What Does the Government Do?

- Consumes Resources
- Transfers Income
- Collects Taxes

The National Pie

GDP is like a national pie; a slice for investment and a slice for consumption.

The Government Takes A Slice

GDP is like a national pie; a slice for investment and a slice for consumption.

When the government consumes resources, the amount available for C and I decreases.

How is G used?

- Down the Sinkhole.
The Sinkhole Theory

• Down the Sinkhole.
  – Trucks pull up to factories, load up and head to giant sinkholes where they dump the goods.
  – Some argue that the government essentially wastes its resources, as if it were pouring them down a giant sinkhole.

Some argue that the government sometimes does good by engaging in such a wasteful purpose.

Government Consumption

• Government Produces Many Services
  – National Defense
  – Education
  – National Parks
  – Hospitals
  – Justice

Are these wise uses of GDP?

We should always provide a test of efficiency.

\[ \text{Cost}_{\text{Govt}} > \text{Cost}_{\text{Private}} \]
Government Consumption

- Government Produces Many Services
  - National Defense
  - Education
  - National Parks
  - Hospitals
  - Justice

This is a subtle point. Part of the cost occurs if the government produces “one size fits all” goods and people would like slightly different goods.

We should always provide a test of efficiency.

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Right Level of Government?

And even assuming the government is an efficient provider of the service, is the level worthwhile?

Each dollar spend on a government program has a marginal benefit and a marginal cost.

Set MB = MC

MC > $1. Tax efficiency losses

Too Little?
Government as Consumer

Too Much?

Government Consumption

Does the government spend too much or too little?

Government Consumption

On what?

Does the government spend too much or too little?

Benefits and Costs

Determine the benefits and costs.

The Decision

Determine the benefits and costs.

B > C?

Yes

Spend

No

No!
Government as Consumer

**Project by Project**

Determine the benefits and costs.

- Yes: Spend
- No: No!

Do for each project!

**On the Margin**

Determine the benefits and costs.

- Yes: Spend
- No: No!

And do it on the margin!

**On the Margin**

Determine the benefits and costs of a marginal $.

- Yes: +1$
- No: -1$

And do it on the margin!

**Logrolling 101**

Determine the benefits and costs.

- Yes: My B>My C?
- No: No!

**End**

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