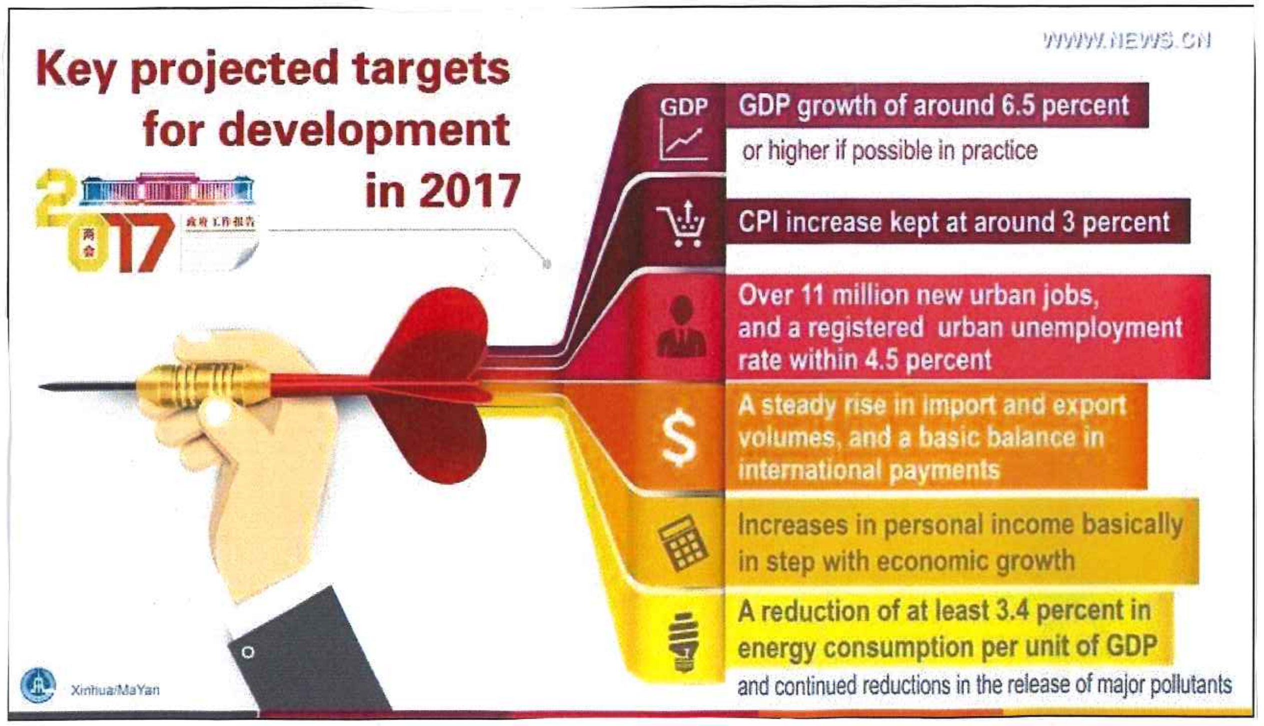
IGCSE Economics Study Booklet – 5.1 Government Aims and Influences



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Role of the government

The government plays a key role as a producer of goods and services and as an employer :

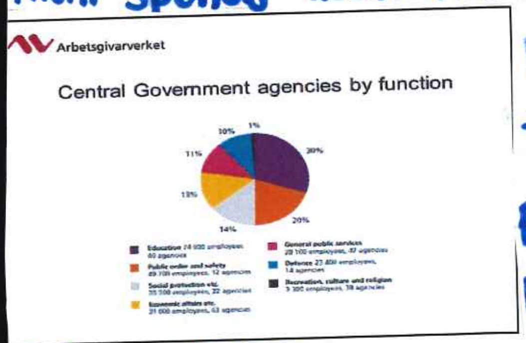
As a producer, it will provide:

→ Public goods: e.g. street lighting, public roads, etc.

→ Public Services: e.g. Postal services, public transport, etc

→ Merit goods: Health care, public libraries, etc.

→ Welfare services: e.g. payments for the unemployed (e.g New Zealand government spends about NZ $12 billion ($9.88bn) each year on these payments



In order to provide these goods and services, the government must employ factors of production - especially the government in mixed/planned economy.

• Regulation:

→ Employment legalisation: e.g. anti-discrimination laws; employees treated fairly.

→ Consumer protection laws: Firms that provide demerit goods are heavily regulated

→ Environmental legalisation: Rules to limit carbon emissions produced by private producers

→ Competition law: e.g. in most countries, it is illegal for firms to engage in price fixing

→ Intellectual property rights: e.g. accusations that Apple and Samsung are copying each other.

• Subsidies: governments often provide subsidies for employment purposes, education

• Taxes:

→ Direct taxes: (imposed on income, wealth, etc.) to reduce income inequalities.

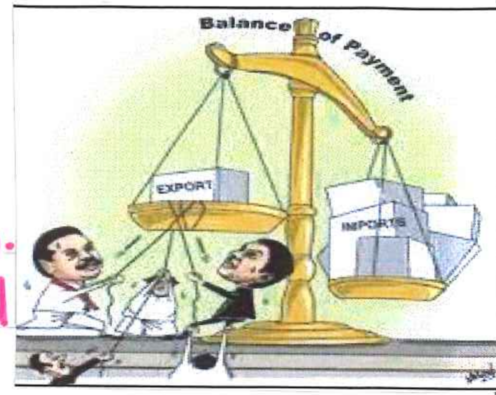
→ Indirect taxes: (imposed on spending) to affect consumer expenditure e.g. sale tax

→ Tariffs (import tax): to discourage purchase of foreign goods in order to protect domestic firms

Government policies also tend to be aimed at achieving the six key macroeconomic objectives which are explained in the next few pages...

Trade (Balance of Payments)

Imports are foreign goods and services brought into a country. They are generally shipped but can also done through different modes of transport.



It helps countries that have limited resources to import goods to increase their GDP.

However, it may cause reliance on their imports.

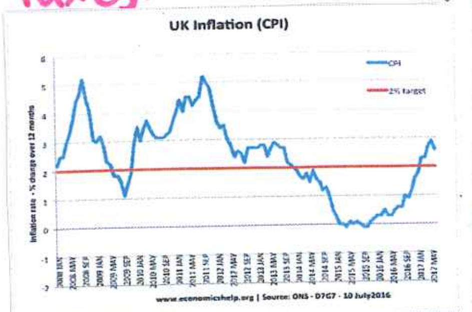
Exports are domestic goods and services shipped out into foreign countries.

An increase in exports can cause employment in the domestic country and increase sales.

If imports are more than exports ~~than~~ the country is going through a trade deficit, otherwise known as a negative balance of trades.

Governments want to make sure that there are more exports than imports, ~~it~~ so the economy grows which increases the employment. It also ~~grows~~ increases consumer spending hence more taxes.

Inflation



Inflation is the increase in the general level of price of goods/services in an economy.

A higher inflation rate happens when aggregate demand is higher than the aggregate supply.

Inflation usually happens during a period of economic boom.
The rate of inflation is measured by the annual % change in consumer price. (CPI measures price change from the perspective of the purchaser). CPI is a weighted price index. (~~Changes in~~ ~~Weight~~ price index (for the year): the sum of (price × weight)/sum of the weights.
Governments like to keep the inflation level low and stable.
High inflation may also lead to more borrowing for businesses and people. ↑spending ↓saving
Deflation is the decrease in the general price level of goods and services.
Deflation can occur when the supply of goods is greater than the demand. Usually during a recession, businesses will try to cut prices to increase spending due ~~to~~ the fall in demand.
Hence, the profit decreases so the firms cut costs, such as wage cost which leads to a higher unemployment.

Growth (Economic Growth)

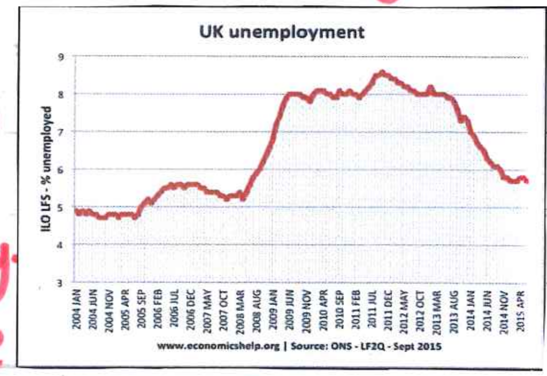
The size of an economy is measured by the GDP in %.
GDP stands for gross domestic product - which is the total value of all products a country produces every quarter (3 months).

Economic growth can mean an increase in the employment rate which could lead to a higher spending as the households have more disposable income. The government will ~~as~~ also have more tax ~~reneuue~~ revenue to invest in public & merit goods, increasing standards of living. If this happens without the government raising ... tax - it's called a fiscal dividend.

Economic growth stimulates new investments as firms are making a higher profit; they are able to spend on research and development. The benefits of economic growth to the government are the reduction in government spending on unemployment and poverty related welfare benefits. Higher taxation income leads to high government ~~spendings~~ spending as they have more money to spend from tax revenues.

Employment

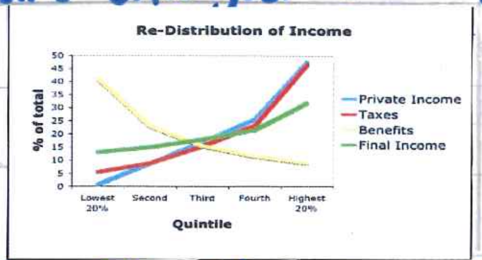
People who are of working age and are able and willing to work and have a job.
The amount of employed people is expressed as a percentage.



Governments strive to reduce unemployment as governments have to pay for the financial costs of the unemployed. Also the standards of living in an area with high unemployments decreases and so causes crime rates to rise and social and health problems to rise.
Unemployment might rise due to an increase in the use of technology. Or if the government introduce a fiscal policy to reduce the aggregate demand of a product. Or firms could decrease the demand for labour if the minimum wage rate rise.
If there is 100% employment, labour supply will be low but the demand will be high so wage costs for the firm could increase as employees could ask for higher wages.

Redistribution (of income)

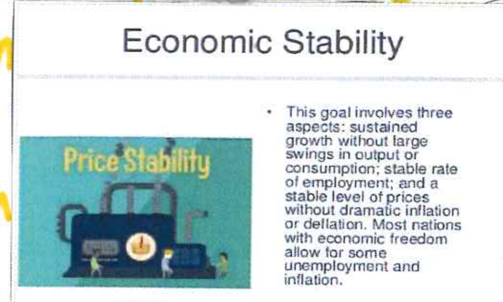
Redistribution of income is an equitable distribution of income means that the gap between rich and poor is not excessive, but still enough to create incentives to work.
Rich people are ~~taxes~~ charged higher taxes and poor people are charged lower taxes.



Governments pass on the collected taxes to the poor using transfer payments. Examples of transfer of ~~income~~ payments include unemployment benefits, old-age pensions, etc.
Governments can also use the collected taxes to provide socially desirable goods to low income people which is also a promotion of equity.

Stability

Economic stability refers to an absence of excessive fluctuation in the macroeconomy. An economy with fairly constant output ~~costs~~ growth and low and stable inflation would be considered economically stable.



Advantages of having a stable economy include increased productivity, improved efficiency and low unemployment.
An unstable economy causes a decline in consumer confidence and reduced international ~~eve~~ investments.
Common signs of an instability are extended time in recession, rising inflation and fluctuations in exchange rates.

Definitions

- Public goods - Goods/Services that is provided without profit to all members of a society, either by the government/a private individual/organisation.
- Merit goods - Goods/Services which when consumed create positive spillover effects in an economy.
- Public services - A service provided by the government (schools, hospitals)
- Welfare services - Services provided by the government to cover the basic well-being of the individuals and the society.
- Regulation - rules made by an authority/government in order to control the way something is done or the way people behave.
- Employment legislation - The regulations protect interests and safety of employees.
- Consumer protection laws - These regulations require private sector firms to provide ~~the~~ truthful descriptions of their goods and services.
- Environmental protection - Laws exists to prevent or reduce the damage to the environment caused by private sector firms.
- Competition law - Government regulation is used to prevent anti-competitive practices of private sector monopolists.
- Intellectual property rights - to encourage innovation and to safeguard the interests of producers, the government can use copyright, trademark and patent laws to protect the intellectual properties of firms.