

Public finance assignment

Business



CHAPTER 1: MEANING, NATURE AND SCOPE OF PUBLIC FINANCE Def: Public Finance is the field of economics that studies government activities and the alternative means of financing government expenditures. Our focus in this course is on the microeconomic functions of government, the way government affects the allocation of resources and the distribution of income.

THE LEGAL FRAMEWORK The Appropriation Act gives the Government of Belize the authority to collect revenue and incur expenditure within the framework of the approved budget.

GOVERNMENT'S BUDGET AND THE ECONOMY The Government's budget is its statement of expected revenue and expenditure for the fiscal year, which begins April 1 of one year and ends on March 31 of the following year. It is the Government's primary instrument of fiscal policy, that is, it is the main tool for effecting changes in the pattern of expenditure and investment throughout the economy. The government's budget, therefore, should be prepared within the context of its objectives for growth and development.

Recurrent and Capital Budget

There are two major components of the budget: the Recurrent Budget and the Capital Budget. The Capital Expenditure Budget is further divided into Capital II (locally funded) Expenditure and Capital III (externally funded) Expenditure.

The Recurrent Budget The Recurrent Budget is composed of revenue and expenditure that occur annually and are fundamental in the daily operation of the Government. Recurrent revenues are of two types, Tax and Non-Tax.

• Tax Revenues: The major categories of tax revenue are income taxes including company taxes; taxes on goods and services including sales tax; excise duties; and taxes on international trade and transactions known as customs duties.

• Non-Tax Revenues: These revenues make up a smaller proportion (about 11%) of recurrent revenue.

They are drawn from a few sources such as licenses; rents and royalties; contribution to pension funds; and transfers from the Central Bank and non-financial public enterprises such as the Port Authority and the Belize Airport Authority. Recurrent expenditure are those which arise from the daily activities of the Government and can be classified as either Functional or Economic in nature. The Functional Classification reflects services provided and functions performed by the Government in spending public funds. These include defense, health, housing, transport and communication, social security, agriculture and fishing, ducation, and general public service. The Economic Classification relates to the broad categories of expenditure across all the functions. It refers to wages and salaries, pension, goods and services, interest payments, subsidies and transfers. The economic classification shows not what the Government spends money for but what it spends money on. The Current Balance is the difference between recurrent revenue and recurrent expenditure. When recurrent revenue exceeds recurrent expenditure, there is a surplus on the current account. On the other hand, when recurrent xpenditure exceeds recurrent revenue, there is a deficit on the current account. ?? The Capital Budget The Capital Budget reflects the Government's revenue and expenditure that are tied to investments in costly, durable goods, which last for more than one year. Such investments include buildings, roads, bridges, schools, and equipment. The revenue earned by the Government on the sale of assets is called Capital Revenue. It includes income from the sale of shares in public organizations and economic citizenship. Activity in the capital budget either creates or disposes of an asset. There are two categories of capital expenditure. Capital II Expenditure is locally funded and includes counter-

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part funding for projects financed by foreign institutions. The Government utilizes any surplus on the current account for Capital II projects. Deficits are financed through borrowings from the domestic financial system Capital III Expenditure is financed by international organizations under loan or grant agreements between the Government and international institutions. ??

Operating Balance The Operating Balance is the balance on all of the Government's locally funded operations in any one fiscal year. It includes the Current Balance plus Capital Revenue less

Capital II Expenditure. ?? **Overall Balance** The Overall Balance is the operating balance plus Capital III Expenditure. When all expenditure is taken into account, the overall balance indicates the extent to which the Government's total expenditure exceeds total revenue and grants (an overall deficit) and vice-versa (an overall surplus). **ECONOMIC BASIS FOR**

GOVERNMENT In a national economy, the market mechanism cannot perform all those functions required to attain an efficient and equitable allocation of resources. Thus a government or public sector may be needed for the following reasons: 1. To promote competition

To promote competitive conditions and to prevent potential abuse of monopoly power (e. g. PUC), government measures such as taxes, subsidies and rules and regulations may be used. 2. To ensure the provision of goods not adequately provided by the private sector. For e. g. public goods such as lighthouses, roads, bridges etc. , and natural monopolies. 3. To tackle externalities For e. g. noise, air and water pollution 4. To enforce contracts To make the market mechanism work, government rules and regulations are

required to enforce contracts entered into between buyers and sellers of goods and resources. 5.

To redistribute income and wealth For e. g. public policy may be required to achieve a more equitable distribution of income and wealth (progressive taxation). 6. To promote macroeconomic objectives For e. g. low

unemployment and inflation rates, a satisfactory balance of payments position, a desired rate economic growth etc. FINANCING GOVERNMENT

EXPENDITURES IN BELIZE Sources of Government Revenues in Belize 1.

Taxation (about 85%) a) Income Tax b) Business Tax (ranges from 0. 75 to 4%) c) General Sales Tax d) Custom and Excise Duties e) Stamp Duty f)

Environmental tax g) Land Tax 2. Non-tax sources (about 15%)) Licenses b)

Rent and royalties c) Fees and Fines d) Sale of Assets e) Return on

Investments f) Grant g) Borrowing ?? Financing A Deficit When overall

expenditure exceeds overall revenue and grants, the Government typically finances such a deficit by borrowing from the domestic system and/or by

borrowing abroad. Of late, however, initiatives have been made to source

financing externally through the issue of bonds. Borrowing from the domestic

system may be effected through a number of mechanisms: v Treasury Bills

are short-term securities which means that they mature in 90 days. Under

the law, the maximum that he Government can presently issue is \$70. 0

million. Treasury Bills are held by institutions such as the Central Bank,

commercial banks, the Social Security Board as well as members of the

public. v Treasury Notes are medium term securities, which means that they

have a maturity period greater than 3 months but not more than 24 months.

Presently, the Government can issue Treasury Notes to the tune of \$25. 0

million. The Notes were first introduced by the Government in 1993. v Defence Bonds are longer-term securities that were issued to finance the expenses of the Belize Defence Force after the departure of the British Forces.

The maximum issue is \$25. 0 million of which \$15. 0 million has been issued to date. v Debentures are long term instruments dating back to the colonial era. They are tied to specific projects. Currently, the value of debentures in the system stands at about \$6. 2 million. v The overdraft facility at the Central Bank provides for advances to be extended to the Government. The advances may amount to \$50. 0 million or to a maximum of 20% of the Bank's gross revenue during the previous financial year, whichever is greater. At the end of the year, advances by the Central Bank to the Government stood at \$49. 7 million and \$45. million in 1997 and 1998 respectively. External debt finances are used to fund Capital III Expenditure and for deficit financing. Foreign debt is incurred from five major sources: (1) Multilateral (international organizations and agencies that cross national barriers such as the World Bank, CDB, and the European Union), (2) Bilateral (agencies of foreign governments, such as USAID and CIDA, and foreign governments such as that of the ROC), (3) Commercial loans, (4) Supplier's Credit (raw materials and equipment provided on account and are paid for at a later date), and (5) International securities markets (bond issue).