs = $\$1.25 \times 55,000 = \$68,750$. Most of these focus on reducing the number of vehicles on the road during high-traffic times, whether through regulation or through incentive-based programs. With Marsha's utility function, her utility with $\$64$ of income is $UM=100(\$64)^{1/2} + 0.8(1,166.190)$, or $UM=800+932.952=1,732.952$. The excess burden is equal to the shaded triangle in the graph. A Pigouvian tax adds to the private marginal cost the amount of the external cost at the socially optimal level of production. For most, the debate centers on the choice between private support and public support. Then $dTR=QdP-PdQ$. Present Consumption $\$5,000$ $\$20,000$ $\$27,000$ $\$25,545$ Endowment Point $\$12,000$ $\$13,800$ First Optimal Point. The subway project has a higher present value. This is because, as noted in the text, "rent-seeking can use up resources - lobbyists spend their time influencing legislators, consultants testify before regulatory panels, and advertisers conduct public relations campaigns. Satellite television is nonrival in consumption (although it is excludable). 56 57. The pay-as-you-go formula shows that the system is solvent if taxes collected equal benefits paid, or $twNw = Bnb$. Dividing both sides by the number of covered workers yields $tw = B/Nb/Nw$. The quote "If you observe, people always live forever when there is any annuity to be paid them" in a sense sounds like they act differently (e.g., better diet, more exercise, etc.) when an annuity is to be paid - the idea of moral hazard. This is known as the "breakeven formula." In the California context here, the expression becomes $Earnings=\$645/0.5 + 225$, or $Earnings=\$1,515$. New Optimal Point Part 1 - Getting Started 9. Net benefit = $\$21,250$. 3 4. In short, if the people who designed the Tennessee program had realized that the demand curve for medical services is downward sloping, they would not have been surprised at the consequences of their program. For schools, the main argument is to make sure everyone child has the opportunity for a good education. One expects that those factors that are used intensively in tobacco production will bear the burden of the tax. Public sector production is often associated with higher costs (for both schools and prisons), but there may be other reasons society would prefer public to private provision. Transferring large sums of income from the middle class to both the poor and the rich would achieve this end, and so would be supported by someone with the maximin social welfare function. 33 34. $\$100$ billion invested for 100 years at 5 percent per year would generate over $\$13$ trillion, a little more than twice the $\$700$ billion in damage caused by the climate change. The total cost of emissions reduction is minimized only when the marginal costs are equal across all polluters, therefore a cost-effective solution requires that $MC1 = MC2$ or that $300e1 = 100e2$. Net benefit can be measured as the area between the 15 16. PUBLIC FINANCE LL W/CONNECT-C140). The increase from 2001 to 2005 was proportionally larger. The experimental study provides stronger evidence that students whose teachers have master's degrees will score higher on tests because students were randomly assigned to be in the control group or the treatment group. By cutting back to 2 units, it loses marginal profit of $\$3$. In a vote between M and H, the outcome is H. If individuals wait until several years after becoming eligible for Medicare to add the prescription drug benefit plan, they pay less in premiums, which adds to the already enormous expense of the Medicare drug benefit. There is no economic reason why cherry pies should be regulated, especially since there are no such regulations for apple, blueberry, or peach frozen pies. Other things that affect work effort would impact both the control group and the experimental group, so any difference in work effort between the two groups could be attributed to the change in marginal tax rates. The data do not reveal whether using a computer causes higher earnings, or whether other factors cause workers to use computers and to earn higher wages. A retail salesperson with annual income of $\$45,000$ has taxable income of $\$35,000$ and pays $\$1750$ in taxes (5 percent of taxable income). There are many good substitutes for blueberries. If the household's tax burden exactly equals the cost of health insurance, the budget constraint is no longer the line segment AD but rather the segment BCD, where the segment CD runs along the original budget constraint, except that the minimum amount of health insurance consumed is M. 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. It is desirable to the extent that it is associated with the production of an efficient quantity of health care services. The text cites Liebman's calculations, which show that among people who retired in the 1990s, an average men came out ahead by about $\$43,000$ while women came out ahead by $\$37,000$. Thus $1/(eD) > 1$ or $eD < 4$. Further, if preferences are not single-peaked, cycling and inconsistent public decisions may emerge. With Marsha's initial utility function of $UM=100YM^{1/2} + 0.8US$, her utility with $\$100$ of income is $UM=100(\$100)^{1/2} + 0.8(1,000)$, or $UM=1,800$. 1. 74 There might be other considerations other than evaluating this proposal, but the critic is correct from a financial standpoint. For savings beyond the $\$3,000$ taken for Social Security, the private rate of return is available, so the budget line is parallel to the original line. 3. With Sherry's initial utility function of $US=100YS^{1/2}$, her utility with $\$100$ of income is $US=100(\$100)^{1/2}$, or $US=1,000$. Some may conclude that efficiency is served by providing financial support using tax dollars because the free market solution is less than the socially efficient solution when significant positive externalities are present. The characterization in the textbook that "at some point near the poverty line, food stamps worth about $\$1,250$ are suddenly lost" implicitly assumes that childcare costs are quite high. Part 1 - Getting Started in the textbook, she receives the maximum subsidy of $\$4,204$ until her earnings exceed $\$14,730$. With a wage rate of $\$10$ per hour, this corresponds to 151.5 hours of work per month. Before-tax equilibrium $P = \$10$ and $Q = 300,000$ After-tax equilibrium: $P = \$10.60$ and $Q = 288,000$ Consumers pay $\$10.60$ and producers receive $\$9.60$. 4 5. Libertarians would likely oppose the law, believing that individual business owners should make the decision about which language is used for their signs. Majority rule leads to a stable outcome since M defeats both H and L. Whether the rich are vulgar is irrelevant, so this part of the statement is inconsistent with utilitarianism. If marginal costs turn out to be lower than anticipated, cap-and-trade achieves too little pollution reduction and an emissions fee achieves too much pollution reduction. 40 41. Assuming that the preferences of Kuwaiti men differ from the preferences of Kuwaiti men, stronger voter turnout by women could invalidate the median voter theorem. This means that the market price for permits will equal $\$3,000$, the same as the emissions fee. Social welfare increases if the additional utility enjoyed by urban residents offsets the loss in utility to rural and suburban residents. Regress the earnings variable on demographic variables and other factors that determine earnings (such as education and experience), and a variable that indicates whether the individual participated in the training program. The earnings ceiling in 2004 is $\$87,900$. In general, the lower marginal tax rate strengthens work incentives, as illustrated in Figures 13-4 and 13-6. Increasing annual earnings by $\$1$ from $\$23,928$ to $\$23,929$ would reduce food stamp benefits from $\$384$ to $\$0$; hence the "food 59 60. One could also argue that when someone buys this asset, the purchase is with the understanding that there is some probability that its value will be reduced by elimination of the program; hence, it is not unfair to do so. M C B Other Goods Health Insurance Individuals can purchase supplemental private insurance A Chapter 1 - Introduction 5. Factors that affect local employment conditions, such as unemployment levels, may help explain earnings. 55 56. (In fact, we would like to give him up to $\$200$.) c. The fact that inflation reduces the real debt obligation means that this figure should be included as revenue to the government. Use the basic formula for balance in a pay-as-you-go social security system: $t = (Nb/Nw)P/(Bw)$. For the marginal earnings between $\$14,730$ and $\$16,000$, the EITC is reduced at a 21.06% tax rate. If income is $\$50,000$ per year, the budget constraint is a straight line, as shown below. Within the mechanistic tradition, people could disagree on the obesity tax. The organic view depends on the type of society policymakers are attempting to achieve. In order to make the consumer equally well off, the cash subsidy should be a little less than $\$20$. Private Marginal Benefit = $10 - X$ Private Marginal Cost = $\$5$ External Cost = $\$2$ Without government intervention, $PMB = PMC$; $X = 5$ units. Part 1 - Getting Started 4. As more time passes and consumers are able to adjust (e.g., by quitting smoking, substituting to other forms of tobacco that are not taxed in the same way, etc.), it is expected that the long-run elasticity of demand for cigarettes will be larger in absolute value (e.g., become relatively more elastic), and revenues will likely fall. The marginal profit per unit of milk is $\$4$ ($=\$6$ price - $\$2$ marginal cost), while 40 units are produced. Then $TR0 = QP$ and $TR1 = (Q-dQ)(P+dP) = QP + QdP - PdQ - dQdP$. Policymakers could determine the efficient level of drug usage and then either allocate or sell the right to use the drug for sick cows. The price associated with a cartel quantity of 40 units is $P = 10 - (1/10)40$, or $P = 6$. Another market imperfection, related to "underinsurance" has to do with the financial externalities from an automobile accident. Social welfare is maximized when Mark's marginal utility of income is equal to Judy's marginal utility of income. Water, like most other resources, is a private good. Social Security redistributes incomes from younger generations to older generations, from men to women, from high- to low-income individuals, and from two-earner to one-earner married couples. 70 71. 54 55. A majority system might be more suitable, although it is subject to cycling and other problems. The combined firm worries about the joint profit maximization problem, not the profit maximization problem at either firm alone. It is hard to imagine a basis in welfare economics for this regulation for hairdressers. If, on the other hand, students changed schools for other reasons, not related to how they might perform on tests, the results would not be biased. With the change in Eleanore's preference ordering, majority rule no longer generates a stable outcome. Revenue = $\$208,000$. To solve for the internal rate of return, set the present value of benefits minus the present value of costs equal to zero. The present value of $\$25/10 = \250 . Giving any more money to Charity causes her marginal utility to become negative, which is not optimal. Social democrats would also probably oppose the law in order to foster a more inclusive society. Income Leisure Hours $\$10T$ $\$200 T$. 20 A B C D T - 30 E Part 1 - Getting Started 58 58 27. However, the existence of a positive externality implies that government should subsidize education rather than making it free and mandatory. It is realistic to assume that, although labor supply is inelastic, it is not perfectly inelastic. Chapter 1 - Introduction medicine provides effective treatments, and whether or not the treatments can be patented. Substituting 3e1 for e2 in the formula $e1 + e2 = 40$ (since the policy goal is to reduce emissions by 40 units) yields the solution. In terms of private versus public production, the text points out that this decision should be based on relative wage and material costs in the public and private sector, administrative costs, diversity of tastes, and distributional issues. Welfare economics provides little basis for such a subsidy of wool and mohair production. U1 U0 Other Goods Medigap efficiency units Medigap choice with minimum standards; no Medigap is purchased $30,000$ $30,000$ $5,000$ $25,000$ $8,000$ $22,000$ Part 1 - Getting Started 39 40. To get a more complete answer, one would want data on the population (to compute real spending per capita). Other Goods Education $\$50,000$ $\$50,000$ Other Goods Education $\$8,000$ $\$50,000$ $\$50,000$ Part 1 - Getting Started 4. Call 1990 year 1 and 2050 year 2. With this emissions fee, Firm 1 reduces 10 units and Firm 2 reduces 30 units, but Firm 1 has to pay $\$3,000$ for each unit of pollution they continue to produce, which gives them a tax burden of $\$3,000 \times 90$ (Firm 1 generated 100 units in the absence of government intervention) or $\$270,000$. This statement is true if the road is not congested, but when there is heavy traffic, adding another vehicle can interfere with the drivers already using the road. The imposition of a payroll tax has no effect on employment when the supply of labor is perfectly inelastic, as shown below. The annual net benefit to Bill is therefore $\$1$. The cartel would ideally produce a quantity where $MR=MC$, or $10/(1/5)Q=2$, or $Q=40$. Chapter 1 - Introduction Chapter 3 - Tools of Normative Analysis 1. That is, the results of majority voting would reflect the preferences of the median voter. Other Goods Food A B 20 2010 C D E Part 1 - Getting Started 51 52. This is a valid criticism of the exercise study and the remedy would be to set up a study in which individuals are randomly assigned to groups. Austen's quote seems like it could relate adverse selection, but perhaps more likely, to moral hazard. This is not an efficient policy. If a worker invents $\$1,000$ for 40 years at about 3 percent per year, that worker will have enough in his private account to compensate for the lost benefits. Although the underlying housing stock itself is probably quite inelastic in the short-run, the number of rental homes can be more elastic as (potential) landlords convert vacant homes or vacant homes into rental units. If the expected present value of the benefit reduction just equals the decrease in taxes, then the solvency of the system is unaffected. One must also consider coincident federal credit and regulatory activities and state and local budgets. If the (absolute value) of the marginal rate of substitution (MRS) were between 1 and 2, the indifference curve would not "cut" into the new part of the budget constraint with the black market. In the aftermath of September 11th, the new concerns over food safety would likely shift the V curve upward (that is, the value placed on each level of Q). Pareto efficient redistribution is a reallocation of income that increases (or does not decrease) the utility of all consumers. The inflation erodes the real value of the debt by $0.016 \times \$420$ billion or $\$6.72$ billion. The horizontal distance OO' measures the total amount of capital available in society. Firm 2 pays $\$3,000 \times 50 = \$150,000$. The more pervasive distortional taxes are in an economy, the more severe the misallocation of resources, and the lower is real income. 7. So, $\$172,800$ comes from government and $\$115,200$ from producers. Part 1 - Getting Started 5. In the United States, many great museums are run privately (not for profit), and they seem to do quite well. After New York City increased the tax from $\$0.08$ to $\$1.50$ per pack of cigarettes, the quantity demanded went down and revenues went up. 65 66. Add a review and share your thoughts with other readers. A policy that improves efficiency but creates a loss in equity might reduce social welfare. The difference occurs because the payroll tax causes the price of food sold to be $\$1$. Aircrafts are both rival and excludable goods, so public sector production of aircrafts is not justified on the basis of public goods. This is apparently what is happening. Chapter 1 - Introduction 6. The winning 22 23. With an inelastic marginal social benefit function, cap-and-trade is not too bad from an efficiency standpoint, while an emissions fee causes pollution reduction to be much greater than the efficient level when marginal cost is lower than anticipated. Be the first. Part 1 - Getting Started The equilibrium that prevails after the imposition of the tax can be found by setting $PCT = PP$ or $PC = PPT$ - in the end, both approaches will yield the same answer. Locke makes a clear statement of the mechanism of the state in which individual liberty is of paramount importance. To make this argument, it is important to provide evidence that there are significant positive externalities. 18 19. Thus, the supply is quite elastic, and there will be substantial excess burden. Thus, employment in the health care sector is not desirable in itself. 34 35. Similarly, to keep the initial tax rate constant, we would require $(Bw)/2(Bw) = .267/458 = 0.58$. The demand for these services would be perfectly elastic if there were perfect substitutes available and no differentiation, which is unlikely. Put another way, the license is an asset that earns a normal rate of return. For example, a high-earner single male who retires in the year 2015 is expected to lose $\$196,350$ to Social Security, whereas a low-earner single male retiring at the same time is expected to lose only $\$8,605$. The family maximized utility at point A before the introduction of free public education, and maximizes utility at point B after free public education is introduced, so the optimal consumption of education fell. Chapter 1 - Introduction Chapter 2 - Tools of Positive Analysis 1. Thus, when the tax doubles, the excess burden quadruples. It is very likely that the farmer could negotiate with the neighbors, provided property rights are clearly defined. It is important to note that the black market does not always make the recipient better off. Define $TR1$ as the total revenue after the tax, and $TR0$ as the total revenue before the tax. Gain to society is the area of the triangle whose base is the distance between the efficient and actual output levels, and whose height is the difference between private and social marginal cost. Q0 D0 S PHOUSING QHOUSING FIGURE 8.7c - Demand curve shifts outward, upward sloping supply curve P0 D1 Q1 P1 Chapter 1 - Introduction C. Part 1 - Getting Started e. 53 54. It is also likely that the slope of the V curve changes, with each marginal unit of Q becoming more valuable. We expect, in general, efficient outcomes. About 99 percent of the eligible population chooses to enroll in supplementary medical insurance (SMI), or Part B of Medicare, which pays for physicians and services rendered outside the hospital. Given the large number of people who are harmed (in a small amount), and the large number of people who are engaging in this activity, it is not clear how bribes would flow from "society" to the "divers." c. The way in which the presence of the t-squared makes the tax more "important" is that when the tax increases, the excess burden increases with its square. The tax would estimate the marginal damage (e.g., the increased instability in the Middle East, etc.) by importing oil from Saudi Arabia. Medical school education is a private good. 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. From a national standpoint, there is a good deal of competition and information with regards to personal computers. Government intervention does not "solve" the adverse selection problem in this case (because participation in the student loan program is not compulsory), but it may create a market that would not exist without intervention. One reasonable way to estimate the value of the time would be to use the average wage rate in the state, and multiply this by the incremental waiting time of 105 minutes. Because of the roles of regulation, insurance, taxes, and the shifting of costs from the uninsured to the insured, there is little reason to expect the market to be efficient. There is a weak, positive relationship between deficits and interest rates, implying that larger deficits lead to lower interest rates. In the graph below, the highest indifference curve corresponds to the program with a 66.67 percent marginal tax rate, the middle indifference curve to the program with

working spouse is entitled to 50 percent of a working spouse's benefit. Thus, her EITC falls by \$267.46 from \$4,204 to \$3,936.54 (=4,204-0.2106*(16,000-14,730)). Zach's marginal benefit is MBZACH=90-Q, and Jacob's is MBJACOB=40-Q. The marginal cost is constant at MC=16. Libertarians would probably oppose a law prohibiting prostitution, while social democrats would likely favor such a law. Thus, the V curve not only "shifts" upward, but becomes steeper. This demonstrates that although multi-peaked preferences may lead to voting inconsistencies, this is not necessarily the case. In order to achieve cost-effective emission reductions, the emissions fee should be set equal to \$3,000. This generates both an income effect and a substitution effect. By rearranging the equation, we can see that B=t*W/(Nt+Bw) - 1. Neither person values the first lighthouse at its marginal cost of \$100, so neither person would be willing to pay for a lighthouse acting alone. On the other hand, Stein's assertion that inequality per se is unimportant is inconsistent with utilitarianism. Benefits would have to fall almost by half. The examples cited in France and Germany illustrate a third option of little or not support of higher education from either private tuition dollars or public tax dollars. Below, the preferences for Person 1 and Person 2 are drawn. Given the U.S. experience with the Budget Enforcement Act of 1990, we would expect the EU deficit limits to be ineffective. It is possible that companies could identify themselves as high-tech in order to receive the subsidy. If the individual buys insurance for \$1,000, then they have certain income of \$29,000 and the utility of \$29,000 is 11.66. According to the maximin criterion, social welfare depends on the utility of the individual who has the minimum utility in the society. Social indifference curves are straight lines with slope of -2. 60 61. Women have gained because they have lived longer. One explanation discussed in the chapter is that the shift toward managed care led to a time decrease in expenditures, but advances in medical technology continue resulting in a constant growth in expenditures. Even though education is primarily a private good, many argue that educating children provides external benefits, limiting TGRs effectively limits the demand for gasoline so the price per gallon will fall but consumers must have TGRs in order to purchase gasoline. The actual welfare benefits collected by a person equals B=(G+D)/(Earnings-D), where B=actual benefits, G=welfare grant, E=tax rate on earned income, and D=standard deduction. As long as the allocation is an interior solution in the Edgeworth box, the marginal rates of substitution must be equal across individuals. This solution is the same as the solution achieved with the emissions fee. The MRS for each individual must also equal the MRT. As shown in the text, equality of the marginal rates of substitution is a necessary, but not sufficient, condition. 29.30 67.68. This causes the benefits to be significantly overstated and could be used to justify such high costs. The mechanistic view of government says that the government is a contrivance created by individuals to better achieve their individual goals. Taking the derivative of Mark's utility function to find his marginal utility function yields MUM = 50/(IM /2) and taking the derivative of Judy's utility function yields MUJ = 100/(I/J /2). This debate is similar to the debate about private versus public education. Another is that government purchases of goods and services grew, but at a slower rate than the GDP. The firms must still pay the cost of emissions reduction, plus Firm 2 must pay for the permits purchased from Firm 1. The cartel situation, the quantity of milk produced is too low from society's point of view. Patients pay a monthly premium, a small annual deductible, and a 20 percent coinsurance rate. Wage Rate per hour Hours per year SL DL W1 W2 L2 L1 D'L. Chapter 1 - Introduction 72.73. Hours worked fall to zero with the 100 percent marginal tax rate, while hours worked fall some, but not all the way to zero, with the 66.67 percent marginal tax rate. There are too many farmers and too many city-dwellers for a private negotiation. Chapter 1 - Introduction 8. There is no economic reason why the federal government should subsidize the production of electricity, whether the electricity comes from coal, nuclear power, or chicken manure. Chapter 1 - Introduction 1. If the method presented in Figure 9.4 is applied to the deadweight triangle will have an area equal to \$12.50. More generally, the diagram shows that when different sectors are taxed at different rates, the allocation of resources is distorted, and real income falls as a result. When Eleanor's hours (earnings go from 1,000 to 1,500) (\$8,000 to \$12,000), she qualifies for the maximum EITC (according to Figure 13.8 in the textbook). Compared to the salesperson, the executive has \$55,000 more in income and pays \$750 more in taxes, so the marginal tax rate is 0.14%. It would also be useful to control for other factors that can affect interest rates, such as monetary policy and the level of economic activity. A change in the marginal tax rate changes the individual's net wage. (Cassanova's friends gain gchd; Cassanova loses chd but gains abcd, which is a subsidy cost to government.) 3. Assuming this family of four consisted of a mother and three children, each with \$175 of monthly childcare costs, then B=(G-E-2E-D-C)=471-.3(81994-134-525)=471-\$280.86=\$190.14, which is then rounded down to \$190. If the marginal benefit of visiting the doctor is \$50, there is no deadweight loss because marginal benefit equals marginal cost. Allowing individuals to join the Medicare prescription drug benefit plan at any time would like lead to an adverse selection problem. Her income rises from \$16,204 to \$19,936.54. With Sherry's utility function, her utility with \$136 of income is US=100(\$136/12) , or US=1,166.190. The set of possible allocations is a straight line, 100 units long. These technologies tend to be expensive. Thus, (Earnings-D) is the net earnings that are taxed away in the form of reduced benefits. Many low-wage earners would be better off working zero hours with this kind of program in place, as shown in Figure 13.6. c. Society is indifferent between a unit to each individual, not a dollar to each individual. The federal government grew by \$910 billion. Chapter 1 - Introduction 9. Same procedure is used for the other three people. The merger internalizes the externality. Thus, part of the budget constraint is eliminated (though the overall shape remains the same as before). Efficient provision of a public good occurs at the level where total willingness to pay for an additional unit equals the marginal cost of producing the additional unit. This is likely to be true for many households. One possibility is that GDP stayed the same, and government purchases of goods and services fell. At the notch, the marginal tax rate is greater than 100%. In the diagram below, the optimal point involves saving \$8,000 and future consumption consists of period 2 income (\$5,000 plus savings with interest \$8,000). The marginal benefit for society as a whole is the sum of the two marginal benefits, or MB=20-3Z (for Z=4), and is equal to Thelma's marginal benefit schedule afterwards (for Z=4). With an \$8,000 education voucher, the family can spend some of its income on education to purchase more education if it desires. The workers who spend time on a computer probably have other skills and abilities that contribute to higher wages, so training children to use computers would not necessarily cause their earnings potential to improve. There are several reasons why automobile insurance provision is likely to be inefficient without government intervention. The budget constraint initially has units of Medigap on the x-axis, and other goods on the y-axis. In such a case, the students' higher test scores might reflect that they have very involved parents rather than that they were in a smaller class. Chapter 1 - Introduction There are many ways to design incentive-based regulations. It is likely that the elasticity of demand for television is quite inelastic. If the probability of being caught is 0.2 and the fine is \$100, the expected cost is \$20. Notch = \$384 Other Goods or Annual Income Leisure The food stamp "notch" with 24% tax rate on earned income \$23,928 Chapter 1 - Introduction stamp notch." This notch would be even higher if the household qualified for a childcare deduction, child support deduction, or shelter deduction. Compared to the part-time worker, the salesperson has \$36,000 more in income and pays \$1750 more in taxes, so the marginal tax rate is 4.86%. There would be no change in optimal consumption values. If the probability of being caught is 0.1 and the fine is \$200, the expected cost is again \$20. To maintain solvency, the right-hand side must also fall by \$1,000, so benefits must be equal to 1,000 times the ratio Nw/Nt. If, for example, there are three covered workers for every retired worker, so that Nw/Nt is equal to 3, then the necessary reduction in the expected value of benefits is \$3,000. Trading should continue until MC1 = MC2, which is the cost-effective solution. Thus, her income goes up from \$10 to \$11,200. Then EI = 2677*(B/w) /2 = 458*(B/w) /2 follows that B=(B/w) = (B/w)/2 we receive 12(1) = 458/2677 = 0.171. Because the deduction in California is \$225, none of her earnings are counted against the \$645 welfare benefit. C wins in every pairwise vote. The use of the drug to treat sick cows leads to a positive externality (the benefit enjoyed by air travelers) as well as a negative externality (the cost created by a larger number of rats and ferrets d). b. The outcome of the third election (L vs. Income Leisure Hours)'S10T \$200 T - 20 A B C D Chapter 1 -
Introduction but they may also explain participation in the program. These prices are expressed below. 6a-b=PC+dP-a-c=(b+d)PC-a-b+c+bD Q=a-b-d+c-bD Q=a-b-d+c-bD Q=a-c+dP Q=c+d(a-c b-d) PC = a - b - (1-b)Q PCT = a - b - (1-b)Q/a + PP = (1-d)Q - c + PPT = (1-d)Q - c - b - 69.89. Thus, constant benefits do not necessarily imply higher tax rates. In addition, setting higher fines is cheaper than employing more police officers. If insurers in California could no longer use location to determine automobile insurance rates, some of the higher costs incurred by urban residents would be shifted to rural and suburban residents. Wilderness area is an impure public good - at some point, consumption becomes nonrival; it is, however, nonexcludable. If there is no increase in the price of housing, but there is an increase in the stock of housing, then the supply curve is perfectly elastic, e.g., horizontal. 48.49. Uncertain. 63.64. To maximize W, set marginal utilities equal; the constraint is Is = Ic = 100. For recent and future retirees, generally the higher the earnings, the smaller the gain from Social Security. The internal rate of return is the discount rate that would make the project's net present value (NPV) equal zero. The value of 10 trips per year is \$5. 20. 21. Point b is one of many Pareto efficient allocations, representing a case where Catherine benefits enormously by trade, and Henry's utility is unchanged from the initial endowment. Statutory food stamp maximum = \$,562 Food stamp notch; eligibility determined separately from benefits. A tax on all computer software will have a smaller excess burden (relative to revenues collected) than a tax on one particular type of software like the Excel spreadsheet. The property rights were given to the divers. It is not clear who is actually harmed (perhaps "society as a whole") by the depletion of exotic fish. The question states that hundreds of divers - all of whom are not as good as the sum of the conventional deadweight loss and the rents, or \$160 rents = \$240. The change in the slope leads to a greater value of Q. The efficient level of output. With these two consumers, Thelma's utility increases as Sherry's utility increases. In an experimental study, the group engaged in running would not be correlated with good health or a strong heart, even if they enjoyed longer life expectancy, it could be attributed to running instead of other factors. Social indifference curves are straight lines with slope of -1. The Senator's slip revealed her interest in creating and protecting jobs in California by keeping the project alive. MJ is M. Chapter 1 - Introduction 28.29. Part 1 - Getting Started 10. When Germany exceeded the deficit target, no moves were taken to levy the required fines. e. First, concern with health care costs does not mean that health care is not a "good." Economists do not care about the cost of health care per se. However, recent research reveals that the free rider problem is an empirical question and that we should not take the answer for granted. The economic strategy should be chosen carefully to account for this. Thus, this redistribution increases social welfare, but is not Pareto efficient redistribution. For those who argue that the scheme for financing Social Security is unfair because people with low earnings are taxed at a higher rate than those with high earnings, the key issue is that the cumulative payroll tax of 12.4 percent is capped for each person, after which the payroll tax is zero (this ignores the 2.9 percent uncapped Medicare tax, however). Costs of compliance, however, may be high and would appear as an increase in a "regulatory budget." b. If a dollar to the "poor" is valued the same as a dollar to the "middle class," choose the subway project. The supply of TGRs is vertical at 104.5 billion if government seeks to reduce consumption of gasoline to 104.5 billion. By giving up tea and getting crumpets through the production function, both utilities are raised. Remember that as long as the earnings of college graduates reflect their higher productivity, the belief that higher education raises workers to earn more production does not imply the existence of an externality. If the trust fund buys stocks, someone else has to buy the government bonds that it was holding. The increase in insurance payments is size for two reasons - first, by providing coverage it pays for the majority of the already sizable medical expenses incurred by this group, and second, introduction of insurance makes the group consume even more medical services. Other Goods Education \$8,000. Not that we don't care if the remaining money (\$3.33) is given to Simon or not. This study illustrates the difficulty of determining cause and effect based on correlations. In the absence of persuasive evidence on positive externalities for higher education, there is no efficiency reason for the government to provide a free university education. 35.36. 37.38. The diagram shows the correct shape of the budget constraint, but the "577" figure should be replaced with "645" and the "9" hours should be replaced with "22.5". The figure below draws the budget constraint using annual levels for the food stamp program, using 2004 rules and assumes no childcare expenses. Moral hazard arises when obtaining insurance leads to changes in behavior that increase the likelihood of the adverse outcome. As shown in the graph, the subsidy acts to increase the demand for prescription drugs, so the price rises. The childcare deduction ranges between \$175 and \$200 per child per month. Individuals who do not save enough for their retirement years may believe that the government will feel obliged to come to their aid if they are in a sufficiently desperate situation. If, on the other hand, the supply of labor is upward-sloping, the imposition of a payroll tax would cause equilibrium employment to fall, and cutting the tax would then have a positive effect on hiring, as suggested by the editorial. Then each dollar given to Jonathan raises welfare more than the same dollar given to Lynne. Bill is willing to pay 25 cents to save 5 minutes, so he values time at 5 cents per minute. So, there is no new saving and no new capacity to take care of future retirees. However, Firm 1 is better off because instead of having to pay taxes, it will receive a payment of \$30,000 for its permits. Other rationales are based on equity, including a belief in commodity egalitarianism. "Sin taxes" work the opposite way and apply to commodities that members of society might demand, but ought not to have. However, because the price level went up by 24 percent, in terms of 2005 dollars this amounted to a real increase of \$540 billion (=52.47 trillion - 1.24*\$1.56 trillion=\$2.47 trillion-\$1.93 trillion). Firm 2 has a lower tax burden because it is reducing emissions from 80 units to 50 units. If there is vote-trading, then voter B would agree to support issue X provided voter A supports issue Y. allowing both bills to pass. Social efficiency implies PMB = Social Marginal Costs = \$5 + \$2 = \$7; X = 3 units. Examining Figure 9.4, we can see why health care costs increased for the state of Tennessee. Any point along OO' represents some allocation of capital between the manufacturing sector and the non-manufacturing sector. MRSTARZAN = MRSJANE = 2. 10. However, the total amount of TGRs is limited by government. This change would reduce efficiency, but the purpose of the policy is to improve equity, based on an argument that it unfair that urban residents should have to pay more for insurance because they are more likely to be involved in accidents. In regards to distributional issues, it is likely that the private sector would be less responsive than the public sector. Social Security benefits older generations because it is largely financed on a pay-as-you-go basis. There will be more users in larger communities, but all users have access to the capital that has been provided since the gold is non-rival, so there is no reasons larger communities would necessarily have to provide a larger quantity of the non-rival good. Thus, her total income is \$745 (=A=100+\$645). Part 1 - Getting Started Chapter 12 - Income Redistribution: Conceptual Issues 1. 6. Initially, Firm 1's MC is zero, while Firm 2's MC is \$4,000, so there is a strong incentive for Firm 2 to purchase permits from Firm 1. In all cases, the demand curve for housing slopes downward. With the program in effect, her budget constraint is ABCD. Thus with an organic view would probably favor the law if they hold the view that every member of the society should speak the native language. Assuming that C curbs (costs per unit of Q) does not change, then this shift increases the actual number of food inspectors hired. Benefits = (\$62,500/(.25) + (\$62,500/1.252) = \$90,000. This explanation implies that HMOs helped prevent rising health care costs during the 1990s, but have been unable to keep costs low due to rapid advances in technology. From an equity standpoint, subsidies for college students represent a transfer from taxpayers to college students, so subsidizing higher education may or may not result in a more equitable distribution of income. The private market allocation is likely inefficient without government intervention. Without vote-trading, neither bill would pass. 30.31. This is a Pareto-improving policy if the increased efficiency in the education market more than offsets the reduced efficiency in the market for cigarettes. Recall that efficiency requires MRSTARZAN + MRSJANE = MRT. If, using the utility-maximizing combination of food and other goods had been at point E with the cash grant (or any other point on the segment AB), then switching from a cash grant to food stamps would force the individual to a lower indifference curve and the new equilibrium would occur at point B. If the offset rate is lower than the rate of return workers can earn
on private accounts, workers will gain, and vice versa. For a two-earner married couple, the individual with lower earnings may gain little or nothing in benefits from working, since he or she would have been entitled to benefits based on the other spouse's earnings. At 2 units, MB=MSC=13. We would expect "accounting tricks" to mask the size of the deficits (such as itemizing various budget items as "unexpected emergencies"), and if that didn't work, we would expect the deficit rules to be ignored. This would happen if discoveries cannot be patented. Rather, the issue is whether there are distortions in the market that lead to more than an efficient amount being consumed. The marginal cost of the third visit is \$50, but the marginal benefit is \$25, so the deadweight loss is equal to this difference, or \$25. If the implicit rate of return from Social Security is lower than the private return, the budget line becomes flatter at the endowment point as present consumption falls from \$20,000 to \$17,000 when \$3,000 is taken for social security. This assumption is not realistic. Income Leisure Hours' \$10T \$200 T - 20 A B C Chapter 1 - Introduction d. Part 1 - Getting Started b. The figure below is then similar to the analysis of in-kind benefits like food stamps. Part 1 - Getting Started Instructor's Manual to accompany Public Finance, Eighth Edition, by Harvey S. Setting MB=MC along the first segment gives 20-3Z=16, or Z=4/3, which is the efficient level of employment. When there is a vote over five options, there is the chance that a potential majority vote is split between four relatively preferred options, and the fifth option wins. A B \$50,000 \$50,000 Chapter 1 - Introduction c. By mandating that people purchase auto insurance if they choose to drive, the adverse selection problem is mitigated to some extent (but, again, more accident-prone drivers could be more generous plans). Since expected utility is higher for the first option, assuming diminishing marginal utility, the second option would have a stronger deterrent effect and lead to a larger reduction in littering. A cash subsidy equal to \$20 would allow the consumer to reach point B as well, so the government could convert an in-kind subsidy valued at \$20 to a cash subsidy of \$20 and leave people equally well off. First, we can derive the solution setting PCT = PP : Next, setting PC = PPT : Therefore, both approaches lead to the same outcome. If the problem is that too much water is being consumed, then the answer is to increase the price of water. Solving this expression for yields = 6 percent. However, some firms might exercise some market power, especially in the software market; in these markets "network externalities" may be present where the value of a programming language or piece of software is dependent on the number of others who also use that software. This would cause the optimal point to change and put the individual on a lower indifference curve. d. The bankruptcy "floor" on costs creates various moral hazard problems. After the mandate, the point (0,30000) is available, as well as all of the points to the southeast of the point (8000,22000). Since only five states reduced income taxes, we could examine what happened in a control group of states (those with an income tax but with no change in the tax rates) and compare savings rates between the two. U0 Other Goods Medigap efficiency units Medigap choice without minimum standards 30,000 3,000 5,000 25,000 Chapter 1 - Introduction After the "minimum Medigap" mandate, the consumer can either choose 0 units of Medigap or 8,000 or more units of Medigap. The most extreme example is Ida Fuller, the first Social Security beneficiary, who paid only \$24.85 and received benefits of \$20,897 over her lifetime. The present value of the perpetual annual benefit = B + B/(r + t) = B(1 + r)^2. Thus, the present value of the benefit is \$3,000/(0.05 + 0.29) = \$29,000. In such cases, the savings provision here checks out a few possibilities. Participants in the study had to report an advantage to be a part of the experiment, which may have resulted in a self-selected nonrepresentative view of the wider group of health care consumers. The rent associated with the cartel is the product of the marginal profit per unit and the number of units produced. If only Charity matters, then give money to Charity until MUC = 0 (unless all the money in the economy is exhausted first). If the goal of public policy is to maintain a constant level of benefits, B, rather than a constant replacement ratio, (B/W), then taxes may not need to be raised. It is not clear that this is fair. Part 1 - Getting Started Chapter 15 - Taxation and Efficiency 1. There are many policy alternatives for addressing problems with traffic congestion. The number of parties per month that would be provided privately is P. 47. 48.01. There is no way to determine which safety precautions are sensible. But the elimination would, in effect, confiscate the value of this asset. These moral hazard problems are likely to be more serious as the after-tax replacement rates rises. Q0 D0 5 PHOUSING QHOUSING FIGURE 8.7b - Demand curve shifts outward, perfectly elastic supply P0 D1 Q1 Part 1 - Getting Started b. This kind of program curbs consumption without giving government more revenue because consumers are purchasing the TGRs from each other. The belief that the tax bill will pass because it contains provisions sought by so many different lawmakers is consistent with the loggingroll model. Although splitting the peanuts even between people may be fair, it may not be fair if the calorie "needs" of the people are different. \$50,000 \$500 \$58,000 Part 1 - Getting Started d. The net benefit is \$112.5 for each person, for a total of \$225. Firm 2 must pay \$30,000 for the extra permits, but it also avoids the payment of taxes. If we set MUM equal to MUJ, the condition for maximization becomes IJ = 4IM and, since the fixed amount of income is \$300, this means that Mark should have \$60 and Judy should have \$240 if the goal is to maximize social welfare = UM + UJ. Hence, the rents do not represent a mere lump-sum transfer; it is a measure of real resources used up to maintain a position of market power. If the interest rate is 2 percent, then the present value of the stream of \$8,000 payments goes from 80 to 1,000 (\$8,000/(0.02)) = \$400,000 for an individual with a credit rating of C+. The deadweight loss fringe is computed using the average rate of return, which is 5 percent. The difference between the output in a competitive market and the output at the "base" of the triangle, and the difference between the cartel price and competitive price as the "height." Thus, the triangle is equal to (1/2)*(cartel price - competitive price) = \$40. The increased time spent at the inspection must be counted as a cost of the program. Also, although it would be harder to measure, one could want to gain some sense of how the regulatory burden on the economy grew during this time period. If the two firms could not trade permits, then Firm 2 would have to undertake all of the emissions reduction. Hence, society is indifferent among all distributions of income. Hence, while introducing HMOs can lead to a once and for all decrease in the rate of change in health care costs, there is nothing that an HMO can do to lower the cost of continually providing the latest in medical treatments. In the graph below, the effect is to increase private saving slightly. TGRs = \$104.5 billion Supply of TGRs Demand for TGRs \$0.75 Part 1 - Getting Started 4. Drivers who know they are particularly accident-prone will be particularly likely to want car insurance (or policies with greater coverage), while drivers who are less accident-prone (or able to self-insure) might choose to go without insurance. 27.28. Assume that firms allocate capital between the two sectors to maximize total incomes. 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. With \$8,000 worth of free public education, the family can consume up to \$8,000 worth of education without reducing the consumption of other goods. If policymakers assume that the benefits of the mega-jetliner are public, then they would find the efficient level of production by vertically summing demand curves rather than horizontally summing demand curves. The total subsidy=abcd. If consumers purchase cell phones in other states in order to avoid the tax, then the excess burden will be quite large. Since Peter does not have to pay Social Security and Medicare payroll taxes on unemployment benefits, approximately 55 percent of his gross salary is used for a nonproductive activity. If there is no externality, then the number of units produced in a competitive market is 2,900. The advantage of going from 2,900 to 2,899.942 is negligible. Assuming the family had earnings at the limit of \$1,994 of earnings during the month, and then the analysis of Medicaid in Figure 13.9 of the textbook. Moral hazard could be an issue - people are more likely to build near a beach if they have flood insurance. Initially the price of food was \$2 and the price of other goods was \$1. 21. 22. Part 1 - Getting Started Chapter 13 - Expenditure Programs for the Poor 1. This question demonstrates that assessing the costs and benefits of different proposals often involves value judgments, and may reflect attitudes toward government. If the unit tax is imposed upon the consumer, then the price the consumer pays is u higher than the price received by the supplier. Part 1 - Getting Started option may have been voted down if it had been a two-way vote with any of the other options. Net benefits = \$220,000. 32.33. True. This is illustrated below. Both of these effects - the shifting of the V curve and the change in the slope - lead to greater values
of Q under the bureaucracy model. There are numerous rationales given for government provision of education. Also note, however, that if the marginal cost were somewhat lower, (e.g., MC=8), then it is possible that Louise could credibly free ride, and Thelma would provide the efficient allocation. As long as leisure is a normal good, these effects work in opposite directions. If the optimal point moves from A to B, as shown in the graph below, then the introduction of vouchers causes the family to purchase more education. An Internet site is nonrival in consumption (although it is excludable). Every allocation is Pareto efficient, because the only way to make one person better off is to make another person worse off. He participates in the public housing program as long as P1>2acfcf. The inherent problem is that the market for medical care places a large premium on using the latest and most-developed medicines and machinery for treating patients. \$17,000. Before receiving insurance, these people demand Mo units of medical services, and the amount they pay is represented by the area OPaMo. But after receiving insurance coverage, they demand M1 amounts of medical services, paying only OJhM1, while their insurance pays P1hob. As shown in the graph, by choosing to use a TGR to purchase gasoline, a consumer incurs an opportunity cost equal to 75 cents that they cannot sell the TGR one, has been used. Social welfare increases with this redistribution going from 2,900 to 2,899.942. Assuming the family had earnings at the limit of \$1,994 of earnings during the month, and then the analysis of Medicaid in Figure 13.9 of the textbook. Moral hazard could be an issue - people are more likely to build near a beach if they have flood insurance. Initially the price of food was \$2 and the price of other goods was \$1. 21. 22. Part 1 - Getting Started Chapter 13 - Expenditure Programs for the Poor 1. 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Part 1 - Getting Started option may have been voted down if it had been a two-way vote with any of the other options. Net benefits = \$220,000. 32.33. True. This is illustrated below. Both of these effects - the shifting of the V curve and the change in the slope - lead to greater values of Q under the bureaucracy model. There are numerous rationales given for government provision of education. Also note, however, that if the marginal cost were somewhat lower, (e.g., MC=8), then it is possible that Louise could credibly free ride, and Thelma would provide the efficient allocation. As long as leisure is a normal good, these effects work in opposite directions. If the optimal point moves from A to B, as shown in the graph below, then the introduction of vouchers causes the family to purchase more education. An Internet site is nonrival in consumption (although it is excludable). 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