

Economic Roles of Government in a Market Economy



1. Provide a legal system to make and enforce laws and to protect private property rights.
 2. Provide public goods that individuals or private businesses wouldn't provide.
 3. Correct market failures such as external costs and external benefits.
 4. Maintain competition by regulating monopolies.
 5. Redistribute income by taxing those with larger incomes and helping those in need.
 6. Stabilize the economy by reducing unemployment and inflation, and promoting economic growth.
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Provide a Legal System. The government needs to provide a system of laws and courts to protect property rights. The right to own property is one of the most basic characteristics of market economies.

Provide Public Goods. Some goods, such as national defense, would not be provided in large-enough quantities by the private (non-government) sector of the economy. These goods are subject to free rider problems: Once someone has provided the goods, others can use them without paying for them. These goods are called public goods and generally need to be provided by the government if people want enough of them.

Correct Market Failures. Sometimes the prices and quantities of goods and services determined solely by markets are not the best for society. Environmental pollution is an example of an external cost or negative externality. If a steel factory disposes of its waste in the air and causes pollution, it imposes costs on others and therefore doesn't pay for all of its production costs itself. An example of an external benefit or positive externality is when a farmer sprays his or her trees to get rid of pests that damage not only his or her crops but also all of the crops in the area. Everyone in the area benefits from this spraying, even though others don't pay for it. These situations are examples of market failures because the farm and the factory do not produce an efficient amount of the goods and services involved. When the decision about how much to produce is left entirely up to the markets, there's too much steel and too little pest spraying. Most economists agree that there is a role for the government to play in cases such as these.

Maintain Competition. Competition is important in market economies because it leads to lower production costs and prices. If businesses become monopolies, the benefits of competition are lost. There is a role for government to regulate some monopolies such as public utilities. Some economists also believe that the government should prevent monopolies from occurring or break them up when they do occur.

Redistribute Income. People, acting through their government, often decide it would be fair for the government to take income from some people and give it to others. Two examples of this are taxes and social-welfare programs. Although many people agree that this is a good idea, there are many different opinions about how to do this fairly.

Stabilize the Economy. Many economists believe the government should take an active role to try to achieve steady economic growth and low levels of unemployment and inflation. The government attempts to do this through fiscal policy: taxation and spending. In the United States, the Federal Reserve System, the country's central bank, conducts monetary policy, which seeks to stabilize the economy through control of the money supply.

6 QUESTIONS ON THE 6 ROLES OF GOVERNMENT *(2 sentence minimum for your responses!!!)*

1. Why is it important for the government to provide a **LEGAL SYSTEM** to protect property rights?

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