Lesson 4: The Roles of Governments
Reading: Chapter 5

In this lesson we will:

- Learn under what conditions government intervention may be justified
- Discuss the roles and budget of the US government

Free markets are quite efficient at supplying most goods and services and, therefore, there is limited need for government intervention. **What makes market efficient?**

When should governments intervene?

- Governments need to provide public goods such as public parks, military defense, etc that markets are ineffective at providing because these goods are *non-rival* (they can be consumed by many) and *non-excludable* (we cannot prevent people from consuming them). Individuals have the incentive to use these goods w/out paying. **Examples of PGs?**
- The most important public good that governments provide is the protection of person and property through law and enforcement. **What would happen without protection?**

- Governments may need to regulate or create new markets for negative *externalities* such as pollution. Externalities occur when the production or consumption of one good imposes an uncompensated cost on a third party. **Think of examples of externalities.**
- When negative externalities are present, firms (individuals) tend to over-produce (over-consume). Governments can reduce the presence of externalities through prohibitions, quotas and taxes. **How do governments regulate smoking & drinking?**

- Governments may need to regulate the prices of uncompetitive markets, especially markets that are controlled by a *monopoly* (a single seller). For example, state governments often regulate the prices of utilities (as electricity and water) that are provided by a monopoly because it is more costly for multiple firms to provide them.
- Even when there is competition a government may want to regulate prices when consumers are not able to “shop around”, such as with taxis, etc.

- Governments may force manufacturers to provide information in order to better-inform consumers (such as calories per serving, etc.)

Government intervention is costly. These costs include the opportunity cost of the resources used, the bureaucratic cost of collecting taxes and administering the policy, and the deadweight loss created by the taxes that are need to implement the policy.

- Since 1929 government expenditures as percent of GDP (national income) has ballooned from 9.6% to 33.9% in 1980 and is now at about 30%.
- The US government spends 38% of its budget on transfer payments (social security, welfare and health care) and another 10% on paying the interest of its debt.

**Do you think the US government is too large or too small? On what programs should the government spend less money or more money**