**The Government as a Producer and an Employer**



**The Government as a producer**

The Government is a producer because they pay attention to the economic struggles that we have on a regular basis and the create [produce] opportunities, **governments** are producers of some kinds of services—such as police services, defence, public schools, and mail delivery—and sometimes goods, such as when a government owns the oil fields and oil production (for example, OPEC).

1. **To produce essential services** - [Goods](http://www.businessdictionary.com/definition/goods.html) or [services](http://www.businessdictionary.com/definition/services.html) (such as [education](http://www.businessdictionary.com/definition/education.html), health, taking care of elderly people) are provided [free](http://www.businessdictionary.com/definition/free.html) because these are considered as essential goods
2. **Merit Good**: [Goods](http://www.businessdictionary.com/definition/goods.html) or [services](http://www.businessdictionary.com/definition/services.html) (such as [education](http://www.businessdictionary.com/definition/education.html) and vaccination) are provided [free](http://www.businessdictionary.com/definition/free.html) for the [benefit](http://www.businessdictionary.com/definition/benefit.html) of the entire society by a [government](http://www.businessdictionary.com/definition/government.html), because they would be under-provided if left to the [market forces](http://www.businessdictionary.com/definition/market-forces.html) or [private enterprise](http://www.businessdictionary.com/definition/private-enterprise.html)
3. **To control monopolies**can lead to under-production and higher prices than would exist under conditions of competition, causing consumer welfare to be damaged. If these services are given in the hands of private sector they will charge high prices whereas government want the people should get it at fair price. E.g ownership of natural resources.
4. **To produce Public goods**- Public goods are goods for which total cost of production does not increase with the number of consumers. Public goods will not be provided by the market. It is not possible that people pay for these services e.g street lightning.

**Full employment**

Full employment is a condition of the national economy, where all or nearly all persons willing and able to work at the prevailing wages and working conditions are able to do so. It is defined either as 0% unemployment, literally, no unemployment (the [rate of unemployment](http://www.wikipedia.org/wiki/Unemployment_rate) is the fraction of the [work force](http://www.wikipedia.org/wiki/Work_force) unable to find work) .We should first start by noting that the goal for unemployment is NOT zero. Some unemployment is inevitable and even desirable. If unemployment is too low, firms cannot find workers, resulting in output loss. Full employment does NOT mean zero unemployment. To understand what full employment means, let’s look at 3 types of unemployment:

* Frictional unemployment is the unemployment that results from people switching jobs or entering the labour market. The job search takes time, so this type of unemployment is inevitable. Frictional unemployment is temporary because the jobs and workers are there. They just have to find each other. Recent college graduates who take a couple of months to land a job are an example of frictional unemployment. Employment agencies, classified ads, the internet all reduce the time is takes to match job offers to job seekers but some frictional employment will always exist.
* Structural unemployment is more serious. This type of unemployment is caused by a mismatch between job skills needed and jobs skills possessed by job seekers, or a mismatch in the location of jobs and job seekers. Although the jobs are out there, the job seekers are not qualified for them or have to move to find them, making structural unemployment more long-term as people retrains or relocate. For example, many garment workers have lost their jobs in the U.S. as factories move overseas, but they are not qualified to fill job openings for computer programmers and web developers. With the rapid pace of technological change and growth of global markets, structural unemployment is also inevitable.
* **Cyclical unemployment** occurs when there are too few jobs available due to an economic slowdown. Due to low demand for goods and services, the number of workers demands is less than the number of workers available in the labour force. Cyclical unemployment corresponds to recessions.
* **Temporary work** or **temporary employment** refers to a situation where the [employee](http://en.wikipedia.org/wiki/Employee) is expected to leave the employer within a certain period of time.
* Technological unemployment - [Unemployment](http://www.allbusiness.com/glossaries/unemployment/4943616-1.html) resulting from the application of new technology, either by eliminating jobs or by changing the nature of work so that those who had performed the work no longer have applicable skills to do so.
* Seasonal employment refers to a situation where a number of persons are notable to find jobs during some months of the year. Example: Agriculture is a seasonal activity. There is an increased demand for labour at the time of sowing, harvesting, weeding and threshing.

**Unemployment rate**

Percentage of total workforce, who are [unemployed](http://www.businessdictionary.com/definition/unemployed.html) and are looking for a paid [job](http://www.businessdictionary.com/definition/job.html). Unemployment [rate](http://www.businessdictionary.com/definition/rate.html) is one of the most closely watched [statistics](http://www.businessdictionary.com/definition/statistics.html) because a rising rate is seen as a [sign](http://www.businessdictionary.com/definition/sign.html) of weakening [economy](http://www.businessdictionary.com/definition/economy.html) that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy which is usually accompanied by higher [inflation](http://www.businessdictionary.com/definition/inflation.html) rate and may call for increase in [interest rates](http://www.businessdictionary.com/definition/interest-rate.html).



#### Why does the Government collect statistics on the unemployed?

When workers are unemployed, they, their families, and the country as a whole lose. Workers and their families lose wages, and the country loses the goods or services that could have been produced. In addition, the purchasing power of these workers is lost, which can lead to unemployment for yet other workers.

To know about unemployment—the extent and nature of the problem—requires information. How many people are unemployed? How did they become unemployed? How long have they been unemployed? Are their numbers growing or declining? Are they men or women? Are they young or old? Are they skilled or unskilled? Are they the sole support of their families, or do other family members have jobs? Are they more concentrated in one area of the country than another? After these statistics are obtained, they have to be interpreted properly so they can be used—together with other economic data—by policymakers in making decisions as to whether measures should be taken to influence the future course of the economy or to aid those affected by joblessness.

**Price Stability**

The situation whereby the [prices](http://www.businessdictionary.com/definition/price.html) of goods and services offered in the [marketplace](http://www.businessdictionary.com/definition/marketplace.html) either [change](http://www.businessdictionary.com/definition/change.html) very slowly or do not change at all. [Factors](http://www.businessdictionary.com/definition/factor.html) affecting this include [employment](http://www.businessdictionary.com/definition/employment.html) and [inflation](http://www.businessdictionary.com/definition/inflation.html). A situation in which [prices](http://www.investorwords.com/3807/price.html) in an [economy](http://www.investorwords.com/1652/economy.html) doesn't [change](http://www.investorwords.com/7046/change.html) much over time. Price stability would mean that an economy would not [experience](http://www.investorwords.com/13271/experience.html) inflation or deflation. It is not common for an economy to have price stability. In most of the countries, average prices are measured by the government using Consumer price Index.

A **consumer price index** (**CPI**) measures changes in the price level of a [market basket](http://en.wikipedia.org/wiki/Market_basket) of consumer goods and services purchased by households. It is one of several [price indices](http://en.wikipedia.org/wiki/Price_index) calculated by most national statistical agencies. The annual percentage change in a CPI is used as a measure of inflation. A CPI can be used to index (i.e., adjust for the effect of inflation) the real value of wages, salaries, [pensions](http://en.wikipedia.org/wiki/Pension), for regulating prices and for deflating monetary magnitudes to show changes in real values.

**Inflation**

Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Another popular way of looking at inflation is "too much money chasing too few goods". The last definition attributes the cause of inflation to monetary growth relative to the output / availability of goods and services in the economy.

In case, the price of say only one commodity rise sharply but prices of other commodities fall, it will not be termed as inflation.  Similarly, in case due to rumours if the price of a commodity rises during the day itself, it will not be termed as inflation.

Measuring inflation is a difficult problem for government statisticians. To do this, a number of goods that are representative of the economy are put together into what is referred to as a "market basket." The cost of this basket is then compared over time. This results in a price index, which is the cost of the market basket today as a percentage of the cost of that identical basket in the starting year.

In a similar way, each year government set out a national budget showing the taxes to be raised for government spending. Inflation reduces the value of some taxes received. The main reason that government wants price stability is to do the perfect planning for future and help businesses, to do their transactions with more certainty.

National Budget

A national budget is a government document presenting the government's proposed revenues and spending for a financial year that is often passed by the legislature, approved by the chief executive or president and presented by the Finance Minister to the nation. The budget is also known as the Annual Financial Statement of the country

**What is Deflation?**

Deflation is the opposite of inflation.   Deflation refers to a situation, where there is decline in general price levels.   Thus, deflation occurs when the inflation rate falls below 0% (or it is negative inflation rate).   Deflation increases the real value of money and allows one to buy more goods with the same amount of money over time.   Deflation can occur owing to reduction in the supply of money or credit.   Deflation can also occur due to direct contractions in spending, either in the form of a reduction in government spending, personal spending or investment spending. Deflation has often had the side effect of increasing unemployment in an economy, since the process often leads to a lower level of demand in the economy.

**Economic policy** refers to the actions that governments take in the economic field. It covers the systems for setting interest rates and government budget as well as the labour market, national ownership, and many other areas of government interventions into the economy.

**Economic growth** is the increase in the market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in *real gross domestic product*, or *real GDP*.

The [gross domestic product](http://www.investopedia.com/terms/g/gdp.asp) (GDP) is one the primary [indicators](http://www.investopedia.com/terms/i/indicator.asp) used to gauge the health of a country's [economy](http://www.investopedia.com/terms/e/economy.asp). It represents the total dollar value of all goods and services produced over a specific time period - you can think of it as the size of the economy. Usually, GDP is expressed as a comparison to the previous quarter or year. For example, if the year-to-year GDP is up 3%, this is thought to mean that the economy has grown by 3% over the last year. GDP [per capita](http://en.wikipedia.org/wiki/Per_capita) is often considered an indicator of a country's [standard of livin](http://en.wikipedia.org/wiki/Standard_of_living)g. GDP is important because it gives information about the size of the economy and how an economy is performing. The growth rate of real GDP is often used as an indicator of the general health of the economy. In broad terms, an increase in real GDP is interpreted as a sign that the economy is doing well. When real GDP is growing strongly, [employment](https://www.imf.org/external/pubs/ft/fandd/basics/unemploy.htm) is likely to be increasing as companies hire more workers for their factories and people have more money in their pockets. When GDP is shrinking, as it did in many countries during the recent global economic crisis, employment often declines. In some cases, GDP may be growing, but not fast enough to create a sufficient number of jobs for those seeking them. But real GDP growth does move in cycles over time. Economies are sometimes in periods of boom, and sometimes in periods of slow growth or even [recession](https://www.imf.org/external/pubs/ft/fandd/basics/recess.htm) (with the latter often defined as two consecutive quarters during which output declines). In the United States, for example, there were six recessions of varying length and severity between 1950 and 2011. The National Bureau of Economic Research makes the call on the dates of U.S. business cycles.

As one can imagine, economic production and growth, what GDP represents, has a large impact on nearly everyone within that economy.

[ces](http://www.economicsonline.co.uk/Managing_the_economy/Stable_prices.html), so that the effect of price rises on the value of national output is removed.

[Sustainable](http://www.economicsonline.co.uk/Global_economics/Measure_of_economic_welfare_MEW.html) economic growth means a rate of growth which can be maintained without creating other significant economic problems, especially for future generations. There is clearly a trade-off between rapid economic growth today, and growth in the future. Rapid growth today may exhaust resources and create environmental problems for future generations, including the depletion of oil and fish stocks, and global warming.

Periods of growth are often triggered by increases in [aggregate demand](http://www.economicsonline.co.uk/Managing_the_economy/Aggregate_demand.html), such as a rise in consumer spending, but sustained growth must involve an increase in [output](http://www.economicsonline.co.uk/Managing_the_economy/Aggregate%2Bsupply.html). If output does not increase, any extra demand will push up the [price level](http://www.economicsonline.co.uk/Managing_the_economy/Inflation_and_deflation.html).

The economic systems in many de­vel­op­ing coun­tries are far from being fully functional: there is a lack of competition, and access to resources is in­equit­able as is the dis­tri­bu­tion of wealth and income, all of which hamper growth and de­vel­op­ment.

The precondition for in­clu­sive eco­nom­ic growth and for boost­ing public in­come in these coun­tries is the intro­duc­tion of an en­abling en­vi­ron­ment for private-sector ac­ti­vi­ties. The pros­pects of success and the effi­cien­cy of economic policy depend essentially on the quality of state structures and institutions. State actors must be able to draft pro-growth economic policy and to translate this policy into practice.

**Trade Cycle**

The trade cycle refers to the ups and downs in the level of economic activity which extends over a period of several years. If we examine the past statistical record of the business conditions, we will find that business has never run smoothly forever. There are many fluctuations in the period. Sometimes prosperity is followed by adversely. In Economics this tendency of the business activities, to fluctuate from prosperity to adversely is called business cycle.

Fluctuations in [trade cycles](http://en.wikipedia.org/wiki/Trade_cycle#Explaining_business_cycles) can be caused by one or many of the following factors :-

1) Low employment levels or in other words High Unemployment rates may cause fluctuations in trade cycles.
2) The cycle may also be affected by employment levels above high or full employment levels which disturbs the equilibrium in a market.
3) The ratios between aggregate demands and aggregate supply.
4) Wages increase in periods of high employment levels and tend to fall in low unemployment scenarios which also affect the trade cycles and which in turn affects the demand/supply ratios.
5) The disparity between input and output levels.
6) Budget deficits.
7) Periods of inflation or periods of recession caused by the disparities in demand and supply.

**Policies to avoid a Recession**

**1. Cutting Interest Rates.** Cutting interest rates should help to boost aggregate demand. Amongst other things, lower interest rates reduce mortgage interest payments, giving consumers more disposable income. Lower interest rates also encourage firms and consumers to spend rather than save. (effect of lower interest rates)

As well as cutting base rates, the monetary authorities could try and reduce other interest rates in the economy. e.g. the Central Bank could buy government bonds or mortgage securities. Buying these bonds causes lower interest rates and helps to boost spending in the economy.

However, lower interest rates don’t always work. In 2008- 09, interest rates were cut to 0.5% in the UK, yet it didn’t avoid a recession. This was because

* Banks didn’t pass the base rate cut onto consumers
* Although interest rates were low, banks were reluctant to lend and consumers reluctant to spend.

In 2011, there is the prospect of a second recession, but interest rates are already low. Therefore, in this case it is not helpful.

**2. Expansionary Fiscal Policy.** Cutting taxes increases consumer disposable income. This can be a policy to increase consumer spending. However, it will cause higher government borrowing. This may not be practical for countries who are already seeing a rise in government bond yields (e.g. Euro members like Greece, Ireland and Italy, have little scope for expansionary fiscal policy)

Also, there is no guarantee tax cuts will boost spending if confidence is very low.As well as tax cuts, the government could try higher government spending on capital investment projects. This directly injects money into the economy, it may be more effective than tax cuts, if tax cuts are just saved.
**3. Devaluation**. Adevaluation in the exchange rate can cause a boost in aggregate demand. A fall in the value of the dollar, makes exports cheaper and imports more expensive increasing domestic demand.

**4. Quantitative Easing** If interest rates are already zero, then the Central Bank may have to pursue unconventional monetary policies. This involves the Central Bank electronically creating money and using this money to buy long dated securities. This increases bank reserves and should help encourage bank lending. Also, it reduces interest rates on bonds which should help encourage spending and investment.

**5. Higher Inflation Target.** This is a conscious decision to target growth rather than inflation.

Inequality

**Economic inequality** (also described as **the gap between rich and poor**, **income inequality**, **wealth disparity**, **wealth and income differences** or **wealth gap** is the difference between individuals or populations in the distribution of their [assets](http://en.wikipedia.org/wiki/Assets), [wealth](http://en.wikipedia.org/wiki/Wealth), or [income](http://en.wikipedia.org/wiki/Income).

**Poverty**

Poverty is about not having enough money to meet basic needs including food, clothing and shelter.  However, poverty is more, much more than just not having enough money. It is a [Condition](http://www.businessdictionary.com/definition/condition.html) where people's basic [needs](http://www.businessdictionary.com/definition/need.html) for [food](http://www.businessdictionary.com/definition/food.html), clothing, and shelter are not being met. Poverty is generally of two [types](http://www.businessdictionary.com/definition/type.html): (1) Absolute poverty is synonymous with destitution and occurs when people cannot [obtain](http://www.businessdictionary.com/definition/obtain.html) [adequate](http://www.businessdictionary.com/definition/adequate.html) resources (measured in [terms](http://www.businessdictionary.com/definition/term.html) of calories or nutrition) to support a minimum level of physical [health](http://www.businessdictionary.com/definition/health.html). Absolute poverty [means](http://www.businessdictionary.com/definition/mean.html) about the same everywhere, and can be eradicated as demonstrated by some [countries](http://www.businessdictionary.com/definition/country.html). (2) Relative poverty occurs when people do not enjoy a certain minimum level of living standards as determined by a [government](http://www.businessdictionary.com/definition/government.html) (and enjoyed by the [bulk](http://www.businessdictionary.com/definition/bulk.html) of the population) that vary from country to country, sometimes within the same country. Relative poverty occurs everywhere, is said to be increasing, and may never be eradicated.

# Poverty line

A minimum income level used as an official standard for determining the proportion of a population living in poverty. Someone is considered as poor if their income falls below the minimum level necessary to meet basic needs.

**For steps by government for redistribution of income refer to book page no 123.**

 **Conflicting aims of government**

**Economic Growth vs Inflation**

The main conflict of policy objective is between economic growth / unemployment and inflation. When the economy expands it is more likely that inflationary pressures will increase. Inflation is particularly likely to occur when growth is above the long run trend rate and AD increases faster than AS. For example, when the economy is growing very quickly, firms have difficulty employing sufficient skilled labour; this can lead to wage inflation which leads to higher prices. Also if growth is very quick, there may be supply constraints pushing up commodity price increases.  This economic boom of the 1980s proved unsustainable and led to the recession in 1991.

**Economic Growth vs Balance of Payments**

When economic growth is led by consumer spending it tends to cause a deficit in the current account. This is because as consumer spending rises there will be a rise in import spending. However, if economic growth is export led then there can be an increase in economic growth without causing a current account deficit.

### Economic Growth vs Budget Deficit

A government may feel it needs to reduce the budget deficit. This will require higher taxes and lower spending. However, this tightening of fiscal policy will lead to a fall in AD and lead to lower economic growth. If spending cuts do lead to unemployment and lower growth, the government will need to pay more on benefits and will get lower tax receipts, therefore the deficit may experience only a small reduction.

However, it depends how you reduce a budget deficit. For example, if you raised the retirement age and made it more difficult to get welfare benefits, then you can reduce government spending but there is little negative impact on economic growth (people have to work harder). Though there may be side effects on issues of equality and fairness.

 **To finance all the government does**

Government provides us with certain services. Those services are financed with tax money. Some of those services are: health care, building roads, water supply, police, firefighters, judiciary system, education system, disaster relief, taking care of  bridges and many, many more.

When governments increase their spending, crowding out can occur – government spending reduces available funds and increases the cost of capital, leading many businesses to abandon expansion projects. Likewise, when a government spends in excess of receipts (a deficit) and must borrow funds to finance that deficit, crowding out can occur.

Likewise, taxation causes problems of its own. Taxes shift the equilibrium for goods and services away from its optimal level, therefore reducing [consumer](http://www.investopedia.com/terms/c/consumer_surplus.asp) and [producer surpluses](http://www.investopedia.com/terms/p/producer_surplus.asp). This reduction is called the deadweight loss and it basically represents the net benefit that is being sacrificed by society because of the presence of the tax.

**Tariffs**

Tariffs are levies charged by a government on imported goods. Tariffs are not as significant to economies now as in years past. A tax imposed on imported goods and services. Tariffs are used to restrict trade, as they increase the price of imported goods and services, making them more expensive to consumers. A specific tariff is levied as a fixed fee based on the type of item (e.g., $1,000 on any car). An ad-valorem tariff is levied based on the item’s value (e.g., 10% of the car’s value). Tariffs provide additional revenue for governments and domestic producers at the expense of consumers and foreign producers. They are one of several tools available to shape trade policy.

Governments may impose tariffs to raise revenue or to protect domestic industries from foreign competition, since consumers will generally purchase foreign-produced goods when they are cheaper. While consumers are not legally prohibited from purchasing foreign-produced goods, tariffs make those goods more expensive, which gives consumers an incentive to buy domestically produced goods that seem competitively priced or less expensive by comparison

An ***ad valorem* tax** ([Latin](http://en.wikipedia.org/wiki/Latin_language) for "according to value") is a [tax](http://en.wikipedia.org/wiki/Tax) based on the value of [real estate](http://en.wikipedia.org/wiki/Real_estate) or [personal property](http://en.wikipedia.org/wiki/Personal_property). It is typically imposed at the time of a transaction, as in the case of a [sales tax](http://en.wikipedia.org/wiki/Sales_tax) or [value-added tax](http://en.wikipedia.org/wiki/Value-added_tax) (VAT). However, an *ad valorem* tax may also be imposed on an annual basis, as in the case of a real or personal [property tax](http://en.wikipedia.org/wiki/Property_tax), or in connection with another significant event (e.g. [inheritance tax](http://en.wikipedia.org/wiki/Inheritance_tax), [expatriation tax](http://en.wikipedia.org/wiki/Expatriation_tax), or [tariff](http://en.wikipedia.org/wiki/Tariff)).[[1]](http://en.wikipedia.org/wiki/Ad_valorem_tax#cite_note-1) In some countries a [stamp duty](http://en.wikipedia.org/wiki/Stamp_duty) is imposed as an *ad valorem* tax.

A per unit tax, or specific tax, is a tax that is defined as a fixed amount for each unit of a good or service sold, such as cents per kilogram. It is thus proportional to the particular quantity of a product sold, regardless of its price. Excise taxes, for instance, fall into this tax category

The term **direct tax** generally means a [tax](http://en.wikipedia.org/wiki/Tax) paid directly to the government by the persons on whom it is imposed.

An **indirect tax** (such as [sales tax](http://en.wikipedia.org/wiki/Sales_tax), a [specific tax](http://en.wikipedia.org/wiki/Per_unit_tax), [value added tax](http://en.wikipedia.org/wiki/Value_added_tax) (VAT), or [goods and services tax](http://en.wikipedia.org/wiki/Value_added_tax) (GST)) is a [tax](http://en.wikipedia.org/wiki/Tax) collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). The intermediary later files a tax return and forwards the tax proceeds to [government](http://en.wikipedia.org/wiki/Government) with the return. An indirect tax may increase the price of a good so that consumers are actually paying the tax by paying more for the products. Examples would be fuel, liquor, and cigarette taxes. An [excise duty](http://en.wikipedia.org/wiki/Excise_duty) on motor cars is paid in the first instance by the manufacturer of the cars; ultimately the manufacturer transfers the burden of this duty to the buyer of the car in form of a higher price. Thus, an indirect tax is such which can be shifted or passed on.

Indirect taxes such as a [sales tax](http://en.wikipedia.org/wiki/Sales_tax) or a [value added tax](http://en.wikipedia.org/wiki/Value_added_tax) (VAT) are imposed only if and when a taxable transaction occurs. People have the freedom to engage in or refrain from such transactions; whereas a direct tax (in the general sense) is imposed upon a person, typically in an unconditional manner. " A direct tax is one that cannot be shifted by the taxpayer to someone else, whereas an indirect tax can be.

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| --- | --- |
|  | **'Progressive Tax'**A tax that takes a larger percentage from the income of high-income earners than it does from low-income individuals. The United States income tax is considered progressive. Individuals who earn more pay higher taxes; those taxes are then used to fund social welfare programs that are used primarily by individuals who earn less. Critics of the progressive tax consider it to be discriminatory and believe that a flat tax system, which imposes the same tax on everyone regardless of income, is a fairer method of taxation.**'Regressive Tax'**A **regressive tax** is a [tax](http://en.wikipedia.org/wiki/Tax) imposed in such a manner that the [tax rate](http://en.wikipedia.org/wiki/Tax_rate) decreases as the amount subject to taxation increases. A tax that takes a larger percentage from low-income people than from high-income people. A regressive tax is generally a tax that is applied uniformly. This means that it hits lower-income individuals harder.Some examples include gas tax and cigarette tax. For example, if a person has $10 of income and must pay $1 of tax on a package of cigarettes, this represents 10% of the person's income. However, if the person has $20 of income, this $1 tax only represents 5% of that person's income.Sales taxes that apply to essentials are generally considered to be regressive as well because expenses for food, clothing and shelter tend to make up a higher percentage of a lower income consumer's overall budget. In this case, even though the tax may be uniform (such as 7% sales tax), lower income consumers are more affected by it because they are less able to afford it.**Proportional Tax**A tax system that requires the same percentage of income from all taxpayers, regardless of their earnings. A tax system that requires the same percentage of income from all taxpayers, regardless of their earnings. A proportional tax applies the same tax rate across low-, middle- and high-income taxpayers. The proportional tax is in contrast to a progressive tax, where taxpayers with higher incomes pay higher tax rates than taxpayers with lower incomes. A proportional tax is also called a flat tax.For example, in a proportional tax system, all taxpayers may be required to pay 10% of income in taxes. A sales tax can be considered a type of proportional tax since all consumers, regardless of earnings, are required to pay the same fixed rate. Supporters claim that proportional tax systems are fair and that they may encourage people to earn more money because they would not have to pay higher tax rates. Opponents believe that proportional taxes are similar to regressive tax (where the tax rate drops as the amount subject to taxation rises), placing a greater tax burden on low-income individuals. For a $1,000 purchase, for instance, consumers might pay $80 in sales tax (assuming an 8% sales tax rate). This $80 tax burden would be a higher percentage of income for low-income earners than it would be for high-income earners.**Why does government chooses progressive tax*** Even a steeply progressive income tax---*right up to 99% on the highest incomes*---would impose *no loss of purchasing power* on wealthy income earners
* *Reducing* the income tax rates of rich citizens will weaken the economy if Congress cuts spending to pay for the tax cuts
* *Increasing* the amount of taxes collected from wealthy citizens will actually provide a *stimulus* to the economy
* The rich cannot get richer---*in real terms*---by getting their taxes cut, but they *can* become richer if they pay *more* in taxes
* The government is a major producer of Real Wealth
* An increase in the size of government is almost always quite desirable
* Wealthy citizens who are wise should be lobbying for an *increase* in government spending and an *increase* in their tax rates
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**Note:For methods of regulation refer to the text book**