OIC ACCREDITATION CERTIFICATION PROGRAMME FOR OFFICIAL STATISTICS

GOVERNMENT FINANCE, FISCAL AND PUBLIC SECTOR STATISTICS

TEXTBOOK

ORGANISATION OF ISLAMIC COOPERATION

STATISTICAL ECONOMIC AND SOCIAL RESEARCH AND TRAINING CENTRE FOR ISLAMIC COUNTRIES

SESRIC

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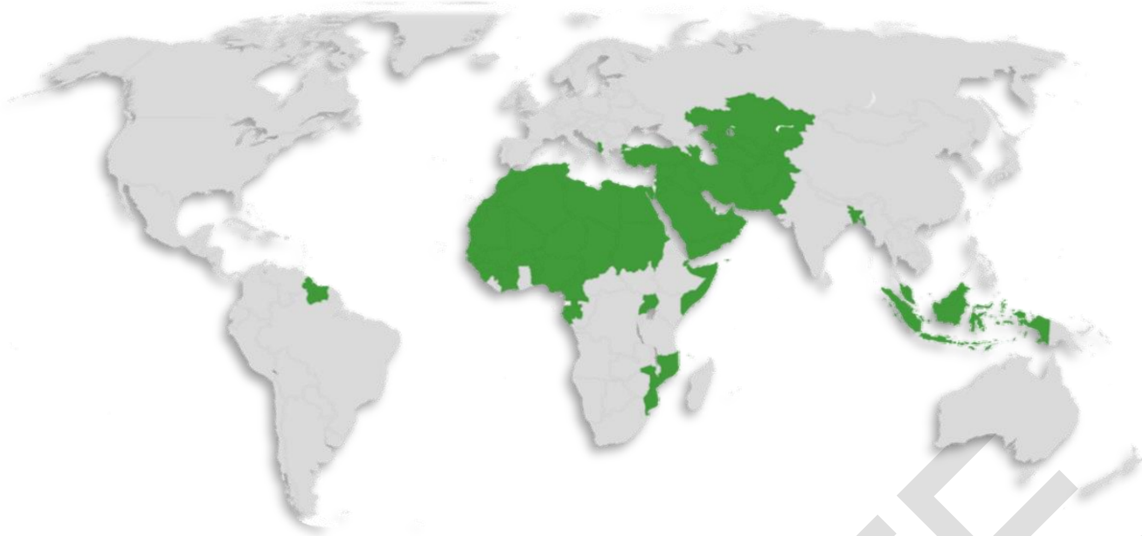

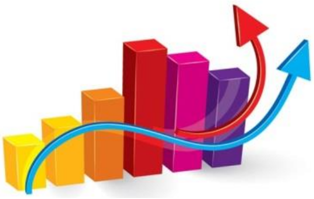

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{{ZIAUDDIN AHMED}}

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STATISTICAL ECONOMIC AND SOCIAL RESEARCH
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ISBN: xxx-xxx-xxxx-xx-x

Cover design by Publication Department, SESRIC.

For additional information, contact Statistics Department, SESRIC.

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ACRONYMS

BBS	Bangladesh Bureau of Statistics
CEA	Classification of Environmental Activities
COFOG	Classification of the Functions of Government
GFS	Government Finance Statistics
FISIM	Financial Intermediation Services Indirectly Measured
NPI	Non Profit Institutions
NPISHs	Nonprofit Institutions Serving Households
PPP	Purchasing Power Parity
SDRs	Special Drawing Rights

ACKNOWLEDGEMENT

Prepared jointly by the {{BANGLADESH BUREAU OF STATISTICS (BBS)}} in {{DHAKA}} – {{BANGLADESH}} and the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) under the OIC Accreditation and Certification Programme for Official Statisticians (OIC-CPOS) supported by Islamic Development Bank Group (IDB), this textbook on Government Finance, Fiscal and Public sector Statistics covers basic theme about the topic.

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UNIT 1

INTRODUCTION

1.1 Defining Government Finance

Government finance is the study of the role of the government in the economy. It is the branch of economics which assesses the government revenue and government expenditure of the public authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones. Government finance is closely connected to issues of income distribution and social equity.

Distinction between private and Government finance

By private finance we mean the financial problems and policies of an individual economic unit as compared with those of the public authorities. It is a convention to look into similarities and dissimilarities between the two so as to provide an analytical foundation for the decision making aspects of government finance.

Similarities:

- Modern economics are monetized. That is to say, most of their economic activities have financial counterparts involving creation and use of financial claims. Both private and public sectors are engaged in activities that involve purchases, sales and other transaction. Similarly, they are engaged in production, exchange, saving, capital accumulation, investment and so on. In order to finance this operations, the government, amongst other things, creates money (which is also financial asset), raises loans, and makes payments, etc. Similarly, a private economic unit lends, borrows receive payments, makes payments, and so on. In these respect therefore, both the public and private finances are quite similar to each other.
- One may also point out that both sectors are engaged in satisfying the wants of the society by sharing economic activities. Both have limited resources at their disposal and try to make their best by taking decisions such that the "most important" wants are satisfied first. In that sense their problems and decisions are similar.
- But the similarities between the two types of finances almost end here. In contrast, the differences between the two are quite sharp.

Dissimilarities:

- It may be stated that a private economic unit has to live within its means. Its deficit budgeting (that is spending more than the income) can be only for a limited period and only up to a limit. Given its economic standing, it can accumulate outstanding debt liabilities up to a limit and no more. But this constraint hardly applies to the state. It can plan to add to its outstanding debt with every budget, and may also succeed and doing so. A number of governments are virtually doing this. The result is that the public debt in many countries has become a high proportion of national income.
- The distinction between private and public borrowings does not end with only amounts of possible borrowings, but extends to their forms, rates of interest and other terms and conditions. A private firm cannot raise non- repayable loans, but the State may and sometimes does. The State can borrow both internally and externally, that is, it can borrow from those who are subject to its authority and from those who are not. But a private economic unit (such as a firm) can not raise an internal loan; all its loan have to be 'external'. Furthermore, high creditworthiness of the state enables it to borrow at rates much lower than the private economic units have to pay. It has support of the central bank of the country as an agent and as an underwriter when its loans are floated in the market. It can draw upon the facilities of the banking and other financial institutions more liberally. In some cases, it may adopt indirect coercive methods to borrow at lower rates.
- The government or a competent authority on its behalf can create legal tender currency, that is, money which the creditors can not refuse to accept in discharge of their claims upon their debtors. With the introduction of paper currency, the authorities of many countries have acquired an unbridled discretionary power to add to currency supply. Often the formal technical restrictions can be waived if the governments so wants. Such types of restriction mainly indicate procedural handicaps and not essential checks. The upshot of the argument is that the government can just create purchasing power and add to the demand side of the market and take away a part of the national produce. It can leave the rest of the economy with more money and a smaller supply of goods than before. A private economic unit can not do so. Its obligations can never become legal tender. A private economic unit is always expected to pay back its obligations. In contrast obligations of public authorities via issue of currency need not be redeemed at all.

- It is claimed that private finance followed the "market principle", or the principle of economic rationality; but the public finance follows the budget principle." It means that private economic units are guided by market signals and of market mechanism and their own economic interest. In contrast the essence of the budget principle is that the services in this sphere are determined not by profit expectation and the willingness of the individuals to spend their money for the purchase of such services, but by decision reached through political and administrative procedures and based on common social objectives." The State does not go by the principle of quid pro quo.

- Quite often, in private finance, the view taken is a short term one. In contrast, the State is expected to take a long term view of the interests of the economy as a whole and be ready to suffer commercial losses for that purpose, both in the short run and in the long run. Also the State would keep in mind the fact that the society is a perpetual entity and for its welfare many activities are needed which have no immediate economic return, even to the society. An example in case is the investment of the State in removing untouchability.

- It is generally pointed out that while a private economic unit proceed by first ascertaining its income and then determining its expenditure, the government first decides about its expenditure and then goes round to seek revenue for it. but, it is an erroneous idea based upon the outmoded thinking that the activities of the State would be confined to the minimum possible and that the State would then find out the best ways of financing them. However, these days, it is not so. It is realized that the activities of the State are not fixed ones. They are ever-widening and with the increasing complexity and growth of the society, the need to increase State activities is also going up. The government, therefore, has to expand its activities though such expansion is restricted, amongst other things, by financial considerations also. Though the State, theoretically speaking, has complete powers of raising additional receipts through taxation, confiscation, borrowing, and printing notes, it would use these powers only within limits so that the fabric of the economy is not over-stretched. For example, over –borrowing by the state could starve the capital market and private investment. Too much of note printing would lead to inflationary pressures and other problems in the economy. Excessive taxation may discourage saving and investment and productive activities, and so on. Therefore, in practice, the government does not use these powers indiscriminately. For example, most governments follow a system of progressive tax in which poorer sections of society are tax lightly. All said and done, the expenditure programme of the governments is, to a great extent, conditioned by the revenue considerations.

1.2 Defining of an Institutional Unit:

An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities.

Some important features of institutional units are:

- The ability of an institutional unit to own goods or assets in its own right means that it is also able to exchange the ownership of goods or assets in transactions with other institutional units.
- An institutional unit is able to take economic decisions and engage in economic activities for which it is itself held directly responsible and accountable by law.
- An institutional unit is able to incur liabilities on its own behalf, to take on other obligations or future commitments, and to enter into contracts.
- Either a complete set of accounts, including a balance sheet of assets, liabilities, and net worth, exists for an institutional unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were required.

Types of Institutional Units

There are two main types of institutional units:

- Persons or groups of persons in the form of households
- Legal or social entities.

Households: A household is a group of persons who share the same living accommodation, who pool some, or all, of their income and wealth, and who consume certain types of goods and services collectively, mainly housing and food. A household can be an individual household, or an institutional household. The latter comprises groups of persons staying for a very long or indefinite period of time, or who may be expected to reside for a very long or indefinite period of time in institutions such as hospitals, retirement homes, prisons, or religious communities such as convents, monasteries, and nunneries.

A household can have one member or could be a multi-person household. In a multi-person household, individual members are not treated as separate institutional units. Many assets are owned, or liabilities incurred, jointly by two or more members of the same household, while some or all of the income received by individual members of the same household may be pooled for the benefit of all members. Moreover, many expenditure decisions, especially those relating to the consumption of food or housing, may be made collectively for the household as a whole. It may be impossible, therefore, to draw up meaningful balance sheets or other accounts for individual members of a militiaperson household. For these reasons, the household as a whole rather than the individual persons in it must be treated as the institutional unit.

Legal and social entities: A legal or social entity is one whose existence is recognized by law or society independently of the persons or other entities that may own or control it. Three types of legal or social entities are recognized as institutional units.

1. Corporations: Corporations are defined as entities that are capable of generating a profit or other financial gain for their owners, are recognized by law as separate legal entities from their owners, and are set up for purposes of engaging in market production. The key to classifying a unit as a corporation in macroeconomic statistics is not its legal status but rather the economic substance of the nature of the entity. The laws governing the creation, management, and operations of legally constituted corporations and other entities may vary from country to country, so that it is not feasible to provide a legal definition of a corporation that would be universally valid. Therefore, in macroeconomic statistics, the term corporation is not necessarily used in the same way as in the legal sense.

2. Nonprofit institutions (NPIs)

Nonprofit institutions (NPIs) are legal or social entities created for the purpose of producing or distributing goods and services, but they cannot be a source of income, profit, or other financial gain for the institutional units that establish, control, or finance them. In practice, their productive activities generate either surpluses or deficits, but the surpluses cannot be appropriated by other institutional units. The articles of association by which they are established are drawn up in such a way that the institutional units that control or manage them are not entitled to a share in any profits or other income they generate.

NPIs may engage in market or nonmarket production, and may be created by households, corporations, or governments. NPIs engaged in market production charge economically significant prices for their services. Schools, colleges, universities, clinics, hospitals, etc. constituted as NPIs are market producers when they charge fees that are based on the majority of their production costs and that are sufficiently high to have a significant influence on the demand for their services. There are no shareholders with a claim on the profits or equity of the NPI. Because of their status as NPIs, they are also able to raise significant additional funds through donations from persons, corporations, or governments. Nevertheless, NPIs engaged in market production and controlled by government units must be treated as public corporations so long as they produce goods and services for the market at economically significant prices.

3. Government units

Government units are unique kinds of legal entities established by political processes that have legislative, judicial, or executive authority over other institutional units within a given area. The principal economic functions of government units are to:

- assume responsibility for the provision of goods and services to the community or individual households primarily on a nonmarket basis;
- redistribute income and wealth by means of transfers;
- engage primarily in nonmarket production; and
- finance their activities primarily out of taxation or other compulsory transfers.

A government unit may also finance a portion of its activities in a specific period by borrowing or by acquiring funds from sources other than compulsory transfers. For example, interest revenue, incidental sales of goods and services, or the rent of subsoil assets. All government units are part of the general government sector.

Defining institutional sectors

An institutional sector groups together similar kinds of institutional units according to their economic objectives, functions, and behavior. Each sector consists of a number of institutional units that are resident in the economy and is intrinsically different from the other sectors. An economy is divided into five mutually exclusive institutional sectors. All resident institutional units are allocated to one of these institutional sectors. The five institutional sectors are:

- Non-financial corporations sector;
- Financial corporations sector;
- General government sector;
- Households sector; and
- Non-profit institutions serving households sector.

1. Nonfinancial corporations sector

The nonfinancial corporations sector consists of resident institutional units that are principally engaged in the production of market goods or nonfinancial services. The sector includes public and private corporations and is composed of:

- All resident nonfinancial corporations , regardless of the residence of their owners;
- The branches of nonresident enterprises that are engaged in nonfinancial production in the economic territory on a long-term basis; and
- All resident NPIs that are market producers of goods or nonfinancial services.

2. Financial corporations sector

The financial corporations sector consists of resident corporations that are principally engaged in providing financial services, including insurance and pension fund services, to other institutional units.

The production of financial services is the result of financial intermediation, financial risk management, liquidity transformation, or auxiliary financial activities. In addition, the sector includes NPIs engaged in market production of a financial nature, such as those financed by subscriptions from financial enterprises whose role is to promote and serve the interest of those enterprises.

Financial corporations can be divided into three broad classes: financial intermediaries, financial auxiliaries, and captive financial institutions and money lenders.

Financial intermediaries are institutional units that incur liabilities on their own account for the purpose of acquiring financial assets by engaging in financial transactions on the market.

The assets and liabilities of financial intermediaries are transformed or repackaged with respect to maturity, scale, risk, and the like, in the financial intermediation process. The financial intermediation process channels funds between third parties with a surplus of funds and those with a demand for funds. A financial intermediary does not only act as an agent for these other institutional units, but places itself at risk by acquiring financial assets and incurring liabilities on its own account. Financial intermediation is limited to acquiring assets and incurring liabilities with the general public or specified and relatively large groups thereof. Where the activity is limited to small groups, no intermediation takes place. Financial intermediaries include deposit-taking corporations, insurance corporations, and pension funds.

Financial auxiliaries consist of financial corporations that are principally engaged in activities associated with transactions in financial assets and liabilities or with providing the regulatory context for these transactions but in circumstances that do not involve the auxiliary taking ownership of the financial assets and liabilities being transacted. They include brokers, managers of pension funds, mutual funds, etc. (but not the funds they manage), foreign exchange bureaus, and central supervisory authorities.

Captive financial institutions and money lenders are institutional units providing financial services other than insurance, where most of their assets or liabilities are not available on open financial markets.

These entities transact within only a limited group of units (such as with subsidiaries) or subsidiaries of the same holding corporations or entities that provide loans from own funds provided by only one sponsor. Captive insurance is the exception and is classified as an insurance corporation.

Financial intermediaries can be divided into seven subsectors according to its activity in the market and the liquidity of its liabilities. These seven subsectors are: central bank; deposit-taking corporations except the central bank; money market funds; non money market investment funds; other financial intermediaries except insurance corporations and pension funds;

The financial corporations sector includes public and private financial corporations comprising:

- All resident financial corporations , regardless of the residence of their shareholders;
- The branches of nonresident enterprises that are engaged in financial activity in the economic territory on a long-term basis; and
- All resident NPIs that are market producers of financial services.

3. General government sector

The general government sector consists of resident institutional units that fulfill the functions of government as their primary activity. These institutional units perform the principal economic functions of government. In addition to fulfilling their political responsibilities and their role of economic regulator. The general government sector comprises:

- All government units of central, state, provincial, regional, and local government, and social security funds imposed and controlled by those units; and

- All nonmarket NPIs that are controlled by government units.

The general government sector does not include public corporations, even when all the equity of such corporations is owned by government units, nor quasi-corporations that are owned and controlled by government units. However, unincorporated enterprises owned by government units that are not quasi-corporations remain integral parts of those units and, therefore, must be included in the general government sector

4. Households sector

The households sector consists of all resident households. Households may be of any size and take a variety of different forms in different societies or cultures. All physical persons in the economy must belong to one and only one household. Households supply labor, undertake final consumption and, as entrepreneurs, produce market goods and nonfinancial services.

5. Nonprofit institutions serving households (NPISHs) sector

The nonprofit institutions serving households (NPISHs) sector consists of resident nonmarket nonprofit institutions (NPIs) that are not controlled by government.They provide goods and services to households for free or at prices that are not economically significant. One type of NPISHs is created by associations of persons to provide goods or, more often, services primarily for the benefit of the members themselves. For example, professional or learned societies, political parties, trades unions, consumers' associations, churches or religious societies, and social, cultural, recreational, or sports clubs. They do not include bodies serving similar functions that are controlled by government units. Religious institutions are usually excluded from general government and classified as NPISHs even when mainly financed by government units if this majority financing is not seen as empowering control by government. Political parties in countries with one-party political systems that are controlled by government units by means of providing the necessary finance are included in the general government sector. A second type of NPISHs consists of charities, and relief or aid agencies that are created for philanthropic purposes, while a third type provides collective services, such as research institutions that make their results freely available, environmental groups, etc. By convention, nonmarket NPIs controlled by foreign governments are classified as NPISHs in the host economy.

1.3 Sectorization of Public sector

The public sector consists of all resident institutional units controlled directly, or indirectly, by resident government units—that is, all units of the general government sector and resident public corporations. Statistics should be compiled for the general government and public sectors, as well as for all the subsectors of the general government and the public corporations subsector.

Delineating General Government and Public Corporations

The general government sector consists of all government units and all resident nonmarket NPIs that are controlled by government units, while the public corporations subsector consists of all corporations controlled by government units or other public corporations. General government also includes public enterprises, legally constituted as corporations, but that do not satisfy the statistical criteria to be treated as corporations. To determine which public enterprises are treated as general government units and which as public corporations, it is necessary to delineate nonmarket and market producers.

A market producer is an institutional unit that provides all or most of its output to others at prices that are economically significant. A nonmarket producer provides all or most of its output to others for free or at prices that are not economically significant. Economically significant prices are prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy.

The General Government Sector and Its Subsectors

The general government sector consists of resident institutional units that fulfill the functions of government as their primary activity. This sector includes all government units and all nonmarket NPIs that are controlled by government units. For analytic purposes, it is often necessary or desirable to disaggregate the general government sector into subsectors. Depending on the administrative and legal arrangements, there may be more than one level of government within a country, and statistics should be compiled for each level (also referred to as subsectors). However, because of these different arrangements, international comparison of data for each subsector of general government should be undertaken with some caution. In macroeconomic statistics, provision is made for three subsectors of general government: central, state, and local. Not all countries have all three levels; some may have only a central government or a central government and one level below. Other countries may have more than three levels.

a) Central government

The central government subsector consists of the institutional unit(s) of the central government plus those nonmarket NPIs that are controlled by the central government. The political authority of the central government extends over the entire territory of the country. Central government has, therefore, the authority to impose taxes on all resident institutional units and on nonresident units engaged in economic activities within the country. Its political responsibilities include national defense, the maintenance of law and order, and relations with foreign governments. It also seeks to ensure the efficient working of the social and economic system by means of appropriate legislation and/or regulation. It is responsible for providing collective services for the benefit of the community as a whole, and for this purpose incurs expenditure on defense, public administration, etc. In addition, it may incur expenditure on the provision of services, such as education or health, primarily for the benefit of individual households, and it may make transfers to other institutional units, including other levels of government. Compiling statistics for the central government is particularly important because of the special impact it has on monetary policy and economic growth. For example, it is mainly through central government finances that fiscal policy impacts on inflationary or deflationary pressures within the economy. It is generally at the central government level alone that a decision-making body can formulate and carry out public policies directed toward nationwide economic objectives. Other levels of government have neither national economic policies as their objective nor the central government's access to central bank credit.

b) State governments

State governments consist of institutional units exercising some of the functions of government at a level below that of central government and above that of the government institutional units existing at a local level. State governments are distinguished by the fact that their fiscal authority extends over the largest geographical areas into which the country as a whole may be divided for political or administrative purposes. They are institutional units whose fiscal, legislative, and executive authority extends only to individual "states" into which the country as a whole may be divided. These states may be described by different names in different countries and the subsector may consist of state, provincial, or regional governments. For ease of expression, this level of government will be referred to here after as state governments. In many countries, especially smaller countries, state governments may not exist. However, in geographically large countries, especially those that have federal constitutions, considerable powers and responsibilities may be assigned to state governments. A state government may consist of many institutional units and usually has the fiscal authority to levy taxes on institutional units that are resident in, or engage in economic activities or transactions within, its area of jurisdiction (but not other areas). It must also be entitled to spend or allocate some, or possibly all, of the taxes or other revenue that it receives according to its own policies, within the general rules of law of the country, although some of the transfers it receives from central government may be tied to certain specified purposes. It should also be able to appoint its own officers, independently of external administrative control. On the other hand, if a regional unit is entirely dependent on funds from central government, and if the central government also determines the ways in which these funds are to be spent at the regional level, it should be treated as an agency of central government for statistical purposes, rather than as a separate level of government.

c) Local government

Local government units are institutional units whose fiscal, legislative, and executive authority extends over the smallest geographical areas distinguished for administrative and political purposes. The local government subsector consists of local governments that are separate institutional units plus those nonmarket NPIs that are controlled by local governments. The scope of their authority is generally much less than that of central government or state governments, and they may, or may not, be entitled to levy taxes on institutional units resident in their areas. They are often heavily dependent on grants (transfers) from higher levels of government, and they may also act, to some extent, as agents of central or regional governments. They should also be able to appoint their own officers, independently of external administrative control. Even when local governments act as agents of central or state governments to some extent, they can be treated as a separate level of government, provided they are also able to raise and spend some funds on their own initiative and own responsibility. Local governments are in closest contact with institutional units occupying their localities. They typically provide a wide range of services to local residents, some of which may be financed out of grants (transfers) from other levels of government. Statistics for the local government subsector may cover a wide variety of governmental units, such as counties, municipalities, cities, towns, townships, boroughs, school districts, and water or sanitation districts. Often, local government units with different functional responsibilities have authority over the same geographic areas. For example, separate government units representing a town, a county, and a school district may have authority over the same area. In addition, two or more contiguous local governments may organize a government unit with regional authority that is accountable to the local governments. Such units should also be included in the local government subsector. Some of the most typical functions of local governments provide services for which users' fees are small in relation to the main costs borne by the local government. Local governments are typically involved in:

- Educational establishments
- Hospitals and social welfare establishments, such as kindergartens, nurseries, and welfare homes
- Public sanitation and related entities, such as water purification systems and plants, refuse collection and disposal agencies, cemeteries, and crematoria
- Culture, leisure, and sports facilities, such as theaters, concerts, music halls, museums, art galleries, libraries, parks, and open space.

UNIT -2

GOVERNMENT REVENUE

2.1 Defining Revenue

Revenue is an increase in net worth resulting from a transaction. Revenue transactions have counterpart entries either in an increase in assets or in a decrease in liabilities— thereby increasing net worth. General government units have four types of revenue: (i) compulsory levies in the form of taxes and certain types of social contributions; (ii) property income derived from the ownership of assets; (iii) sales of goods and services; and (iv) other transfers receivable from other units. Of these, compulsory levies and transfers are the main sources of revenue for most general government units. Public corporations do not levy taxes, but derive their revenue from all the other sources—of these, property income and the sales of goods and services are the main sources of revenue.

2.2 Revenue Receipts

It is a normal practice with a government to divide its receipts into 'revenue' and 'capital' categories. Broadly speaking, revenue receipts include "routine" and "earned" ones. For this reason, they do not include borrowings and recovery of loans from other parties, but they do include tax receipts, donations, grants, fees and fines etc. Capital receipts, on the other hand, cover those items which are basically of none-repetitive and non-routine variety and change government's financial liabilities/assets.

Capital Receipts

Capital receipts of the government take many forms. The most important one comprises of fresh borrowings which can be classified in terms of their origin and maturity etc. For example, on the basis of origin, public borrowings may be external[i.e from the outside the country], or internal[i.e; from within the country] In terms of maturity, there may be non-terminable [or perpetuities],"long term", "medium term" or "short term" loans with specific demarcation of boundaries for each. They may be marketable, interest- free or interest-bearing, etc.

The next category receipts cover recovery of loans due from debtors to the government. Some capital receipts may be in the form of grants and donations, deposits, and appropriation to various funds and so on.

2.3 Tax-revenue vs non tax-revenue.

Tax- revenue itself is divided into three sections:

- Taxes on income and expenditure: This section covers all those taxes which are levied on receipts of income and expenditures such as corporation tax, expenditure tax, and similar other taxes, if any in force.
- Taxes on property and capital transactions: This section covers taxes on specific forms of wealth and its transfers such as estate duty, wealth tax, gift tax, house tax, and land revenue and stamps and registration fees, etc.
- Taxes on commodities and services: This section includes taxes on production, sale, purchase, transport, storage and consumption of goods and services.

Non-tax revenue of the government is divided into three sections:

- Currency, coinage and mint
- Interest receipts, dividends and profits: This section comprises, apart from interest receipts on loans by the Government by the other parties, dividends and profits from public sector undertakings run by or as Government departments including other income generating departments.
- Other non-tax revenue : This section covers revenue from various government activities and services such as from administrative services, Public service commission, police, jails, agriculture and allied services, industry and minerals, water and power development services, transport and communications, supplies and disposal, public works, education, housing, information and publicity, broadcasting, grants-in–aid and contributions etc. Note that income and profit from the creation and currency by the Government, i.e, the excess of face value of currency over its cost of creation are also included in this group of revenue.

2.4 Detail Classification of Revenue

Revenue comprises heterogeneous elements, classified according to different characteristics depending on the type of revenue. For taxes, the classification scheme is determined mainly by the base on which the tax is levied. Revenue other than taxes is classified by the nature of the economic flow, and in some cases by the source from which the revenue is derived. The classification of revenue is given below.

1. Taxes

Taxes are compulsory, unrequited amounts receivable by government units from institutional units. Taxes are classified mainly according to the base on which the tax is levied. Normally, designating a tax for a particular use does not affect its classification. An exception is the distinction between taxes on payroll and workforce and social security contributions. If a tax on payroll or workforce is designated for use in a social security scheme, then it is classified as a social security contribution. Otherwise, it is classified under taxes on payroll and workforce. Taxes also exclude compulsory payments receivable by government, as contributions to employment-related pension schemes. Since these compulsory contributions are associated with the expectation of future benefits payable, they are not tax revenue receivable, but rather recorded as the incurrence of a pension entitlement liability. In principle, interest charged on overdue taxes or fines and penalties imposed for the attempted evasion of taxes should be recorded as interest, or fines, penalties, and forfeits and not as taxes. However, it may not be possible to separate receivables of interest, fines, or other penalties from the taxes to which they relate, so in practice they are usually grouped with the relevant tax receivable

Tax categories

i) Taxes on income, profits, and capital gains

Taxes on income, profits, and capital gains consist of taxes assessed on the actual or presumed incomes of institutional units. They include taxes assessed on holdings of property, land, or real estate when these holdings are used as a basis for estimating the income of their owners. These taxes, often referred to as income taxes, include:

- Taxes on individual or household income—These consist of personal income taxes, including those deducted by employers (pay-as-you-earn taxes) and surtaxes. Such taxes are usually levied on the total declared or presumed income from all sources of the person concerned: compensation of employees (e.g., wages, salaries, tips, fees, commissions, fringe benefits), property income (e.g., interest, dividends, rent, royalty incomes), and pensions (taxable portions of social security, pension, annuity, life insurance, and other retirement benefit distributions), etc., after deducting certain allowances in accordance with tax laws. Taxes on the income of the owners of unincorporated enterprisesare included here. Also included are income taxes on the income of family estates and trusts where the beneficiaries are individuals.

- Taxes on the income of corporations—These consist of corporate income taxes, corporate profits taxes, corporate surtaxes, etc. Such taxes are usually assessed on the total incomes of corporations—with corporations understood as in macroeconomic statistics. This item includes taxes on the income of units such as partnerships, sole proprietorships, estates, and some trusts that are recognized as corporations. This covers income from all sources and not simply profits generated by production. Also included are income taxes on trusts where the beneficiaries are corporations.
- Taxes on capital gains—These consist of taxes on the capital gains (including capital gains distributions of investment funds) of persons or corporations that become payable during the current reporting period, irrespective of the periods over which the gains have accrued. They are usually payable on nominal, rather than real, capital gains and on realized, rather than unrealized, capital gains.
- Taxes on winnings from lotteries or gambling— These are taxes payable on the amounts receivable by winners. They do not include taxes on the turnover of producers that organize gambling or lotteries, which are recorded as taxes on goods and services.

ii) Taxes on payroll and workforce

Taxes on payroll or workforce are taxes payable by enterprises assessed either as a proportion of the wages and salaries paid or as a fixed amount per person employed. They do not include:

- Payments earmarked for social security schemes, which are classified as social security contributions
- Taxes paid by the employees themselves out of their wages or salaries, which are classified as taxes on income, profits, and capital gains, payable by individuals.

iii) Taxes on property

Taxes on property are taxes payable on the use, ownership, or transfer of wealth. The taxes may be levied at regular intervals, one time only, or on a change in ownership. Taxes on the ownership or use of specific types of property often are based on the value of the property at a particular time but, when using the accrual basis of recording, are deemed to accrue continuously over the entire year, or the portion of the year that the property was owned, if less than the entire year. Taxes on the transfer of wealth are recorded at the time of the transfer, and some taxes on the ownership or use of property are recorded at a specific time, such as a one-time tax on net wealth. When using the cash basis of recording, these property taxes are recorded when the cash is received.

iv) Taxes on goods and services

Taxes on goods and services are taxes that become payable as a result of the production, sale, transfer, leasing, or delivery of goods and rendering of services, or as a result of their use for own consumption, or own capital formation. Taxes on goods and services are divided into six categories,

- General taxes on goods and services
- Excises
- Profits of fiscal monopolies
- Taxes on specific services
- Taxes on the use of goods and on permission to use goods or perform activities, comprising various types of licenses to use motor vehicles and other goods, or to perform specific activities
- Other taxes on goods and services that include taxes levied on the extraction, processing, or production of minerals and other products.

Social contributions

Social contributions are actual or imputed revenue receivable by social insurance schemes to make provision for social insurance benefits payable. Social contributions exclude contributions receivable under employment-related pension and other retirement schemes that create a liability for future benefits payable. Social contributions are further classified according to the nature of the payee and the nature of the scheme that received these contributions. These receipts are from employers on behalf of their employees, from employees, or from self-employed or unemployed persons on their own behalf to secure entitlement to social benefits, payable in cash and in kind, to the contributors, their dependents, or their survivors. The contributions are usually compulsory, but may also be voluntary. Voluntary contributions are usually made in arrangements where a means test determines whether contributors are exempted from compulsory contributions, but are eligible to participate by choice. If any contributions are voluntary, a memorandum item of their total amount would be useful for computing the fiscal burden and other analytical uses. Social contributions are classified as social security contributions or other social contributions depending on the type of scheme receiving them.

Grants

Grants are transfers receivable by government units, from other resident or nonresident government units or international organizations, that do not meet the definition of a tax, subsidy, or social contribution. Transfer is a transaction in which one institutional unit provides agood, service, or asset to another unit without receiving from the latter any good, service, or asset in return as a direct counterpart. Grants are normally receivable in cash, but may also take the form of the receipt of goods or services (in kind). Grants receivable are classified first by the type of unit providing the grant and then by whether the grant is current or capital.

Other revenue

Other revenue is all revenue receivable excluding taxes, social contributions, and grants. This category of revenue includes property income, sales of goods and services, and miscellaneous other types of revenue.

UNIT-3

GOVERNMENT EXPENDITURE

3.1 Meaning and Nature of Public Expenditure

Public expenditure refers to the expenses which a government incurs for (i) Its own maintenance, (ii) the society and the economy, and (iii) helping other countries. In practice, however, with expending State activities, it is becoming increasingly difficult to separate the portion of public expenditure meant for the maintenance of the government itself from the total.

Historically, public expenditure has recorded a continuous increase over time in almost every country. However, traditional thinking and philosophy did not fever this trend because it rated market mechanism as a better guide for the working of the economy and allocation of its resources. It was argued that each economic unit was the best judge of its own economic interests and the government should not try to decide on behalf of others. Furthermore, while a private economic unit was guided by its own economic interests, the public sector had no such motivation. Accordingly, its efficiency was bound to be very low. Had this philosophy been practiced in its entirety, public expenditure would not have grown as rapidly as it did. In reality, however, the State could not ignore problems of economic growth and social injustice. It could not remain a silent spectator of the miseries of the people. This resulted in the acceptance of several versions of socialist and welfare philosophy.

However, in spite of the fact that public expenditure has increased rapidly during the last two centuries or so in almost every State, and in spite of its growing role and importance in national economies, the area of public expenditure remains relatively unexplored. As Lowell Harries says, "the economists have generally concentrated their attention on the theory of taxation. The theory of public expenditure has been more of less confined to that of generalities in terms of the effects of public expenditure on employment and prices etc".

3.2 Detail Economic Classification of Expense

Defining Expense

Expense is a decrease in net worth resulting from a transaction. Expense transactions have counterpart entries either in a decrease in assets or an increase in liabilities—thereby decreasing net worth. The general government sector has two broad economic responsibilities: (i) to assume responsibility for the provision of selected goods and services to the community, primarily on a nonmarket basis; and (ii) to redistribute income and wealth by means of transfers. These responsibilities are largely fulfilled through expense transactions, which are classified in two ways in GFS: an economic classification and a functional classification.

The economic classification of expense identifies the types of expense incurred according to the economic process involved. When supplying goods and services to the community, a government unit may produce the goods and services itself and distribute them, purchase them from a third party and distribute them, or transfer cash to households so they can purchase the goods and services directly. For example, compensation of employees, use of goods and services, and consumption of fixed capital all relate to the costs of producing nonmarket (and, in certain instances, market) goods and services by government. Subsidies, grants, social benefits, and transfers other than grants relate to transfers in cash or in kind, and are aimed at redistributing income and wealth.

1. Compensation of employees

Compensation of employees is the total remuneration, in cash or in kind, payable to an individual in an employer-employee relationship in return for work performed by the latter during the reporting period. These amounts are payable as an exchange for manual and intellectual labor services of individuals used in the production process of the institutional unit. Compensation of employees excludes amounts connected with own-account capital formation. It is payable to employees engaged in own-account capital formation, which is the production of nonfinancial assets for own use, is directly recorded as a component of the cost of the acquisition of nonfinancial assets. Compensation of employees also excludes amounts payable when an employer-employee relationship does not exist, such as for contractors and self-employed outworkers. Such amounts payable are classified as use of goods and services

Compensation of employees comprises wages and salaries and employers' social contributions payable by employers on behalf of employees to social insurance schemes.

Wages and salaries

Wages and salaries are compensation of employees payable in cash and/or in kind, except for social contributions payable by employers.

Wages and salaries in cash

Wages and salaries in cash are the amounts payable in cash, or any other financial instruments used as means of payments, to employees in return for work performed. Wages and salaries in cash exclude amounts connected with own-account capital formation. Included are the following kinds of remuneration:

- Basic wages or salaries payable at regular weekly, monthly, or other intervals, including payments by results and piecework payments; enhanced. The use of the term "cash" should not be viewed as denoting the cash basis of recording, but rather denotes monetary remuneration. payments or special allowances for working overtime, at nights, on weekends, or other irregular hours; allowances for working away from home or in disagreeable or hazardous circumstances; expatriation allowances for working abroad, etc.
- Supplementary allowances payable regularly, such as housing allowances or allowances to cover the costs of travel to and from work, but excluding social benefits payable by the employers
- Wages or salaries payable to employees away from work for short periods—for example, on vacation or as a result of a temporary halt to production, except during absences due to sickness, injury, etc.
- Annual supplementary pay, such as bonuses and "13th month" pay
- Adhoc bonuses or other exceptional payments linked to the overall performance of the enterprise made under incentive schemes
- Commissions, gratuities, and tips received by employees: these should be included in payments for services rendered by the unit employing the worker, even when they are payable directly to the employee by a third party. They are thus regarded as being paid by the employer to the employee.

Wages and salaries in kind

Wages and salaries in kind are amounts payable in the form of goods, services, interest forgone, and shares issued to employees in return for work performed. Wages and salaries in kind exclude amounts connected with own-account capital formation. This category consists of goods and services provided without charge, or at reduced prices. When provided at reduced prices, the value of the wages and salaries in kind is given by the difference between the full value of the goods and services and the amount payable by the employees. These goods and services provided in kind by the government to its employees are not necessary to enable them to perform their work. They could be used by employees in their own time, and at their own discretion, for the satisfaction of their own needs or wants, or those of other members of their households. Almost any kind of good or service may be provided as wages and salaries in kind. The following are the most common types of goods and services provided without charge, or at reduced prices:

- Meals and drinks provided on a regular basis, including any subsidy element of an office canteen (for practical reasons, it is not necessary to make estimates for meals and drinks consumed as part of official entertainment or during business travel)
- Clothing or footwear that employees may choose to wear frequently outside of the workplace and while at work
- Housing services or accommodation of a type that can be used by all members of the household to which the employee belongs
- The services of vehicles or other durables provided for the personal use of employees
- Goods and services produced by the employer, such as free travel on government airplanes or trains
- Sports, recreation, or holiday facilities for employees and their families
- Transportation to and from work, free or subsidized parking, when it would otherwise have to be paid for
- Child care for the children of employees

Employers' social contributions

Employers' social contribution are social contributions payable by employers to social security funds, employment-related pension funds, or other employment-related social insurance schemes to obtain entitlement to social benefits for their employees. Employers' social contributions are payable by employers for the benefit of their employees, and are therefore recorded as a component of compensation of employees. Employers' social contributions exclude amounts connected with own-account capital formation.

2. Consumption of fixed capital

Consumption of fixed capital is the decline, during the course of the reporting period, in the current value of the stock of fixed assets owned and used by a government unit as a result of physical deterioration, normal obsolescence, or normal accidental damage.

3. Interest

Interest is a form of investment income that is receivable by the owners of certain kinds of financial assets (SDRs, deposits, debt securities, loans, and other accounts receivable) for putting these financial and other resources at the disposal of another institutional unit. Interest is not adjusted for the service charge related to FISIM. The liabilities generating the Interest may have arisen from the supply of financial or nonfinancial resources (as in the case of financial leases). Interest should be recorded according to the subsector of the counterparty to allow for consolidation of the general government and public sectors. The amount of the liability due to the creditor declines as payments are made on the debt by the debtor and increases as interest accrues.

4. Subsidies

Subsidies are current unrequited transfers that government units make to enterprises on the basis of the level of their production activities or the quantities or values of the goods or services they produce, sell, export, or import. Subsidies are receivable by resident producers or importers, and in exceptional cases, nonresident producers of goods and services. Subsidies may be designed to influence levels of production, the prices at which outputs are sold, or the profits of the enterprises. Subsidies include payable tax credits receivable by enterprises for these purposes. By the nature of subsidies, only government units incur an expense in this form. When an institutional unit, other than a government unit, incurs subsidy expense on behalf of a government unit, the subsidy should be attributed in accordance with attribution guidelines, similar to those for tax attribution. When an institutional unit acts on behalf of another unit to distribute subsidies, these should be reported as financial transactions by the distributing agency. Subsidies payable should be recorded only in the account of the entity that has the control over the subsidy scheme. Subsidies are payable to producers only, not to final consumers, and are current transfers only, not capital transfers. Transfers that government units make directly to households as consumers and most transfers to nonprofit institutions serving households are recorded as either social benefits or transfers not elsewhere classified, depending on the reason for the payment. Most transfers made to other general government units are included in grants.

5. Grants

Grants are transfers payable by government units to other resident or nonresident government units or international organizations and that do not meet the definition of a tax, subsidy, or social contribution. Grants are normally payable in cash, but may also take the form of provision of goods or services (in kind). Grants payable are classified first by the type of unit receiving the grant and then by whether the grant is current or capital.

Three types of recipients of grants are recognized: grants to foreign governments, grants to international organizations, and grants to other general government units. The category of grants payable by government units to other general government units has a nonzero value only in the case of statistics compiled for a subsector of the general government sector. For the general government sector, these transactions are eliminated in consolidation. To allow for consolidation, grants payable to other general government units should be identified according to the subsector of the counterparty

6. Social benefits

Social benefits are current transfers receivable by households intended to provide for the needs that arise from social risks—for example, sickness, unemployment, retirement, housing, education, or family circumstances. These benefits are payable in cash or in kind to protect the entire population or specific segments of it against certain social risks. Social risks are events or circumstances that may adversely affect the welfare of the households concerned either by imposing additional demands on their resources or by reducing their income. Examples of social benefits are the provision of medical services, unemployment compensation, and social security pensions.

3.3 Detail functional classification of expense

The functional classification of expense provides information on the purpose for which an expense was incurred. Examples of functions are education, health, and environmental protection.

The Classification of Functions of Government (COFOG) is a detailed classification of the functions, or socioeconomic objectives, that general government units aim to achieve through various kinds of expenditure. COFOG is integral to the GFS presentation. It is one of a family of four classifications referred to as classifications of expenditure according to purpose. COFOG provides a classification of government outlays by functions that experiences have shown to be of general interest and useful to a wider variety of analytic applications. Statistics on health, education, social protection, and environmental protection, for example, can be used to study the effectiveness of government programs in those areas. In contrast, the Classification of Environmental Activities (CEA) is a functional classification that covers a more limited but specialized activity.

Classification of Expenditure by functions of Government is broadly categories as follows:

1. General public services
2. Defense
3. Public order and safety
4. Economic affairs
5. Environmental protection
6. Housing and community amenities
7. Health
8. Recreation , culture and religion
9. Education
10. Social protection

UNIT -4

PUBLIC DEBT

4.1 The Meaning of Public Debt

Normally, the government of a country has a large variety of debt obligations. Therefore, public debt may be defined in several different ways covering their alternative combinations and to suit the purpose of the definition. Thus at one extreme, it may include all financial liabilities of a government (including its currency) while at the other extreme, it may include only a few of them. A clear cut stand has also to be taken regarding inter-governmental obligations like loans from the central government to the States. Similarly, a decision is required as to whether the central bank of the country is to be considered a part of the government or not for the purpose of estimating the volume and composition of public debt.

It would be helpful if we have a brief idea of the type of obligations which the government of a country usually incurs.

Firstly, there is the currency itself. Generally, however, the government creates only a part of the currency, the rest is created by the central bank of the country. Therefore, the entire currency circulating in the market can be a part of public debt only if the central bank is classified as a part of the government sector. In any case, currency obligations normally remain dormant or inactive and the government does not 'pay them off ' - at the most one set of currency is replaced by another set and that is all.

Secondly, another set of obligations of the government constitutes its short-term debt, These obligations are normally of a maturity of less than one year at the time of issue and consists of items like the treasury bills.

Thirdly, some obligations do not have any specific maturity but may be repayable subject to various terms and conditions. They are referred to as floating debt. Examples of this category include provident funds, small savings, reserve funds and deposits, and so on.

Fourth category of government obligations consists of the permanent or funded debt. Such loans have a maturity of more than one year at the time of issue, in practice, their maturity is usually between three and thirty years. Some of them may even be non-terminable (or perpetuities) so that the government is only to pay the interest on such debt without ever repaying the principle amount.

fifthly, obligations owed to foreigners-governments, institutions, firms and individuals are called external loans. They may have a variety of maturities and be subject to a variety of terms and conditions.

It should be clear by now that depending upon the purpose and context, institutional arrangements and so on, different people could define public debt differently. At one extreme all financial obligations of the government including the demand debt (that is currency obligations) are sought to be included in the definition of the public debt, while in other cases only some of the above-mentioned categories of obligations are considered. In general, however, the currency obligations of the government are usually excluded from the definition of the public debt and only the floating, funded, external and other obligations are included in it.

4.2 Interpreting Deficit, surplus and debt

The deficit during a time period is the excess of spending over revenues. If revenues exceed expenditures, there is a surplus. One must distinguished between the concepts of deficit and debt. The debt at a given time is the sum of all past budget deficits. That is, the debt is the cumulative excess of past spending over past receipts, thus, in a year with a deficit the debt goes up; in a year with a surplus, the debt goes down. In the jargon of economics, the debt is a "stock variable" (measured at a point in time), while deficits and surpluses are "flow variables" (measured during a period of time).

4.3 Public Debt and Private Debt

In certain respects government borrowings resemble the private ones. Like a private borrower, the government may also borrow either for consumption or for investment purposes. It will also be paying interest on such borrowings. But the dissimilarities between the two are more glaring.

i. A private economic unit cannot borrow internally, that it to say, it cannot borrow from itself. However, the government usually borrows internally, that is, from its own subjects and from within the country.

ii. While a private economic unit can repay the debt either out of its earnings or out of its accumulated assets or by borrowing from other sources (thus substituting one debt for the other), such need not be the case with the government. The government is the creator of currency and can pay its debt straight-away by creating more of it. The fact that it usually does not do so only reflects its concern for the welfare and stability of the economy and not the lack of its power to do so. However, external debt can be discharged in this manner only if it is repayable in local currency. But creation of domestic currency can not be the means of repaying it if the foreign debt is repayable in foreign currency or gold. In that case, foreign currency will have to be procured through export earnings or through some other means, failing which gold will have to be paid out.

iii. Public borrowings have a profound effect on various dimensions of the economy--distribution, capital accumulation, economic growth, income and employment stability, and so on. This way, public debt is both a source of problems and a tool of economic management in the hands of the authorities.

4.4 Why public debt?

Let us now see the reasons on account of which a government might raise public debt.

1. A government, like any other economic unit, collects revenue and spends it. And, it is also a fact that its revenue and expenditure flows may not match each other during any given time interval. There are bound to be intervals when its receipts will exceed its expenditure and vice versa. Of course, unless the government adopts a policy of spending too much or too little compared with its receipts, it will try to equate the two. In other words, the deficits and surpluses will tend to counterbalance each other so that over a longer time interval there will be a tendency for the budget to 'balance'.

2. There may be a sudden spurt in government expenditure. There may be wars, or natural calamities in which case the government would be forced to incur much larger expenditure and may run into a debt.

3. Modern governments do not subscribe to the philosophy of avoiding a surplus or a deficit budget for its own sake. Rather they are ready to use them as a matter of policy. This approach is sometimes referred to as that of ‘functional finance’- in which the government is ready to have repeated surplus or deficit budgets for achieving a variety of objectives including those of economic growth and stabilization. In contrast, the traditional philosophy was based upon the following reasons.

<u>Firstly</u>, the historical experience of the governments raising loans had not been a happy one. Public loans had been frequently raised by the rulers for financing useless and expensive wars, conspicuous consumption, and other form of wasteful expenditure. To thinkers of those days,

therefore, the practice of raising public loans and having deficit budget symbolized an irrational behaviour which should be avoided.

Secondly, the belief in laissez-faire also dictated that the authorities should avoid undue interference in the working of the market. Raising loans and spending them was not likely to contribute to this policy.

Thirdly, government loans were considered akin to private loans. It was believed that like to private loans, public loans also have to be cleared eventually. But we know that public loans need not be repaid at all. Maturing loans may be replaced by new ones by either conversions or through cash subscriptions. Also some loans may be perpetuities.

4. These days it is widely believed that the government of an under developed country should play an active role in the development of economy. In the view, budgetary policy is an important and effective tool in accelerating the process of capital accumulation and economic growth. This may be done through borrowing and investing those funds in various projects. Loans may even be earmarked for certain project.

In this context care should be taken to note that when a government adopts a deficit budget, it need not necessarily add to its debt also. This is because government may finance its budgetary deficit by one or more of the following alternative means:

(a) It may run down its cash reserves.
(b) It may sell some of its assets like properties and investments, etc.
(c) It may create more currency and use it.
(d) It may borrow and spend.

It is seen that the second method of meeting the deficit does not increase the indebtedness of the government, though a government seldom adopts this approach. The first and third methods increase the supply of currency of the government in the market, whether or not public debt increases depends upon whether currency obligations of the government are included or not in the definition of public debt. As regards the fourth method, the government may borrow from the market proper or it may borrow from the central bank. In the former case, there is obviously an increase in outstanding public debt. Borrowing from the central bank increases the governments indebtedness only if the central bank is included in the government proper.

4.5 Public Debt and Inflation

The above considerations lead us to look at the relationship between public debt and inflation. Most governments' market borrowings only divert funds from the market into the hands of the government. As a result, there is no net addition to aggregate demand and hence no increased pressures on prices.

This reasoning is quite misleading because it tries to hide some basic facts.

Firstly, even if public debt does not add to aggregate demand, it is bound to be inflationary because the economy's productive resources get diverted from the production of consumption goods into that of capital goods by their very nature, investment goods industries have longer gestation periods and therefore for the intervening period, the demand for consumption goods tends to exceed their supply.

Secondly, borrowings used for war activities, for meeting natural calamities and for other relief measures are most likely to be inflationary in their impact because they are basically consumption-oriented.

Thirdly, when a government borrows from the central bank, there is an addition in money supply which in turn adds to demand and pushes up prices.

Fourthly, holding of public debt by commercial banks can also lead to an addition in demand and inflationary pressures. Banks rate government securities as highly liquid which can be encashed at any time without much of capital loss. This assured liquidity position, therefore, tempts them to increase their loans and advances and thus add to the inflationary pressures in the market.

However, if public debt is used to bring about an increase in productivity of the economy leading to an increased supply of the demanded goods, inflationary forces would be checked to that extent. In addition, the authorities may resort to price controls, rationing and other measures to keep prices under control.

4.6 Public Debt versus Taxation

The merits and demerits of debt and tax finance are often debated. It must be remembered that no definite preference can be established for any one method under all circumstances. The choice depends upon the attendant situation and the over-all long-term implications for the economy. It is obvious that a part (and a major part for that) of government expenditure has to be financed through tax revenue. The real issue, therefore, is to decide how to choose between tax and debt finance for the remaining expenditure.

According to Garley and Shaw, mounting volume of public debt is a necessary feature of a strong and healthy financial structure of an economy. With that end in view, therefore, some secular increase in public debt should be planned by every government of a market-oriented modern economy. However, it appears that no government plans a long-term increase in debt with that end in view. The volume of public debt has tended to increase in response to compulsions of the moment. Its benefits through contributions to the financial structure of the economy are only incidental.

Under some circumstances debt financing becomes either necessary or preferable. Thus, under war and other emergencies, when suddenly large funds are needed and additional tax revenue cannot be raised, debt financing has to be resorted to. Actually, most of the public debt in many countries has accumulated on account of war financing. Similarly, another reason necessitating debt financing is where actual tax receipts are falling much below the anticipated volume, while expenditure is not showing a corresponding reduction or is tending to go up.

A third good case for debt financing is that where the debt is meant for particular projects. Such projects are estimated to benefit specific areas or sections of the people who can be expected to bear the cost of the project out of the benefits they would receive. For example, the cost of an irrigation dam maybe first met through public borrowing, and then recovered from the beneficiaries through a levy or some other means. Similarly, there can be some commercial projects which are helpful for the economy and which can be expected to be self-financing. Their investment funds can be raised through market borrowing and the debt can be retired through the profits of these undertakings. Examples are of electricity generating projects, transport undertakings, and so on.

Debt financing, however, as compared with tax financing, has its own limitations which can sometimes outweigh its advantages. Public debt, by definition, has to be serviced. Interest has to be paid on it. And the principle is also to be repaid. This means that those who contribute to the financing of the expenditure in the first instance, really do not lose. In the case of taxation, the tax-payers straight away lose some resources in favour of the government without any claim to their recovery. Debt financing, therefore, adds to the future budgetary commitments of the authorities. A part of the future revenue has to go into servicing of the debt. Ordinarily, therefore, the authorities may be expected to favour tax financing, unless the other attending considerations are more weighty. Moreover, since it is the richer sections only which can subscribe to the public debt, debt servicing becomes a medium for redistributing national income in favour of the rich unless counter-balanced by taxation measures. It is also a possibility that the projects chosen for debt financing are really not run efficiently enough and do not generate surpluses to pay off their cost. But this, we must remember, is a question of wrong calculations at the planning stage and mismanagement of the projects which should be avoided. A major drawback of debt financing of a war is that effective supplies in the market are reduced without a corresponding reduction in the purchasing power. This does not happen with taxation. Therefore, the problem of keeping inflation under check is more troublesome under debt financing than under tax financing of war.

UNIT 5

SOCIAL SECURITY

5.1 Social security schemes

Social security schemes are social insurance schemes covering the community as a whole, or large sections of the community, and are imposed and controlled by government units. These schemes cover a wide variety of programs, providing benefits in cash or in kind for old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, health care, etc. There is not necessarily a direct link between the amount of the contribution payable by an individual and the benefits receivable. Social security schemes that are organized separately from the other activities of government units, hold their assets and liabilities separately from the latter, and engage in financial transactions on their own account qualify as institutional units. These institutional units are described as social security funds. A social security fund is a particular kind of government unit that is devoted to the operation of one or more social security schemes. These special types of government units are identified separately in a subsector to allow for the alternative methods of constructing subsectors of the general government sector. The existence of a social security fund depends on its organization as a separate institutional unit, not on other characteristics of the scheme, such as types of benefits provided or sources of finance.

Not all social security schemes are operated by social security funds. Where a separate social security fund does not exist, the transactions of the social security scheme would be reported as an integral part of the transactions of the government unit that controls operations of the social security scheme. Social security schemes can therefore be operated by government units that are not social security funds. Consequently, statistics for the social security funds subsector may not include all social security schemes. If a social security scheme is not a separate institutional unit, however, there may be separate accounts to manage the scheme’s finances, which would permit compiling supplementary statistics on social security activities with broader coverage than that of the social security subsector.

By definition, social security schemes are contributory—participants in the scheme are required to make regular contributions to be eligible to receive benefits for themselves or their dependents. The primary receipts of social security schemes are social security contributions. Social security contributions are classified according to their source, which may be employers or households. Participation in social security schemes can be compulsory or voluntary. Further breakdown in the classification of these social contributions would allow a distinction between contributions receivable in cash and in kind, and between compulsory and voluntary contributions. In addition to social contributions, social security schemes may receive grants from general government resources and may earn property income from the investment of their assets.

5.2 Other employment related Social Insurance Scheme

Other employment-related social insurance schemes derive from an employer-employee relationship in the provision of pension entitlement and other social benefit to employees as part of the conditions of employment. By definition, these schemes are contributory and, for government or public sector units, protect only their own employees and dependents. The provision of social insurance benefits by government to its own employees is considered to be part of an actual or implicit contract between the government, as employer, and the employees, to compensate them for the provision of their labor services. Therefore, employment-related social insurance schemes give rise to requited expense transactions for government when the social contributions became payable. To accurately reflect the accrued costs of employment, the actual and imputed social insurance contributions should be recorded as employers' social contributions in the expense category for compensation of employees.

Employment-related pensions and other retirement benefit schemes

Employment-related social insurance schemes that provide pensions and other retirement benefits can be organized as a funded or unfunded social insurance scheme. There are three types of employment-related pension schemes:

- A non autonomous pension scheme that is therefore regarded as an integral part of the employer;
- A separate institutional unit that operates a pension scheme that is therefore regarded as an autonomous pension fund; and
- A scheme managed by an insurance enterprise on behalf of the employer regarded as a financial corporation.

Non autonomous employment related pension schemes

Non autonomous social insurance schemes are operated by the employer, and these schemes are usually unfunded schemes because they are organized by the employer without assigning specific accounts or otherwise creating special reserves for the payment of benefits. Instead, the benefits are payable from the employer's general resources.

Autonomous employment related pension schemes

To be regarded as autonomous, the entity responsible for the employment-related pension scheme must have the characteristics of an institutional unit. These institutional units are considered to provide financial services (i.e., insurance/ pensions) to the household sector, and are therefore classified in the financial corporations sector. They are classified as either private or public financial corporations, depending on whether they are controlled by the private or public sectors. An employer may contract with a third party to administer the pension funds for its employees. The employment-related pension scheme is then managed through an insurance enterprise or an autonomous pension fund. The employer's primary responsibility with respect to the scheme is to pay the social contributions on behalf of its employees. The government unit records the payment as part of compensation of employees, under actual social contributions. No other transactions are recorded by the government unit as employer, as it has no direct liability for future provision of social benefits. However, in cases where the employer continues to determine the terms of the pension schemes and retains the responsibility for any deficit in funding, as well as the right to retain any excess funding, the employer is described as the pension manager and the unit working under the direction of the pension manager is described as the pension administrator. If the agreement between the employer and the third party is such that the employer passes the risks and responsibilities for any deficit in funding to the third party in return for the right of the third party to retain any excess, the third party becomes the pension manager as well as the administrator.

5.3 Defined –benefit Pension Scheme

A defined-benefit pension scheme is one where the benefits payable to an employee on retirement are determined by the use of a formula, either alone or as a minimum amount payable. The level of benefits promised to participating employees is determined by a formula embodied in the terms of the social insurance scheme. These terms are usually based on factors such as the participants' length of service and salary. The calculation of imputed contributions and net present value of future benefits requires advanced actuarial techniques, beyond the responsibility of GFS compilers. The present value of future benefit entitlements increases each period because there is one fewer period over which it is discounted. This increase should be a transaction in property expense for investment income disbursements. Furthermore, a holding gain should be recorded with respect to the liability in order to reflect any change in the value of the liability because of a change in the interest rate used to discount the future benefits. A change in the liability resulting from a change in the benefit structure should always be treated as another volume change, because it does not constitute a transaction but represents a unilateral change brought about by the employer.

5.4 Defined –contribution Pension Scheme

A defined-contribution pension scheme is one where the benefits payable to an employee on retirement are defined exclusively in terms of the level of the funds built up from the contributions made over the employee's working life and the increases in value that result from the investment of these funds by the manager of the scheme. The risk of the scheme to provide an adequate retirement income is thus borne by the employee, and the benefits that will be payable depend on the assets of the fund. For a defined contribution pension scheme, a pension fund is always deemed to exist. Contributions to a defined-contribution pension scheme are invested on behalf of the employees as future beneficiaries. The investment income on the cumulated assets of the pension fund is recorded as revenue for the fund, classified according to the nature of the respective property income revenue (usually including interest, dividends, or rent. The investment income is also recorded as being distributed to the beneficiaries (classified as property expense for investment income disbursements, who are deemed to reinvest the income in the pension fund as contributions. Therefore, the investment income payable on defined-contribution entitlements is equal to the investment income on the financial investments plus any net operating surplus earned by renting land or buildings owned by the fund.

For a defined-contribution pension scheme, the risks and costs associated with the scheme are borne by the beneficiaries. There are no imputed contributions for defined-contribution pension schemes, unless the employer operates the scheme directly. In that case, the value of the costs of operating the scheme is treated as an imputed contribution payable to the employee as part of compensation of employees. This amount is recorded by the employer as the sale of a financial service to the employees, classified as imputed sales of goods and services. When the fund is operated by a unit other than the employer, the operating costs are financed from investment income retained by the fund to meet its costs and generate a profit. Therefore, in keeping with the recording of insurance, the investment income generated is treated as being attributed in full to the beneficiaries in the household sector who use part of the income to purchase a financial service from the fund, and reinvest the remainder with the fund.