

## LESSON 4

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# WHAT ARE THE ECONOMIC FUNCTIONS OF GOVERNMENT?

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### INTRODUCTION

In order to ensure and support economic freedom as well as political freedom, the founders of the United States envisioned a limited role for the government in economic affairs. In a market economy such as the one established by the U. S. Constitution, most economic decisions are made by individual buyers and sellers, not by the government.

Still, the U.S. government's role in the economy is not trivial. It includes, most economists believe, responsibility for six major functions. The government (1) provides the legal and social framework within which the economy operates, (2) maintains competition in the marketplace, (3) provides public goods and services, (4) redistributes income, (5) corrects for externalities, and (6) takes certain actions to stabilize the economy.

Citizens, interest groups, and political leaders disagree about the proper scope of government activities within each of these functions. Over time, as society and the economy have changed, government activities in each area have generally expanded. Moreover, around the world, other societies with market economies have generally favored a larger economic role for government, sometimes endorsing actions beyond the six functions addressed in this lesson.

### LESSON DESCRIPTION

The teacher introduces six economic functions of government in a brief lecture. In a guided practice activity, the students classify newspaper headlines according to the six functions. A brief reading introduces “liberal” and “conservative” views of the proper scope of government economic activity. The lesson concludes with students working in groups to develop liberal and conservative arguments about one of the newspaper headlines.

### CONCEPTS

- Competition
- Economic stabilization
- Externality
- Income redistribution
- Public goods and services
- Social and legal framework

### OBJECTIVES

Students will be able to:

1. Classify government economic activities according to the six economic functions of government.
2. Analyze governmental economic actions within the liberal/conservative framework.

### CONTENT STANDARDS

#### Economics (CEE Standards)

- There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income. (Standard 16)
- Federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices. (Standard 20)

#### Civics and Government (NSCG Standards, Grades 9-12)

- The relationship of limited government to political and economic freedom. (Standard I.B.4)
- Character of American political conflict. (Standard II.C.2)

- Major responsibilities of the national government in domestic and foreign policy. (Standard III.B.2)

## TIME REQUIRED

90 minutes

## MATERIALS

- A transparency of Visual 4.1
- A copy for each student of Activities 4.1, 4.2, and 4.3

## PROCEDURE

1. Tell the students that the purpose of this lesson is to examine the economic functions of government. Ask the class to suggest some economic activities of local, state, and national governments. List several responses on the board. *(Possible responses include providing for national defense, providing low-cost meals at school, paying Social Security benefits, building and repairing roads, etc.)*
2. Point out that government *could* do all sorts of things. For example, it could provide everyone with an MP3 player, or provide everyone with an annual vacation at a theme park. Ask: What problems might arise if the government expanded its role along these lines? *(These new programs would cost a lot of money. To pay for them, people would have to pay higher taxes. Higher taxes would create economic inefficiencies. And people not interested in MP3 players or theme parks would object that their tax money was being wasted.)*
3. Pose another hypothetical example, this time concerning government regulation: Government imposes lots of rules in the economy—workplace safety regulations, for example. But some things still go unregulated. Why not regulate in every problem area? What would happen if the government decided that all new cars produced in the United States must be yellow, since yellow cars are easier for other drivers to see? What might be problematic about that? *(Many Americans would object to such a restriction of their freedom of choice. Finding one's own yellow car in a parking lot full of yellow cars might be difficult. The yellow-only rule might encourage people who don't like yellow to purchase cars manufactured outside the United States, or to repaint their yellow cars illegally.)*
4. Review the examples discussed thus far, real and hypothetical: from governmental provisions for national defense to government-sponsored vacations for everybody. Explain that most Americans (not all) agree that government should do some of these things and should not do others, for various reasons. But what reasons? What general ideas might Americans look to for guidance in thinking about the government's proper, limited role in the nation's economy? Economists who study this question have a six-part answer. They generally contend (again, not all of them) that government has six legitimate functions to perform within the U.S. economy. The class now will turn to a consideration of these six functions.
5. Display Visual 4.1 and distribute copies of it (Visual 4.1 also serves as Activity 4.1). Explain each of the six economic functions of government. Solicit examples from the students for each function, and ask what would happen if government did not perform this function. Have the students write examples and notes on their copies of the activity.
  - Maintain the Legal and Social Framework:
 

Define and enforce property rights. *(Government passes laws and establishes a court system. No one could sell property, invest, or have confidence in contracts if this legal system did not exist.)*

Establish a monetary system. *(The federal government controls the amount of money circulating in the economy; it also regulates banks and other financial institutions. People*

*would have to barter for the goods and services they wanted if this monetary system did not exist, and they might stay away from banks if banks were not regulated.)*

- **Maintain Competition:**

Create and enforce antitrust laws, and regulate natural monopolies.

*(The government sued Microsoft for monopoly practices; the government regulates the prices charged by companies that distribute natural gas to homes. Companies might charge higher prices and provide poor products if government policies did not promote competition.)*

- **Provide Public Goods and Services:**

Public goods and services are those that markets will not provide in sufficient quantities.

*(Examples include national defense, roadways, post offices and mail carriers, lighthouses, public defenders, public health clinics, public schools, and other important goods and services. Some important goods and services would be unavailable if the government did not provide them.)*

- **Correct for Externalities:**

Reduce negative externalities.

*(Negative externalities exist when some of the costs associated with production or consumption “spill over” to third parties—people other than the producer or consumer of the product. One example is pollution of lakes and rivers caused, for example, by industrial waste. The pollution affects everybody who uses the lakes and rivers, including those who had no part in producing or purchasing the products causing the pollution. Government regulates pollution. The environment would be far more polluted without government action.)*

Encourage increased production of goods and services that have positive externalities.

*(Positive externalities exist when some of the benefits associated with production or consumption “spill over” to third parties—people other than the producer or consumer of the product. One example is public education. Government subsidizes education because its benefits flow to the students and to society in general. We would have fewer benefits linked to education without subsidization.)*

- **Stabilize the Economy:**

Reduce unemployment and inflation, and promote economic growth.

*(The federal government attempts to stabilize the economy through applications of fiscal policy [by raising or lowering taxes, or by government spending] and monetary policy [by controlling the money supply or by changing interest rates]. Without these actions, the economy might take much longer than it ordinarily does to recover from recessions.)*

- **Redistribute Income:**

Redistribute income from people who have higher incomes to those with lower incomes.

*(Redistribution usually involves higher tax rates for people with higher incomes. The tax revenue raised in this way helps to pay for various welfare programs, the Medicaid program, legal defense clinics, etc. Some people could not afford basic necessities without government redistribution programs.)*

6. **Distribute Activity 4.2.** Explain that the 12 newspaper headlines are fictitious but realistic, each one referring to a government activity. The students are to classify each headline by writing in the letter of the economic function that fits it best. Check the students' answers and discuss the exercise in class.

**Headlines**

1. Federal Reserve Raises Key Interest Rate (E)
  2. Congress Raises Tax Rates for Top Income Brackets (F)
  3. EPA Plan to Reduce CO2 Emissions (D)
  4. Homeland Security Funding Increased (C)
  5. President Says More Spending Will Fight Recession (E)
  6. Agency Blocks Merger of Two Airlines (B)
  7. City Police Increase Neighborhood Patrols (A or C)
  8. Lawsuit Establishes Patent Rights (A)
  9. Legislature Passes Funding for Subsidized Housing (F)
  10. New Info from Government Agency Helps Consumers Choose Wisely (A, B, or C)
  11. Songwriter Sues Singer; Says Song Stolen (A)
  12. County Funds Free Flu Vaccinations (D)
7. Distribute Activity 4.3. If appropriate, have a few students read the information aloud. Call on students to state specific liberal and conservative arguments, informed by Activity 4.3, and list these on the chalkboard. Check for understanding with the following two questions.
- Suppose a U.S. senator proposes legislation that increases taxes for higher-income taxpayers, in order to provide more funds for public education. Is this senator more likely to have a conservative view or a liberal view of the economic role of government?  
*(Liberal view.)*
  - A Congressional leader argues that there should be a constitutional amendment that limits the size of the federal government. Is this policymaker more likely to be liberal or conservative?  
*(Conservative.)*
8. Explain that the class will examine headline 9 (*Legislature Passes Funding for Subsidized Housing*) in Activity 4.2, from the liberal and conservative perspectives. Divide the class into small groups. Designate each group as holding either a liberal or a conservative viewpoint. Each group should then discuss how a liberal or conservative would view headline 9. Ask the members of each group to select a spokesperson to report their findings. After the groups have completed their work, have the spokespersons present their arguments to the class as a whole.
9. Conclude this activity by pointing out that liberals and conservatives are at the opposing end of a spectrum. Many people find themselves to be located in different places along the spectrum.

**CLOSURE**

Call on the students to name the six economic functions of government. After each function is named, ask other students to give an example. Ask the class why, since there is broad agreement that government should perform these functions, there is disagreement sometimes about whether government should engage in particular activities.

**ASSESSMENT****Multiple-Choice Questions**

1. Public goods and services are
  - A. all goods and services paid for by government.
  - B. goods and services provided by publicly held companies.
  - C. **goods and services that would not be adequately provided by the market.**
  - D. goods and services that are available to the public.

2. Establishing and enforcing clearly defined property rights is an example of government
  - A. providing a social and legal framework.**
  - B. maintaining competition.
  - C. providing public goods and services.
  - D. redistributing income.
  
3. Smoke from a factory drops ash all over your car. Government's economic function in this case is to
  - A. stabilize the economy.
  - B. maintain competition.
  - C. provide public goods and services.
  - D. correct a negative externality.**

### Constructed-Response Questions

1. Federal regulations now require Internet radio stations to pay substantial royalty fees (fees to the artists and songwriters) for the music that they play. Some stations were not able to pay the fees and have gone “off the air.” What economic function of government is this an example of? Who benefits and loses from the regulation? What argument would you make for and against the regulation?

*(These regulations are an example of government policy aimed at establishing and enforcing property rights. The protection of property rights is an element of the legal and social framework government establishes. In this case, songwriters and artists benefit from the legal protection in question; the regulation maintains their property rights and enhances their incentive to produce music. Radio station operators and listeners lose. There are fewer Internet radio stations and less choice for listeners.)*

2. Many city governments subsidize the construction of sports stadiums as a way to attract or hold on to sports teams. Write an argument for this practice, using the economic functions of government in support of your claim. Then present an alternative view, arguing against your initial claim.

*(Public support for sports stadiums might be regarded as an example of correcting for externalities. The economic argument for taxpayer-financed subsidization is that the sports teams provide substantial external benefits. The city gains visibility that might attract new businesses and visitors who will spend money in the city. Thus, many people benefit, including those who never attend any stadium events. Opponents argue that there is little “spill-over” benefit since people who attend stadium events do so instead of paying for other recreational activities, like going out to restaurants, museums, or shopping in local stores. Moreover, attending a stadium event seems to be a private activity, like going bowling or golfing or seeing a movie; those who want to participate in such activities should pay their own way.)*

VISUAL 4.1/ACTIVITY 4.1

**SIX ECONOMIC FUNCTIONS OF GOVERNMENT**

1. Maintain the Legal and Social Framework
2. Maintain Competition
3. Provide Public Goods and Services
4. Correct for Externalities
5. Stabilize the Economy
6. Redistribute Income

## ACTIVITY 4.2

### CLASSIFYING GOVERNMENT ACTIONS

**Directions:** Below is a list of the six economic functions of government, followed by a set of 12 (fictitious) newspaper headlines. Decide which of the six economic functions is referred to, directly or by implication, in each headline. Classify each headline according to the six functions by writing in the letter of the economic function that best fits that headline.

**The Six Economic Functions:**

- A. Maintain the Legal and Social Framework
- B. Maintain Competition
- C. Provide Public Goods and Services
- D. Correct for Externalities
- E. Stabilize the Economy
- F. Redistribute Income

**The Headlines:**

- \_\_\_ 1. Federal Reserve Raises Key Interest Rate
- \_\_\_ 2. Congress Raises Tax Rates for Top Income Brackets
- \_\_\_ 3. EPA Plan to Reduce CO<sub>2</sub> Emissions
- \_\_\_ 4. Homeland Security Funding Increased
- \_\_\_ 5. President Says More Spending Will Fight Recession
- \_\_\_ 6. Agency Blocks Merger of Two Airlines
- \_\_\_ 7. City Police Increase Neighborhood Patrols
- \_\_\_ 8. Lawsuit Establishes Patent Rights
- \_\_\_ 9. Legislature Passes Funding for Subsidized Housing
- \_\_\_ 10. New Info from Government Agency Helps Consumers Choose Wisely
- \_\_\_ 11. Songwriter Sues Singer; Says Song Stolen
- \_\_\_ 12. County Funds Free Flu Vaccinations



## ACTIVITY 4.3

# WHAT ROLE SHOULD THE GOVERNMENT PLAY IN THE ECONOMY?

Although it is generally agreed that there is a role for the government to play in redistributing income in favor of the poor, providing public goods and services, and dealing with externalities, there is considerable disagreement over how far the government should go in these areas—and about additional areas for which some people believe the government should be responsible. Some people believe that “big government” is already a problem—that government is doing too much. Others believe that the government sector of the economy is being starved and that government should be allowed to do more. In the United States, the former view is associated with what is commonly called “conservative” political thinking; the latter view is associated with “liberal” political thinking.

### The Conservative View

Conservatives believe that the government’s role in the economy should be severely limited. They believe that economic and political freedom will be undermined by excessive reliance on government. Moreover, they question the government’s ability to solve social and economic problems. They believe that faith in the government’s power to solve these problems is unreasonable. They point to the slowness of government bureaucracy, the difficulty in controlling huge government organizations, the problems political considerations can breed, and the difficulties that arise when people try to learn whether government programs are successful or not. On the basis of these considerations, they argue that the government’s role should be carefully limited. They call for more and better information about what government can reasonably be expected to do (and do well).

### The Liberal View

While conservatives often question the government’s ability to solve important social and economic problems, liberals often question the market’s ability to solve such problems. They point to important limitations within the market system, and they claim that the government can do a great deal to overcome these limitations. Government can regulate private economic activity—for example, through minimum-wage laws. It can also provide goods and services that private businesses produce in insufficient quantities—for example, health care for the poor. In their advocacy for government programs of this sort, liberals tend to be less concerned than conservatives about the effects on personal freedom that may be a consequence of governmental intervention in the economy. They are more concerned with certain consequences of market activity—contending, for example, that the price system is unfair because it awards goods and services to those who can pay the price. In their view, people who acquire little in the way of goods and services through market activity are forced into lives of hardship. Liberals are, therefore, more concerned than conservatives about the unequal distribution of income produced by market activity and are more likely to propose government policies aimed at redistributing income in a manner that will reduce income inequality.

## ACTIVITY 4.3, CONTINUED

# WHAT ROLE SHOULD THE GOVERNMENT PLAY IN THE ECONOMY?

### Questions for Discussion

1. Suppose a U.S. Senator proposes legislation that increases taxes for higher- income taxpayers in order to make more funds available for public education. Is this Senator more likely to have a conservative view or a liberal view of the economic role of government?
2. A Congressional leader argues that there should be a constitutional amendment that limits the size of the federal government. Is this policymaker more likely to be liberal or conservative?