Fiscal Policy

14 CHAPTER

INTRODUCTION

Every succeeding government believes that satisfaction of human wants, such as provision of social amenities, is very essential and this cannot be done without sourcing for revenue in order to meet aggregate demand of the economy. Therefore, fiscal policy is used as a tool for public finance.
This chapter examines the meaning of fiscal policy, meaning of public finance, objectives of public finance, revenue allocation in Nigeria, taxation, direct and indirect taxes, effects of taxation, incidence of taxation, public expenditure, structure and effect on government budget.

OBJECTIVES

At the end of this chapter, students should be able to:
- Explain the meaning of fiscal policy;
- Explain the meaning of public finance;
- Highlight the objectives of public finance;
- Explain revenue allocation in Nigeria;
- Explain the meaning of taxation;
- Differentiate between direct and indirect taxes;
- Highlight the effects of direct and indirect taxation;
- Explain what is meant by incidence of taxation;
- Explain what public expenditure is;
- List and explain the structure and effects of public expenditure on government budget.

14.1 Meaning of Fiscal Policy

Fiscal policy is the adjustment of taxation and control of government expenditure. It is concerned with the raising of government revenue, through taxes and the management of expenditures.

14.2 Meaning of Public Finance

It is the financial activities of a government using revenue, expenditure and debt operations to provide practical mechanism to the management and control of the economy.

14.3 Objectives of Public Finance

The objectives of public finance are as follows:
a. To promote a more equitable distribution of income.
b. To help stabilize the national economy
c. To meet the social needs of citizens in such areas as education, health, water supply etc.
d. To provide for the defence and security of the country and for embassies abroad.
e. To finance capital investment on infrastructure and public works.
f. To meet government recurrent expenditure on salaries of public sector employees.

14.4 Revenue Allocation in Nigeria

This is the subject that deals with the sharing of national wealth, income or revenue among the three tiers of government such as Federal, State and Local government. Revenue allocation in Nigeria has become a thing of disagreement among these tiers of government because every state of the federation wants to have a large share from the federation accounts to enable her meet her responsibilities.
The revenue allocation formula has always been revised in Nigeria due to pressure from those who feel they do not have a fair deal. The main principles governing revenue allocation in Nigeria include: (i) derivation of natural resources (ii) population and (iii) revenue efforts (iv) equality of states (v) minimum responsibility (vi) ecological problem and (vii) social consideration for mineral producing states.

14.5 Meaning of Taxation

This is a compulsory levy usually in monetary terms which a citizen has to pay to the government. This is to enable the government perform its functions such as provision of infrastructures, security, e.t.c. to her citizens.

14.6 Direct and Indirect Taxes

Taxes are divided into two broad categories namely: direct and indirect taxes.
(i) Direct Taxes: These are taxes levied directly on the incomes of individuals or institutions and the burden falls directly on them. Examples of direct taxes are: personal income tax, capital gains tax and company tax. Direct tax have the advantages of being progressive, based on ability to pay and being employed to control aggregate expenditure, while their disadvantages include disincentive to work, difficulty in assessment, collection and imperfections in tax assessment.
(ii) Indirect Taxes: These are taxes levied on the activities of an individual or institution and the burden of the tax may be shifted. Examples of indirect taxes include sales tax and value – added tax, import duties etc. The advantages of indirect taxes are that, they are easy to collect and can also be used to control the supply of the taxed commodities. While the disadvantage is that they are regressive and can be passed on to consumers in form of higher prices.

14.7 Effects of Direct Taxation

Here are some of the effects of direct taxes.
a. Direct taxes lead to a redistribution of wealth.
b. Direct taxation discourages investment and this would cause unemployment.
c. A tax on profit reduces the capital available for a company to be ploughed back into the fi rm.
d. It leads to a reduction in disposable income which further leads to reduction in consumption.
e. High taxation could scare away foreign investors that would have invested in an economy.

14.8 Effects of Indirect Taxation

Some of the main effects of indirect taxes are as follows:
a. It encourages smuggling.
b. It can lead to inflation.
c. It can lead to changes in the investment pattern.
d. It can lead to changes in the consumption pattern.

14.9 Incidence of Taxation

The incidence of taxation refers to where the final burden of taxation rests. Most taxes on production expenditure are initially levied on the producer or manufacturer since he pays the tax directly. But while selling the product, manufacturer will always recover his payment of the tax by adding it to his price in order to shift the tax burden onto the final consumer who bears the incidence of the tax.

However, if the manufacturer is unable to shift the tax to the consumer, then he bears the tax burden. This largely depends on the elasticity of demand for the product. If the demand is elastic, price increases as a result of tax which will discourage consumers from buying the product.

Manufacturer will therefore bear the full burden of the tax. But if the demand is inelastic, the manufacturer can successfully shift the burden of the tax to the consumers.

14.10 Public Expenditure

Public expenditure can also be called government expenditure. It means total expenses carried out by federal, state and local government so as to meet the need of the people. Government spending usually takes the form of purchases of goods and services and transfer payments.

A transfer payment is a payment made by the government to an individual for which such individual does not provide any goods and services in return. Examples are: social security benefits, pension and welfare payments e.t.c.

14.11 Structure of Public Expenditure

Public expenditure of the budget normally has two components which are recurrent and capital expenditure.

a. Recurrent Expenditure: This constitutes government spending on wages and salaries of civil servants and general maintenance of public services and property. It is recurrent because it does not exceed one financial year and such expenditure is repeated again the following year.

b. Capital Expenditure: This constitutes the investment made in acquiring things such as machinery, equipment and structures like roads, bridges, port facilities e.t.c. These structures usually last for long period of time.

14.12 Effects of Public Expenditure on Government Budget

A major aspect of fiscal policy is aggregate demand management, which is an attempt to influence the behaviour of the whole economy by influencing aggregate expenditure through alternations in the government’s budget. If there is a rise in government expenditure on goods and services or transfer payments, it will increase the total output and employment in the economy.

Also, if there is a fall in tax rates, it will have a positive effect on the economy because it will lead to an increase in total output and employment. On the other hand, if there is a fall in government expenditure on goods and services, transfer payments, or a rise in tax rates, reduces total demand which will definitely reduce total output and affect employment adversely.

The effect of public expenditure is noticeable during wartime because the military will require not only guns and bullets, but also food, clothing and shelter which drastically changes the whole process of commodity pricing, resources allocation and distribution of income.

Summary

This chapter discussed: Fiscal policy which is the adjustment of taxation and control of government expenditure. Public finance is the financial activities of a government by using revenue, expenditure and debt operations to provide practical mechanism to the management and control of the economy.

❖ Objectives of public finance include: promotion of a more equitable distribution of income; stabilization of the national economy e.t.c.

❖ Revenue allocation in Nigeria deals with the sharing of national wealth, income or revenue among the three tiers of government, which are: Federal, State and Local government.

❖ Taxation which a compulsory levy usually in monetary terms which a citizen has to pay to the government. Taxation is said to be direct or indirect. Direct taxes have the following effects: redistribution of wealth, reduction in disposable income which leads to reduction in consumption, discourages investment and it causes unemployment, e.t.c.

❖ Indirect taxes have the following effects: encouragement of smuggling, leads to inflation, changes in the pattern of investment e.t.c.

❖ Other titles examined in this chapter are: effect of direct and indirect taxes; incidence of taxation, meaning of public expenditure; structure of public expenditure and effects of public expenditure on government budget.

Class Activity

Students should ask their parents to educate them on the meaning of taxation. Students should also ask their parents on how they (parents) pay their direct or indirect taxes to the government.

Review Questions

Objective Questions

1. The imposition of high income tax by government to cut down demand is known a ___________.
(a) monetary policy
(b) budgetary policy
(c) fiscal policy
(d) internal policy
(e) development policy. **(SSCE 1988)**

2. All of the following are specific examples of indirect taxes except.
(a) purchases tax
(b) import duty
(c) export duty
(d) excise duty
(e) poll tax. **(SSCE 1990)**

3. Which of these factors does not affect revenue allocation in Nigeria?
(a) needs of an area
(b) size of the population of an area
(c) number of industries and land area
(d) revenue derivable from an area
(e) development needs of the country. **(SSCE 1998)**

4. Public finance is basically an analysis of the ___________.
(a) income and expenditure of government
(b) expenditure patterns of government
(c) current and capital receipts of government
(d) current and capital expenditure of government. **(SSCE 2008)**

5. Fiscal policy is associated with ___________.

(a) taxation and government expenditure
(b) re-structuring of the banks
(c) injection of more money into the economy
(d) reduction in economic activities. **(SSCE 2009)**

Essay Questions

1. (a) What is public recurrent expenditure?
(b) What are the objectives of public finance?
2. (a) What are the different ways in which revenue of a country is been allocated?
(b) Give reasons for the rapid increase in government expenditure in your country.
3. What is the difference between Fiscal policy and public finance?
4. (a) Distinguish between direct and indirect tax.
(b) What care the advantages of direct taxes? **(SSCE 2002)**

Glossary

Fiscal Policy: This is the adjustment of taxation and control of expenditure. It is concerned with how government raises revenue through taxation and the management of expenditure.
Public Finance: It is the financial activities of a government using revenue, expenditure and debt operations to provide practical mechanism to the management and control of the economy.
Taxation: This is a compulsory levy usually in monetary terms which a citizen has to pay to the government.