What Does the Government Do?

- Consumes Resources
- Transfers Income
- Collects Taxes

We all own a Piece of the Pie

In fact the pie—or at least a piece of the pie—belongs to each of us.

The Basic Accounting Identity

GDP = NI (well almost)

John and Sally

Part of the national income belongs to John, and part to Sally (well almost)

Decisions, Decisions

John and Sally can each decide how much of their income to consume and save (i.e., invest)
What Determines the Slices

John and Sally’s shares are determined by how much they earn, either as wages or as return on the capital they own.

Government and Transfer Payments

A Complication

There is a complication: Transfer Payments. John and Sally’s shares are determined by how much they earn, either as wages or as return on the capital they own.

Government and Transfer Payments

Transfer Payments

In a transfer payment, the government takes money from John and Sally via taxes and then gives it right back.

Government and Transfer Payments

Redistribution

In some cases, the government redistributes money by taking from John and giving it to Sally and then gives it right back.

Government and Transfer Payments

From One Hand to Another

In some cases, the government simply gives the money back to the person and then gives it right back.

Government and Transfer Payments

Transfer Payment Basics

The programs do not change the amount of resources available for the private sector, but change who gets the resources.

Government and Transfer Payments
**Government and Transfer Payments**

**Transfer Payment Basics**

It does not do this by saying “John hand $X over to Sally (or to yourself)”, but by setting up transfer programs and taxing to pay for these programs.

John

Sally

**Examples**

- Social Security
- Food Stamps
- Rent Subsidies
- Education Subsidies

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In some cases, these programs distribute from the high income to low income households.

In other cases, the money comes right back. The high income to low income households.

**Winners and Losers**

There may be winners and losers over to Sally (or to yourself), but by setting up transfer programs and taxing to pay for these programs.

John

Sally

There may be winners and losers, but by setting up transfer programs and taxing to pay for these programs.

**Incentives**

Transfer programs have incentive effects. Taxes matter.

There may be winners and losers, but by setting up transfer programs and taxing to pay for these programs.
Incentives

Transfer programs have incentives. This is a major issue which we will discuss later. These may be winners and losers.

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get the resources.