What Does the Government Do?

- Consumes Resources
- Transfers Income
- Collects Taxes

The National Pie

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

Taxing

The government must take part of their earnings from John and Sally to pay the cost of government programs, including transfer payments.

Neither John nor Sally must set Consumption=Income. They can borrow and lend programs, including transfer payments.

Borrowing

So too with the government, but let’s set this complication aside. Assume Taxes = Expenditures programs, including transfer payments.
**Government as Tax Collector**

**A Promise**

So too with the government, but let's set this aside. A Promise: deficit financing is an important issue and we come back to it. The government must take part of their earnings from John and Sally to pay the cost of government programs, including transfer payments.

**How We Tax**

John and Sally's shares are determined by how much they earn, either as wages or as return on the capital they earn. The government does not say "John pay $X and Sally pay $Y". The taxes it levies determine how much different people pay. It effectively does so by saying "everyone must pay income and sales taxes".

**The Role of Taxes**

John and Sally's shares are determined by how much they earn, either as wages or as return on the capital they earn. The government does not say "John pay $X and Sally pay $Y". It effectively does so by saying "everyone must pay income and sales taxes". We get to decide how to allocate our after tax income between consumption and saving. We get to decide how to allocate our after tax income between consumption and saving.

**Consumption and Saving**

John and Sally's shares are determined by how much they earn, either as wages or as return on the capital they earn. The government does not say "John pay $X and Sally pay $Y". It effectively does so by saying "everyone must pay income and sales taxes". We get to decide how to allocate our after tax income between consumption and saving. We get to decide how to allocate our after tax income between consumption and saving.

**Work or Leisure**

John and Sally's shares are determined by how much they earn, either as wages or as return on the capital they earn. The government does not say "John pay $X and Sally pay $Y". It effectively does so by saying "everyone must pay income and sales taxes". We get to decide how to allocate our after tax income between consumption and saving. We get to decide to work harder or less hard depending on the tax laws. We get to decide how to allocate our after tax income between consumption and saving.

**Do Taxes Matter?**

A Simple Example: the government started taxing 100% of all wages.
Yes

A Simple Example: the government started taxing 100% of all wages. Common sense says people would stop working and the pie would shrink.

Do Taxes Matter?

A second example: the government started taxing 100% saving. Common sense says people would stop saving and the pie would eventually shrink.

End

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