

Introduction to Public finance



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Introduction to public finance

- ▶ Public finance
- ▶ Public expenditure
- ▶ Government functions
- ▶ Public revenues
- ▶ Trends in public finance



Introduction to public finance

▶ Public finance

- ▶ Financial operations between public institutions and other subjects (citizens, households, companies, non-profit organizations etc.)
- ▶ Yet not any united definition



Public finance X Public sector

- ▶ **Public Finance**

- ▶ Financial operations, relations and its tools

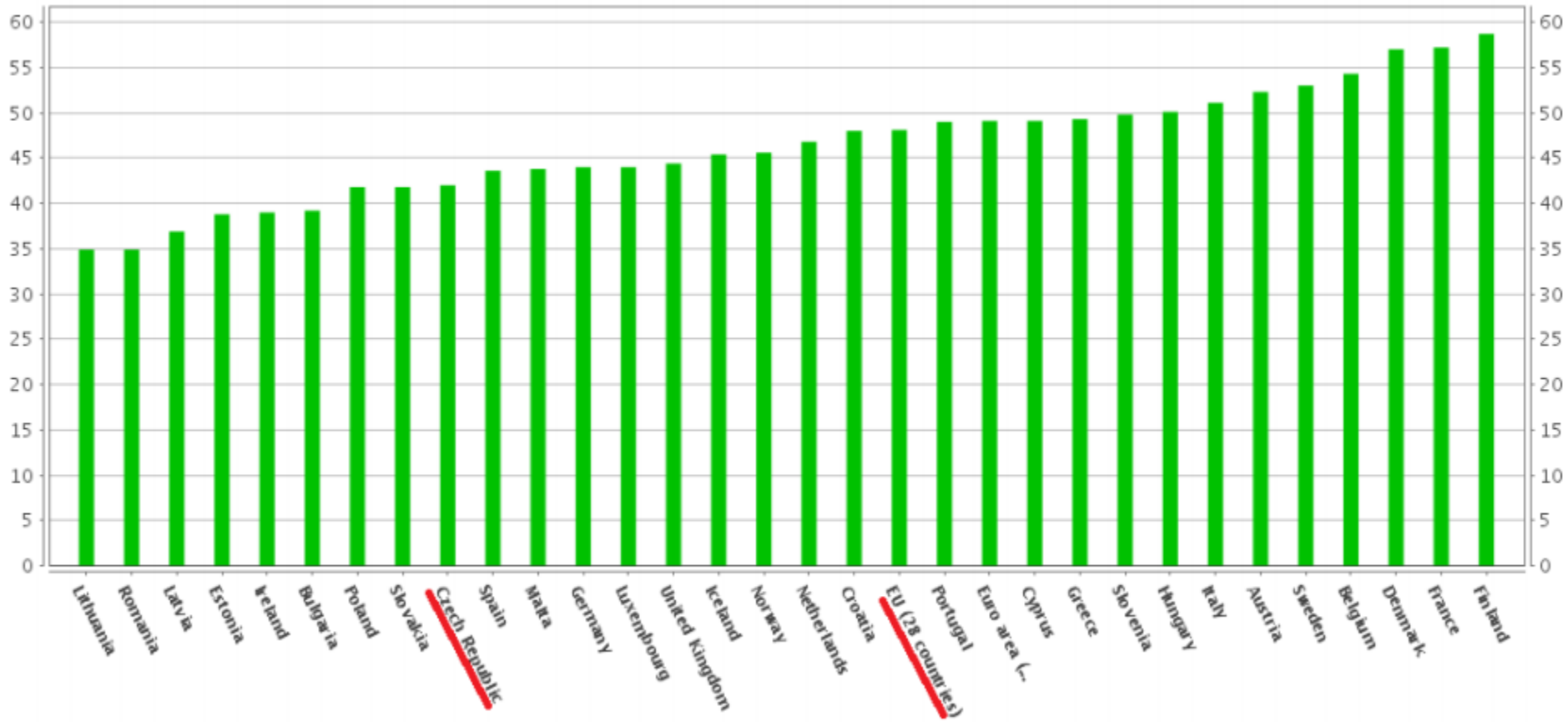
- ▶ **Public sector**

- ▶ Part of national economy
 - ▶ Financed from public budgets

**How to measure
the size of public sector?**



Public expenditure in Europe (2014, % GDP)



Growth factors of the public sector

- ▶ **geographic factors** (floods, hurricanes, volcanic activity, ...)
 - ▶ **demographic factors** (population boom influence priorities within public expenditure)
 - ▶ **urban factors** (urbanization – higher demand on social and technical infrastructure)
 - ▶ **technical and technological factors** (state assistance for implementation of significant discoveries - eg. linking technology)
 - ▶ **social factor** (form of the welfare state and its changes)
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Growth factors of the public sector

- ▶ **inflation** (↑ share of public expenditure/ GDP, growth of relative prices of public goods in comparison with private goods)
- ▶ **demonstration effect** (citizens "want" what they see abroad)
- ▶ **fiscal illusion** (overconsumption, inefficiency)
- ▶ Other influences especially political and social (social justice, ideology)



Principles of public finance

- ▶ **Non-recovery principle** – nobody has claim to return expenditure in some specific form (eg. Social transfers, public goods etc.)
- ▶ **Non-equivalency principle** – the purpose of paid tax is not known in advance
- ▶ **Non-voluntarily principle** – taxpayers are forced to pay taxes (nobody want to pay voluntarily)



Public expenditures

- ▶ Part of the GDP which is related to realization of government functions
- ▶ Part of the GDP which is consumed rather collectively than privately
- ▶ Several levels:
 - ▶ State budget expenditures
 - ▶ Government expenditures (including governmental organizations)
 - ▶ Public expenditures (including local budget)



Public expenditure - two main categories

- ▶ **Government purchases** (eg. Labour force, consumer goods etc.) and **capital expenditure** (eg. Investment to highway, education, hospitals etc.) – purchase of input from the public sector side
- ▶ **Transfers expenditures** (Pensions, social benefits, Interest on debt, etc.) – to ensure redistribution function of public sector, public sector is only mediator



Mandatory and quazi-mandatory expenditures

▶ **Mandatory expenditures**

- ▶ expenditures, which has to be paid and can't be changed (are determined by law or arising from commitment)
- ▶ e.g. retirments, social benefits
- ▶ About 60% of public expenditures

▶ **Quazi-mandatory expenditures**

- ▶ Are not determined by law, but goverment is highly expected to pay them
 - ▶ e. g. salaries of state employees
 - ▶ About 20% of public expenditures
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Mandatory expenditure

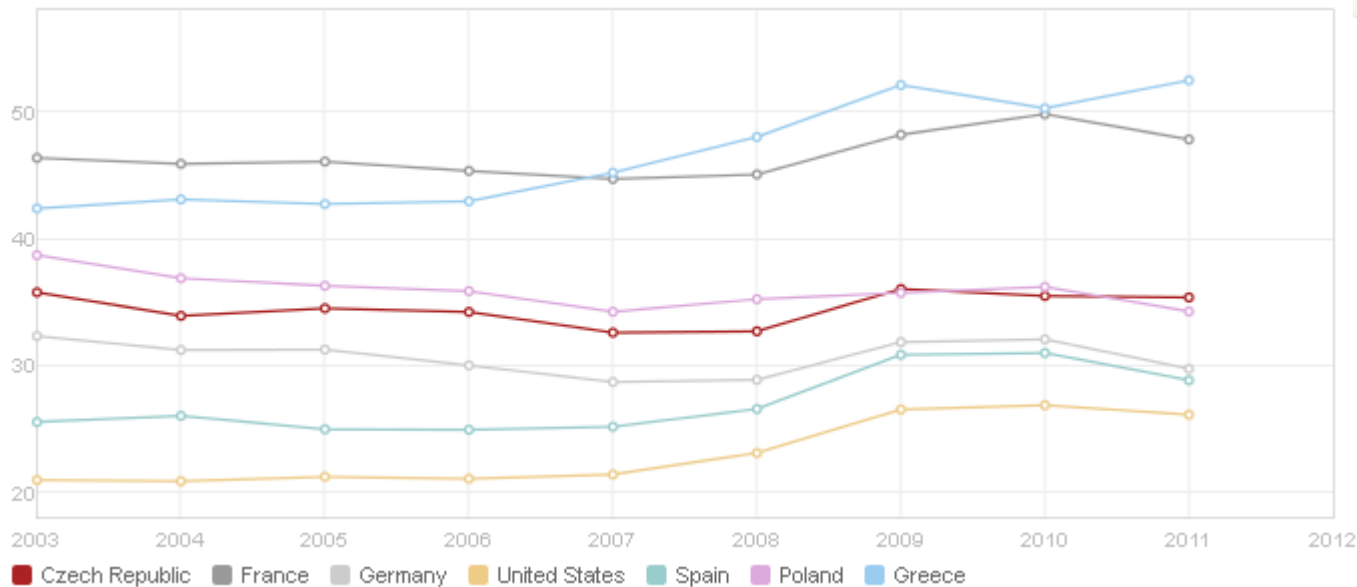
Monitored:

- ▶ the amount of mandatory expenditure to GDP
- ▶ the amount of mandatory expenditure to total public expenditure
- ▶ The amount of mandatory expenditure to total public revenues

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014*	2015*
GDP (billion CZK)	2984	3222	3535	3689	3628	3667	3814	3 846	3 884	4 061	4 216
Share of mandatory expenditure	15,8	16,2	15,7	15,8	17,1	17,1	17,1	17,0	17,3	17,3	17,0
Share of quasi-mandatory expenditure	6,9	6,7	6,2	5,8	6,3	5,9	5,3	5,3	5,3	5,1	5,1
Share of total mandatory expenditure	22,7	23,0	21,9	21,6	23,5	23,0	22,4	22,3	22,6	22,4	22,1
State budget expenditure (billion CZK)	923	1021	1092	1084	1167	1157	1191	1 152	1 173	1211	1218
Share of mandatory expenditure	51,1	51,3	50,8	53,7	53,3	54,3	56,5	56,7	57,2	58,1	58,7
Share of quasi-mandatory expenditure	22,3	21,3	20,1	19,9	19,6	18,7	17,7	17,7	17,5	16,9	17,6
Share of total mandatory expenditure	73,4	72,5	70,9	73,6	72,9	73,0	74,2	74,4	74,7	75,0	76,3
State budget revenues (billion CZK)	866	923	1026	1064	975	1000	1013	1051	1091	1099	1118
Share of mandatory expenditure	54,4	56,7	54,0	54,7	63,8	62,8	64,5	62,1	61,5	64,0	63,9
Share of quasi-mandatory expenditure	23,8	23,5	21,5	20,3	23,5	21,6	20,2	19,4	18,8	18,7	19,1
Share of total mandatory expenditure	78,2	80,2	75,5	75,0	87,3	84,4	84,7	81,5	80,3	82,7	83,0

Public expenditures

- ▶ Indicators of size of the public expenditures
 - ▶ percentage of public expenditures on GDP *(source: worldbank)*
 - ▶ percentage to the increase of other economic indicators etc...



Government functions

- ▶ Allocation
- ▶ Stabilization
- ▶ Redistribution



Allocative function

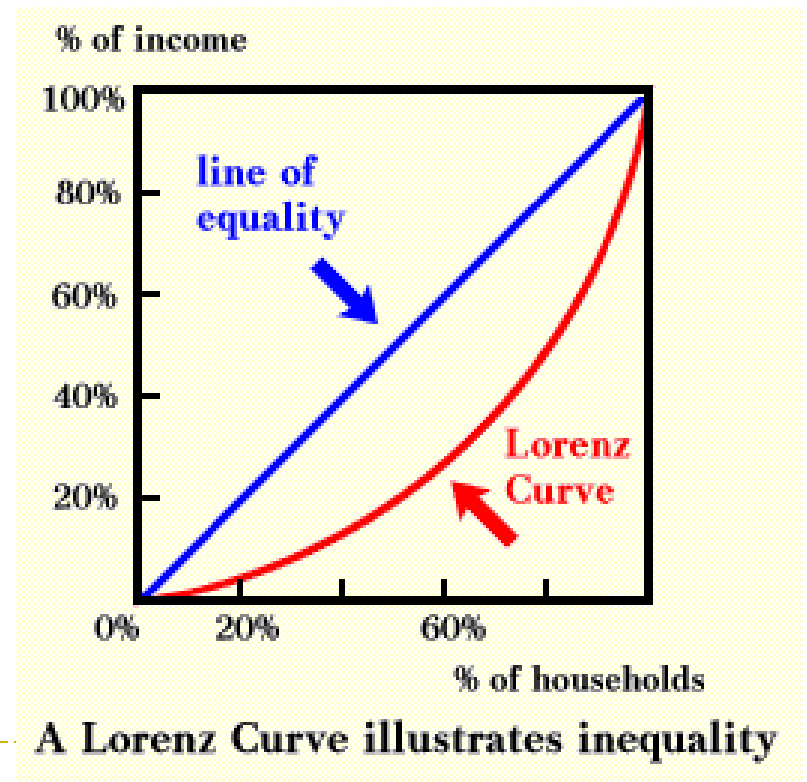
- ▶ Providing services in situations where private sector does not generate sufficient quantity or quality of these services
- ▶ This function is associated with remedying market failures

Which market failures you know?

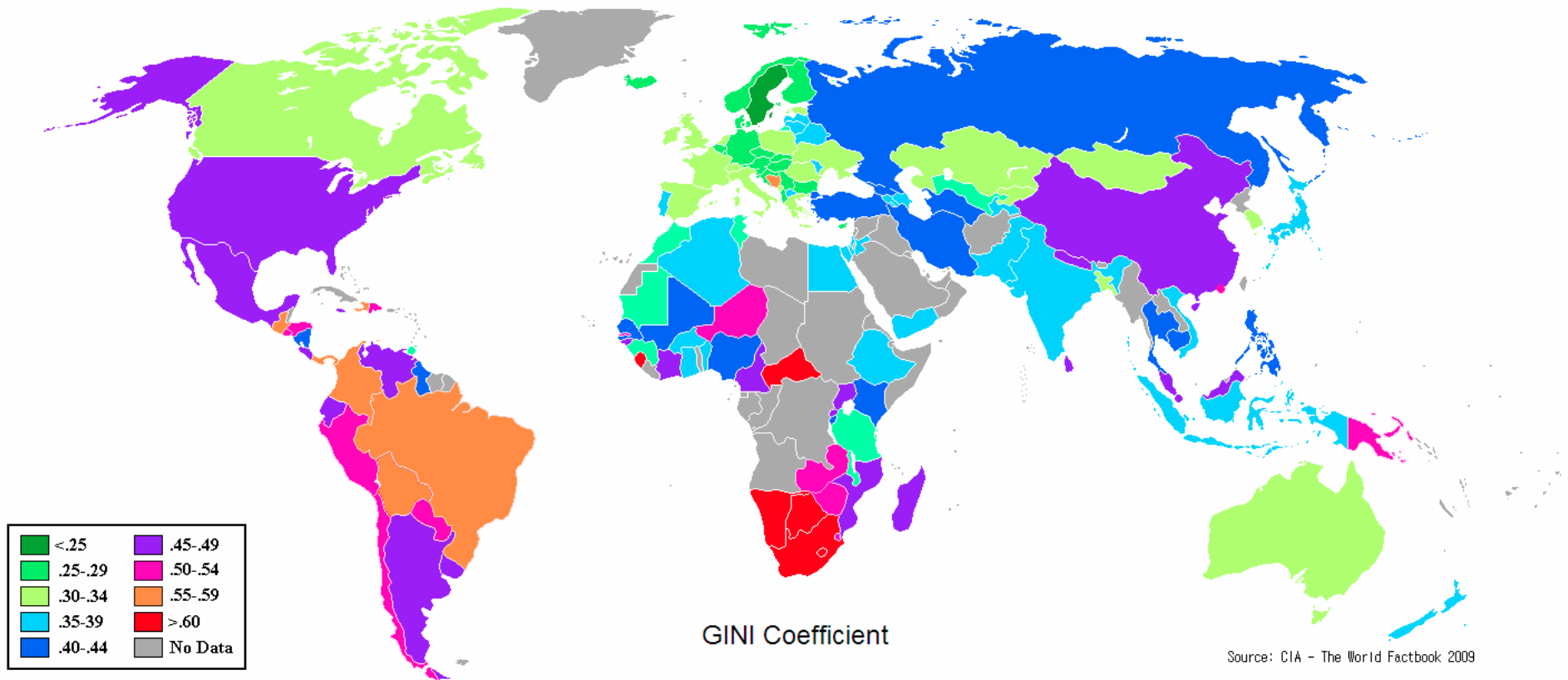


Redistributive function

- ▶ Performing by using tax and transfers (main tools)
- ▶ „Fair“ allocation of sources
- ▶ Lorenz curve measures income distribution in the society
- ▶ Gini coefficient
 - 0 (total equality)
 - 1 (total inequality)

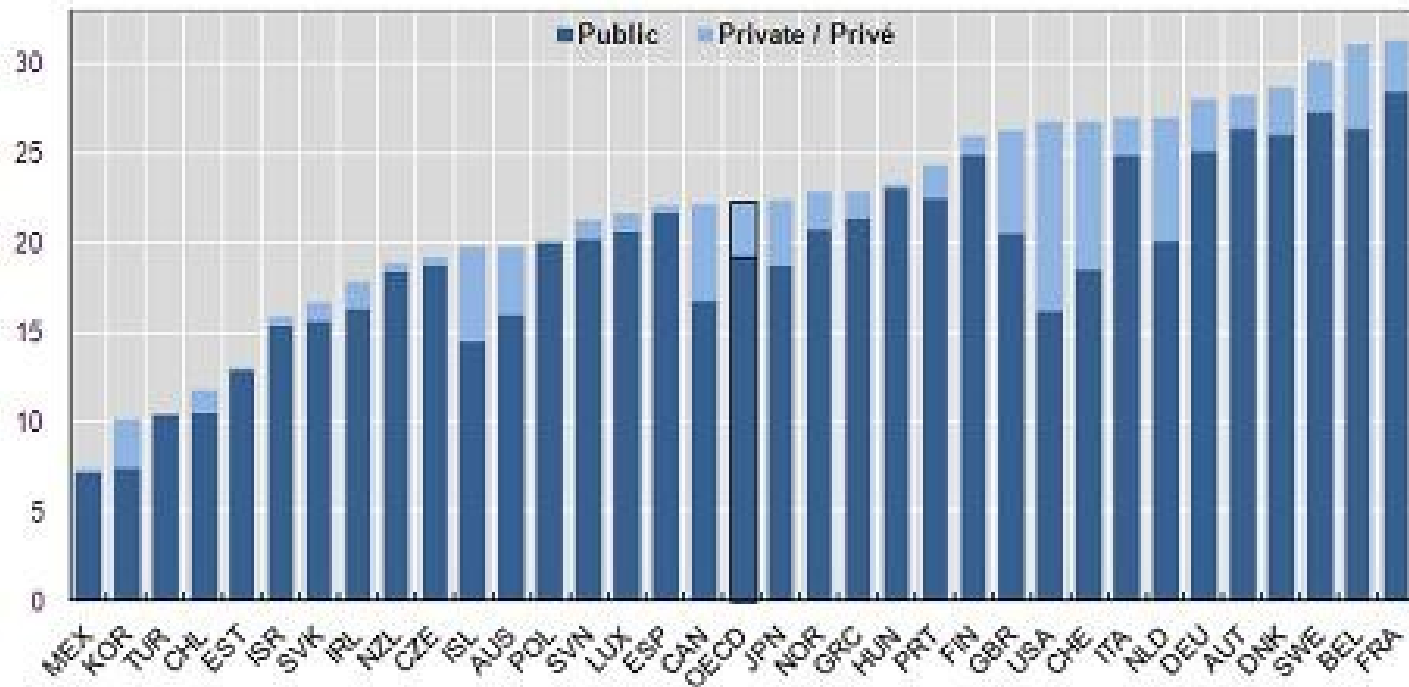


Gini keoficient



Social expenditures

▶ Public and private social expenditures 2007



Source: oecd

Redistributive function

▶ Tools

- ▶ Revenues (Taxes – e. g. Progressive taxes)
- ▶ Expenditures
 - Subsidies
 - Transfers



Stabilization

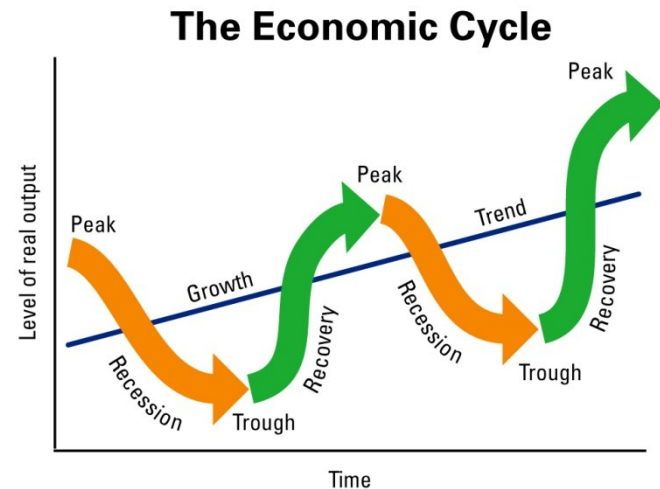
▶ Tools

▶ **Monetary** (at national level - central banks)

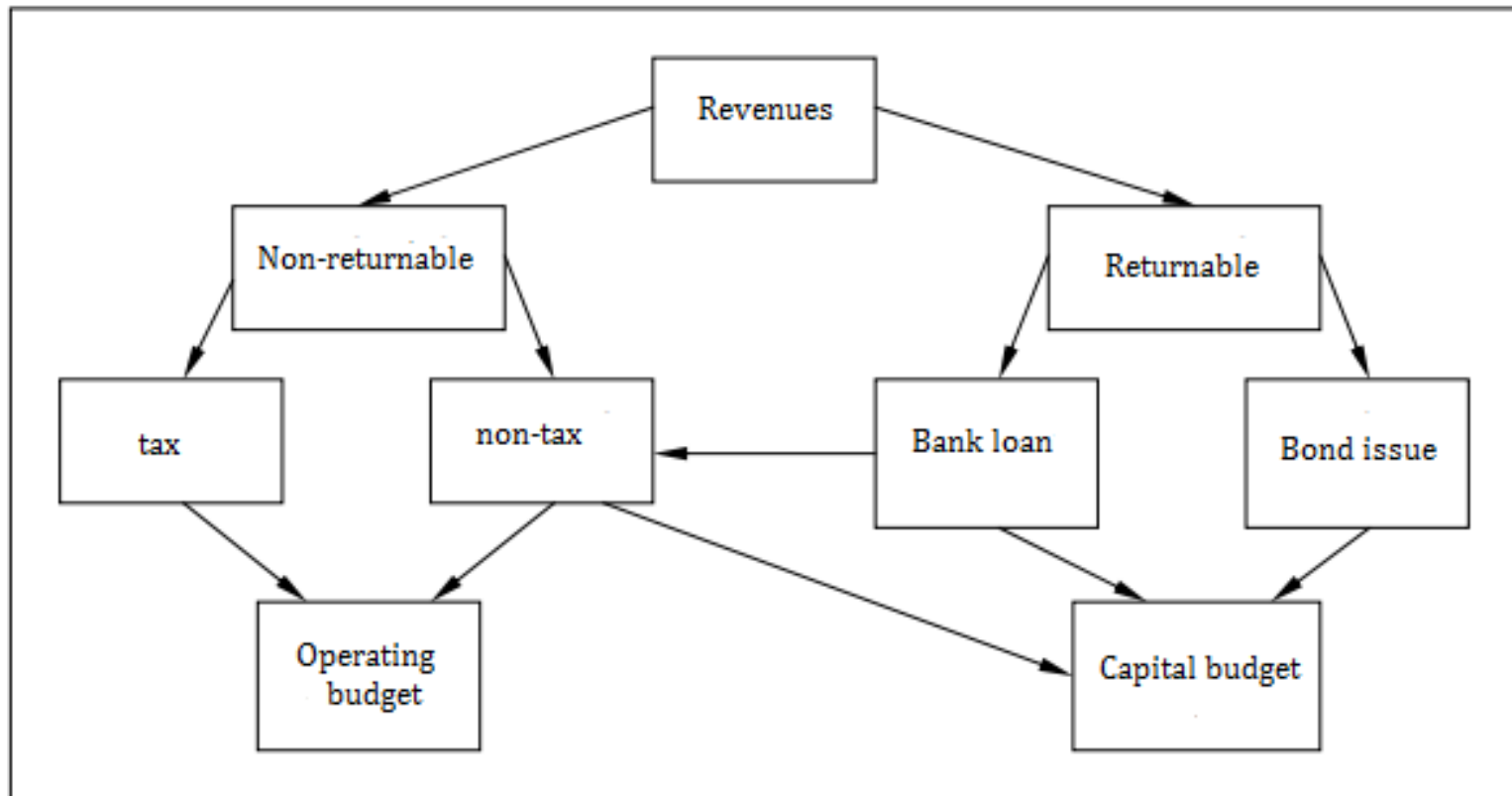
- ▶ Discount rate (interest rates of national banks)
- ▶ Reserve requirements
- ▶ Open market operations

▶ **Fiscal**

- ▶ Public expenditures
- ▶ Public revenues (taxes)
- ▶ Budgeting of deficit



Public revenues - types



Public revenues – main categories

- ▶ Tax revenues
- ▶ Capital revenues
- ▶ Subsidies
- ▶ Other

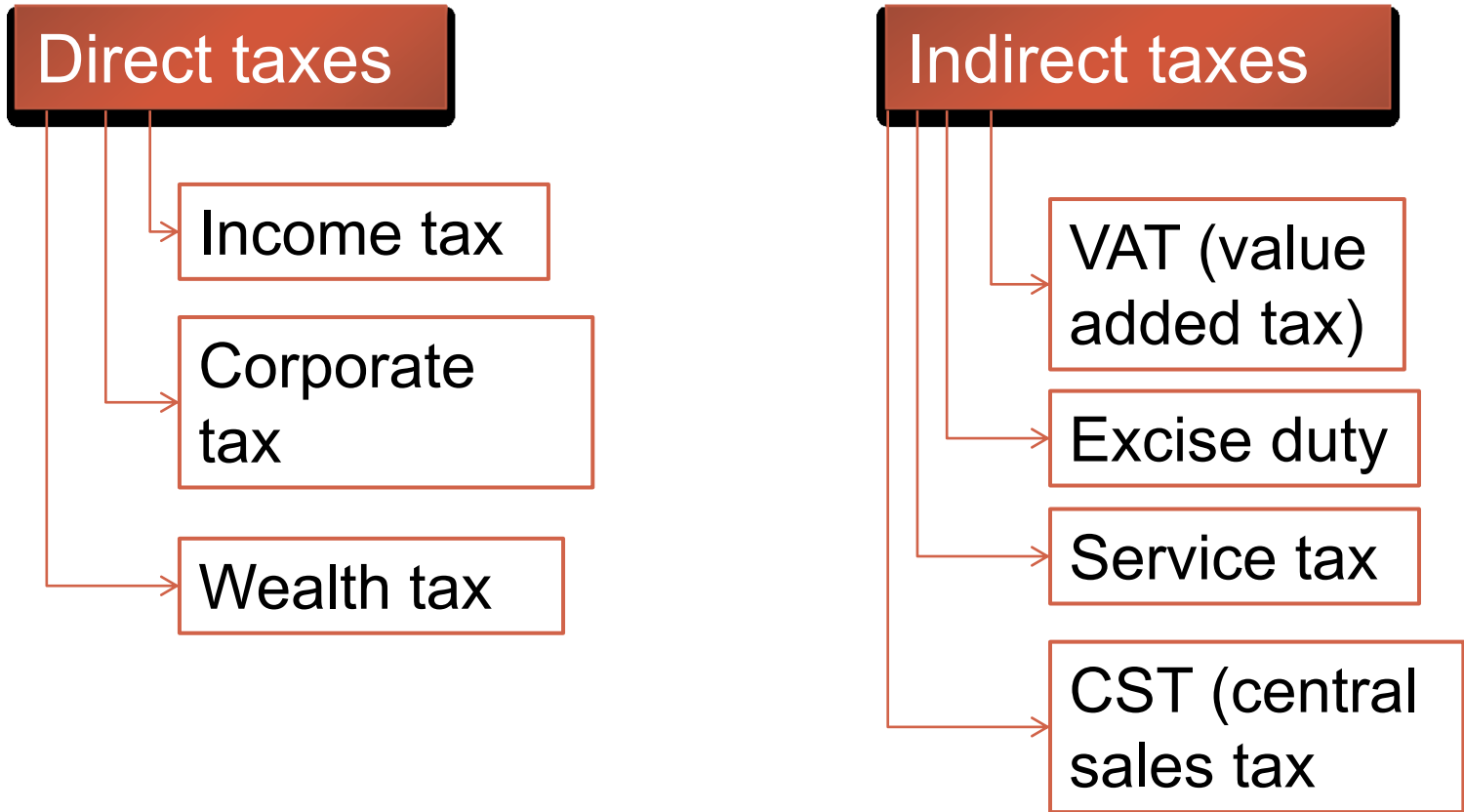


Tax revenues

- ▶ Taxes (direct and indirect taxes)
- ▶ Fees
- ▶ Customs duty
- ▶ Social security and health insurance



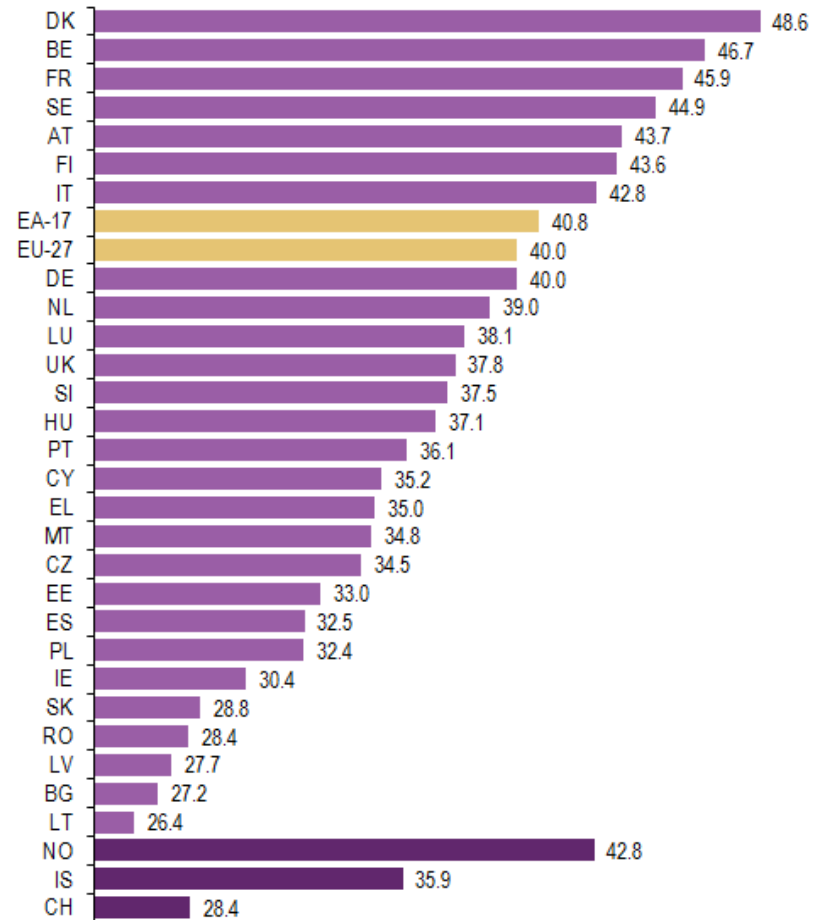
Categories of taxes



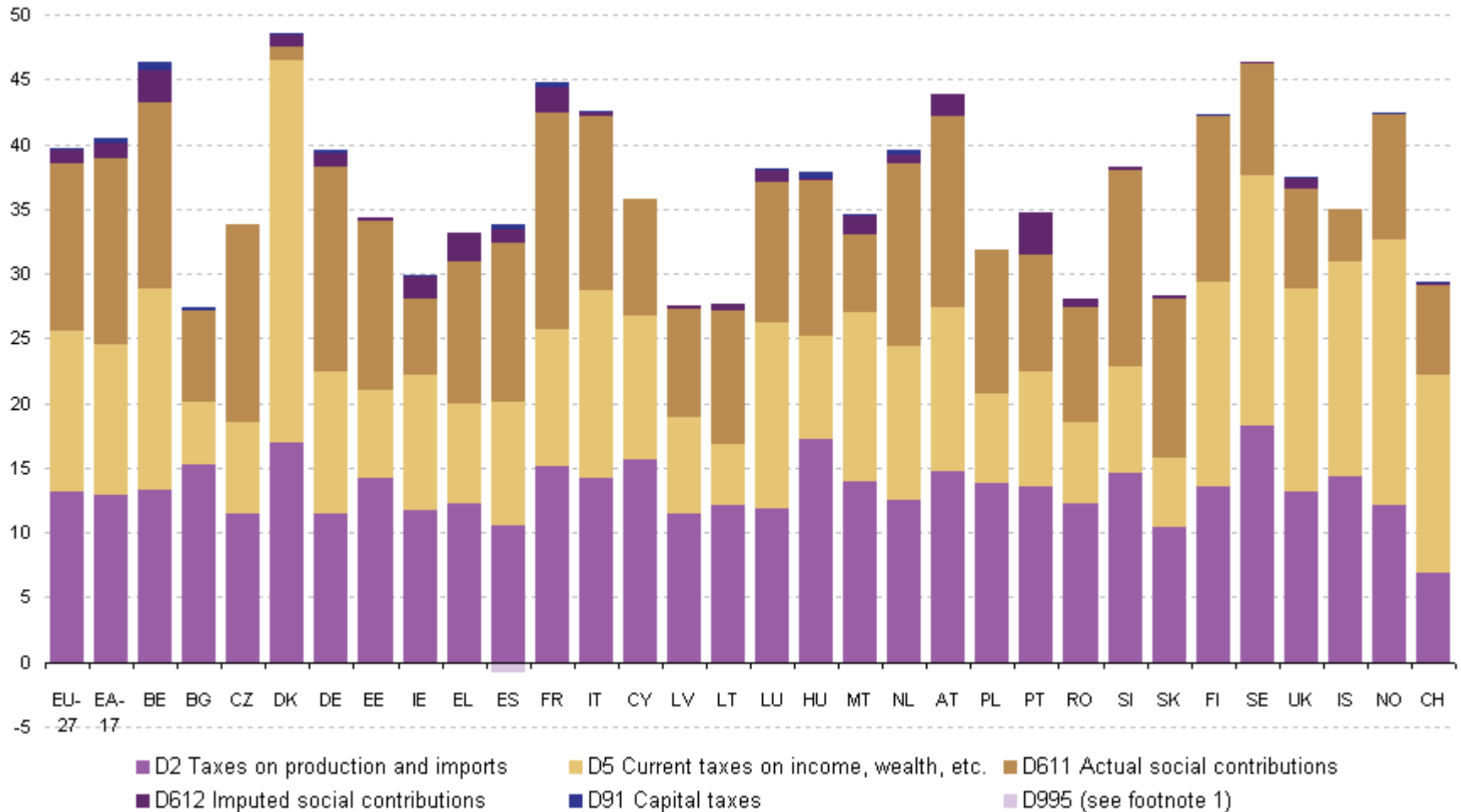
Tax revenues – tax quota

Tax revenues as a percentage of
GDP = **tax quota**
(simple, compound)

[Eurostat](#) (Year 2011)
[Worldbank](#)



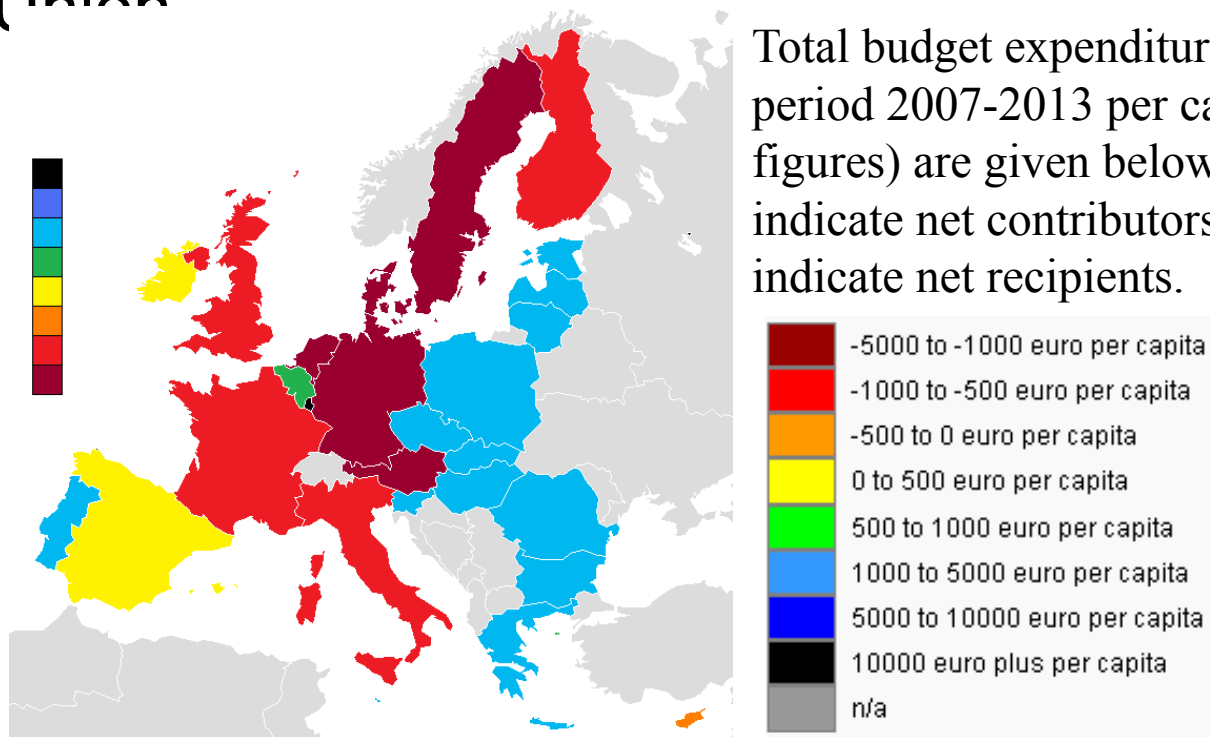
Structure of tax revenues



Source: Eurostat

Subsidies

- ▶ e. g. from European Union



Capital revenues

- ▶ Revenues from selling state property
- ▶ Mostly quite small amounts
- ▶ Irregular, one-time revenue

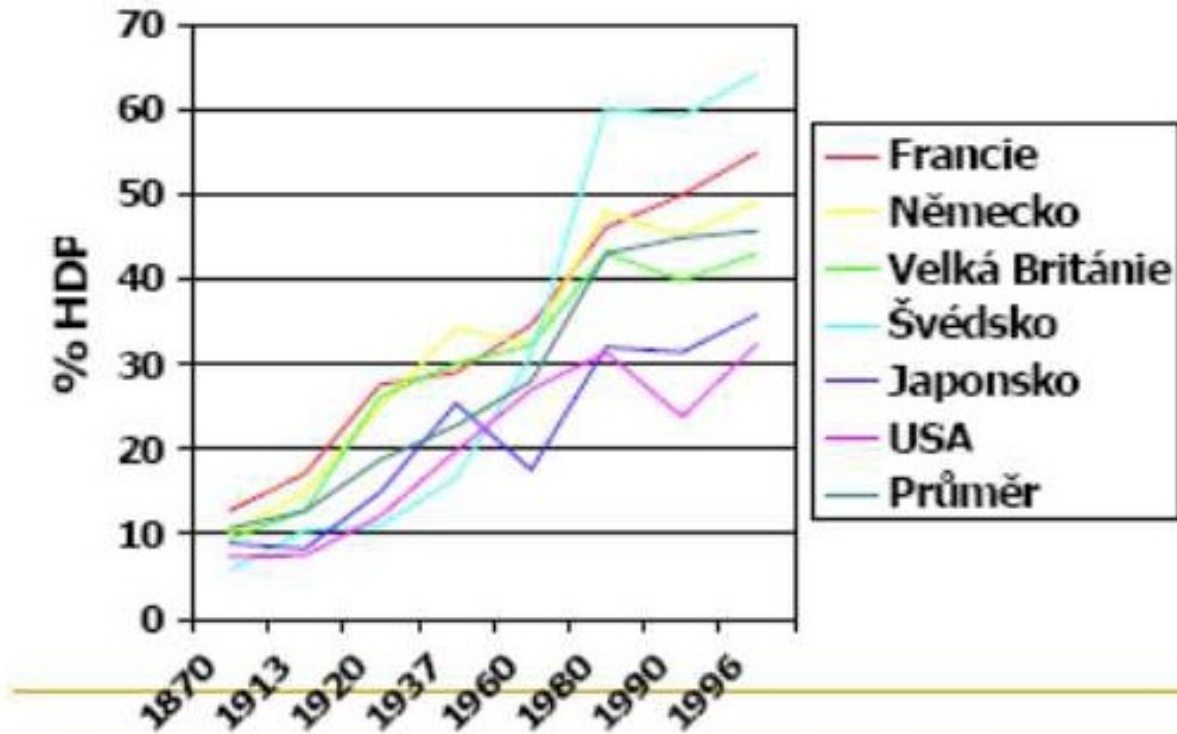


Other revenues

- ▶ Revenues from services provided to public (e. g. Highways)
- ▶ Penalties
- ▶ Revenues from selling non-capital property
- ▶ ...



Trends in public expenditures



Trends in public finance

- ▶ Alfred Wagner – 1890

- ▶ *„Together with growing income in economics grows the size of public sector“*

- ▶ Why?

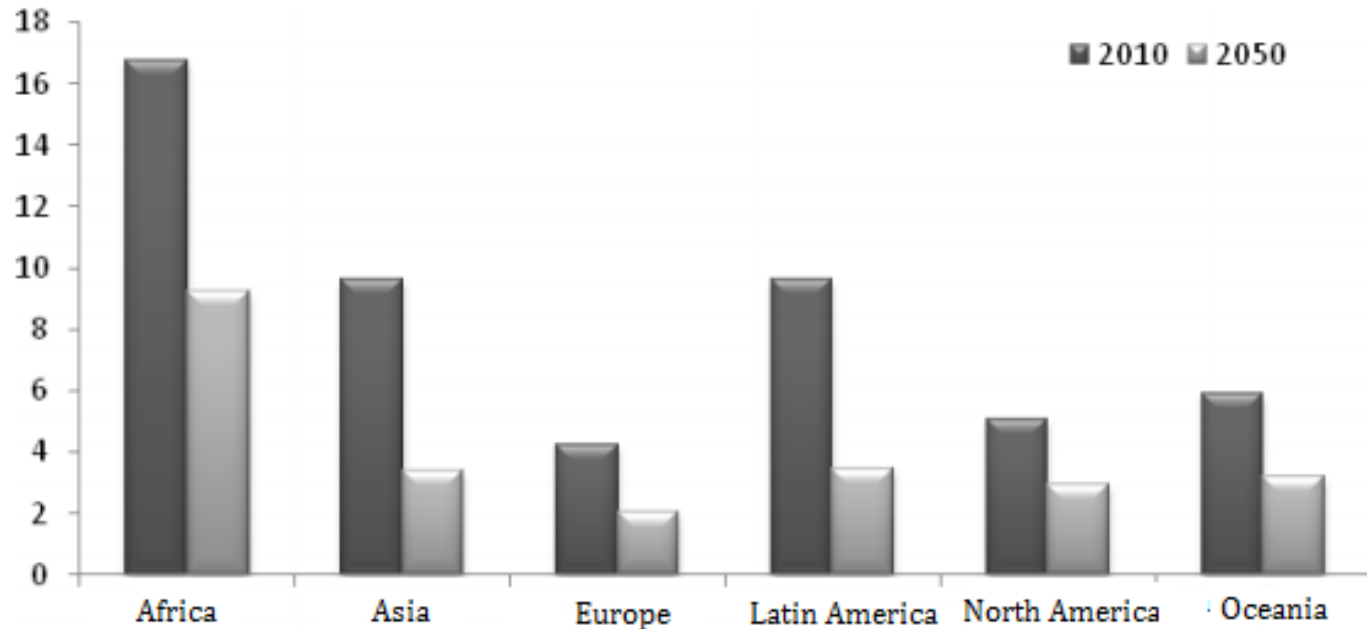
- ▶ Technological changes (e. g. health care)
 - ▶ Social and demographic factors
 - ▶ Threshold effect (wars, floods...)
 - ▶ Political reasons
-



Changes in population

- ▶ Changes in population (ageing, low fertility rate)→ why does it affect government spending?

The number of people in productive age (15-64 years) per person in post-productive age (65 +)



Source: International Data Base
(2011)

Economic growth x government size

▶ **Negative relationship**

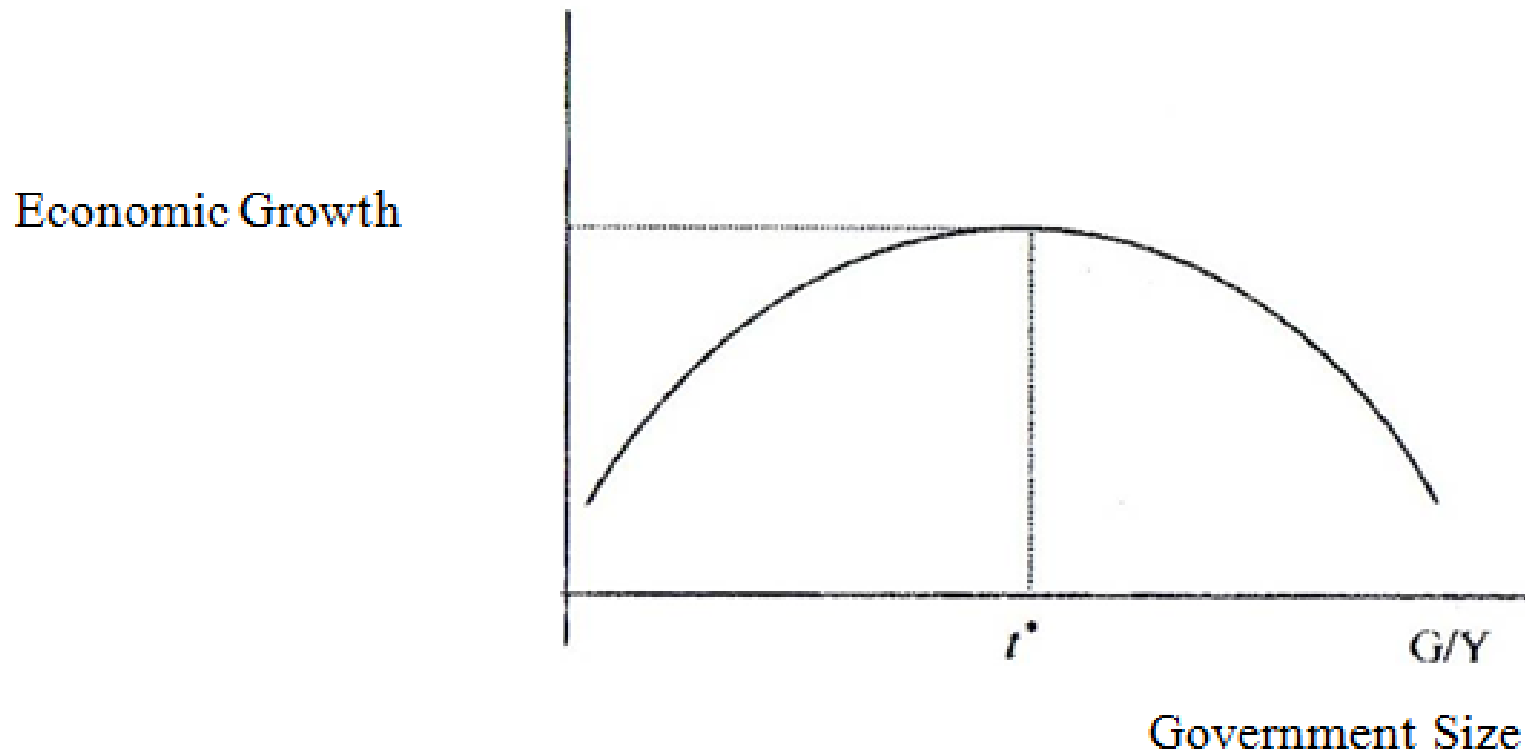
- diminishing returns
- crowded-out effect to private investment
- inefficient expenditure
=> distorted allocation of resources
- space for corruption

▶ **Positive relationship**

- insurance function to private property
- encourage private investment
- Improve the investment environment



Relationship between Economic Growth and Government Size



Factors affecting the growth of government spending

- ▶ Demographic changes (ageing, low fertility)
- ▶ Increasing labour productivity and related growth of income (higher tax revenues -> higher expenditures)
- ▶ Increasing living standards
- ▶ Increasing unemployment rate
- ▶ Technological progress (higher claims on financial resources)
- ▶ Inflation
- ▶ Politic and social influences (level of welfare state, populism, bureaucracy)
- ▶ Demonstration effect and the related effort to cope with living standards of neighboring countries



Political reasons – welfare state

- ▶ Greece...
- ▶ Czech republic – social security system, health care system, free education...
- ▶ Your country...?



...thank you for your attention