CEE Growth & Development

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UPCES
Lecture 16

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Government role in economic development

Government affects economic growth through influence on

- Accumulation of capital

- Technological progress

Government involvement in economy can have two extremes *laissez-fair* or complete government ownership.

When does government intervene in the economy?

1. Market failure
   - Public goods
2. Externalities
   - Positive
   - Negative
3. Monopolies
4. Coordination failures
5. Income distribution

How does government affect growth?

1. Maintenance of the *Rule of Law*

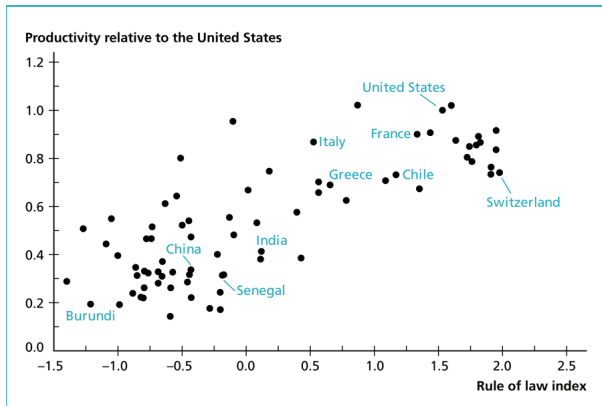2. Control of government size

3. Practice of planning

Rule of Law

Rule of Law indicator describes enforceability of contracts and the effectiveness and predictability of the judiciary and the incidents of crime.
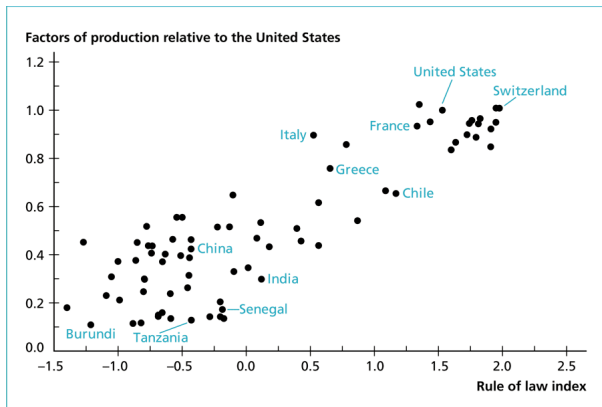
Source: Kaufmann, Kray, and Mastruzzi (2007). Data are scaled to have a standard deviation of 1.
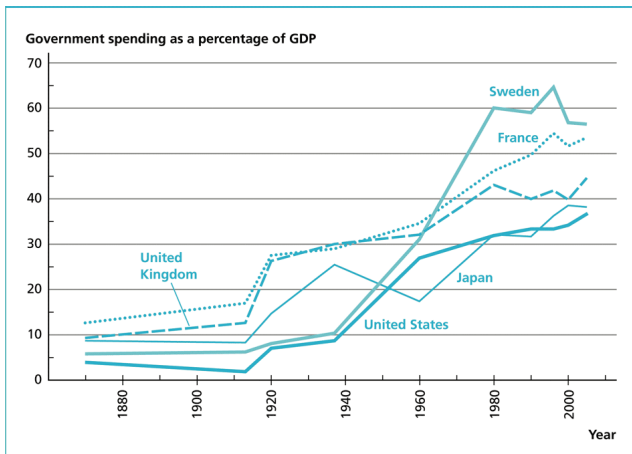
Rule of Law

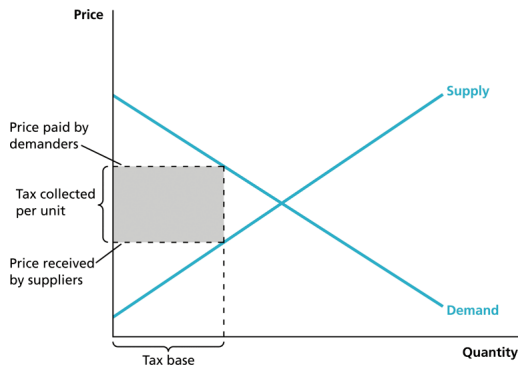*Source:* Kaufmann, Kray, and Mastruzzi (2007). Data are scaled to have a standard deviation of 1.

Government size

Wagner's Law argues that government increases as countries
become wealthier.

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Supply $Q = P$;
where P is the price of good and Q is the quantity supplied or demanded.

- Solve for the equilibrium price?

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- What is the tax rate (τ) that maximizes the government's revenue?