Role of the Government/Government Spending/Transfer Payments

by Sophia Tutorial

WHAT'S COVERED

This tutorial will cover the role of government, government spending, and transfer payments, including opposing views regarding the amount of appropriate government intervention.

Our discussion breaks down as follows:

1. Role of Government: Points of Disagreement
2. Role of Government: Points of Agreement
    a. Public Goods
    b. Economic Stabilization
3. Government Spending: Counter-Cyclical Approach
4. Automatic Stabilizers

1. Role of Government: Points of Disagreement

Let's begin our discussion with a question: How much do you think the government should be involved in our lives? Well, obviously this is a topic that causes much disagreement among people.

Now, some of these statements are generalizations, but typically, Democrats are going to be in favor of more government involvement in our economic lives in terms of providing programs.

This means paying higher taxes sometimes, as again, Democrats are generally proponents of our progressive income tax system. A **progressive tax** is a tax that increases with income, so as you make more money, you actually pay a higher percentage of that income in taxes.

EXAMPLE Our state income tax system is a progressive tax system.

The reason it is a progressive tax system is that it funds the idea of some type of**income redistribution**. Income redistribution is defined as any kind of government policy that seeks to provide economic relief to low-income earners by providing transfer payments, like welfare and other benefits. These transfer payments are funded through our progressive tax system, by tax revenue generated from higher income earners.

On the other hand, Republicans, generally speaking, are going to disagree with this system. They typically like less government in our economic lives.

They understand that as a result, we will have fewer programs, but they want lower taxes and more control of the individual in our economic lives.

TERMS TO KNOW

Progressive Tax
Tax that increases with income; income tax is an example

Income Redistribution
Government policy that seeks to provide economic relief to low-income earners by providing welfare and other benefits (transfer payments) funded by tax revenue generated from high-income earners

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2. Role of Government: Points of Agreement

Now that we have covered the points of contention about the government's role in our lives, let's move on to matters that most people can agree on.

First of all, most people in our country agree that the government does need to be involved in order to provide *some things*, such as national defense and police protection.

So, the question is, "Why does our government need to provide things like this? Could a private business provide them?" While some people might say yes and make an argument for it, most of us can recognize that it would be fairly difficult, and there are two reasons for this.

2a. Public Goods

First of all, there are shared benefits, and you cannot exclude people from enjoying them.

> EXAMPLE Everybody enjoys the protection of national defense and police protection in a community; even if you do not pay taxes in our country, you still enjoy the fact that we have a military defending us.

So, because there are shared benefits inherent in these protections, and you cannot exclude people from enjoying them, they are known as **public goods**. A public good is a good that is typically provided or made available through the government. It is made available through the government because of those characteristics referenced above, such as being non-rivalrous, or having shared consumption, and being non-exclusive.

TERM TO KNOW

Public Good
A good that is typically provided or made available through the government; the good is characterized as being both non-rivalrous and non-exclusive

2b. Economic Stabilization

Another thing that people generally agree on is that the government should work to maintain some kind of stability in our economy.
Now, we know that ups and downs in the economy will happen because we have a business cycle of expansions and contractions in the short term. However, the goal is to reduce the length and severity of recessions, to make sure we never have another Great Depression.

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3. Government Spending: Counter-Cyclical Approach

Now, when the economy begins to slow, the government can use its government spending as a tool. They can spend money to try to stimulate the economy and prevent it from worsening.

Spending money in various ways can give people jobs, or simply give them quick money to spend in the economy, to jump start it or get it going again.

This is known as a counter-cyclical approach, which means that while the economy is slowing or contracting -- what we would call a recession -- the government would increase their spending. This basically means that government spending will be greater than the money it takes in, in tax revenue. Note, this is a time when the government is generally going to take on debt.

However, in this counter-cyclical approach, it follows that during a time period of expansion or recovery, government spending can be decreased again and tax revenue can actually be somewhat greater than the government spending. This is a time, then, when the government, in theory, should be repaying its debt.

Counter-Cyclical Approach	
Recessions (Contractions)	**Expansions (Recoveries)**
Spending increases Spending > Tax Revenue Government takes on debt	Spending decreases Tax Revenue > Spending Government repays debt

Now, some of this government spending needs to be passed and approved by Congress when it looks like the economy is slowing. Here are some examples from our nation's recent past.

IN CONTEXT

During the Bush administration, when it looked like the economy was entering into a recession, the administration passed some policies to send out stimulus checks. People received $600 as an individual, for example, and an additional $300 for every child they had, up to a certain number of children.

The point of this measure was to give people money, so that they, in turn, would go out and spend it, to help rejuvenate businesses and pick the economy back up.

During the Obama administration, when we were in a recession, that administration passed policies to provide a payroll tax cut, referred to as a "tax holiday."

Again, it is an example of a less direct way to give people a bit more money to go out and spend.

4. Automatic Stabilizers

However, there is other government spending that actually happens automatically, without the approval of Congress. It kicks in automatically as the economy begins to slow.

This type of spending is what we call **automatic stabilizers**, which are government policies that go into effect automatically as the economy slows to counter this economic slowing.

Payments are going to increase in a recession and decrease as people get jobs again, and as the economy grows and enters into the expansionary phase of the business cycle.

EXAMPLE Examples of automatic stabilizers are the transfer payments mentioned at the beginning of the tutorial, like welfare and unemployment compensation. As people start to lose jobs, they will automatically begin to qualify for these programs, and the payments will automatically kick in and increase as the economy is worsening.

Taxes are another example. We do not have to change the tax system, but as people start making less money, they naturally owe less in taxes. Similarly, as people are buying less, they are paying less in sales taxes.

Again, these measures are automatic, and the point of them is to lessen the severity of an already slowing or contracting economy.

TERM TO KNOW

Automatic Stabilizer
Government policies that go into effect automatically as the economy slows to counter economic slowing; the payments increase in a recession and decrease with increased employment as an economy grows and enters into the expansionary phase

SUMMARY

Today we learned that while there are many **points of agreement and disagreement** between people on the **role of government** intervention in our economic lives, most agree that the government should provide **public goods** and **economic stabilization**. The **counter-cyclical approach** to **government spending** is the most important tool used in stabilizing the economy. We also learned about a few **automatic stabilizers** that go into effect automatically as the economy begins to slow.

Source: Adapted from Sophia instructor Kate Eskra.

TERMS TO KNOW

Automatic Stabilizer
Government policies that go into effect automatically as the economy slows to counter economic slowing; the payments increase in a recession and decrease with increased employment as an economy grows and enters into the expansionary phase.

Income Redistribution
Government policy that seeks to provide economic relief to low-income earners by providing welfare and other benefits (transfer payments) funded by tax revenue generated from high-income earners.

Progressive Tax
Tax that increases with income; income tax is an example.

Public Good
A good that is typically provided or made available through the government; the good is characterized as being both non-rivalrous and non-exclusive.