THE ROLE OF GOVERNMENT IN PUBLIC EXPENDITURE AND TAXATION

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In the economic development, the unruly competition is increasingly regulated by the government intervention. The present efficient market economy is a modern mixed economy in which the invisible hand of the competitive market and the visible hand of government are decisive factors in the economic growth. This mechanism results from interactions between three components: competition, monopoly and government intervention.

In this mechanism, the role of government is limited to: making rules and regulations on economic activity with a view to ensuring equality, competition, ownership, economic efficiency and social interests, that is, making policies to stabilize and develop the economy, and secure social benefits for all classes. Thus, in the market economy, government undertakes the regulating role in order to offset shortcomings of the market system and redistribute wealth among different social classes by supplying directly certain goods and services or using different tools to regulate the economy. In this article, we want to study the role of government in using public expenditure and taxation as instruments for regulating the economy.

1. Public expenditure

After the Great Depression, the capitalist economics fell into a decline, the unemployment rate sky-rocketed, and as a result, the classical economics was replaced by the Keynesian economics. Keynes argued that the government could take various measures to recover, maintain and accelerate the economic growth. His book, The General Theory of Employment, Interest and Money (1936) provided bases for the government intervention in the economy. The role of governments, step by step, became an important factor in the development of the world economy. This statement could be easily verified by the increase in public expenditure in different countries.

Table 1: Government expenditures in relation to GDP of some powers

Nation	Annual average (%)			
	1955-1957	1967-1969	1974-1976	1981-1995
The US	25.9	31.7	35.1	36.2
England	32.3	38.5	44.5	47.3
Italy	28.1	35.5	43.1	51.7
Germany	30.2	33.1	44.0	48.6
France	35.5	39.4	41.6	40.7
Japan		19.2	25.1	34.6

Thus, in last four decades, the proportion of public expenditures to GDP of many countries increased quickly: by 39.77% in the US (or 1.05% annually); 46.44% in England (1.20% annually); 83.98% in Italy (1.92 annually), etc. In many ASEAN countries, public expenditures, in absolute value, on economic activity also increased remarkably.

Table 2: ASEAN Public Expenditures On Economic Activity

Nation	1976	1980	1985	1990	1995
Indonesia (Rp.bil.)	1,460	3,596	6,479	9,295	16,077
Malaysia (R.mil.)	1,996	5,726	6,029	9,147	9,873
Philippines (PP mil.)	7,983	14,523	19,377	51,891	90,753
Thailand (Bt.mil.)	15,289	22,804	30,534	53,420	132,148
Vietnam (VNĐ bil.)			5.24	524	4,625
Singapore (Sing$ mil.)	874.9	2,210	2,273	2,389	2,511

In last two decades, absolute value of public expenditure on economic activity have increased very fast: by over 11 times in Indonesia, by 8.6 times in Thailand, by 11.36 times in the Philippines, etc. In Vietnam, because the economy was in the transition to the market economy, the treasury has spent a lot on subsidies so the spending has sky-rocketed in both absolute and relative values. Vietnam's public expenditures on production represented 35.7% of total public expenditure in 1986, 41.5% in 1988 (or 7.8% annually). In last five years, public expenditure on economic activity increased by 8.8 times (not taking changes in price into consideration).

In different countries, governments have given priority to different businesses: of public expenditures on economic activity, Hong Kong authorities spent 67.7% on transportation and postal service, 16.8% on electricity and gas, 7.8% on industry and 0.8% on agriculture (1988); South Korea government spent 20.8% on transportation and postal service, 8.5% on gas and electricity, 8.5% on industry, 41.6% on agriculture (1988). Generally, these expenditures aimed at accelerating economic growth, reducing unemployment rate, developing domestic and foreign markets.

Public expenditures on economic development could be used to supply subsidies, finance R&D programs and production of public goods, purchase goods and services, give soft loans or preferential taxes, etc.

a. Subsidy

In order to achieve socio-economic targets, governments usually give subsidies to companies or farmers with a view to maintaining, stabilizing or expanding production of certain goods

Subsidies could be given to the following activities:

- Production: government monopolies, infrastructure development, public utility services, export-oriented or import substitution industries, labor-intensive businesses

(including sea and land farming)

- National security: defense industry, power and engineering industry, food production, etc.
- Traditional occupations: subsidy supply aims at developing traditional occupations in order to create more jobs and make the best use of natural resources.

Subsidy could take many forms: price support, tax reduction, soft loans supply, equipment and materials supply, buying up unsold output, etc.

Governments spent a lot of money on subsidies: at the beginning of the 1980s, government subsidies represented some 50% of sales of US sugar industry. Similarly, Canadian government paid big subsidies to milk industry, ECC supported cow husbandry and cow meat processing business, Japanese Government supported wheat, rice, sugar and milk production, etc.

Table 3: Agricultural subsidy

Nation	Subsidy to production				Subsidy to consumption			
	Total		% of output value		Total		% of output consumed	
	1989 (US$ bil.)	Compared with 1988 (%)	1989 (US$ bil.)	Compared with 1988 (%)	1989 (US$ bil.)	Compared with 1988 (%)	1989 (US$ bil.)	Compared with 1988 (%)
Australia	1.3	0	10	0	0.3	-10	7	-1
Austria	1.9	-18	44	5	1.8	-17	44	-7
Canada	5.2	-14	35	8	2.6	-15	23	-5
The US	32.3	-18	27	8	14.9	-17	15	-3
Finland	4.5	7	72	2	3.3	-2	68	-4
Japan	33.7	-9	72	3	34.0	-14	48	-5
Norway	2.6	-2	74	2	1.2	-9	58	-3
New Zealand	0.2	-25	5	2	0.1	0	5	-1
Sweden	2.2	-8	4	5	2.2	-12	49	-5
Switzerland	4.3	-14	75	5	3.2	-19	53	-4
Turkey	-	-	-	-	-	-	-	-
EC	53.0	-15	38	5	40.6	-15	31	-5
OECD	141.2	-13	39	6	104.2	-15	31	-4

The table 3 shows that Japan and the US governments gave the largest subsidies. In 1989, Japanese Government gave US$33.7 billion worth of agricultural subsidy representing 72% of output produced and other 34-billion subsidies to consumption of agricultural products (representing 48% of output consumed); in America, US$32.9 billion subsidies were given to agricultural production (27% of output produced) and 14.9 billion to agricultural product consumption (15% of output consumed) in order to export American agricultural products, maintain farming area and bridge the gap between agriculture and industry, and between rural areas and cities.

b. Financing R&D programs and production of public goods

Techno-sccientific progress has changed the human thought. In the past, the people were afraid of government intervention in the economy, but at present they demand to be supplied with education, health care services, housing and jobs, etc. so the government has to intervene in the economy. Many public works require large investment but bring in no income but government must undertake such as the building of roads, schools and hospitals, national defense, anti-social evils programs, etc.

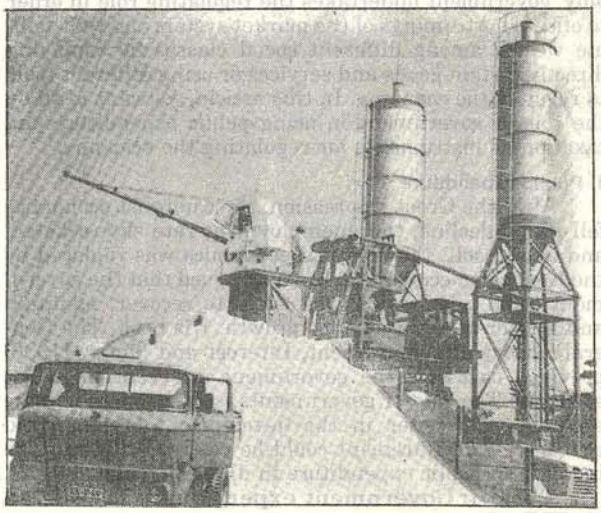
The competitive market can't distribute wealth evenly among social classes, so there must be social security schemes to pay allowances to those who are ill, unemployed or disable. These schemes hardly attract participation of private persons.

The populace consume a lot of public goods provided by governments. These goods and services are of a collective nature that makes it difficult for us to use market prices to value them. Naturally, the private sector can undertake the supply of certain goods or services that can be valued exactly and require no too big investments, but there must be public expenditures

Table 4: Spending on scientific research and public goods in Vietnam public expenditure 1990-1993

	1990	1991	1992	1993
Total (VND bil.)	9,186	12,081	23,711	39,063
I. Public investment	2,705	2,715	8,143	11,846
II. Interest and debt paid	1,260	1,274	1,873	4,150
III. Public goods and services	5,221	8,091	13,695	23,067
1. Education	683	1,127	1,868	2,130
2. Health care	368	636	1,066	1,617
3. Birth control and family planning	8	22	51	137
4. Sports and cultural activities	136	118	357	497
5. Scientific research	115	114	279	507
6. Economic concerns	524	784	1,452	2,498
7. Social security	695	1,278	2,126	3,752
8. Administrative machinery	676	1,290	2,404	4,335

The government's supply of public goods aims at not only providing benefits for most of the populace, but also affecting positively the economic development, that is, government expenditure on public goods could be seen as an instrument for regulating the level of spending in the economy.



When public expenditure increases, the aggregate demand in market increases because administrative machinery and social security schemes become sources of income for other sectors. The increase in demand helps to limit cyclical depression. In the market for capital goods, investment in production of public goods, subsidies, price support have really accelerated the growth rate.

Besides good effects on the economy, there are also bad effects. Increases in public expenditure can lead to a rise in market prices, budget deficit and inflation. Moreover, an increase in social security allowances can restrict activeness of beneficiaries and reduce aggregate supply because dynamic factors are destroyed.

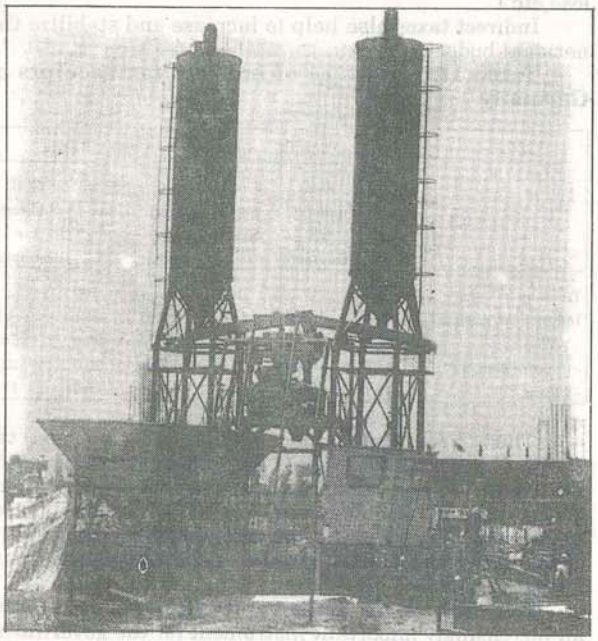
In addition, governments also pay for R&D programs which require big investments and a lot of time. Private companies of small and medium scales can't afford them. Moreover, techno-scientific achievements need to be ap-

plied to various fields (increasing output, reducing production cost, saving labor, etc.) with a view to supplying more products and services of higher quality to the market, and therefore this also requires investments. The economic development also requires the government to play a leading role in certain key industries which involve high degree of risk and are of low profitability. Government spending on R&D programs is on the increase and represents an increasingly larger percentage.

Table 5: Expenditures on R&D

Nation	Year	On R&D (US$ mil.)	% of NI	Financed by government (%)
Japan	1978	15,560	2.11	27.5
	1980	27,797	2.35	25.8
	1985	48,169	3.19	19.4
	1988	76,249	3.35	18.4
The US	1980	62,593	2.57	47.1
	1985	107,436	3.02	47.7
	1988	126,115	2.89	48.0
Germany	1987	35,690	3.21	37.7
France	1986	19,926	2.21	50.9
	1988	21,890	2.70	38.5

Within 8 years from 1980 to 1988, expenditure on R&D in the US increased from 62.593 billion to 126.115 billion and the goverment financed from 47.1% (1980) to 48% (1988)



c. Purchase of goods and services

Besides production of public goods, the government can purchase products made by certain industries in order to maintain aggregate demand, stabilize market prices and help these industries develop. It's difficult to discriminate between government expenditures on production of public goods and on public investment or purchase of goods and services. These expenditures have close relations to each other, this one is both precondition and result of others. However, we can discern government's purchase of goods and services made by state-run enterprises by studying overseas aid given by a government to developing countries. This aid is usually repaid by buying goods from donor countries.

Table 6: Development aid to developing countries

Regiou	1970	1980	1985	1986	1987	1988
All developing countries	6,738.2	33,780.0	33,361.0	39.541.0	42,904.8	46,441.9
Asia-Pacific	3,122.1	9,104.1	8,637.7	10.946.9	11,739.1	13,678.1
(DMCs from ADB)	(2,556.9)	(8,585.0)	(7,989.5)	(10,046.6)	(10,802.1)	(12,729.6)
Africa	1,602.5	9,553.8	11,048.9	2,706.2	4,480.8	6,119.1
Europe	182.9	1,174.8	413.5	597.1	570.4	562.5
Middle East	277.4	6,637.7	5,700.7	5,699.4	5,187.7	3,989.6
Western Hemisphere	1,181.3	3,059.7	3,987.7	4,394.7	4,968.0	5,119.1

2. Tax policy

The government can regulate the economy by attracting resources to the national treasury. The structure of receipts of national budget depends on social, economic and political conditions of each nation. However, a large percentage of budget receipts comes from taxes

Table 7: Budget receipts in some countries (1994)

Nation	Total	Tax receipts		Nontax receipts	
		Receipts	%	Receipts	%
Indonesia (Rp.bil.)	61,370	55,373	90.2	5,997	9.8
Malaysia (R.mil.)	45,692	34,639	75.8	11,053	24.2
Philippines (PP mil.)	335,227	271,456	81.0	63,771	19.0
Thailand (Bt mil.)	680,455	619,048	91.0	61,047	9.0
Vietnam (VNĐ bil.)	42,660	35,237	82.6	7,423	17.4
Singapore (Sing$ mil.)	24,670	15,135	61.3	9,535	38.7

Tax receipts usually represent 60-90% of budget receipts. Differences, if any, are caused by the nation's tax policy and structure of receipts. In 1994, tax receipts represented 91% of the national budget receipts in Thailand, 90.2% in Indonesia, and 82.6% in Vietnam. Thus, tax is usually considered as an instrument for keeping the budget balanced; encouraging economic growth, competition and development of all sectors; encouraging exploitation of domestic resources, attracting foreign investment and expanding trade, etc. In addition, taxes can alter the distribution of income and wealth thereby reducing social inequality.

In Vietnam, unreasonable tax rates, small tax take and tax avoidance or evasion have led to budget deficit in recent years.

Table 8: Budget receipts and expenditures (1990-1994)

(VNĐ Bil.)

	1990	1991	1992	1993	1994
Total receipts	6,372	10,609	21,023	32,199	42,660
Domestic sources	6,153	10,083	20,175	31,171	-
Aid	219	526	848	1,028	-
Total expenditures	9,186	12,081	23,711	39,063	46,310
Deficit	2,814	1,472	2,688	6,864	-3,650

Although the tax take in comparison with GDP was rather high 22.8% (compared with 15.1% in Taiwan,

16.9% in Thailand or 17.4% in Indonesia), but public expenditures were also very huge while tax evasion and avoidance were common with the result that budget deficit became permanent. In 1989, the proportion of budget expenditure to receipts was 171.1%, and 108.6% in 1994, so the government had to borrow money from foreign sources and the people to reduce the deficit. Thus, in recent years, taxation didn't play well the role as an instrument for regulating the economy, securing social equality and financing government expenditure.

The tax take of each nation depends on its social, political, economic and historical conditions. By their nature, taxes can be divided into two groups. The first includes direct taxes (income tax, corporate tax, property tax, inheritance tax, etc.) and the second are indirect taxes (turnover tax, excise duty, customs duties, VAT, etc.). Direct tax receipts usually represent a larger percentage of tax take in countries that didn't charge VAT. These receipts tend to increase in certain countries (88.73% in the US and 73.4% in Japan) but represent a smaller percentage in other countries (57.2% in the UK, 56.0% in Germany, or 40.2% in France) and show a downward tendency.

Table 9: The structure of tax receipts in some countries in 1984-1985 fiscal year (%)

	The US	The UK	Germany	France	Japan
Direct taxes	88.7	57.2	56.0	40.2	73.4
-Income tax	72.2	38.6	41.7	24.1	39.2
-Corporate tax	15.0	6.9	14.3	9.1	31.8
-Others	1.5	11.7	-	7.0	2.4
Indirect taxes	11.3	42.8	44.0	59.8	26.6
-VAT	-	19.9	25.1	44.4	-
-Others	11.3	22.9	18.9	15.4	26.6

Direct taxes aim mainly at redistributing wealth and income, and raising revenue for the government.

In 1986, the per capita tax payment in Sweden was SKr69,737 including per capita income tax of SKr25,350; national insurance contribution of SKr17,610 and VAT plus excise duty and other taxes of SKr26,780. These tax payments are collected from high-income earner and used for paying allowances and for producing public goods.

Table 10: Swedish public expenditures (SKr mil.)

Hospital and health care	7,690
Education	1,990
Pension, children allowance, national insurance	10,150
Allowances for aged persons	3,010
Kindergarten	2,180
Medical treatment	2,460
Schools	5,320
Housing benefit and food stamp	3,260
Vocational training	2,300
Library and sports	1,080
Roadworks	3,140
Subsidies	2,460
National defense	2,910
National debt	7,550

In addition, direct tax receipts are used to regulate the volume of investment, innovate technology, control production, etc.

In 1982, the US Government carried out tax reformation aiming at modernizing technology. To achieve this aim, the government reduced corporate tax by shortening duration for amortization by 37% (from 8.6 to 5 years). Up to 1982, only one year after, American companies got enough money (US$10 billion) to modernize technology. Up to 1985, they got 45 billion, that is, they accumulated some 164 billion during the period 1981-1985.

Indirect taxes help to regulate investment, control the level of spending, raise revenue for the government, control the volume of exports and imports, and encourage domestic production.

By changing tax rates, the government can encourage or discourage production or consumption of certain products. In Sweden, the VAT charges a rate of 3.97% on construction, 12.87% on service and 23.46% on other businesses. In Vietnam in 1994, a 0-20% tax bracket was charged on manufacturing industry, 1-4% tax bracket on transportation and 2-40% tax bracket on service industry.

A high tax rate can be used for reducing spending or production of certain goods (this tax is called excise duty). In Vietnam (1993) a 32-70% tax bracket was charged on tobacco, 15-19% on spirits, 75-90% on beer, 100% on firecracker. To encourage domestic production, exportation, investment and reduce imports, the governments charge different rates of customs duty on different products. In 1992, the Vietnam Government gave tax exemption to almost exports or charged a low tax rate on them (the highest was 20% charging on wooden products). A heavy luxury tax is charged on imported automobiles (100%), spirits (100%), and on products that could be made locally (30% on tractors and other agricultural machines). Tax exemption is given to raw materials needed for local production of essential goods (seeds, medicine, cellulose,etc.)

Indirect taxes also help to increase and stabilize the national budget.

Table 11: Structure of indirect tax receipts of Germany

	1970		1985		1988	
	% of tax take	% of indirect tax receipts	% of tax take	% of indirect tax receipts	% of tax take	% of indirect tax receipts
Tax take	100	-	100	-	100	-
Indirect tax receipts	52.1	100	44.0	100	44.1	100
- VAT	24.7	47.4	25.1	57.0	25.6	58.0
- Consumption tax	14.7	28.2	10.5	23.9	10.0	22.7
- Others	12.7	24.4	8.4	19.1	8.5	19.3

Thus, VAT represented 58% and consumtion tax 22.7% of indirect tax receipts in 1988 in Germany. With the trend of trade globalization, receipts from customs duties was on the decrease. In 1979, customs duties contributed only 2% of the Japanese budget income; 1.67% of the American budget income and 3% of the German budget income.

Generally, in the market economy, taxation becomes an increasingly important instrument for the government to regulate the economy. A reasonable tax policy could increase budget income and at the same time, control economic activity, encourage competition and ensure all sectors equal opportunities■

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