

Macroeconomics, Module 17: Government Expenditure

Homework Assignment: Current vs Future Taxes

(The attached PDF file has better formatting.)

Barro assumes people are indifferent between

- Paying higher taxes now for government services vs
- Borrowing now and paying higher taxes in the next generation.

This view is the Ricardian equivalence theorem. It is much debated among economists. Barro discusses the arguments for and against this view.

- Some economists (and most magazine articles) say that people have finite lives. A person may be happy to reduce taxes now and have the next generation pay higher taxes.
- Barro assumes people have children to whom they leave money. If they expect higher taxes on their children, they want to provide them with larger inheritances.

The debate is about the average taxpayer in the economy. Groups differ, and their attributes affect their preferences for current vs future taxes. Suppose taxpayers are of two groups:

- Social conservatives, with an average of three to four children per family.
- Secular liberals, with an average of one child per family.

The government may pay for its spending by increasing taxes now or by borrowing now and increasing taxes when the bonds come due.

- A. Which group would prefer to increase current taxes?
- B. Which group would prefer to borrow now and increase future taxes?

This homework assignment assumes *ceteris paribus* – all else is equal. In practice, other attributes differ between these two groups, such as average income levels and the benefits each group gets from government services.

Note: For most debates, Barro's perspective is mainstream U.S. economic theory or one of the dominant theories. For the Ricardian Equivalence Theorem, Barro's perspective is accepted by a minority of economists. Barro's justification (for the average taxpayer) is not persuasive for many readers.