

Macro Economics I: Starting to Look at the Big Picture

The first macro-economics test will be **TOMORROW**. This test will have a combination of multiple choice, true/false, matching, and essays. As always, the emphasis will be on the application of concepts that we covered in class discussions, worksheets, activities, and group projects. You should feel comfortable with ALL of the concepts listed below. The test will be worth 250 points.

Characteristics of a Market Economy (Market vs. Command Economy)

- Private Property
 - Free Enterprise
 - Self-Interest
 - Competition
 - System of Markets and Prices
 - Limited Government
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The Role Of Government In A Market Economy

What role does the government play in our economy? What does the government provide for us?

- Provide a Legal System to make and enforce laws and to protect private property rights.
 - Provide Public Goods that individuals or private businesses wouldn't provide.
 - Correct Market Failures such as external costs and external benefits.
 - Maintain Competition by regulating monopolies.
 - Redistribute Income by taxing those with larger incomes and helping those in need.
 - Stabilize Economy by reducing unemployment and inflation, and promoting economic growth.
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Provide a Legal System (The Economics of the U.S. Constitution)

What are the biggest things that the government spends money on? Where does the money come from?

Understand the roles of government that the Preamble to the Constitution provides for:

- Establish Justice
 - Ensure Domestic Tranquility
 - Provide for the Common Defense
 - Promote the General Welfare
 - Secure the Blessings of Liberty
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EXAMPLES: Create laws and provide courts, provide information and services to help economy function better, establish a monetary system, define and enforce property rights.

Provide Public Goods and Services (Public vs. Private)

Why does the government provide certain goods and services ... but not others?

Understand the difference between **public goods & private goods**. The tests for a public good are:

- **Non-exclusion**, which means that it is difficult to exclude non-payers from receiving the benefit of a good or service; and
- **Shared consumption**, which means that the consumption of a good or service by one consumer does not reduce the benefit to other consumers.

Through taxation, government can require all citizens to pay for their share so that no one gets a "free" good or service (this limits "**Free Riders**"). For example, everyone wants police protection. However, because it is difficult to exclude people from the benefits of police protection, government supplies the service to everyone, and everyone pays for it through taxation.

EXAMPLES: Provide goods and services that markets are unable or unwilling to provide, such as national defense.

Correct Market Failures (Externalities)

Government is more-or-less "hands off" in a market economy, but what kinds of "market failures" (problems) should the government step in to fix?

People sometimes make private decisions that have an unintended impact on others. These are called external effects. They occur when one person or group does something that affects other people without the usual costs or payments. These are called externalities. Externalities are of two sorts: **negative externalities** (like pollution) and **positive externalities** (like education).

EXAMPLES: Taxes to reduce negative externalities, such as environmental pollution; subsidies to encourage positive externalities, such as education. Externalities exist when some of the costs or benefits associated with the production or consumption of a product "spill over" to third parties other than the direct producer or consumer of the product.

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Maintain Competition

Why do you think that we never really have “perfect” or “pure” COMPETITION? In other words, why are most markets imperfectly competitive?

There are four degrees of competition: **pure competition**, **monopolistic competition**, **oligopoly**, and **monopoly**. Understand these types of competition, and be able to provide examples of each. When comparing competitive markets, look at these five characteristics:

- Number of Firms in Industry (How many competitors are there?)
- Similar or Different Products (Are the products all the same or different?)
- Ability to Control Prices (Can any one company control the prices charged?)
- Ease of Entering the Industry (How easy is it for a new company to start up and compete?)
- Existence of Non-Price Competition (Are there other ways that companies compete?)

EXAMPLES: Create and enforce antitrust laws; regulate natural monopolies.

Redistribution of Income

Why does the government need to “redistribute income”? How does it do this? (give some examples)

What does it mean when we say that the government redistributes income? How does the government redistribute income? Why is this an important role? What are some negatives of redistributing income? What are some of the causes of income inequality?

EXAMPLES: Higher income tax rates for rich than for poor, provide social security, and aid to dependent children, Medicare, Medicaid.

Stabilize the Economy

What are some of the ways that the government tries to “stabilize the economy”? (give some examples).

Why is stability important in our economy? What can the government do to help?

EXAMPLES: Use government spending, taxation, interest rates and the money supply to promote economic growth, control inflation, and reduce unemployment.

Taxation

Why are taxes necessary? So, why don't people like to pay taxes?

Different levels of government impose several different types of taxes and fees. The purpose of imposing these taxes is to generate revenue to pay for goods and services provided by government. **Federal, state, and local governments** depend on different types of taxes and provide different types of government services. The different types of taxes have different advantages and disadvantages. Economists have attempted to identify criteria for a **fair tax**. **Four criteria** commonly noted are the ability to pay, efficiency, simplicity, and benefits derived.

Governments depend on taxes for revenue. While most people agree that government is essential, **most people do not like to pay taxes**. Two reasons are frequently cited. First, government has the authority to set the rules of the economic system. Within our system of laws, government is authorized to use coercion to enforce the rules. Since the exchange of taxes for government services is not voluntary, it may not be of equal benefit to all taxpayers. Second, the nature of taxation diminishes the link between payment and consumption. In some cases, individuals pay their taxes but do not see much direct benefit for their payment. In other words, the cost is obvious but the benefit is not.

Taxes are a cost. As such, they influence people's behavior in predictable ways (they act as **incentives**). Changing the types of taxes or the tax level will encourage certain types of behavior and discourage others. For example, increasing or decreasing taxes influences people's behavior by encouraging or discouraging the use of substitutes for goods and services which are taxed.