



3.Public Finance

Mojmír Sabolovic
mojmir.sabolovic@law.muni.cz



Main roles of Public Expenditures



- **contributes to current effective demand**
- **it expresses a coordinated impulse on the economy, which can be used for stabilization, business cycle inversion, and growth purposes**
- **it increases the public endowment of goods for everybody**
- **it gives rise to positive externalities to economy and society, the more so through its capital component**

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- **In democracy, public expenditure is an expression of people's will, managed through political parties and institutions. At the same time, public expenditure is characterised by a high degree of inertia and law-dependency, which tempers the will of the current majority.**

Public Expenditures Composition

- **First, public expenditure can be classified in terms of the kind of goods and services bought, also with very general items:**
 - 1. capital goods**
 - 2. consumption goods**
 - 3. personnel expenditure**

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- **By contrast, public expenditure in national accounts does not comprehend mere transfers among social groups, as it is the case of pension schemes. Payments of interest on public debt are not comprehended as well.**

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- **Second, public expenditure can be classified according to the official body an organization from which budget it is paid, as for example:**
 - 1. the central state and its ministries**
 - 2. regional and local authorities**
 - 3. separate public bodies**
 - 4. international organizations**

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- **In particular, as a very sketched framework, one may distinguish at least three general models of state to which public expenditure corresponds:**

1. the minimal state, where only justice, public order, foreign policy and some other basic functions should be carried out by the state, relying on private initiative for the others

2. the welfare state, where the State cares about the people's well-being directly, also through expenditure in schooling, health, support for the poor, the old, the disadvantages

3. the developmental state, where the State takes the responsibility of fostering economic development, also through expenditure in infrastructure, support for firms, export and production in general

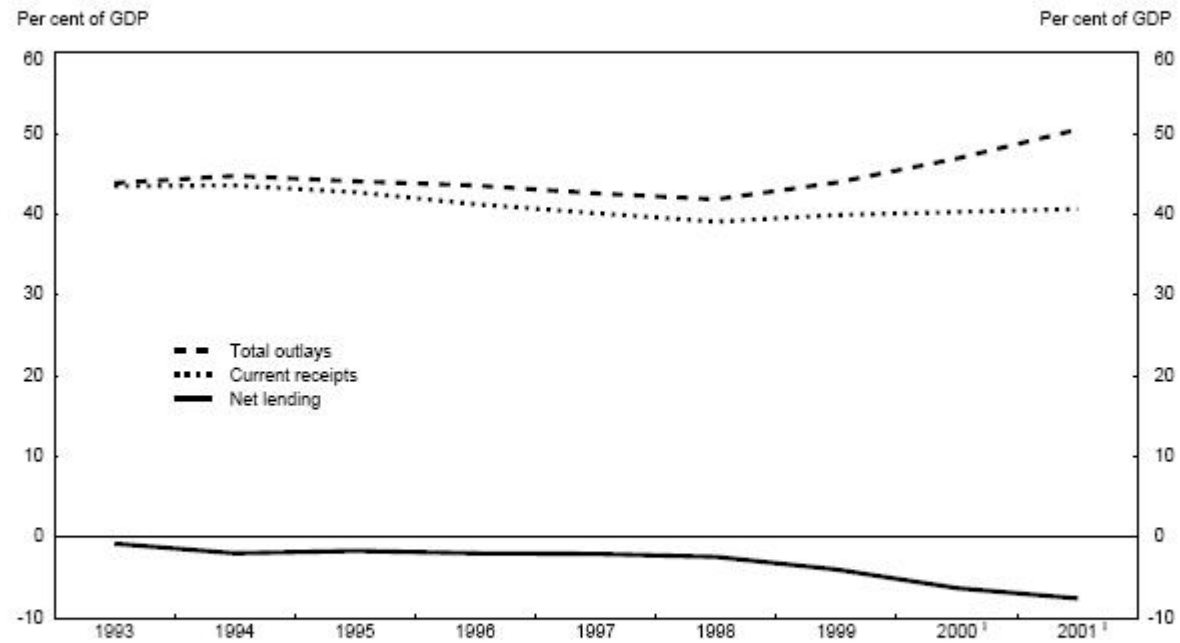
Long-term trends

- **In developed countries, it has always grown, whatever the political orientation of the government. Just the tempo can change. With a few exceptions, only under extremely strong constraints has public expenditure been cut in absolute terms.**
- **Wars are episodes of extremely high public expenditure, followed usually by a return to normality.**

Business cycle behavior

- **Public expenditure may turn out to be pro-cyclical or anti-cyclical depending on the political and institutional attitude public deficit,**

Figure 1. General government expenditures and receipts

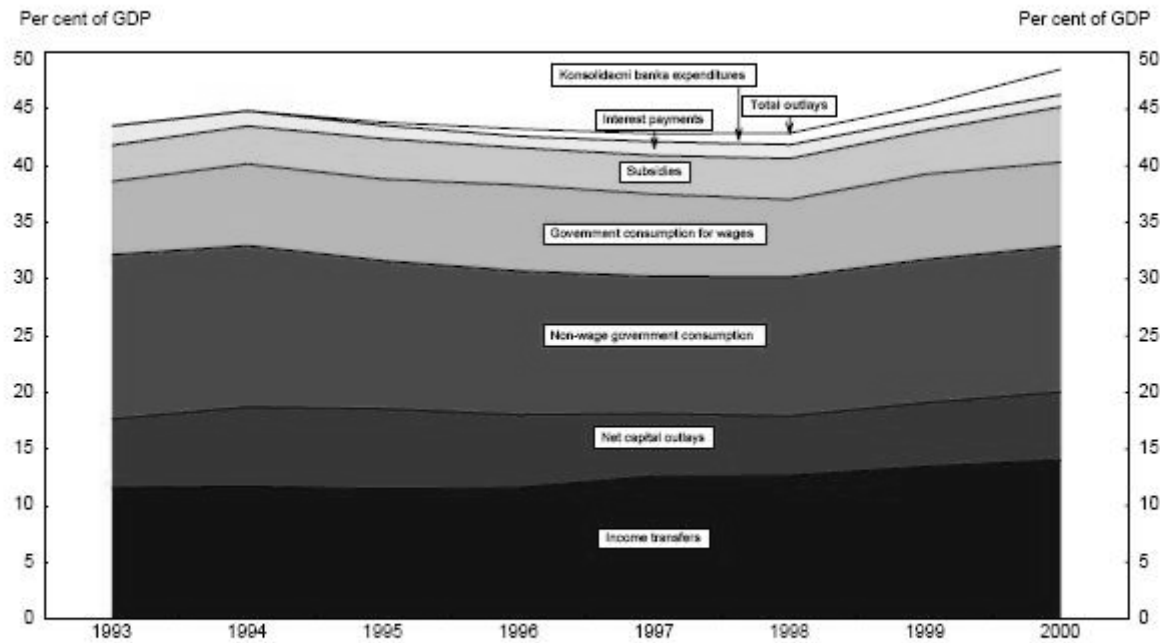


1. Estimates.

Source: OECD Economic Outlook.

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Figure 3. General government outlays by economic category



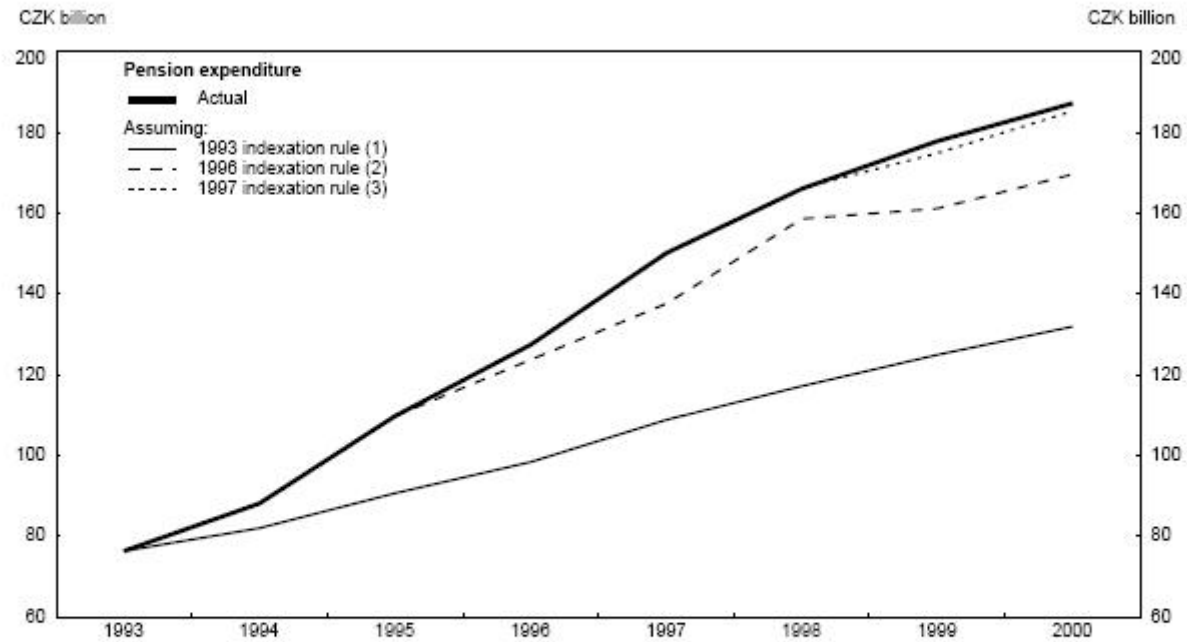
Source: OECD, revised GFS (Government Financial Statistics) accounts.

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Pension systems

- **Funded pension system is one which money is collected and invested in a special fund from which payments are made**
- **Unfunded pension system is one in which pension are paid from current revenues**

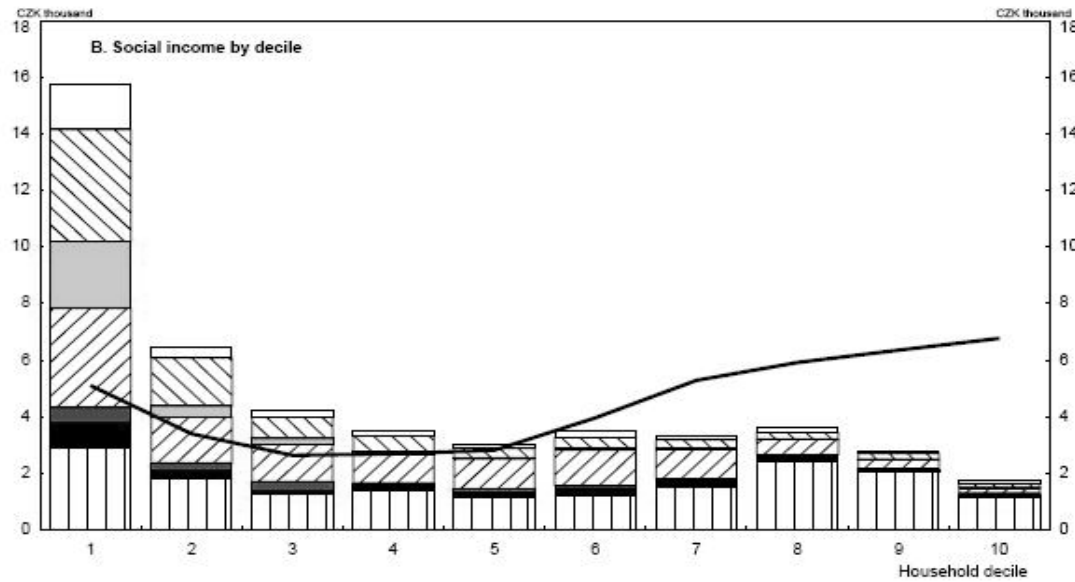
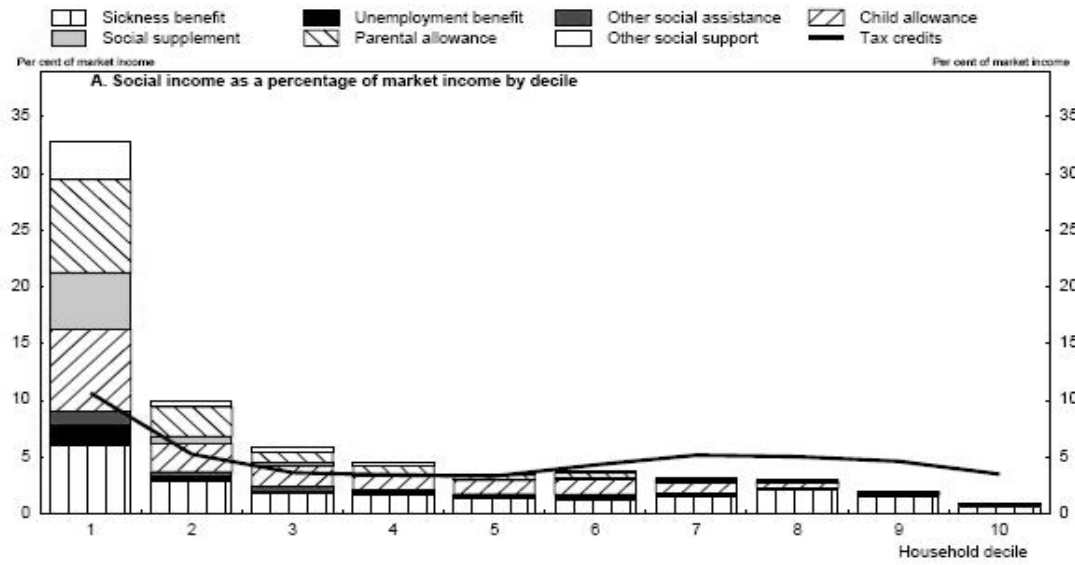
Figure 5. Pension spending under various indexation rules



1. Indexation rule stipulated in 1991 law.
2. Indexation rule stipulated in 1995 law.
3. Indexation rule stipulated in 1997 law.
Source: OECD calculations.

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Figure 7. Social transfers and the distribution of income



Assignment requirements

- **Government deficit**
- **Government debt**
- **GDP**
- **Inflation**
- **Exports and Imports of goods and services**
- Unemployment
- Cost of living

Gross Domestic Product

- **GDP aggregate final output of residents and businesses in an economy in one-year period**
- **GNP aggregate final output of citizens and businesses of an economy in a one-year period**

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- ***GDP = consumption + investment + (government spending) + (exports – imports)***

C is private consumption in the economy

G is the sum of government expenditures on final goods and services



I is defined as business investments in capital

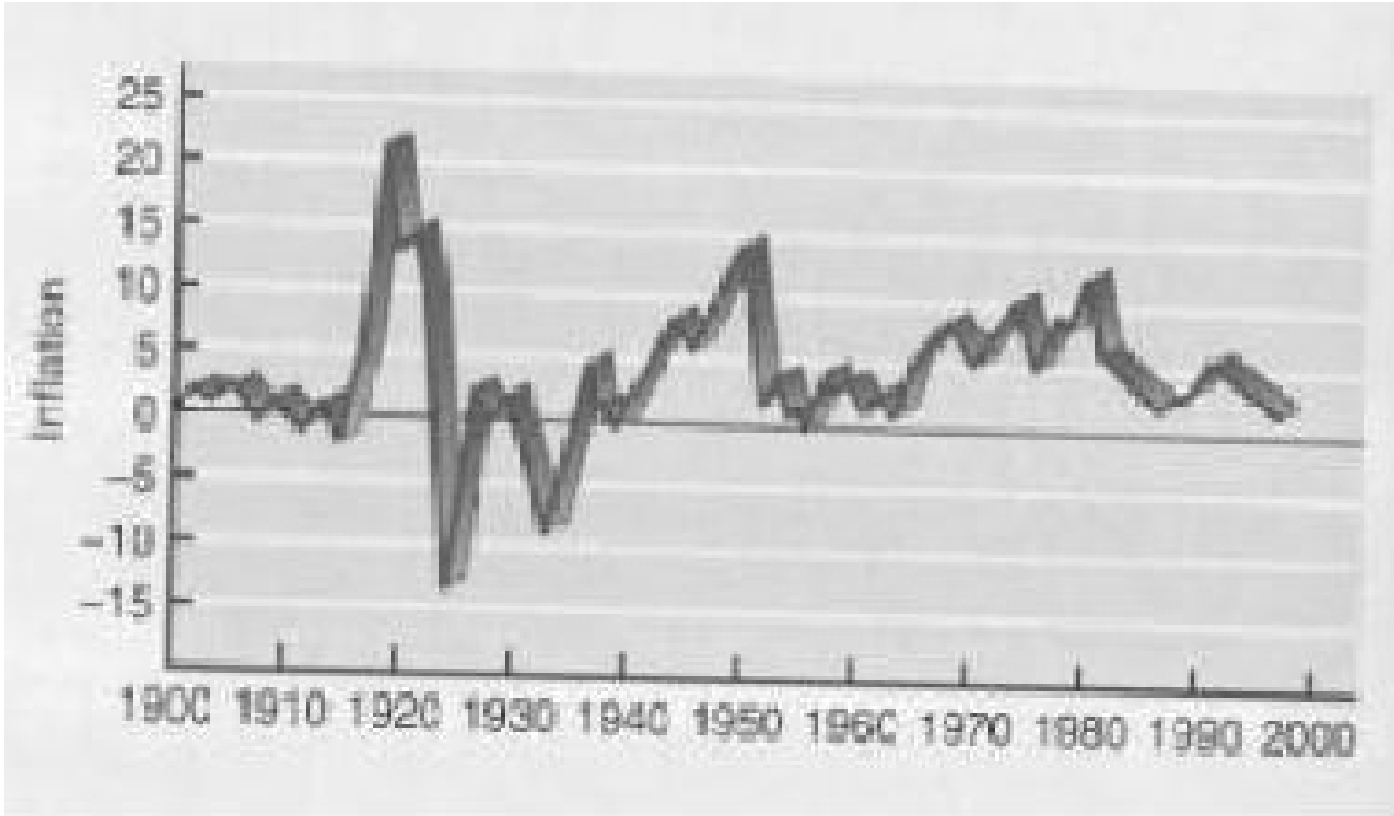
X is gross exports

M s gross imports

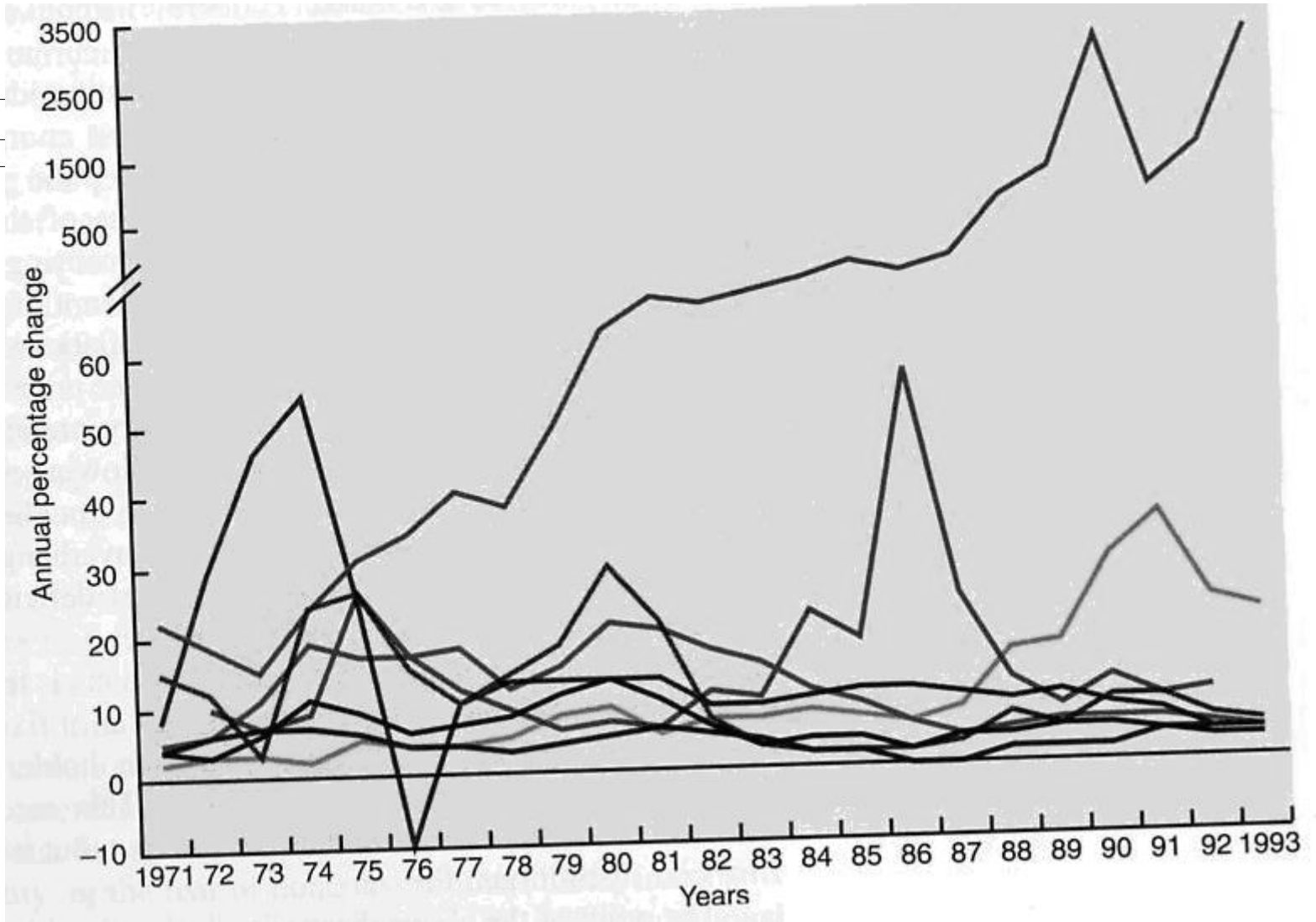
Inflation

- **Inflation is a continual rise in the price level**
- **The price level is an index of all prices in the economy**
- **Inflation is on *going rise***
 - *f.i. If price level goes up 10 percent in a month, but then remains constant, the economy does not have problem*

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- **Since the W.W. II. the price level has continually risen**
 - **Opposite of infaltion is deflation**
 - **there ar number of ways of measure the general price level**



- Bangladesh
- Brazil
- Gambia
- Germany
- Hungary
- Italy
- Korea
- U.S.



Production price index

- **PPI is an index of ratio of composite of prices of a number of raw materials, such as steel, relative to a composite materials in a base year.**
- **It does not measure inflation but to give an early indication of which way inflation will head**

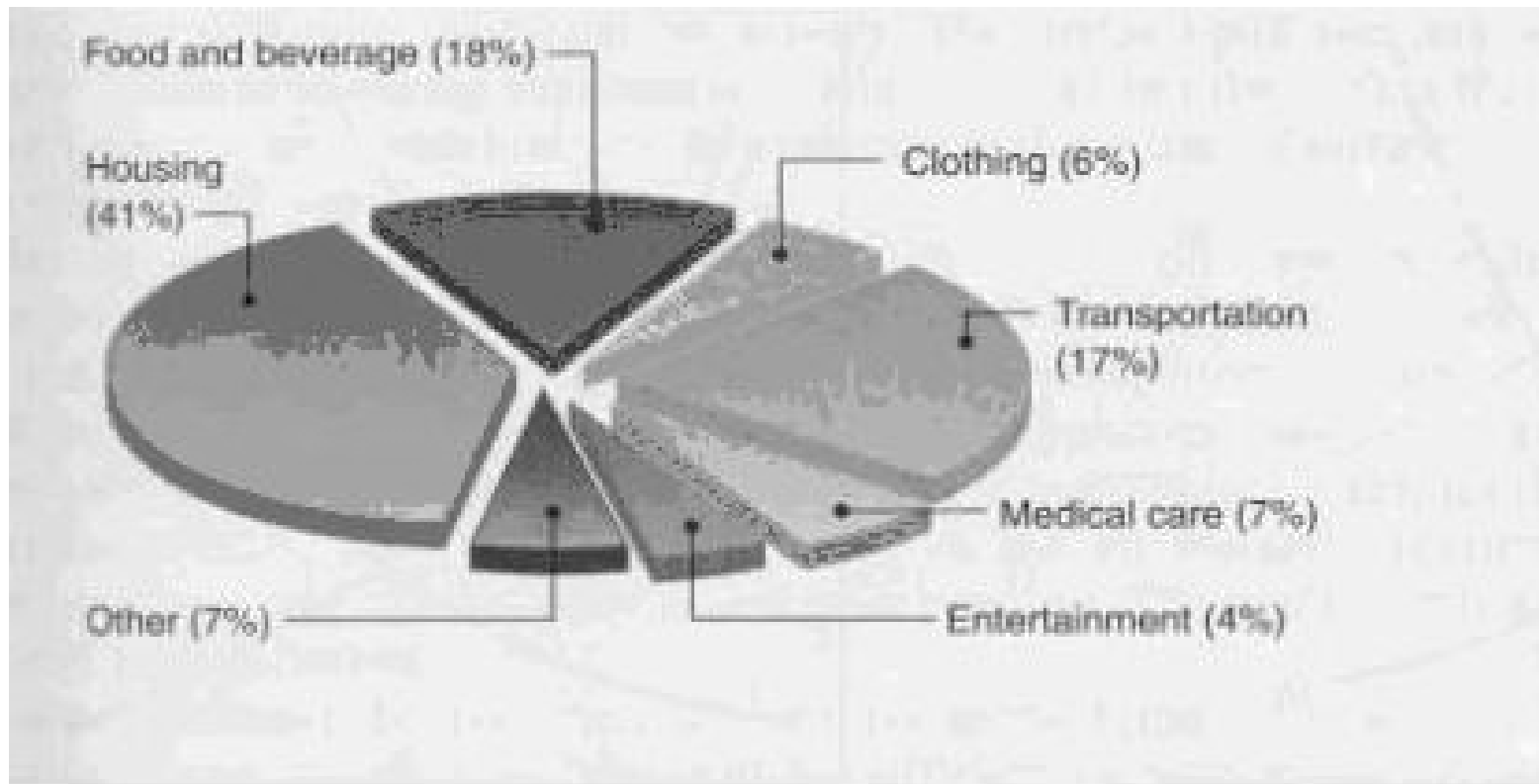
GDP deflator

- **GDP deflator is an index of the price level of aggregate output or the average price of the components in GDP relative to a base year**
- **Very suitable because includes widest number of goods**
- **Deficiencies are above all static value of achieved results**

Consumer Price Index

- **CPI measuring prices of fixed basket of consumer goods, weighted according to each component's share of an average consumer's expenditures**
- **The most used index in reports about economy**



Consumption Basket USA




- **Let's say food prices rise 10 percent in a year and all other prices remain constant**
- **Since food is about 20 percent of the total, the CPI will rise $20\% \times 10\% = 2\%$**

Export

- **Goods and services produced in a country and sold to non-residents.**
- ***An export* is any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.**
- **Export is an important part of international trade.**
- **International trade is the exchange of goods and services across international boundaries or territories. In most countries, it represents a significant share of GDP.**
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- **Export goods or services are provided to foreign consumers by domestic producers.**
 - **Export of commercial quantities of goods normally requires involvement of the Customs authorities in both the country of export and the country of import.**

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- **The advent of small trades over the internet have largely by-passed the involvement of Customs in many countries due to the low individual values of these trades.**

Import

- **Goods and services bought by residents of a country but provided by non-residents.**
- **An import is any good or commodity, brought into one country from another country in a legitimate fashion, typically for use in trade. Import goods or services are provided to domestic consumers by foreign producers.**
- **Import of commercial quantities of goods normally requires involvement of the Customs authorities in both the country of import and the country of export.**

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- **Customs**
- **authorities in both the country of import and the**
- **country of export.**

7. Tasks for the next seminar

- **What is your opinion on of tax system reform?**
- **What is the economics impact?**

References

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