PUBLIC FINANCE

**(1)**. ***Government expenditure will continue to grow. Discuss***.

Government plays a crucial role in modern economies and spending money for a number of reasons is one way in which they intervene. Government expenditure is public sector spending on a wide variety of goods and services.

Overtime, the size and composition of public spending is likely to change depending on the stage of development of a country, its demographic profile, and the ideological views of voters and governments.

Government expenditure will continue to grow for a number of reasons including income elasticity and increase in per capita income, the population effect, inflation and welfare state ideology.

An increase in per capita income over a period of time may cause a relative rise in public expenditure. For free and mixed economies, the lower the average income of the country, the lower is likely to be the percentage of GDP spent by the government. This is partly because lower income countries lack a tax base to raise revenues to pay for government spending. Taxes like income tax and VAT are difficult to administer and easy to evade in low-income countries like Nigeria, for example. Moreover, the higher the income of the country, the more its citizens will demand higher-quality goods and services of the sort that are typically provided by the government, i.e. government provided goods and services are income elastic. Citizens demand for better roads, better education and safety nets in the form of welfare benefits to guard against sickness, unemployment and old age as GDP rises.

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

During inflation, government has to pay additional to its employees as inflation erodes the value of money wages.

The modern state is a welfare state. It aims at promoting the economic, political, and social well-being of its citizens. For this purpose it has to undertake many functions such as the provision of public and merit goods.

All these contribute to the growth in government expenditure.

**(A).** ***Explain the various canons of public expenditure***.

(i). Canon of Benefit: The Canon of Benefit is fundamental to public spending. Government revenue should be spent so as to promote social welfare. Benefits from public expenditure may be identified with achievement of proper allocation of economic resources, proper distribution of income and wealth in society, stability of price level and economic growth.

(ii). Canon of Economy: This Canon asserts that scarce resources such as revenue should be used in a productive manner.

(iii). Canon of Elasticity: Rules governing expenditure policy of government should not be rigid. It should be allowed to vary according to needs and circumstances.

(iv). Canon of Sanction: This Canon requires that government authorities should spend money only after obtaining prior sanction from the concerned authority for the specified purpose. This is done as a safeguard against the possibility of unwise and reckless expenditure.

**(B).** ***Why do governments borrow?***

Government decisions about how much to spend, tax and borrow are the fiscal policy of the government. Essentially, government borrows so that it can enable higher spending without having to increase taxes. Reasons for government borrowing are:

***Automatic fiscal stabilisers***: In a recession, government tax revenues fall as people earn less so they pay less income tax. Also, the government have to spend more on unemployment benefits. Therefore, in an economic downturn, borrowing rises. To eliminate borrowing in a recession would make the recession worse and increase inequality.

***Investment***: Spending on capital goods such as schools, hospitals and better roads gives a return on the investment which helps to boost productive capacity and increase economic growth.

***Spending commitments***: The government is committed to providing certain benefits such as pensions and healthcare spending. With an ageing population, this puts upward pressure on government spending causing it to rise; therefore, governments may start to run a structural deficit.

***Political:*** The biggest tendency to borrow comes from political pressures.

***War or natural disaster***: During a war or State of emergency, government spending is stretched leading to increased borrowing. This present period of the Coronavirus pandemic saw an increase in government borrowing from the World Bank of over 3,000,000,000 naira.

***Should Nigeria borrow, given its economic situation?***

The borrowing of the public sector (central government, local government, and other state bodies such as localised industries) over a period of time is called public sector net borrowing. Reasons for borrowing include financing a budget deficit, automatic stabilisers and a state of emergency or war.

In most years, the Nigerian government has run budget deficits, spending more than they receive. As a result, in most years government has had to borrow money. Major sources of borrowing are the IMF and World Bank. As a developing country, Nigeria has been encouraged by banks to borrow money at low rates of interest denominated in US dollars. However, past decades have seen a rise in the value of the US dollar against other currencies and a rise in interest rates.

This has left the Nigerian government paying substantially more in their own local currencies simply to pay the interest on their foreign currency loans. The response was to borrow more money to keep up with interest payments.

Borrowing in itself may not be desirable but is not always a disadvantage to developing countries like Nigeria. Borrowing money to finance spending on the implementation of supply side policies such as improving infrastructure, research and development will influence long run aggregate supply, leading to shift outward of the LRAS curve (which shows the productive potential of the economy), which indicates economic growth.

Therefore, as long as borrowed funds are invested correctly, policies designed to influence long run aggregate supply and thus increase GDP would enable government to pay back its loans and debt interest as the economy expands.

Nonetheless, high accumulated debt can result in a debt crisis which can be very damaging or cause the country to default on its debt like Mexico did in 1982.

In conclusion, borrowing should go only as far as the ability to pay of government in the future and with Nigeria’s current economic situation, this is not advisable. The present government administration under President Buhari is already burdened with high accumulated debt. Moreover, it is well-known that the Nigerian government receives a tremendous amount of money in revenue daily for crude oil production, ***thus should the government even consider borrowing money?***

Reference: Essay written by: Akanimoh Anita Udoh.2020.

**(2)**.***What is the indicator of a laissez faire economy by Adam Smith?***

Laissez-faire is a French phrase that translates to “leave us alone”. It is refers to apolitical ideology that rejects the practice of government intervention in an economy. Further, the state is seen as an obstacle to economic growth and development.

Economic theorist **Adam Smith** believed thatoptimal functioning of markets needed minimal government intervention. The key indicators of a laissez-faire economy according to Adam Smith are Capitalism, Free-market economy and Rational market theory.

**(A)**. Akwa-Ibom state is the largest oil-producing state, the only state in Nigeria to own and operate an airline. It is also the only state to own and run a 4-star hotel & golf resort.

Yet, the state is highly under developed in that a large percentage of the population lives below the poverty line. Institutional structures are weak, unemployment and underemployment levels are high coupled with high population growth. Individuals suffer poor health as some lack access to safe drinking water, live in cramped conditions and have limited access to medical facilities. Illiteracy rates are still high even as the number of those seeking education is rising steadily.

As Chief Economic Adviser whose role is to advise the government concerning its budget decisions, I will influence government to draw up budget that will prioritise:

* improvements to the management of revenue sources such as the leisure and golf resort and Ibom Air to enable the government generate more revenue for its spending
* increasing incentives to work by cutting the marginal rate of tax for tax payers
* the provision of benefits to low-income households
* improving the efficiency of the labour market through improving labour market flexibility
* introduction of minimum wages by the sate
* the improvement of the skills and quality of the labour force through improving the quality of education and training
* improvement of infrastructure such as roads, street lighting, electricity and constant power supply, hospitals, schools, sport and leisure centres such as parks and libraries and social housing
* the encouragement of the growth of small and medium-sized businesses
* and investment in research and development (R&D)

Reference: Akanimoh Anita Udoh.2020.

**(B)**. *Adam Smith wrote a length on the subject of Taxation in his famous book. He argued that a tax was one which had 4 characteristics; and how practical are the canons to Nigeria?*

1. The cost of collection should be low relative to the yield of the tax. EFFICIENCY.

The Pay As You Earn system is relatively easy to administer on Nigerian tax-payers, however there is no sufficient data to suggest that the cost of collection is low.

1. The timing of collection and the amount to be paid should be clear and certain. CERTAINTY.

This Canon is evident in Nigerian PAYE tax system

1. The means of payment and the timing of the payment should be convenient to the tax payer. CONVENIENCE.

The application of this canon to the Nigerian tax system is questionable as there is no sufficient data on the tax bracket in Nigeria.

1. Taxes should be levied according to the ability to pay of the individual taxpayer. EQUITY.

`This Canon is also questionable as there are no reliable surveys to support or refute a claim.

These canons relate to efficiency and equity. For instance, the cost of collection is about productive efficiency. Ability to pay is about equity.

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