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DEPARTMENT: ECONOMICS

COURSE CODE: ECO 206

COURSE: PUBLIC FINANCE

ASSIGNMENT

1.Public expenditure will continue to grow. Discuss.

a. Explain the various canons of public expenditure with appropriate scenarios...

b. Why do governments borrow? Looking at the economic situation of the Nigerian state will you advise borrowing? Justify your answer.

ANSWER

1. Public expenditure would continue to grow due to these factors;

i)Defense expenditure due to modernization of defense equipment by the navy, army and air force to prepare the country for war or for prevention causes- for- growth- of –public expenditure.

ii)Population growth: It increases with the increase in population, more of investment is required to be done by government on law and order, education, infrastructures, etc. Investment in different fields depending on the different age group required.

iii)Welfare activities; Welfare, mid-day meals, pension provisions etc.

\*Provisions of public and utility services; provision of basic public goods given by government (their maintenance and installation) such as transportation.

\*Accelerating economic growth; in order to raise standard of living of the people.

\*Price rise; higher price level compels the government to spend an increased amount on purchase of goods and services.

\*Increase in public revenue; with the rise in public revenue governments bound to increase the public expenditure.

\*International obligation; maintenance of socio-economic obligation, cultural exchange etc. (these are indirect expenses of government).

iv)Wars and social crises: Fighting amongst people and communities, and prolonged drought or unemployment, earthquake, hurricanes or tornadoes may lead to an increase in public expenditure of a country. This is because it will involve governments to re-plan and allocate resources to finance the reconstruction.

v)Creation of super national organizations: By creating national organizations such as the United Nations, NATO, European community and other multinational organizations responsible for the provisions of public goods and services on an international basis, they have to be financed out of funds subscribed by member states, thereby adding to their public expenditure.

vi)Foreign Aid: Acceptance by the richer industrialized countries of their responsibility to help the poor developing countries has channeled some of the increased public expenditure of the donor country into foreign aid programmes.

vii)Inflation: This is the general rise in the price level of goods and services. It increases the cost of all activities of the public sector and thus a major factor in growth in money in terms of public expenditure.

Answer(1a)

i)Canon of Benefit:

This is the fundamental canons of public spending. According to this canon, public money should be spent so as to promote Maximum Social Advantage(MSA). Every expenditure should be directed to achieve maximum social advantage to the community. Benefit from public expenditure may be identified with achievement of proper allocation of economic resources, proper distribution of income and wealth in society and stability of price level and growth of economy. According to Prof. Findlay Shiras public expenditure should bring with it important social advantages such as increased production, equitable distribution, social justice and maximum social welfare.

ii)Canons of Economy:

The canon of economy, as canons of public expenditure, suggests that the state should be economical in spending. It implies two things, firstly; The government should not spend more than the amount required to be spent on particular item of expenditure. Secondly, the state should spend money in such a way that might develop the productive capacity of the community as much as possible. The first consideration has reference to the present while the second consideration has reference to the future. The main aim of the canon is to avoid the wastage and extravagance of any kind. In this reference, it is necessary to check duplication of expenditure. In this connection, the government should see that the expenditure should not produce, any adverse effect on production and on the will and the power of the people to sue.

iii)Canons of Sanction:

This implies that the government, before incurring any expenditure on any item should obtain the proper sanction and approval of the competent authority. Without its approval, the government department cannot incur any expenditure or any expenditure beyond the specified limit. In a democratic country, competent authority is the legislature. The government present its budget before the legislature and gets the approval and only then the government departments can incur expenditure.

iv)Canon of Surplus or Balanced Budget:

According to this canons of public expenditure, the state must avoid resort to deficit financing as far as possible. The classical economists always preferred surplus budget just like an ordinary citizen. But in modern time, balanced budget (no deficit no surplus budget) is preferred. It implies that the balanced expenditure must be balanced to public revenue. The policy of deficit financing is not tenable for long. Surplus budget also cannot find favor because it implies that the government is spending much less than what it should. The tax payers will realize a burden in paying tax. So, the government should prepare a balanced budget.

v)Canons of Flexibility or Elasticity:

Flexibility must be there in public expenditure. It implies that the expenditure may be expended or contracted according to the requirement of the time. At a time of crisis, the expenditure should be cut down because the income of the government is expected to be short at such a time.

Answer(1b)

Essentially, the government borrow 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. These are few reasons why government borrow.

i)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 overdraft facility, government borrowing gives the government more flexibility and means they can maintain wages and spending commitments without having to keep cutting spending.

ii)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.

iii)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: What are the indicators a laissez faire economy by Adam Smith.

1. 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.
2. With practical examples, identify the canons of taxation as proposed by Adam Smith. How practical are the canons to the Nigeria?

Answer

The indicators of a laissez faire economy is the underlying beliefs that make up the fundamentals of laissez faire economics include, first and foremost, economic competition constitutes a “natural order” that rules the world. Because this natural self-regulation is the best type of regulation, laissez faire economists argue that there is no need for business and industrial affairs to be complicated by government intervention. As a result, they oppose any sort of federal involvement in the economy.

Answer(2a)

As the new chief economic adviser of Ekiti state, I would do the following to make my tenure to be remembered for a long time.

Firstly, I would ensure that everyone in the state obeys the rules and regulation of the land. 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.

I would impose effective tax on citizens of the state but would only make it compulsory to the citizens who have the ability and is capable of paying. Would emphasized to the citizens how important the effects of paying tax is.

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. I would try my possible best to ensure that the bribery and corruption of the politicians in the state is reduced and enable that the taxes paid by the people are not embezzled but use for the development and growth of the state.

Answer(2b)

Canon of Equality:

This states that the burden of taxation must be distributed equally or equitably among the taxpayers. However, this sorts of equality robs justice because not all taxpayers have the same ability to pay taxes. Rich people are capable of paying more tax than the poor. Hence, justice demands that a person having greater ability must pay large taxes. If everyone is asked to pay taxes according to his ability, then sacrifices of all taxpayers become equal. This is the essence of canon of equality (of sacrifice). To establish equality in sacrifice, taxes are to be imposed in accordance with the principle of ability to pay.

Canon of Certainty:

The tax which an individual has to pay should be certain and not arbitrary. According to Adam Smith, the time of payment, the manner of payment, the quantity to be paid, i.e., tax liability, ought all to be clear and plain to the contributor and to everyone. Thus, canon of certainty embraces a lot of things. It must be certain to the taxpayer as well as to the tax levying authority. Not only tax payers should know when, where and how much taxes are to be paid. In other words, the certainty of liability must be known beforehand.

Canon of Economy:

This canon implies that the cost of collecting a tax should be as minimum as possible. Any tax that involves high administrative cost and unusual delay in assessment and high collection of taxes should be avoided altogether. According to Adam Smith,” Every tax ought to be contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.”

Canon of Convenience:

Taxes should be levied and collected in such a manner that it provides the greatest convenience not only to the taxpayer but also to the government. Thus, it should be painless and trouble free as far as practicable. “Every tax” stresses according to Adam Smith” ought to be levied at time or the manner in which it is most likely to be convenient for the contributor to pay it.”