**QUESTION 1**

1. Public expenditure will continue to grow. Discuss.
2. Explain the various canons of public expenditure with appropriate scenarios.
3. Why do governments borrow? Looking at the economic situation of the Nigerian state will you advise borrowing? (justify your answer)

Public expenditure is spending made by the government of a country on collective needs and wants such as pension, provision, infrastructure, etc. Until the 19th century, public expenditure was limited as liassez-faire philosophies believed that money left in private hands could bring better returns. In the 20th century, John Maynard Keynes argued the role of public expenditure in determining levels of income and distribution in the economy. Since then, government expenditures have shown an increasing trend.

Some of the main causes of public expenditure growth are: 1. Income Elasticity and Increase in Per Capita Income 2. Effects of War and the Need for Defence 3. Resource Mobilisation and Ability to Finance 4. Inflation 5. The Role of Democracy and Socialism. 6. The Population Effect.

**1. Income Elasticity and Increase in Per Capita Income:**

According to Musgrave, a rising share of public expenditure in national income is associated with a rise in per capita income. Thus, an increase in per capita income over a period of time may cause a relative rise in public expenditure. This is because the demand for public goods tends to expand with the rise in per capita income. Usually, it rises faster than the latter.

**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.

**6. 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.

**B) Why do government borrow?**

Essentially, the government borrows so that it can enable higher spending without having to increase taxes.

* The annual 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.

There are many different reasons for government borrowing.

* **Tax revenues are less than predicted**. Borrowing means the government can meet a temporary shortfall by borrowing, rather than having to immediately cut back on spending. Like an overdraft facility, government borrowing gives the government more flexibility and means they can maintain wages and spending commitments without having to keep cutting spending.
* **Investment.** The government may invest in public sector investment. For example, building schools, hospitals, better roads. This investment can give a return on the investment which helps to boost productive capacity and increase economic growth.  In this case, the government is acting like a firm who takes out a loan to finance investment.
* **Spending commitments**. The government is committed to providing certain benefits, such as pensions and health care spending. With an ageing population, this puts upward pressure on government spending to rise; therefore, governments may start to run a structural deficit.
* **War**. During a war, government spending is stretched leading to higher borrowing. The highest rates of borrowing occurred during the two world wars. Also, during wars, it may be easier to sell bonds as you can play the patriotic card to encourage people to finance government borrowing.

**QUESTION 2**

1. What are the indicators a liassez faire economy by Adam Smith.
2. As the new chief economic adviser of your state, how best will you want your tenure to be remembered, noting that government cannot do it all alone.
3. With practical examples, identify the canons of taxation as proposed by Adam Smith. How practical are the canons to Nigeria?

Adam Smith allowed 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 society in the process. Therefore, according to Adam Smith, the production by individuals is led as if by the ‘invisible hand’ to promote social welfare. Though, individual capitalists produce goods to make profit for them but in doing so, they promote social welfare though it was not part of their intention. Adam Smith advocated the removal of all restrictions on trade, choice of occupation and the use of property by individuals.

2a) As the new economic advisor of Ondo State, I would urge/assist the governor in the following:

* I would provide ways to increase the states’ Internally Generated Revenue (IGR).
* The improvement on the collection of valued added tax in the state.
* Broadband infrastructure would be made available.
* Provision of basic education and health facilities would be provided.
* Generate more revenue from agriculture.

2b)

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 canons have only been practicable in some parts of Nigeria which have good tax systems. An example of those states are Abuja and Lagos 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.