

# The Size and Role of Government: Economic Issues



The size and role of the government is one of the most fundamental and enduring debates in American politics. Economics can be used to analyze the relative merits of government intervention in the economy in specific areas, but it cannot answer the question of whether there is too much or too little government activity overall. That is not to say that one cannot find many examples of government programs that economists would consider to be a highly inefficient, if not counterproductive, way to achieve policy goals. Reducing inefficient government spending would benefit the economy; however, reducing efficient government spending would harm it, and reducing the size of government could involve either one. Government intervention can increase economic efficiency when market failures or externalities exist. Political choices may lead to second-best economic outcomes, however, and some argue that, for that reason, market failures can be preferable to government intervention. In the absence of market failures and externalities, there is little economic justification for government intervention, which lowers efficiency and probably economic growth. But government intervention is often based on the desire to achieve social goals, such as income redistribution. Economics cannot quantitatively value social goals, although it can often offer suggestions for how to achieve those goals in the least costly way. The government intervenes in the economy in four ways. First, it produces goods and services, such as infrastructure, education, and national defense. Measuring the effects of these goods and services is difficult because they are not bought and sold in markets. Second, it transfers income, both vertically across income levels and horizontally among groups with similar incomes and different characteristics. Third, it taxes to pay for its outlays, which can lower economic

efficiency by distorting behavior. Not all taxes are equally distortionary, however, so there are ways of reducing the costs of taxation without changing the size of government. Furthermore, deficit spending does not allow the government to escape the burden of taxation since deficits impose their own burden. Finally, government regulation alters economic activity. The economic effects of regulation are the most difficult to measure, in terms of both costs and benefits, yet they cannot be neglected because they can be interchangeable with taxes or government spending. There are many different ways to measure the size of the government, making its economic effects difficult to evaluate. Budgeting conventions are partly responsible: tax expenditures, offsetting receipts and collections, and government corporations are all excluded from the budget. But some governmental functions, like regulation, simply cannot be quantified robustly. Discussions about the overall size of government mask significant changes in the composition of government spending over time. Spending has shifted from the federal to the state and local level. Federal production of goods and services has fallen, while federal transfers have grown significantly. In 2009, nearly two-thirds of federal spending is devoted to Social Security, Medicare, Medicaid, and national defense. Thus, there is limited scope to alter the size of government without fundamentally altering these programs. The share of federal spending devoted to the elderly has burgeoned over time, and this trend is forecast to continue. The size of government has increased significantly since the financial crisis of 2008 as a result of the government's unplanned intervention in financial markets and subsequent stimulus legislation. Much of the increase in government spending is temporary and could be reversed when financial conditions return to normal, although many question how easy it will be for the government to extricate itself from new commitments it has made.

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