

# The Public Sector

## The role of Gov.

- 4 reasons for G in the economy:**
1. Private sector and market forces can produce goods & services much more effective than G
  2. G helps private sector to do business by upholding law, property rights, etc.
  3. G should try to correct market failures.
  4. G should force equity in society (helping the poor) when markets are not fair.

## Gov intervention

- 5 ways in which G can intervene**
- 1. Delivery of public goods & Service**
    - Public owned and financed
    - G pays private firm to deliver public good or service
    - G teams up with private firm called PPP (Public Private Partnership)
  - 2. Participate in the market.**
    - G buys goods & service and employs people
  - 3. G spending**
    - G influences economy when they decide to buy, G can make transfer payments (make payment without receiving anything in return)
  - 4. Taxation = powerful instrument.** E.g. if G wants more equal distribution they tax rich more and poor less.
  - 5. Regulations and laws that affect the economy**

## Nationalisation & Privatisation

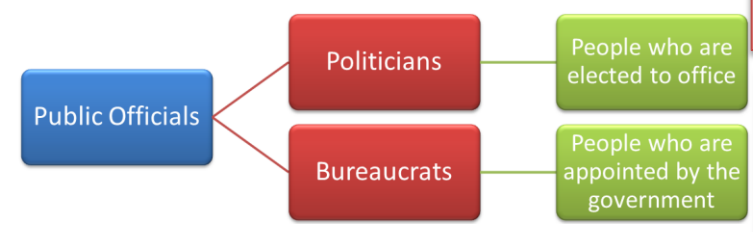
- Nationalisation:**
- Gov. takes ownership of private companies
  - *State owned companies (ESKOM) = not nationalisation.*
  - *Nationalisation = transfer of private to public ownership*
  - *Nationalisation leads to economic failure*
- Privatisation:**
- Private companies take ownership of public enterprises
- Reason:*
1. If G expense decrease, income tax decrease
  2. Private ownership = more efficient
  3. Relieves G from some expenditures (*improve budget deficits*)

## Taxation – Adam Smith

- 1. Neutrality:**  
Tax should **disturb** prices & allocation of resources as **little as possible**
- 2. Equity**  
Tax should be spread fairly across society
  - **Horizontal equity:** people in same position pay the same tax
  - **Vertical equity:** people in different positions pay differently
- 3. Admin simplicity**  
Should not be difficult or costly to collect tax

## Gov Failure

- Politicians can fail:**
- Goal = to be re-elected (*Popularity vs what is right*)
  - Long term goals vs short term (*want votes – now!*)
- Bureaucrats can fail:**
- G is not in constant competition and no competition = inefficiency
- Other failures:**
- Rent-seeking – Influence G behaviour to own advantage and society's disadvantage.



## Privatisation arguments

For	Against
Gov = good in politics; bad in business	There will not necessarily be competition resulting in monopoly
Privatisation attracts Direct Foreign investments	G take stock of external costs, Private firms do not (pollution, etc)
Gov will have less expenditures and private company will pay taxes.	Private firms not concerned with society at large (reducing poverty)
Private companies can change and adopt easily to economic circumstances	
Gov will have more to spend on education, service delivery, etc	
Instrument for BEE (black economic empowerment)	

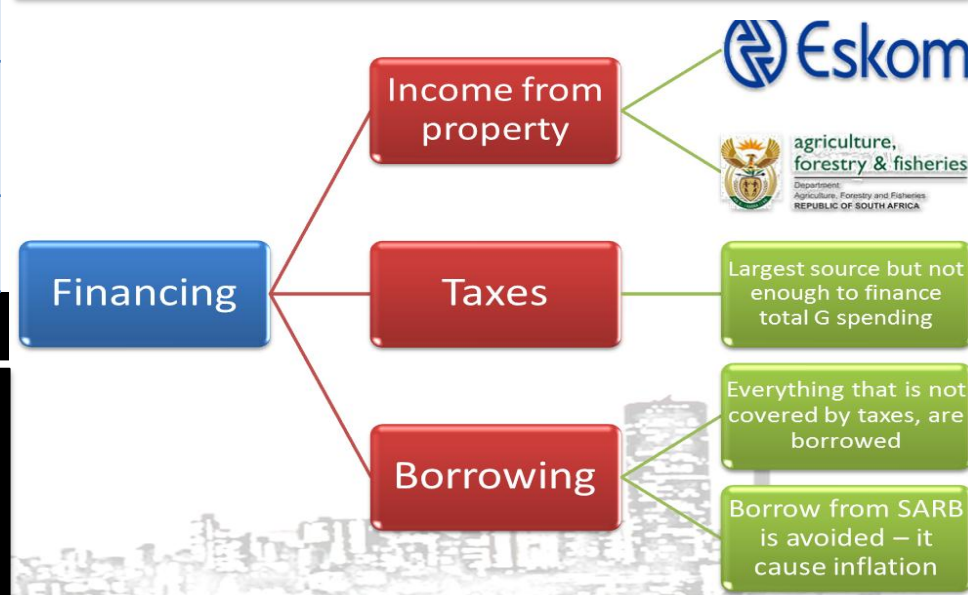
## Fiscal policy & budget

- What the Gov spend (Gov has its own budget)
  - What they borrow
  - How they tax the public
- EXPANSIONARY FISCAL POLICY:**
- If economy is in recession, Gov need to spend more or decrease income taxes
- CONTRACTIONARY FISCAL POLICY:**
- If economy have high growth rates, Gov should spend less or increase taxes

## Gov spending

- Reasons for Gov spending more:
- Changing consumer preferences
  - Political & other shocks
  - Redistribution of income
  - Misconception and entitlement
  - Population growth and urbanisation

## Financing Gov Spending



Budget deficit =

$$\text{TAXES} - \text{Government Expenditure}$$

(Expansionary fiscal policy will worsen the deficit or reduce the surplus because government expenditure increases)

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Budget surplus =

$$\text{TAXES} - \text{Government Expenditure}$$

(Contractionary fiscal policy will better the deficit or cause a surplus because government expenditure decreases)

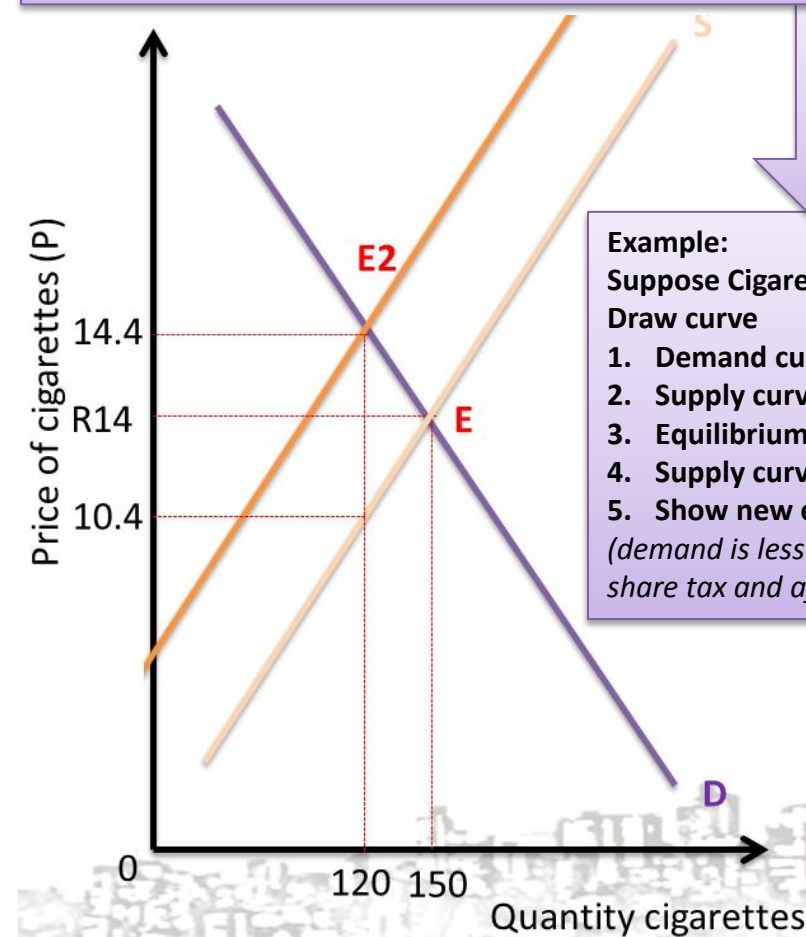
# Study Unit 3

## The Public Sector Continued..

Different type of taxes	
<b>MAJOR CATEGORIES:</b> <b>Direct tax</b> (Levied per person) <b>Indirect Tax</b> (taxes on goods and service) <ul style="list-style-type: none"> <li>- VAT</li> <li>- Selective (<i>sin tax</i> on alcohol)</li> </ul>	<b>Progressive</b> * Rich pay larger % of income on tax than poor
	<b>Proportional</b> * Rich and poor pay same % of income on tax
<b>NOTE!</b> Its about the % not the amount in R	<b>Regressive:</b> * Rich pay smaller % of income on tax than poor

TAX IN SA
<b>PIT (Personal income tax)</b> <ul style="list-style-type: none"> <li>• Largest source of income for Gov</li> <li>• Tax brackets are used to calculate how much tax should be paid per person</li> <li>• If you get R1 more, the tax rate is marginal tax rate.</li> <li>• Overall tax rate = average tax of effective tax ratio</li> </ul>
<b>CT (Company tax)</b> <ul style="list-style-type: none"> <li>• Example of proportional tax rate</li> </ul>
<b>VAT (Value added tax)</b> <ul style="list-style-type: none"> <li>• Example of regressive tax rate</li> </ul>
<b>Rise in overall tax burden</b> <ul style="list-style-type: none"> <li>• Crowding out (<i>increase in gov spending causes decrease in consumption</i>)</li> </ul>

### Who really pays tax?



**Example:**  
 Suppose Cigarettes cost R12, R4 sin tax is levied.  
 Draw curve  
 1. Demand curve  
 2. Supply curve  
 3. Equilibrium  
 4. Supply curve will shift back by R4  
 5. Show new equilibrium  
*(demand is less when sin tax is levied, Consumer & supplier share tax and affect of it)*