

Cambridge IGCSE · Economics 0455 · Notes

The role of government

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Read first: **Mixed economic system**, **Market failure**

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What you need to know

This topic has one syllabus outcome. In plain words, you should be able to:

1. **The role of government:** describe what a government does in the economy at three levels: **locally** (in towns and regions), **nationally** (for the whole country) and **internationally** (in its dealings with other countries), and tell which level an action mainly works at.

It is a short topic that sets up the rest of "Government and the macroeconomy": the aims, fiscal, monetary and supply-side policy come next.

Understand it

Why an economy needs a government

In a **mixed economy** most goods are made by private firms, but markets on their own fail in some ways: they do not supply **public goods**, they under-supply **merit goods**, they over-supply **demerit goods**, and they can leave some people very poor. So the government steps in. It does this in several ways at once:

- as a **producer**: running state-owned enterprises and supplying services such as schools and hospitals;
- as an **employer**: of teachers, nurses, police officers and civil servants;
- as a **buyer**: of roads, equipment and medicines from private firms;
- as a **regulator**: setting and enforcing laws on safety, pollution, competition and minimum wages;
- as a **tax collector and spender**: raising taxes and paying for services and benefits (fiscal policy);
- as a **manager of the economy**: trying to reach its macroeconomic aims.

The local role

Local government (councils, city and regional authorities) provides the services people use close to home, usually paid for by **local taxes** (such as a property tax) and money from central government:

- collecting rubbish and recycling, street cleaning and street lighting;
- local roads, public transport, parks, libraries and sports centres;

- local schools, local health clinics and social care;
- planning permission: deciding where homes, shops and factories may be built;
- local regulation, such as checking food safety in restaurants.

For example, a city council that plans to spend \$50m in a year and raises \$30m from its local property tax needs $50 - 30 = 20$, so \$20m, from central government: $\frac{20}{50} \times 100 = 40\%$ of its spending.

The national role

Central government acts for the whole country:

- **Provides public goods** that the market will not supply, such as **defence**, the justice system and national flood defences.
- **Provides or subsidises merit goods**, such as education and health care, and **taxes or bans demerit goods**, such as cigarettes.
- **Redistributes income**: progressive taxes and **state benefits** (pensions, unemployment benefit) to reduce poverty and inequality.
- **Makes and enforces laws** that let markets work: property rights, contracts, consumer protection, competition law.
- **Runs state-owned enterprises** in some industries, such as railways or water.
- **Manages the economy** to meet its **macroeconomic aims**: economic growth, full employment, stable prices, balance of payments stability and a fair distribution of income. Its tools are **fiscal policy** (taxes and government spending), **monetary policy** (interest rates and the money supply, often run by the central bank) and **supply-side policy** (training, deregulation, privatisation).

The international role

Governments also deal with other countries and with international organisations. An action is **international** when it mainly changes the country's **trade, external competitiveness or relations with other countries**:

- **Trade policy**: signing **trade agreements** and joining trade blocs; **imposing tariffs** or quotas on imports; subsidising exports.
- **Exchange-rate policy**: letting the currency **depreciate** makes exports cheaper abroad and imports dearer at home.
- **Movement of people**: issuing **visas** to tourists, students and workers, and controlling immigration.
- **International organisations**: membership of bodies such as the World Trade Organization, the United Nations and the International Monetary Fund.
- **Aid**: giving **foreign aid** and **humanitarian aid** (for example to refugees after a war or disaster).
- **Shared problems**: agreements on climate change, pollution that crosses borders, and defence alliances.

Domestic or international? The test to use

Ask: **does the action mainly change conditions inside the country, or the country's links with the rest of the world?**

Action	Level	Why
Raising the national minimum wage	National (domestic)	It changes wages in the home labour market
Deregulating an industry	National (domestic)	It changes competition in a home market
Building a power station or wind farm	Local or national (domestic)	It adds to the country's own energy supply; it is often done by a firm, not the government
Imposing a tariff on imports	International	It restricts imports from other countries
Letting the exchange rate fall	International	It makes exports more competitive abroad
Issuing visas to foreign visitors	International	It controls who enters from abroad
Sending aid to refugees abroad	International	It is help given to people in other countries

What a government does not do

Some economic jobs belong to other decision makers, not the government:

- **Paying dividends to shareholders** is done by **companies** out of their profits.
- **Deciding what to produce for profit** in a private market is the job of **firms**.
- **Saving and spending wages** is done by **households**.

A government can own shares or run a state-owned enterprise, but paying out profits to private shareholders is the firm's role, not one of the government's roles in the economy.

Key facts and formulas

There is no formula list for 0455, and this topic has never been examined by calculation; the council sum above only shows how local services are paid for. "Learn it" means you must remember it.

Fact	Status
The government's roles in the economy: producer, employer, buyer, regulator, tax collector and spender, manager of the economy	Learn it

Fact	Status
Local role: local services such as rubbish collection, local roads and transport, parks, local schools, planning permission, paid partly by local taxes	Learn it
National role: public goods (defence, justice), merit goods (education, health care), state benefits, laws and regulation, managing the macroeconomic aims	Learn it
International role: trade agreements, tariffs and quotas, exchange-rate policy, visas and immigration, international organisations, foreign and humanitarian aid	Learn it
An action is international if it mainly changes trade, external competitiveness or relations with other countries	Learn it
Paying dividends to shareholders is a firm's role, not the government's	Learn it

How to do it

We have tagged only 3 questions on this topic, all multiple choice on Paper 1, in **2022** (May/June), **2025** (October/November) and **2026** (February/March). All 3 are different. A Paper 2 part could still ask you to identify, explain or discuss a role of government, so section 3 below covers the written types too.

Question type	Questions
Multiple choice (concept): sort government actions into domestic and international	2
Multiple choice (concept): pick the role a government does not perform	1

1. Multiple choice (concept): sort government actions into domestic and international (2 questions)

1. For each action, ask the test question: does it mainly change conditions **inside** the country, or its **links with other countries**?
2. Trade, the exchange rate, visas, aid abroad and international agreements are **international**.
3. Wages, regulation of home industries, building energy or transport at home are **domestic** (local or national).
4. In a yes/no table, tick only the actions that pass the test, and pick the row that matches.

Variations you will meet:

- **"Which actions are aimed at an international impact?"** (2026): the international ones are those that change trade or competitiveness, such as tariffs and a depreciating currency. A minimum wage and deregulation work inside the home economy.
- **"Which action is not part of the government's international role?"** (2022): three options concern other countries (tariffs, visas, aid to refugees); the odd one out is something done at home, such as building energy capacity.

2. Multiple choice (concept): pick the role a government does not perform (1 question)

1. Run through the government's roles: provides public and merit goods, pays benefits, taxes, regulates, manages the economy, signs trade deals.
2. The odd one out belongs to **another decision maker**: a firm (paying dividends, making profit), a household (spending wages, saving) or a bank (lending to customers).

3. If a written part is set

No written part has been tagged yet, but the command words work as in other topics:

- **Identify** (2 marks): two precise roles, such as "provides public goods such as defence" and "signs trade agreements".
- **Explain** (4 marks): two roles, each identified (1) and developed with why the government does it or its effect (1).
- **Analyse** (6 marks): three chains, a mark for each link, ending at the effect asked for.
- **Discuss** (6 or 8 marks): why the government's role helps, why it may not (cost and opportunity cost, government failure, taxes needed to pay for it), then a judgement on what it depends on.

Worked examples

Example 1

Which government action works mainly at the **international** level?

- **A** granting planning permission for a new shopping centre
- **B** joining a free trade agreement with neighbouring countries
- **C** raising the state pension
- **D** funding a new local hospital

[1]

B (1). A free trade agreement changes the country's trade with other countries. A and D are local services and C is a national transfer payment, all inside the country.

Example 2

Explain two roles of a government at the national level. [4]

A government provides public goods such as defence and the justice system (1), because they are non-excludable, so private firms could not charge for them and would not supply them (1). A government also redistributes income (1): it taxes people on high incomes at higher rates and pays state benefits to the poor, which reduces poverty and inequality (1).

Example 3

Analyse how a government acting internationally can help firms in its own country. [6]

A government can sign a trade agreement that removes tariffs in other countries (1). This makes the country's exports cheaper for foreign buyers (1), so domestic firms sell more abroad (1). Firms then produce more and employ more workers, which raises output and growth (1). A government can also impose tariffs on imports (1), which makes foreign goods dearer, so households switch to buying from domestic firms (1). (Any 6.)

Common mistakes

- **Treating any big policy as international.** In 2026 many students picked a minimum wage or deregulation as international. Ask what the action changes: a minimum wage changes pay at home and deregulation changes competition at home, so both are domestic. Only actions that change trade, the currency or links with other countries are international.
- **Reading a yes/no table too quickly.** Check every column against the test, not just the first two, before choosing a row.
- **Giving the government jobs that belong to firms.** Paying dividends and making profits for shareholders are what companies do.
- **Mixing up local and national.** Rubbish collection, local roads and planning permission are local; defence, the national minimum wage and pensions are national.

How to get the marks

- **Multiple choice:** 1 mark each, no penalty for guessing. Use the test question (inside the country, or links with other countries?) on each option and cross out the ones that fail.
- **Identify:** a precise role with an example ("provides merit goods such as education"), not a vague word like "helps".
- **Explain:** say **why** the government does it (market failure, fairness, an aim) or **what effect** it has.
- **Use economic terms:** public goods, merit goods, demerit goods, state benefits, regulation, tariffs, exchange rate, trade agreement, macroeconomic aims.

Quick check

1. Which action is part of a government's **local** role?
 - **A** collecting household rubbish
 - **B** setting tariffs on imported cars
 - **C** sending aid after an earthquake abroad
 - **D** deciding the national rate of income tax
2. Which is **not** a role of a government?

- **A** enforcing competition law
- **B** providing unemployment benefit
- **C** setting the prices charged in a private bakery
- **D** supplying national defence

3. Which pair of actions are both aimed mainly at an international impact?

- **A** cutting income tax and raising the minimum wage
- **B** issuing work visas and signing a trade agreement
- **C** building a new motorway and privatising the railway
- **D** subsidising schools and taxing cigarettes

4. Explain two roles of a government at the international level. **[4]**

Answers

1. **A.** Rubbish collection is a local council service. B and C are international; D is national. (1)
2. **C.** In a market economy a private firm sets its own prices. A, B and D are government roles. (1)
3. **B.** Visas control who enters from abroad and a trade agreement changes trade with other countries. The others all work inside the country. (1)
4. A government imposes tariffs on imports (1), which makes foreign goods dearer, protecting domestic firms and jobs (1). A government gives humanitarian aid to other countries (1), which helps people affected by wars or disasters and builds good relations with those countries (1). (Also: trade agreements, exchange-rate policy, visas, membership of international organisations, each with its explanation.)

Past questions to try

- 0455/12/F/M/26 Q17: which government actions mainly have an international impact.
- 0455/13/O/N/25 Q17: the one role a government does not perform.
- 0455/13/M/J/22 Q23: the action that is not part of the international role.