

Economics and Government: Weeks 1 and 2

1. What is this course about?
 - a. Ideas: Role of Government in Society
 - i. What does Government Do?
 - (1) Government is big.
 - ii. What makes government different from firms?
 - (1) Not profit maximisation—could have other goals.
 - (2) Has coercive power; membership is not voluntary (except, eg, choice of citizenship, location...)
 - iii. What makes it better?
 - (1) Same 2 things.
 - (a) Sometimes the invisible hand gives you a big punch in the gut—profit maximisation can have bad results.
 - (b) Sometimes we don't want to do what is right, so coercive power can have good results.
 - iv. What makes it worse?
 - (1) Same 2 things.
 - (a) Sometimes profit maximisation is really great.
 - (b) Sometimes coercive power is misused.
 - b. Topics
 - i. Public Debt
 - (1) Definitions: debt, deficit, tax, revenue, expenditure.
 - (2) What and why.
 - (3) How much and when.
 - ii. Inequality, Poverty, Homelessness
 - iii. Public Health Care
 - iv. Public Pensions
 - c. Learning Goals
 - i. Big picture: ideas you can use to think about government decisions
 - ii. Little picture: at least 1 useful thing per day for your everyday life, denoted with * symbols in lectures.

1. How Big is the Government?

- a. Guesses? What does government do?
- b. (At least) Three definitions:
 - i. *Production*
 - (1) Are the producers direct government employees? Are they indirect government employees (eg, employees of contractors)? Are they just not government employees?
 - ii. *Financing*
 - (1) Is government the sole financier for the commodity? If there is shared financing, is it obligatory or voluntary?
 - iii. *Regulation*
 - (1) Government can affect economic activity without financing it or producing it by regulating it. Sometimes, regulation is shared, eg, BC Medical Assn. Sometimes, regulation is effectively private, eg, oil industry in USA these days.
 - iv.

	Gov't Produced	Privately Produced
Gov't Financed	hospital doctors	non-hospital doctors
Privately Financed	car insurance; electricity	most restaurants

2. Financing

- a. Revenues. Governments get money from you in many ways.
 - i. *personal tax (tax forms in May)
 - (1) personal taxes are *progressive*, meaning that the average tax rate paid by rich people is higher than that paid by poor people.
 - (2) there are *thresholds* defining different tax rates for different levels of income. These tax rates rise with income (see *progressive*).
 - (3) In BC, there is a threshold at \$41,544. For income below this amount, the total (Fed+prov) rate is **20%**. For income above this amount, the rate is **27%**.
 - (4) Suppose you have an income of \$41,500, and I offer you \$1,000 to do *nothing*. Should you take it?
 - ii. corporate tax (charged to firms, usually quarterly)—you don't really perceive it
 - iii. sales taxes:
 - (1) GST/HST are *value-added* taxes
 - (a) firms get tax credits for all the GST/HST they pay for inputs. Thus, the total tax paid by the consumer is always the same (e.g., GST=5%)
 - (2) PST is/was/is a *final sales* tax.
 - (a) firms pay tax **and** consumers pay tax. firms pass tax costs on to consumers (except in special cases, like monopolists).
 - iv. import duties (stuff from foreign countries)
 - v. energy taxes (gas is expensive)
 - vi. excise taxes (liquor, smokes)

- vii. air travel
 - viii. payroll taxes
 - (1) Employment Insurance
 - (2) Canada Pension Plan—off the Govt of Canada books because it is separately accounted for
 - ix. other revenue includes crown corporations and government investments
 - (1) eg Canada Post (crown corp), PetroCan (former crown corp, now an investment)
- b. Spending:
- i. Federal government does a lot of ‘transfers to persons’
 - (1) Old Age Security; Canada Pension Plan (off-budget); Employment Insurance.
 - ii. and ‘transfers to other levels of governments’
 - (1) Canada Health and Social Transfer; Equalisation
 - (2) These transfers amount to about 40% of federal expenditures: about 1/5 to people and 1/5 to provincial governments.
 - iii. provincial governments do a lot of direct production: big 3 are:
 - (1) higher and lower education
 - (2) health care
 - (a) is **all** health care government produced? No—doctor’s offices are private offices, financed by government.
 - iv. provinces also transfer money to people and governments
 - (1) welfare payments
 - (2) municipal grants
 - v. BC puts about 2/3 of its expenditure into health, advanced education and K-12.
 - vi. BC gets about 1/6 of its revenue from Federal transfers. This fraction used to be much higher, which is part of the reason the province mostly ignores the Federal government these days.
 - vii. Governments have debt. They pay interest on the debt. That interest payment is also a type of spending.
3. *Debt and Deficit
- a. Deficit = Spending - Revenue
 - b. Debt = accumulated deficit = last year's debt + this year's deficit
 - c. negative deficit is called a 'surplus'.
4. Scale: These numbers are typically expressed in millions and billions of dollars. They can be hard to get your head around. George Bush entered ‘trillion’ into the popular discourse in the 2000 campaign “We’re gonna take 20 trillion in over the next 10 years; I’m just saying why not give a trillion back?”.
- a. Express them as a proportion of the whole economy (% of GDP)**
 - b. Express them in per-person terms.**
 - c. Express line-items as proportions of the total.**
5. The bigness of government has changed over time.
- a. Security/police/protection/military financed by the population is an old idea. The version of the government that takes from whoever has stuff and attempts to secure all people against bad guys is as old as cities. Kings and lords had farm

production in feudal Europe which was exchanged for protection from raiders (and other kings and lords).

- b. Welfare is also a surprisingly old idea—the Great Poor Law Act of 1601 put responsibility of poor relief on the villages where paupers were born.
 - i. Local responsibility for welfare is still practised today in many places.
 - ii. Initially, this was in-kind assistance for the poor and elderly. Mostly, food and shelter would be provided. In early days, it was in exchange for labour.
 - iii. Early big-spenders were Great Britain and the Nordic countries (Sweden, Norway, Denmark, Finland).
 - iv. Canada and Australia were terribly cheap with social transfers in this era.
 - v. The USA outspent us big-time during this half-century.
 - vi. Big at the turn of the last century was, say, 1 or 2 percent of GDP spent by government on welfare, unemployment relief, pensions, health and housing.
 - vii. During this period, assistance to poor people mostly took unpleasant forms—workhouses, nasty food and accommodation, etc.
- c. The Great Depression was a big shock. It was a decade-long economic downturn. Unemployment rates were 20 to 40 percent around the developed world. 40% for several years in Germany, 30% for several years in the USA, much longer depression in Canada, but somewhat shallower, with unemployment around 20-30%.
 - i. The unemployment rate now is 7.2% (August 2004), and likely counts more people as unemployed than would have been counted by the Depression bean-counters.
 - ii. Recessions these days last a year or two.
 - (1) A friend (who was trying to make me feel useful) once noted that maybe one of the reasons we don't have depressions any more is that economists learned some stuff about the economy, and policy-makers learned those things from economists. Could be true...
- d. Governments got way bigger, though data collection got way worse, after 1930. Continuing the picture from 1960, we see that the modal size government social spending started about about 5 or 10 percent of GDP in 1960, and ended up at 10 to 30 percent of GDP by the mid 1990s. This is a big big growth in the scope of government social spending. There is also plenty of variation across countries:
 - i. We think of the USA as a 'little-spender' (because it is), but even there, spending more than doubled as a share of the economy, from 5 to 14 percent of GDP.
 - ii. In Canada, it grew from 7 to 18 percent.
 - (1) The divergence between Canada and the USA occurred between 1980 and 1990—It is the difference between Reagan and Bush Sr. and the 1980s Tories.
 - (2) After the mid 1990s, government contracted in Canada and USA.
 - iii. In Sweden, from 12 to 33 percent.
 - iv. These are all rich countries. Big social transfers are neither the road to

poverty nor the road to wealth.

- e. Why did government grow so much in rich countries over the last half-century?
- f. Lots of theories:
 - i. *Government is a luxury*: As we get richer, we want more collectively produced and financed goods: health care, education, security, insurance.
 - (1) If so, the growth of government should slow down when economic growth slows down.
 - (a) Economic growth has slowed down since the early 1970s, but the size of government has only contracted in the late 1990s. Maybe things happen with a lag?
 - (2) If government is a luxury, then it is one whose prices rises with quantity, because government activity is financed by taxes which reduce people's productivity a bit. So, even as a luxury, there is a brake on the rate of growth of government.
 - ii. *Government is theft from the rich by the poor*: In democracies, the poor can gang up on the rich, and as growth generates winners and losers, the distribution of income widens out, and the poor get more in the mood to steal from the rich through the mechanism of the government. Of course, redistribution itself might be a luxury, and that would look pretty much the same.
 - iii. *Government has momentum*: Government agencies like to grow, but their ability to grow declines over time as the cost of that growth rises. Mancur Olson calls this 'institutional sclerosis' or 'bureaucratic sclerosis', but these names seems uncool to me.
 - iv. *Demography: Government spends on old and young people*: As populations age (due to not dying so young) or grow (due to life being good), there are more needy people depending on less producing people.
 - v. *Calamities create government*: The Great Depression clearly caused an expansion in the scale and scope of government across the developed world. Maybe when all the Depression-survivors die, so will big government....
- 6. Government as a producer is different.
 - a. Social expenditures include lots of transfers to people.
 - b. Government production is stuff like defense, health care, old age pensions.
 - c. In the 1950s and 1960s, government production was much higher in the USA. Throughout the 1950s, government production was about 12 percent in Canada, and 15 percent in the USA.
 - d. In the late 1960s, the government share of production rose in Canada and declined in the USA—this was medical care and pensions being absorbed by the public sector in Canada. In the 1970s, government production was 17 percent of the economy in Canada, and about 14 percent in the USA.
 - e. In the 1990s, the government share of production declined about 3 percentage points in both countries.
- 7. Myths:
 - a. We're big spenders.
 - i. We are not. In the context of the 50 richest countries in the world, the

USA is a big outlier in spending very little and doing very little through the government. Of course, little still amounts to a third of the economy funneling through government production or financing.

- ii. European countries (with the exception of the UK) funnel more like half the economy through the government, and have much more production and financing through the public sector. The Nordic countries do the most in this regard.
 - iii. Canada is somewhere in between the USA and Europe. So is Great Britain. Both are 'closer' to the USA than to Northern Europe in terms of social spending and/or public financing.
- b. The USA is a little-spender which results in a way better economy.
- i. This, too, is false. The USA is marginally richer than Canada—average incomes are marginally higher there than here—and marginally richer than Northern Europe. However, if you look at the median rather than the average, this difference disappears.
- c. The USA spends nothing on public health care, and we spend too much.
- i. False. About 8 percent of GDP in the USA is public spending on health care; the figure is almost 8 percent of GDP in Canada, too. However, in the USA, this spending basically only covers the elderly and the poor, whereas here it covers everyone.
 - ii. Private spending on health care amounts to almost 12 percent of GDP in the USA and about 5 percent of GDP in Canada.