PREFACE

Revising a textbook is not unlike renovating your home. Certainly, the motives are the same. You want to bring it up to date and add new features, remove things you don't like, develop a new appearance and impression, and improve functionality, flow, and continuity. Of course, you also want to make the final product more attractive to potential buyers. Added to this is a conflicting desire to maintain the integrity of the original structure as well as to preserve the tried, true, and familiar. The main difference, at least in the case of a public finance textbook, is sheer necessity. People can choose whether or not to renovate their homes, but in the fast-changing world of public finance, textbook material becomes obsolete in short order. It is a matter of revise or demise. One example is the federal budget. When I wrote the first edition, unified budget deficits of over $100 billion had been the norm for twenty years. In the second edition, it was necessary to address the issue of actual and projected surpluses large enough to pay off the entire national debt within a decade.

Revision and renovation have some other things in common. At the planning stage, ambition runs wild and no change seems too big. Later, reality sets in and you begin to wonder if, perhaps, a certain room (or chapter) does not need a complete makeover. But midway through the renovation, you are overwhelmed by the disarray and wish you had left things the way they were, or could start afresh with a whole new blueprint. You have nagging doubts about whether the object of your attention will ever be whole again, and, if it is, whether the patchwork will show. I hope that all traces of construction are gone and that instructors familiar with the first edition will find this not just a different book, but a better one.

NEW FEATURES IN THE SECOND EDITION

Authors sometimes experience a flicker of guilt in preparing a new edition. Was this new edition really needed, or is it just a marketing ploy? I have no such feelings. As a remodel, the second edition of *Public Finance and the American Economy* is an ambitious undertaking. The changes are too many to enumerate, so I will simply highlight the main ones.

Brand New Chapters

In addition to other changes, there are two whole new chapters. A new Chapter 7 contains a systematic description of the theory of government redistribution and a complete analysis of the different reasons for government transfer programs. There is also new information on the existing distribution of income and wealth, including cross-country comparisons. The chapter explains in more detail than most the benefits and costs of redistribution and the equity-efficiency trade-off.

Chapter 17, another new chapter, outlines the main options for federal tax reform, including the national retail sales tax and other reform proposals in the news, such as the flat tax and the consumed-income tax. In each case, the efficiency, equity, and administrative implications of the reforms are identified and analyzed. The cases for and against taxing consumption rather than income are fully discussed, along with the different methods of taxing consumption. Reforms that would shift the tax system toward taxing wealth or taxing pollution are also described and analyzed.

New Material Added in Many Chapters

Many chapters have been changed and rewritten to make them more interesting and exciting for students to learn and instructors to teach. For example, Chapter 3 on public goods now includes the theory of privately provided public goods and a discussion of the use of electronic tolls to reduce road congestion. Chapter 4 on externalities looks at the U.S. experience with traceable permits in sulfur dioxide and other pollutants. Chapter 8 on the antipoverty programs describes the recent welfare reforms in depth and has an expanded section on new methods of measuring poverty. Chapter 9 on Social Security and Medicare has extensive coverage of the potential reforms to these programs, including privatization. The chapter also describes the experience of other countries that have tried different reforms.

Chapter 10 uses the topical issue of tobacco taxes to explain the basic theory of an excise tax, and Chapter 11 contains a diagrammatic explication of Harberger's general equilibrium model of tax incidence. Chapter 12 features a new treatment of the issue of tax fairness and also uses the methods of tax policy analysis to explain the double dividend of environmental taxes. In Chapter 13, the "marriage tax" debate receives additional coverage. The chapter also includes new material on the problems of measuring income for tax purposes. A summary of new methods and research on the effects of income taxes on the labor supply is found in Chapter 14. The difficult material on business income taxation in Chapter 15 has been revised extensively to make it more interesting for students to read and easier for them to understand. The chapter also has a new section on "corporate welfare."

Economic events forced me to make extensive changes to Chapter 16 on federal budget surpluses and deficits. The causes and effects of current and projected federal budget surpluses are explained in detail, and the chapter examines the relationship between the surplus and the problem of "saving" the Social Security program. The chapters on state and local public finance have been consolidated into a single section for greater continuity. Chapter 18 on state and local expenditures has expanded coverage of spending on education, including research on school voucher experiments. Chapter 19 discusses the latest developments in state and local taxation, with new material on the hot topic of internet taxation.

New Internet Sources and Exercises

What a difference three years make. the first edition, I spent countless hours in the basement of the library, looking up data in obscure and hard-to-find documents. In preparing the second edition, I spent numerous hours surfing the internet for the most current data and interesting issues to include. In the process, I discovered that the internet is a terrific research tool for students of public finance. At many sites, data on government spending and taxes are readily and freely available, sometimes in spreadsheet form. To name a few, at different sites can be found the entire Federal Budget, the *Statistical Abstract of the United States,* the *Green Book on Entitlements,* and the statistical appendix to the *Economic Report of the President.* The internet is also a great place to find government policy documents and studies, as well as analysis by many "think tanks" with an interest in government policy.

Because I want to share with my readers the dozens of useful sites I located, I have added copious references to internet sites within each chapter. Also, to give students practice in using the internet as a research tool, I have designed *internet exercises* for each chapter. Each exercise directs the student to an interesting and useful site, and asks him or her to answer questions or analyze a policy issue based on the information found there. In some cases, the student can actually perform government policy simulations, such as changing the tax system from an income tax to a sales tax.

New Case Studies

Engaging the student in learning was a major goal of the first edition. I have tried to enhance participatory learning in this edition by adding case studies to each chapter. In each chapter, two sections titled "A Case in Point" apply the material learned in the chapter to a real-world problem. Each case is followed by questions designed to provoke students into thinking more deeply about the issue and are also useful for generating informed classroom discussion. Many cases are based on all-new material. In Chapter 1, a case examines the government's balance sheet and the question of government solvency, and in Chapter 2 a case on the deadweight loss of Christmas illustrates the concept of deadweight loss. Chapter 4 presents a case study on tradeable pollution permits so the student can learn how these markets work in practice. Coalition busting is the subject of a case in Chapter 6, which explores the implications of nontransitive majority voting for legislative decision making. In Chapter 7, a case on measuring the marginal cost of redistribution is used to explain the equity-efficiency trade-off. A case in Chapter 8 requires the student to estimate the cost of expanding Medicaid to cover everyone without health insurance, and Chile's privatized social security system and Canada's single-payer health system are the subjects of cases in Chapter 9. The "case of the double dividend" helps students understand the material they learned in Chapter 12, and a case in Chapter 17 estimates the rate of tax needed if the federal government were to adopt a national retail sales tax. In other cases, I have expanded on examples used successfully in the first edition.

CONTENT AND ORGANIZATION

Despite the many changes in the second edition, I have endeavored to preserve the main content and organization of the first edition. The book is organized traditionally, with the chapters divided equally between spending programs and revenue policies. Although I have followed the usual approach of presenting the spending topics before the tax topics, the chapters are written so that instructors who prefer to cover taxation first can do so without loss in continuity. As in the first edition, Part One provides an overview of the basic facts about government spending and revenue, and Part Two covers the theory of market failure, public goods, and externalities. One pedagogical change is that Part II now focuses exclusively on government policies that change the allocation of resources and the impact of these policies on economic efficiency. Issues and policies concerning equity and the distribution of income have been consolidated in Part Four to provide a more coherent treatment. Of course, efficiency and equity concerns are typically entwined in the real world of policy, but my experience has been that the systematic treatment of these different issues aids student learning and understanding. I have taken special effort, however, to explain and illustrate that efficiency and equity are often in conflict, which often causes disagreement about the best policies to choose. As in the first edition, Part III covers two aspects of the government decision-making process—public choice and benefit-cost analysis.

Part V introduces the basic theory of taxation, including the effects of taxes on markets, the incidence of the tax burden, and the methods for evaluating different tax systems. Part Six provides a comprehensive and completely up-to-date examination of the federal income tax system and its effects on the economy. In another organizational change, I bowed to convention and collected chapters on state and local public finance in Part Seven. In the first edition, the spending policies of state and local governments were covered in the first half of the book along with the other spending topics. This arrangement emphasizes my belief that the important subject of state and local government should not be relegated to the "back of the book." I hope that I have maintained my commitment to a greater emphasis on the state and local sector with two strong chapters, as compared to the single chapter devoted to the topic in other public finance textbooks.

In writing the first edition, I was guided by my belief that the subject of public finance is essential for interpreting and understanding the parade of fiscal events and proposals we encounter in the news practically every day. This is no less true in the second edition. For this reason, *Public Finance and the American Economy* stresses policy issues more emphatically than do many other public finance textbooks. At the same time, understanding these issues requires the appropriate background in economic methods. This text is written for students who have taken intermediate microeconomics, or at least a solid principles course that equips them with the requisite analytical tools, such as the indifference curve diagram. Nonetheless, the book should be accessible to students who have more limited backgrounds, provided that they are willing to do some preparation. I have used intuitive and diagrammatic explanations wherever possible, often coupled with numerical examples. More technically demanding topics, such as the private provision of public goods and the Harberger model of tax incidence, can be skipped without loss in continuity. The main Appendix can be used to review microeconomic theory, as deemed necessary.

I have attempted to write a book that students will enjoy and have taken every opportunity to pique their interest. The "Case in Point" sections are good starting points for generating classroom discussion on current policy questions, something that I have found highly productive in teaching public finance. The Instructor's Manual provides further help in using the case studies in a classroom context. Many of the problems at the end of the chapters are also designed with classroom discussion in mind, and the Instructor's Manual is again useful in developing these questions for classroom discussion.

Two problems that all public finance instructors face are the provisional nature of the results of empirical research and the highly politicized nature of many of the topics we teach. Policy advocates, of course, seem far more confident than economists in their knowledge of the way things are. In discussing the debatable empirical research in public finance, I attempt to make judgments without being dogmatic. I present empirical results that I believe to be relatively robust as if they are facts, but point out the uncertainties and defects in research that I find more problematic. Similarly, I avoid promoting my own political viewpoint but I have not avoided presenting the political arguments of others. I try to present the best arguments the two sides have to offer in any debate and leave it to instructors and students to decide which argument has greater merit.

SUPPLEMENTARY MATERIALS

An Instructor's Manual is available to adopters of the text. It contains chapter summaries, suggestions for organizing lectures and classroom discussions based on examples from the book, answers to the end-of-chapter discussion questions, and questions and problems suitable for problem sets, quizzes, and tests. The material in the Instructor's Manual draws on my experience in teaching public finance for more than twenty years and is designed to be helpful to both more and less experienced instructors.

The textbook also has a companion web site with content keyed to pages in the text. The site contains new questions and answers, discussion of public finance issues in the news, suggestions for reading, and links to data and information sites relevant to public finance. Visit the site at http://www.awl.com/bruce.

ACKNOWLEDGMENTS

Once again, I have been fortunate to receive comments, suggestions, and help from several sources. I would like to thank the reviewers of the second edition, who made wonderful suggestions that improved the book immeasurably. They were particu-

larly adept at picking up errors, omissions, and inconsistencies. Perhaps their biggest help was in keeping me honest when I was tempted to take shortcuts. I appreciate it now much more than I did at the time!

Barbara Burnell, The College of Wooster
Ismail Ghazalah, Ohio University
Jonathan Hamilton, University of Florida
Randall Holcombe, Florida State University
Renee Irvin, University of Nebraska—Omaha
Kate Krause, University of New Mexico
Genevieve Peters, University of California—San Diego
Todd Sandler, Iowa State University
Benjamin Scafidi, Georgia State University
Catherine Schneider, Boston College
Michael Wolkoff, University of Rochester

I would also like to thank the reviewers of the first edition. Without their earlier input, there probably would never have been a second edition.

Jim Alm, University of Colorado, Boulder
Gary Anderson, California State University, Northridge
John H. Beek, Gonzaga University
Robert A. Blewett, St. Lawrence University
Robert T. Bray, California State Polytechnical University, Pomona
Paul Farnham, Georgia State University
Robert Fischer, California State University, Chico
Mary N. Gade, Oklahoma State University
Gary M. Galles, Pepperdine University
Fred Giertz, University of Illinois, Urbana
Timothy Gronberg, Texas A&M
Jonathan Hamilton, University of Florida
Charles Hawkins, Lamar University
Thomas Ireland, University of Missouri, St. Louis
Alan Kessler, Providence College
David Kiefer, University of Utah
Bruce R. Kingma, State University of New York, Albany
Stephen E. Lile, Western Kentucky University
Jerry Miner, Syracuse University
Susan Parks, University of Wisconsin, Whitewater
George Plesko, Northeastern University
Thomas Pogue, University of Iowa
Esther Redmount, Colorado College
Paul Rothstein, Washington University
Jeffrey Rubin, Rutgers University
Daniel G. Rupp, Fort Hays State University
Bernard Saffran, Swarthmore College
Kathleen Segerson, University of Connecticut
Wendell Sweetser, Marshall University

David Terkla, University of Massachusetts, Boston
Richard Tresch, Boston College
Nancy White, Bucknell University
Nancy Williams, Loyola College

As always, my colleagues at the University of Washington were helpful and supporting. Laurent Martin, in particular, read several of the revised chapters and made many excellent suggestions. Thanks also to Robert Halvorsen, Shelly Lundberg, and Cindy Madden, who gave suggestions for the first edition, and Gregory Ellis of Seattle University who did the same for the second edition. Thanks to my students who were not shy about letting me know what they liked and didn't like in the first edition.

I would like to take this opportunity to rave about the folks I worked with at Addison Wesley Longman. Whenever authors complain about their publishers, I suggest they publish with Addison Wesley. It is a pleasure to work with their helpful and friendly staff including Joyce Consentino, who developed the eye-catching cover for this edition, and Jim Rigney and Katie Watson, the in-house production representatives. Thanks are also due to Scott Hitchcock and the production staff at Electronic Publishing Services, Inc. I want to express a special debt of gratitude to Mary Clare McEwing at Addison Wesley for her advice, suggestions, and, most of all, her timely encouragement when I most needed it. I would also like to acknowledge her amazing patience, which I am sure I tried severely as I missed deadline after deadline. Mary Clare, you are the best.

Finally, as always, none of the aforementioned people is responsible for any errors, omissions, and shortcomings that remain.