NAME; Daniel zigwai joy

MATRIC NUMBER; 18/SMS01/009

DEPT; ECONOMICS

COURSE CODE; ECO 206

1. Public expenditure will continue to grow.Discuss

**Answer**

Public expenditure grows in response to growth in general price level(inflation). Which means that if the population does not increase, or its growth remains constant, the public expenditures will still increase to keep pace with the rising costs of EXPENDITURE

REASONS WHY THEY CONTINUE TO GROW ARE:

#### 1.Welfare State Ideology and Wagner’s Law:

The modern State is a welfare state. It aims at promoting the economic, political, and social well-being of its citizens. It makes every effort to improve the living standard of the common people. For this purpose, it has to undertake may functions and services never visualised before.

Even in an avowedly capitalistic economy, there has been increasing State intervention through legislative and administrative measures for augmenting production and improving distribution. Many wants which were formerly satisfied individually by private means are now satisfied collectively through public expenditure.

In the classical era, the State was assumed to have a very limited function under the laissez faire policy. The functions of the State were restricted to justice, police, and army.Today, however, the role of the State has changed under the welfare criterion and there is a persistent trend towards an extensive and intensive increase in the scale of governmental performance. Apart from performing old functions more efficiently and on a larger scale, a modern State constantly undertakes new functions and added responsibilities day by day.

It now embraces many new ideas such as social insurance, unemployment relief, and provisions for underprivileged classes. In order to reduce inequalities of income, the State has to spend a large sum on free and cheap medical aid, subsidised food and housing, free education. Especially in underdeveloped countries such as India, the State expenditure on these social services is rising fast.

In India, for instance, expenditure on social service is rising fast. In India, for instance, expenditure on social services has gone up from Rs. 419 crores in the First Plan to Rs. 2,772 crores in the Fourth Plan. In the Seventh Plan, it was envisaged to be Rs. 29,350 crores.

Fundamentally, public expenditure in modern times shows an increasing trend on account of the “ever- increasing scale of State activity”. This tendency, in economic literature, is known as “Wagner’s law of increasing expansion of

#### 2. Effects of War and the Need for Defence:

The tremendous growth in public expenditure may also be attributed to wars and threats of war in modern times. In the Second World War, countries like England incurred heavy war expenditures, amounting to £ 15 million per day. Wars and threats of war and the consequent defence needs compel governments to spend more and more on the production of war goods.Due to the invention of nuclear weapons, there is always the danger of foreign aggression. International political situation is uncertain and insecure. Modern States are already facing a cold war. As such, every nation has to prepare itself for strong defence.

The defence expenditure is thus continuously rising. It contains expenditure on war materials, maintenance and growth of armed forces, naval and air wings, expenses on the development of military art and practice, pensions to retired war personnel, interests on war debt, cost of rehabilitation, etc.

#### 3. Resource Mobilisation and Ability to Finance:

#### When the government innovates more and more methods of taxation and resource mobilisation, its ability to finance public expenditure increases and the size of public expenditure grows. Public sector outlays could be increased by more taxation yields, public debt, foreign aid and deficit financing.

#### 4.Inflation:

With the rising prices, the government has to keep on increasing public expenditure to carry out its functions and maintain the supply of public goods intact. During inflation, the government has to pay additional DA to its employees which obviously call for an extra burden on public expenditure.

#### 5. The Role of Democracy and Socialism:

The recent growth of democracy and socialism everywhere in the world has caused public expenditure to increase very much. A democratic structure of government is inevitably more expensive than a totalitarian government. In India, democracy has certainly become a costly affair. Expenditure on elections and bye-elections is increasing.

The number of ministries and executive offices has also been increasing. Further, the ruling party has to fulfill its promises and launch upon new policies and programmes to achieve socialist objectives, in order to create a favourable image in the public. This also requires increasing State expenses in order to provide new amenities and opportunities to the people at large.

#### 6. The Urbanisation Effect:

The spread of urbanisation is an important factor leading to the relative growth of public expenditure in modern times. With the growth of urban areas, there has been an increasing tendency of expenditure on civil administration.

#### Expenses on water supply, electricity, provision of transport, maintenance of roads, schools and colleges, traffic controls, public health, parks and libraries, playgrounds, etc. have increased enormously these days. Likewise, the expenditure on courts, prisons etc. is increasing, especially in the urban ssector.

#### 7. The Rural Development Effect:

In an underdeveloped country, the government has also to spend more and more for rural development. It has to undertake schemes like community development projects and other social measures.

#### 8. The Population Effect:

A high growth of population naturally calls for increase in the expenses as all State functions are to be performed more extensively. Rising population also poses various problems in poor countries.

The State will have the added responsibility of solving such problems as food, unemployment, housing and sanitation. Further, overpopulated countries like India will have to check the population growth. The State has, therefore, to spend more and more on family planning campaigns every year.

#### 9. The Growth of Transport and Communication:

With the expansion of trade and commerce, the State has to provide and maintain a quick and efficient transport system. Transport being a public utility, the State has to provide it cheaply also. Hence, railway and passenger transport is nationalised.

Government has, therefore, to run transport services even at a loss. This obviously calls for a high expenditure for maintenance and expansion. Further, the government in a poor country has to spend a lot on constructing new railway lines, new roads, national highways, bridges and even canals to connect the different areas with a smooth transport system as a precondition of growth.

#### 10. The Planning Effect:

In a less developed economy, the government adopts economic planning for the development of the country. In a planned economy, thus, when the public sector is expanding its role, public expenditure obviously shows an increasing trend.

1b) why does the Government Borrow? - Essentially, the government borrow so that it can enable higher spending without having to increase taxes. Looking at the economic situation of nigeria I advice the country on borrowing cause it leads to 1.The annualHigher debt interest payments:.

 As borrowing increases, the government have to pay more interest rate payments on those who hold bonds. This can lead to a greater percentage of tax revenue going to debt interest payments.

Higher interest rates. In some circumstances, higher borrowing can push up interest rates because markets are nervous about governments ability to repay and they demand higher bond yields in return for perceived risk. This was particularly a problem for countries in the Eurozone because in 2011/12 there was no real lender of last resort. In periods of high inflation, investors will also demand higher bond yields – e.g. in the 1970s, high government borrowing caused an increase in

Crowding out A classical monetarist argument is that high levels of government borrowing cause ‘crowding out’. What they mean is that the government borrow from the private sector by selling bonds. Therefore, because the private sector lends money to the government, they have less money to spend and invest. Therefore, although government spending increases, private sector spending falls. Also, it is possible government spending may be more inefficient than the private sector and so we get a decline in output.

1. However, crowding out is unlikely to apply in a recession because in a recession private sector saving is rising and there are surplus savings. If the government borrows, they are making use of surplus savings and so do not ‘crowd out’ the private sector. The government are spending to offset the rise in private sector saving.

Higher taxes in the future. If the debt to GDP rises rapidly, the government may need to reduce debt levels in the future. It means future budgets will need to increase taxes and/or limit spending. The danger is that if taxes are increased too early too quickly, it could snuff out the recovery and cause a further downturn. But, if they don’t raise taxes, markets may be alarmed at the size of borrowing. High government borrowing can cause difficult choices for future chancellors; it is a difficult situation to be in.

Vulnerable to capital flight. If a government finances its deficit by borrowing from abroad, then there is potential for the economy to suffer from [capital flight](https://www.economicshelp.org/blog/glossary/capital-flight/) in the future. For example, if investors feared a country like Greece would be forced out of the Euro and devalue, investors would lose out from the devaluation. Therefore, this would encourage foreign investors to sell – causing more pressure on the economy.

Inflationary pressures. It is rare for government borrowing to cause inflation. But, some governments may be tempted to deal with high levels of debt by printing more money. This increase in the money supply can cause inflationary pressures to increase.

Suppose markets fail to buy enough gilts to finance the deficit, the deficit can always be financed through ‘monetisation’. i.e. creating money. This creation of money creates inflation, reduces the value of the exchange rate and makes foreign investors less willing to hold that countries debt.

However, in the period 2010-16 in the UK and US, quantitative easing did not cause inflation because of the falling velocity of circulation (and depressed economy). But, if the economy was close to full capacity, printing money to ‘monetize the debt’ would lead to inflation. In the case of Zimbabwe, high government debt and printing money led to a severe case of hyperinflation.

## **Evaluation of government borrowing**

It depends on the state of the economy. In a recession, Keynes argued borrowing can be beneficial in creating economic stimulus and shortening the recession. A growing deficit when the economy is close to full capacity will be more damaging. For example, see: [irresponsible tax cuts](https://www.economicshelp.org/blog/132894/economics/irresponsible-tax-cuts/)

It depends on levels of domestic saving. In 2016, Japan has a national debt over 225% of GDP, but bond yields are low because there is strong domestic demand for buying government borrowing.

It depends on levels of government debt. If bond yields are low and borrowing relatively low, a government can finance debt by a relatively small share of tax revenues.

However, if debt increases beyond a certain level and a growing share of GDP needs to go on debt repayments, debt can start to take tax revenue that is needed for public sector investment. Many developing countries suffered from a growing debt burden, which meant they struggled to meet even the debt interest payments.

 amount the government borrows is known as the budget deficit. The total amount the government has borrowed is known as the national debt or public sector debt.

2.) According to Adam Smith what are the indicators of laissez faire economy?

**Answer**

As an instrument of economic development, Adam Smith was a strong champion of the policy of laissez-faire because he proponded the following:

 Allowing economic freedom to every individual not hampered in any manner by State action.

He believed that “there is a set of rules of rights or justice, and perhaps even of morality in general, which are, or may be known by all men by the help either of ‘reason’ or of a moral sense.” He was thus a strong believer in ‘natural reason’ guiding human affairs and he regarded State interference not only superfluous but positively harmful to economic progress.

Guided by enlightened self-interest, each individual was capable of promoting his own well-being and while promoting his own interests he promotes the welfare of the whole society in the process. It is, therefore, according to Adam Smith, the production by individuals is led as if by the ‘invisible hand’, to promote social welfare. Thus, though individual capitalists produce goods to make profits for them but in doing so they promote social welfare though it was no part of their intention. As a matter of policy, therefore, Adam Smith advocated the removal of all restrictions on trade, choice of occupation and the use of property by individuals.

2a.) As the new Chief Economic Adviser of your state, how best will you want your tenure to remembered, noting that government cannot do it all alone

**Answer**

As the new economic adviser of Kaduna state I would do the following:

 = firstly I would advise the Governor on how to generate revenue for the state through the royalties the state is entitled from revenue crude oil and through effective tax.

* We would impose effective tax on citizens on the state but we would sensitize the crowd on the effects of paying tax
* I would also set in place policies that would help improve savings and investment so that the state would be prepared for any eventualities or emergencies.

2b.)  With practical examples, identify the canons of taxation as proposed by Adam Smith. How practical are the canons to the Nigeria?

**Answer**

1. Canon of equity- According to Adam Smith's canon, taxation imposed on an individual should be in accordance with his ability to pay.
2. Canon of certainty- A tax should not cause hardship to the tax payer. Therefore, this canon requires that the tax payer should be certain about the amount, time and revenue of payment of the tax.
3. Canon of convenience- This maxim seems to ensure that the time and method of payment of the tax become most convenient to the tax payer.
4. Canon of economy- This principle indicates that a good tax system will require the least possible expenditure on collection of taxes. If a large part of the tax revenues is spent in collecting it, it is undoubtedly an inefficient tax system.

In recent times, these cannons have only be practicable in some parts of Nigeria which have good tax systems. An example of some of those states are Lagos state and FCT where revenue is remitted back to the federal Government regularly. But as for the other states there is much needed to be done to improve the tax system.