I. major reasons for government involvement in market economy

Economics, Tax

I. MAJOR REASONS FOR GOVERNMENT INVOLVEMENT IN MARKET ECONOMY

1. Providing the economy with a legal structure: This is the first and most important function a government should provide and without it an economy may collapse. This function requires the government to ensure property rights, provide enforcement of contracts, act as a referee and impose penalties for foul play. In order to perform this function, the government should furnish the economy with regulations, legislations, and means that ensure product quality, define ownership rights and enforce contracts. 2. Maintaining competition: Since competition is the optimal and efficient market mechanism that encourages producers and resource suppliers to respond to price signals and consumer sovereignty, the government should fight monopoly power and non-competitive behavior. Thus, anti-monopoly laws are designed to regulate business behavior and promote competition. 3. Redistribution of income: The government should strive to provide relief to the poor, dependent, handicapped, and unemployed. Welfare, Social Security and Medicare programs are examples of programs that support the poor, sick and elderly. These programs are built on transferring income from the high income groups to the limited income ones, through progressive taxes. Other means of redistribution might include price support programs such as the farm subsidy and low interest loans to students based on their family incomes. 4. Provision of public and quasi-public goods: When the markets fail to provide the needed goods or the correct amounts of certain goods or services, the government fills in the vacuum. Examples of public goods that the markets do not provide are defense, security, police protection and the judicial system. Education and health services are

examples of quasi-public (merit) goods that the market does not provide enough of. 5. Promoting growth and stability: The governmet should promote macroeconomic growth and stability (increasing the GDP, fighting inflation and unemployment) through changes in its fiscal and monetary policies. The fiscal policies means the use of taxes and spending and it is managed by the executive branch represented mainly by the Treasury Department. The monetary policies signifies the use of interest rates, money supply, reserve requirements, etc. and it is managed by the Federal Reserve System.