

# Government intervention in the economy

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# What do we mean by „government”?

- \* **GOVERNMENT** = state administration represented by:
  - \* parliament,
  - \* ministries,
  - \* institutions that represent army, police, public health service etc.,
  - \* state-owned enterprises.

# Market vs. government

- \* What, how and for whom is produced in the economy may be determined by:
  - \* market,
  - \* government,
  - \* both.
- \* Basically government intervenes because of so called **market failure**.

# What do we mean by „market”?

- \* **MARKET** = arrangement through which **buyers** and **sellers** meet or communicate in order to trade goods or services.

# „Invisible hand of market”...

- \* Own interest leads to individual and national wealth.
- \* Market is a self-regulating mechanism. The mechanism leads scarce resources to their best uses.

- \* „By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it”.

Adam Smith, „The Wealth of Nations”

# ... and „visible hand of government”

- \* Government can intervene in markets.

# What should the government do and for what reason?

<i>What should it do?</i>	<i>For what reason?</i>
Set legal frames	To protect competition, to eliminate externalities, to reduce asymmetric information etc.
Purchase and sell some goods and services	To offer so called public goods
Pay so called transfers (benefits)	To redistribute income
Impose and collect taxes	To finance public goods and redistribute income
Stabilize the economy	To make business cycles less harmful
Adjust allocation of resources	To promote socially-desired goods

# Government as a guard





# Government as a monopolist punisher

- \* **Monopoly** = there is only one supplier of a commodity
- \* Monopolist may take unjustified advantage of its dominant market position.
- \* To protect competition government monitors the operation of firms suspected of monopolistic practices (e.g. Office of Competition and Consumer Protection in Poland).



# Government on the war with economic cycles

## \* Fiscal policy:

- \* taxes
- \* expenditures

## \* Monetary policy (?):

- \* amount of money in circulation
- \* interest rates

# Government affects the allocation of resources

- \* Goods that should be promoted (eg. vaccine).
- \* Goods that should be discriminated (eg. alcohol).

# Liberals vs. state control believers

- \* Liberals:
  - \* they believe in markets
  - \* everyone is responsible for one's fate
- \* State control believers:
  - \* they believe in government as an economic player
  - \* the division of income must be controlled by government

# Types of economies

- \* **Free market:**

- \* solely private property rights
- \* market controls the allocation of resources
- \* example: West-European economies in w XIX century

- \* **Mixed:**

- \* not only private, but also public property rights
- \* allocation of resources is controlled not only by market, but also by government
- \* example: Polish economy at the moment

- \* **State-controlled:**

- \* public property rights
- \* allocation of resources is controlled by government
- \* example: Polish economy under communism

# History of government intervention in a nutshell

## Government spending as % of NI

<i>Country</i>	<i>1880</i>	<i>1929</i>	<i>1960</i>	<i>2000</i>
Japan	11	19	18	40
USA	8	10	28	32
Germany	10	31	32	47
UK	10	24	32	41
France	15	19	35	54
Sweden	6	8	31	59

# World map of economic freedom

- \* There are significantly liberalised mixed economies with small share of government (eg. USA).
- \* There are also significantly „tutelary” mixed economies (eg. Sweden).
- \* Both may succeed.

# Third model – far-east model

- \* Important role of government, however not in the social sphere (economic stewardship – yes, tutelage – no).



# The measurement of economic freedom

- \* Index published in „Economic Freedom of the World” report (Fraser Institute).
- \* Index of Economic Freedom (Heritage Foundation and Wall Street Journal).
- \* In both cases Poland took places that oscillate around 65 in the last few years.

# Index of Economic Freedom – top 5

- \* Hongkong
- \* Singapur
- \* Australia
- \* Switzerland
- \* New Zealand

# A bit about the way state-control is executed: democracy and election



# Principal and agent

- \* State-control is executed by those who were elected.
- \* Those who were elected (agents) may behave in the way that is not in the best interest of their principals (agency conflict).

# Who's right, who's wrong?

- \* What is the source of inefficiencies in economies: government intervention or market freedom?
- \* What's better: state control or liberalism? Socialism or capitalism?
- \* **„Socialism means even division of poverty while capitalism means uneven division of wealth”.**

**Henry Kissinger**