

Chapter 8: Government budget

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Sources:

- D.N. Hynman , Public finance (2010), 10th Ed, South-western
- N.G. Mankiw (2010), Macroeconomics, 7th ed, Worth Publishers

Content

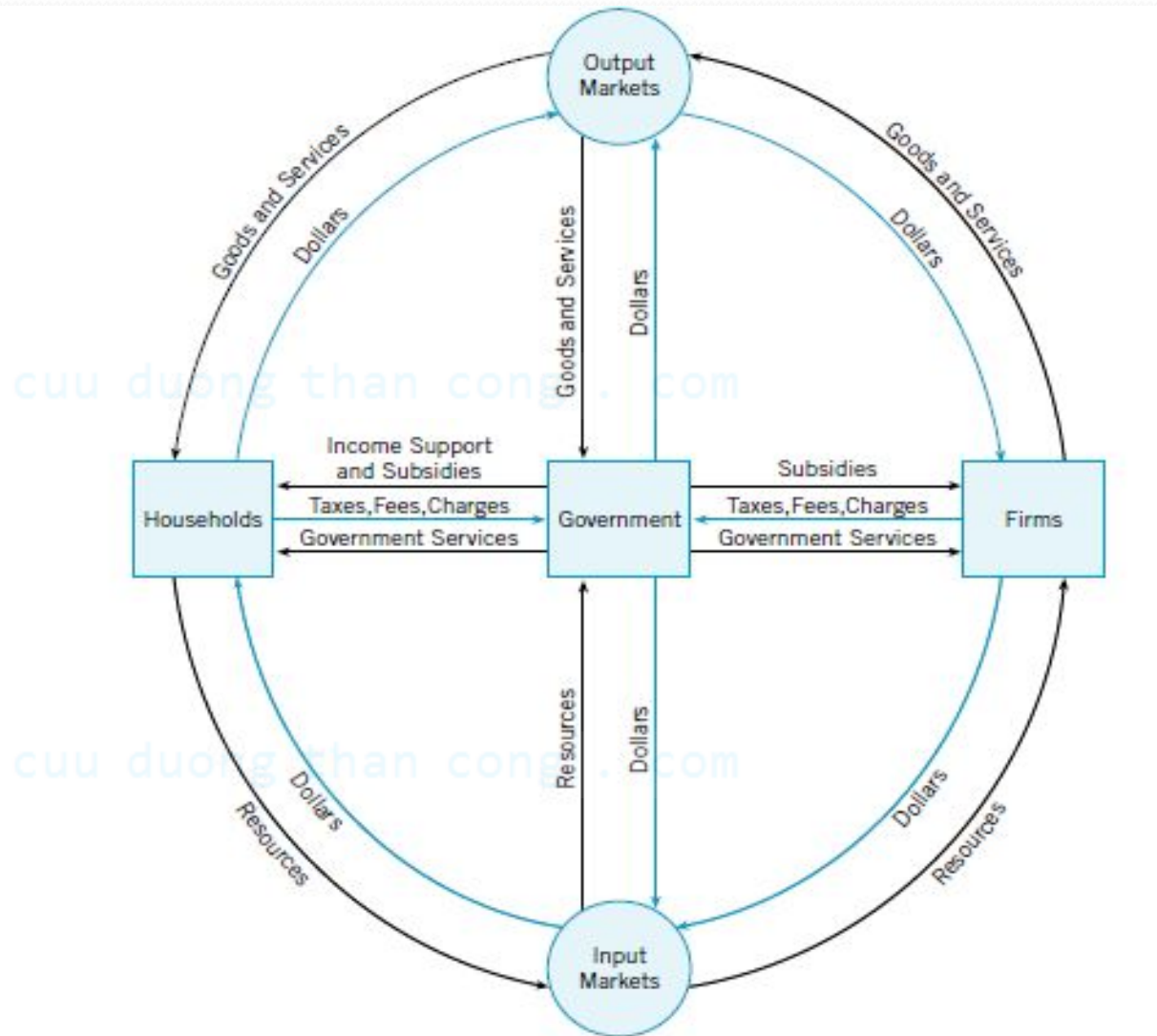
1. Introduction to government budget
2. Government expenditures
3. Government financing
4. The budget balance and government debt

1. Introduction to government budget

- Definition of government budget
- Roles of government budget
- The government budget process
 - The government budget process of Vietnam

Definition of government budget

Circular
flow in
the
mixed
economy



Definition of government budget

- **Government budget** is the critical exercise of allocating revenues and borrowed funds to attain the economic and social goals of the country.
- It also entails the management of government expenditures in such a way that will create the most economic impact from the production and delivery of goods and services while supporting a healthy fiscal position.

Roles of government budget

- Government budget enables the government to plan and manage its financial resources to support the implementation of various programs and projects that best promote the development of the country.
- Through the budget, the government can prioritize and put into action its plants, programs and policies within the constraints of its financial capability as dictated by economic conditions.

The government budget process

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The government budget process of Vietnam

Government budget

Central
government
budget

Vietnamese
government
budget
system

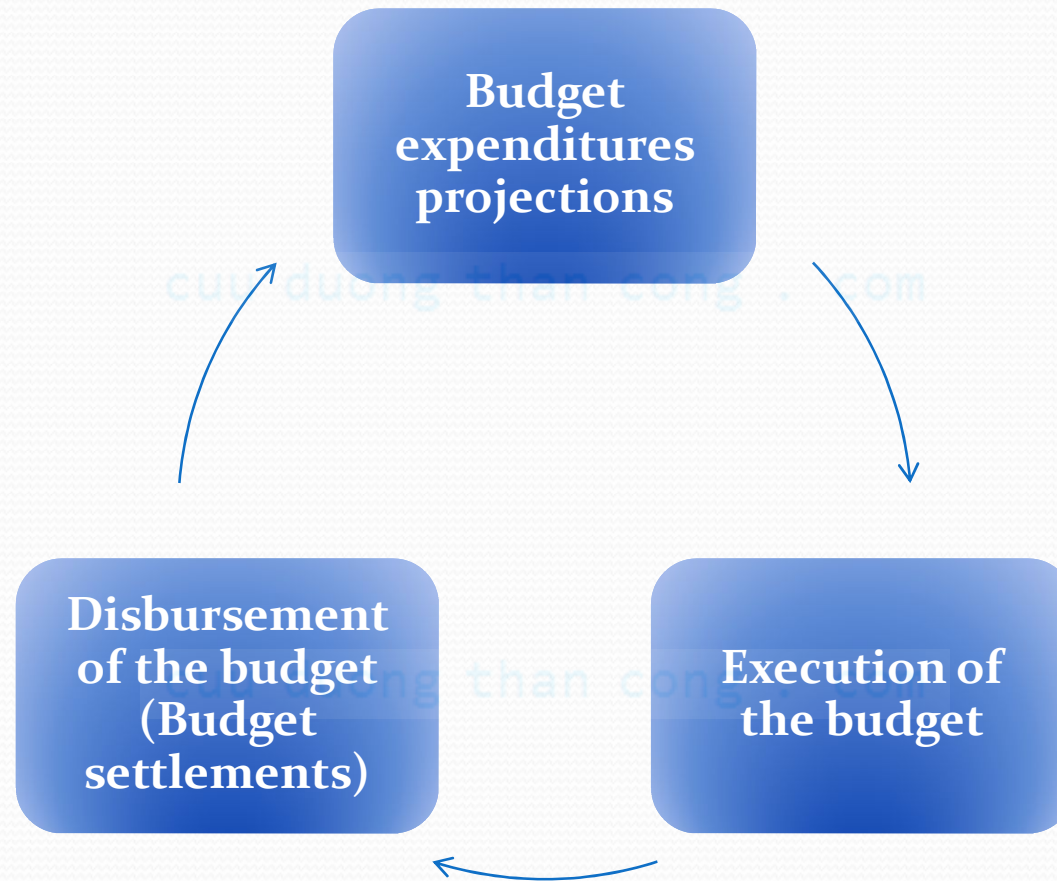
Local
government
budgets
at grass-
roots
levels

Provinces level
government budget

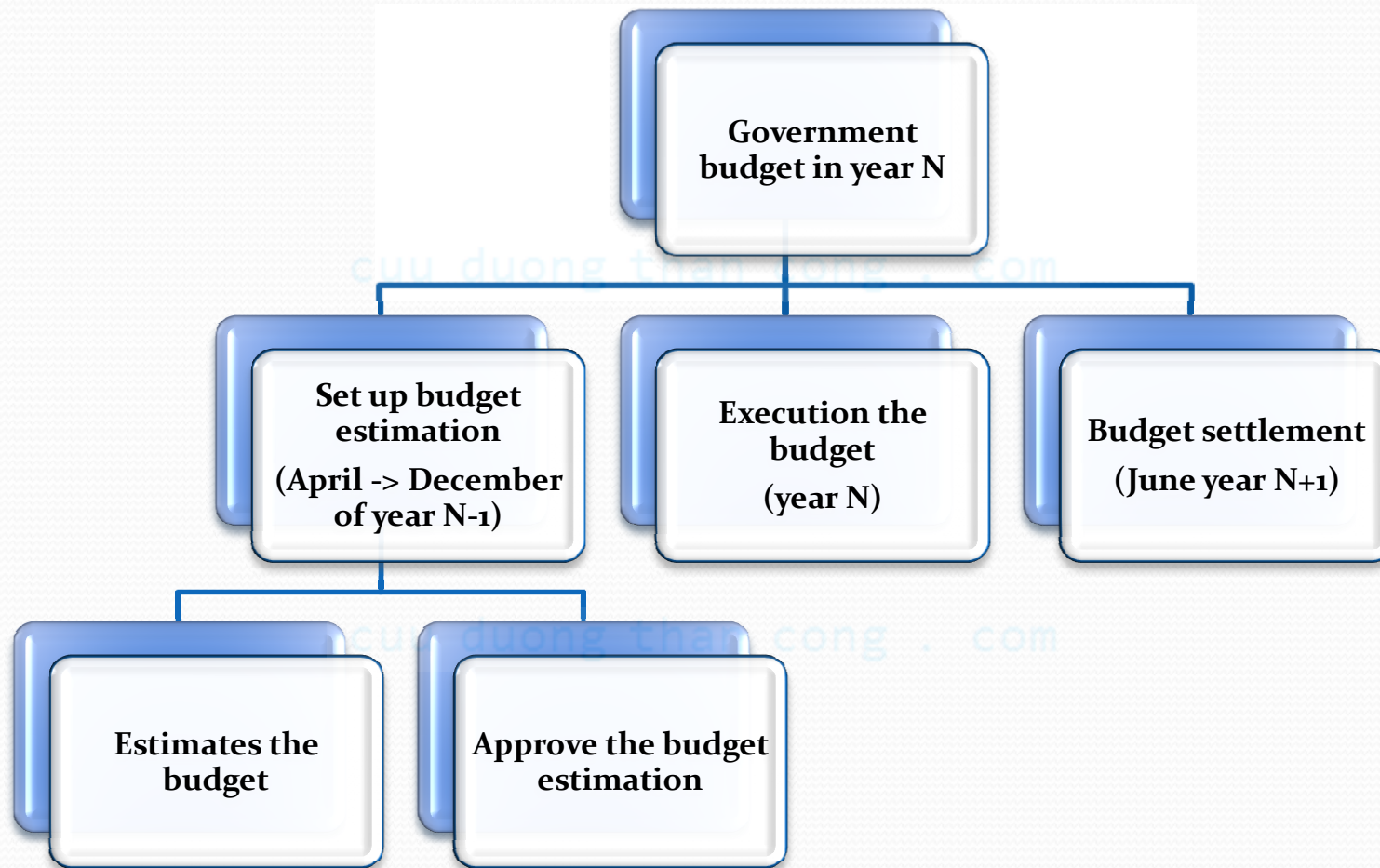
District level
government budget

Communal
government budget

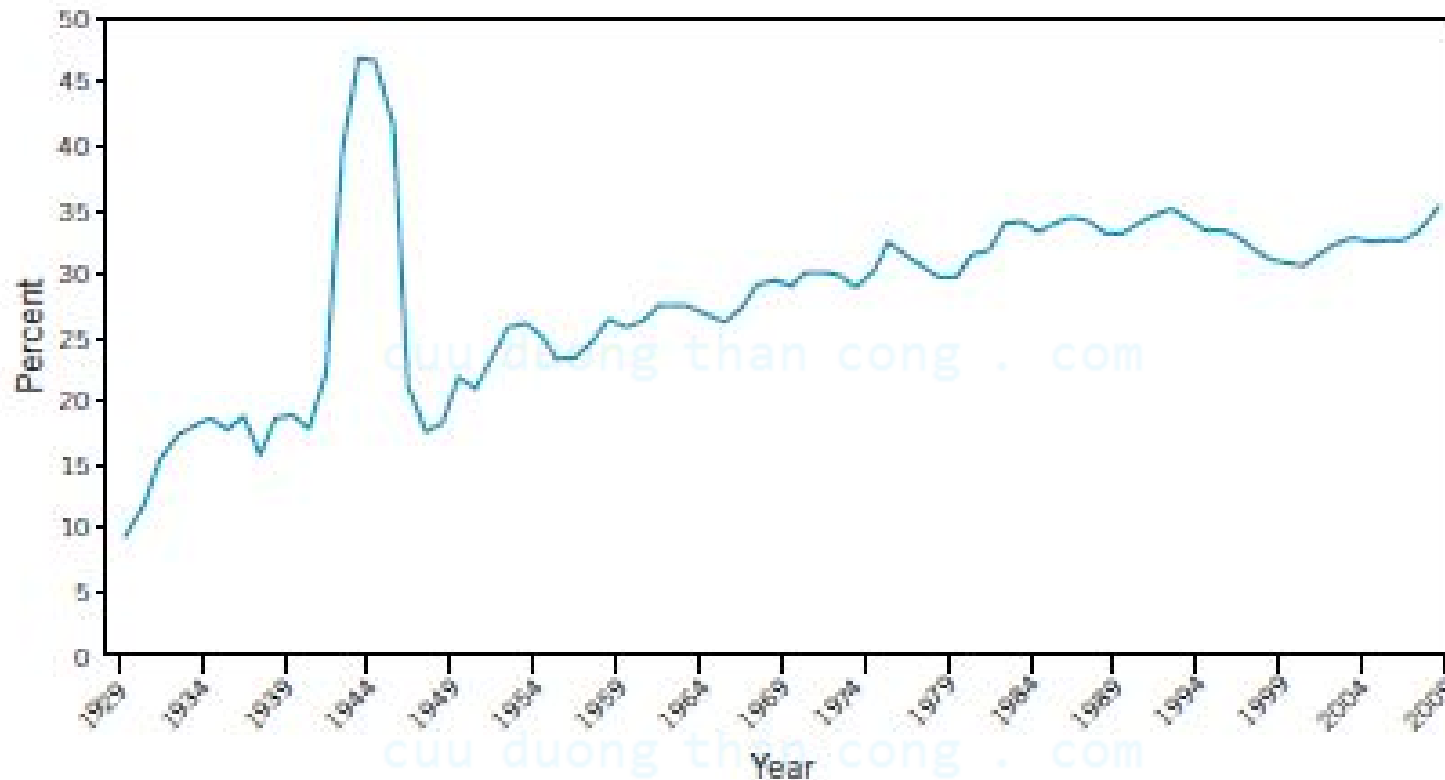
The government budget process of Vietnam



The government budget process of Vietnam



2. Government expenditures



The share of GDP devoted to government expenditures in the United States has increased dramatically, from about 10 percent to 35 percent since 1929.

Total government expenditures of the US as a percentage of GDP, 1929-2008

2. Government expenditures

- **Government expenditures (government outlays/government spending) includes:**
 - Government purchases (G)
 - Transfer payments (TP)
 - Net interest payments (INT)
 - Others: E.g.: Subsidies less surpluses of government enterprises.

Government purchases

- **Government purchases** are goods and services bought by state and local governments.
- Government purchases are part of GDP
- **Examples:** military equipment, highways, education and the services that government workers provide.
- Government purchases include:
 - *Government consumption expenditures*
 - *Government (gross) investment:* purchases of capital goods

Transfer payments

- **Transfer payments** are expenditures for which the government receives no current goods or services in return.
- Transfer payments redistribute purchasing power among citizens.
- Because transfer payments reallocate existing income and are not made in exchange for goods and services, they are not part of GDP.
- **Examples:** welfare, social securities, pension for government retirees.

Net interest payments

- **Net interest payments** are interest paid to holders of government bonds less interest received by the government.

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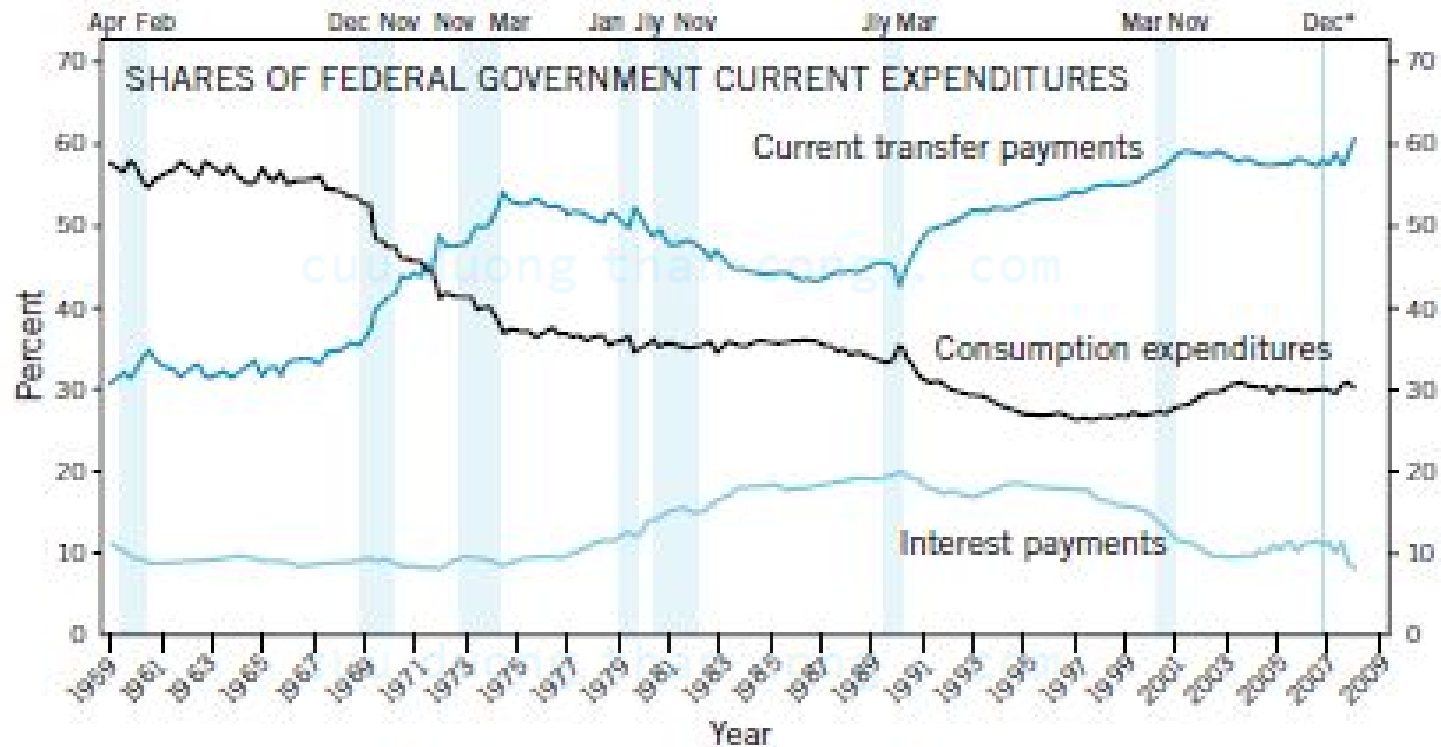
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US Federal government expenditure by category, 2008 calendar year

EXPENDITURE CATEGORY	AMOUNT (BILLIONS OF DOLLARS)	PERCENTAGE OF TOTAL FEDERAL EXPENDITURE
Transfer Payments	1840.6	59.0%
Consumption Expenditures	934.4	30.0%
Net Interest Paid	292.0	9.4%
Other	50.6	1.6%
Total	3117.6	100.0%

Source: U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts.

Distribution of US Federal expenditures, 1959-2009



Since 1959, transfer payments have grown as a share of federal expenditures. (Shaded areas indicate recessions.)

Source: U.S. Department of Commerce, Survey of Current Business, June 2009.

3. Government financing

- Purpose of government finance
- Taxes
- Alternative methods of government finance

Purpose of government finance

- Government activity requires the reallocation of resources from private to government use. To accomplish this, individuals must be induced to surrender their right to command resources for their own private uses so that government authorities can then obtain those rights for the purpose of providing goods and services.

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Taxes

- **Taxes** are compulsory payments associated with certain activities.
- Taxes are principal means of financing government expenditures
- Taxes do not necessarily bear any direct relationship to the benefits from government goods and services received.

Taxes

- Taxation reallocates resources from private to government use in two distinct steps:
 1. The ability of individuals to command resources is reduced
 2. The revenues collected by government then are used to bid for resources necessary to provide government goods and services and to provide income support payments to recipients of government transfers such as Social security pensions.

Tax base

- **Tax base** is the item or economic activity on which the tax is levied.
- Tax bases can be grouped into three broad categories: *income*, *consumption*, and *wealth*. These are economic bases; their values depend on decisions made by individuals:
 - A person's *income* is the sum of the value of his annual consumption of goods and services and annual savings.
 - A person's annual *consumption* is his annual income less the amount of that income saved that year.
 - *Wealth* represents the value of a person's accumulated savings and investments at any point in time

Tax base

- Taxes on economic bases can be general or selective:
 - A **general tax** is one that taxes all of the components of the economic base, with no exclusions, exemptions, or deductions from the tax base.
 - A **selective tax** is one that taxes only certain portions of the tax base, or it might allow exemptions and deductions from the general tax base.

Tax rate structure

- **The tax rate structure** describes the relationship between the tax collected during a given accounting period and the tax base.
- Taxes rate can be calculated as the ratio of taxes paid to the various values of the base:

- **Average tax rate (ATR):** is simply the total dollar amount of taxes collected divided by the dollar value of the taxable base

$$ATR = \frac{\text{total taxes paid}}{\text{value of the tax base}}$$

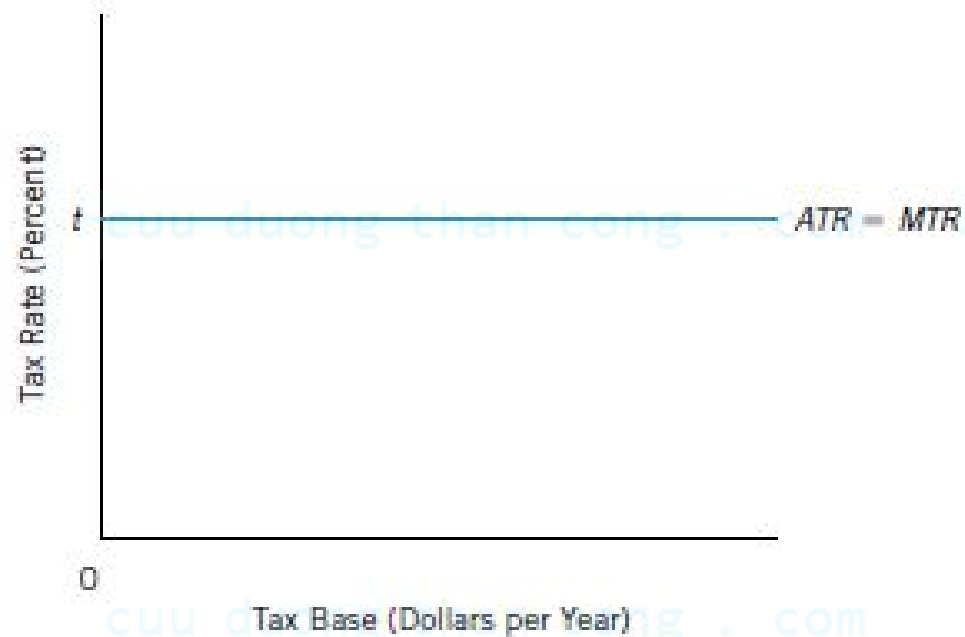
- **Marginal tax rate(MTR):** is the additional tax collected on additional dollar value of the tax base as the tax base increases

$$MTR = \frac{\Delta \text{ total taxes paid}}{\Delta \text{ value of the tax base}}$$

Tax rate structure

- **Proportional tax rate structure:** is one for which ATR, expressed as a percentage of the value of the tax base, does not vary with the value of the tax base.
 - A tax with a proportional rate structure is sometime called a **flat-rate tax**.
- **Progressive tax rate structure:** is one for which the ATR increases with the size of the base. The larger the tax base, the larger the ATR applied.

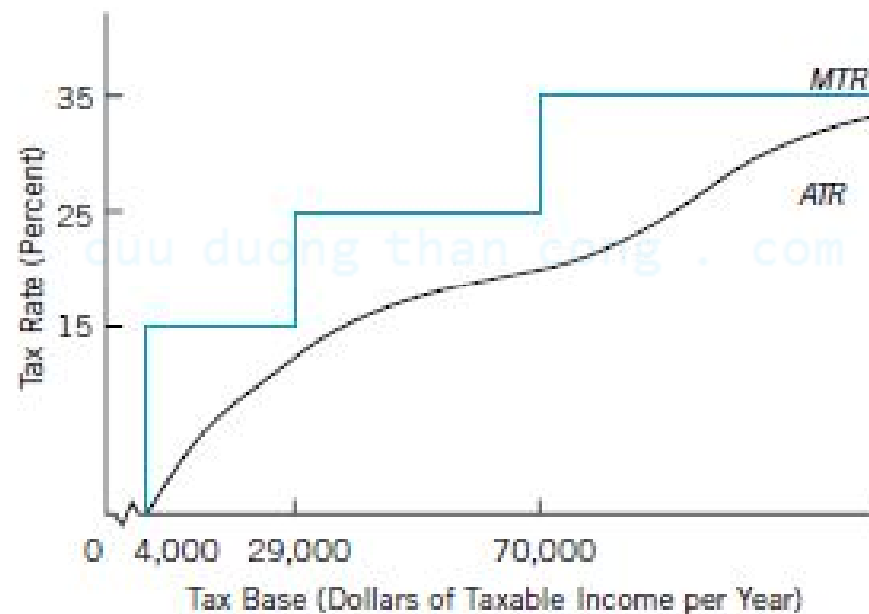
Tax rate structure



The tax base is subject to a flat rate of t percent at all annual values. Under a flat-rate tax, the average tax rate (ATR) is always equal to the marginal tax rate (MTR).

Proportional tax rate structure

Tax rate structure



Under a progressive tax rate structure, the ATR increases with the size of the tax base. The MTR exceeds the ATR after a point.

Progressive tax rate structure

Alternative methods of government finance

- Fees and charges (E.g.: tuition charges at state-run universities)
- Revenues from state-owned enterprises
- Borrowed funds

US Federal government receipts 2008

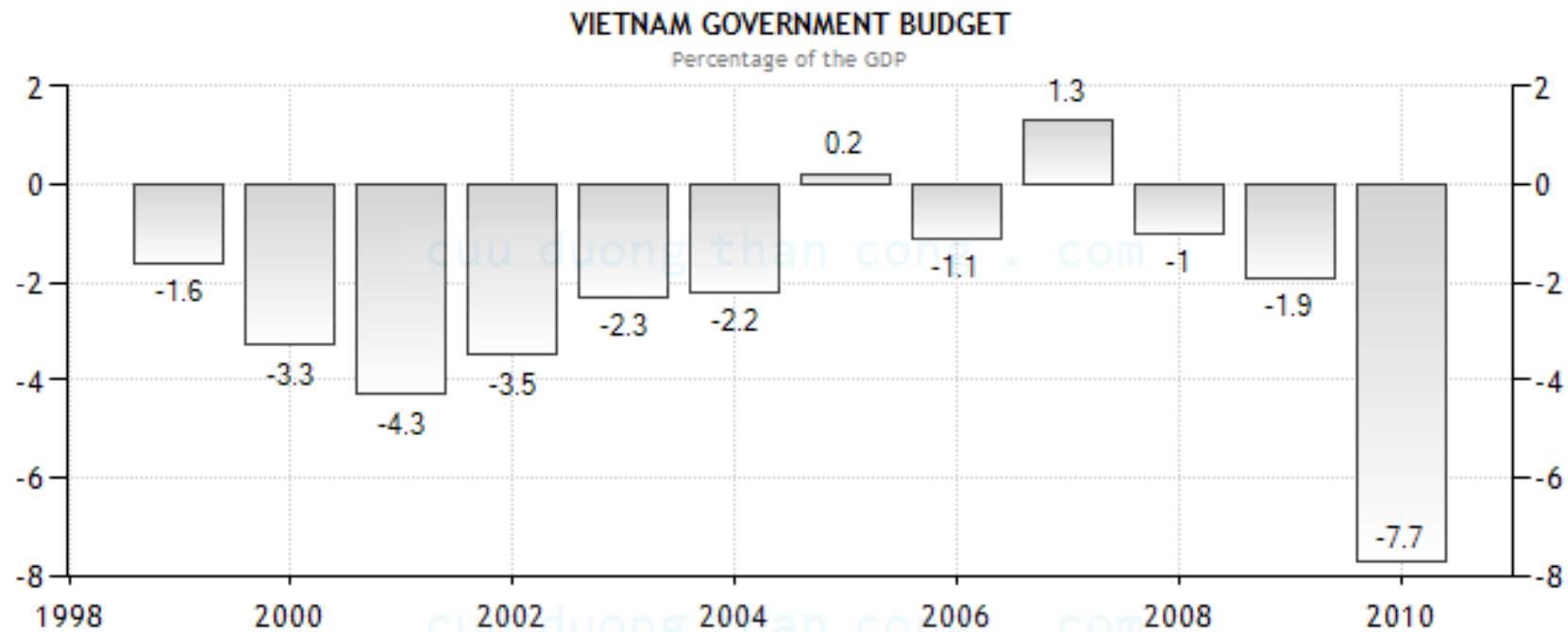
FEDERAL GOVERNMENT RECEIPTS 2008

FEDERAL GOVERNMENT RECEIPTS	AMOUNT (BILLIONS OF DOLLARS)	PERCENTAGE OF TOTAL
Personal Income Taxes	1127.2	43.81%
Payroll Taxes	972.2	37.79%
Corporate Profit Taxes	291.1	11.31%
Excise Taxes	67.2	2.61%
Custom Duties	29	1.13%
Other	86.2	3.35%
Total	2572.9	100.00%

4. The budget balance

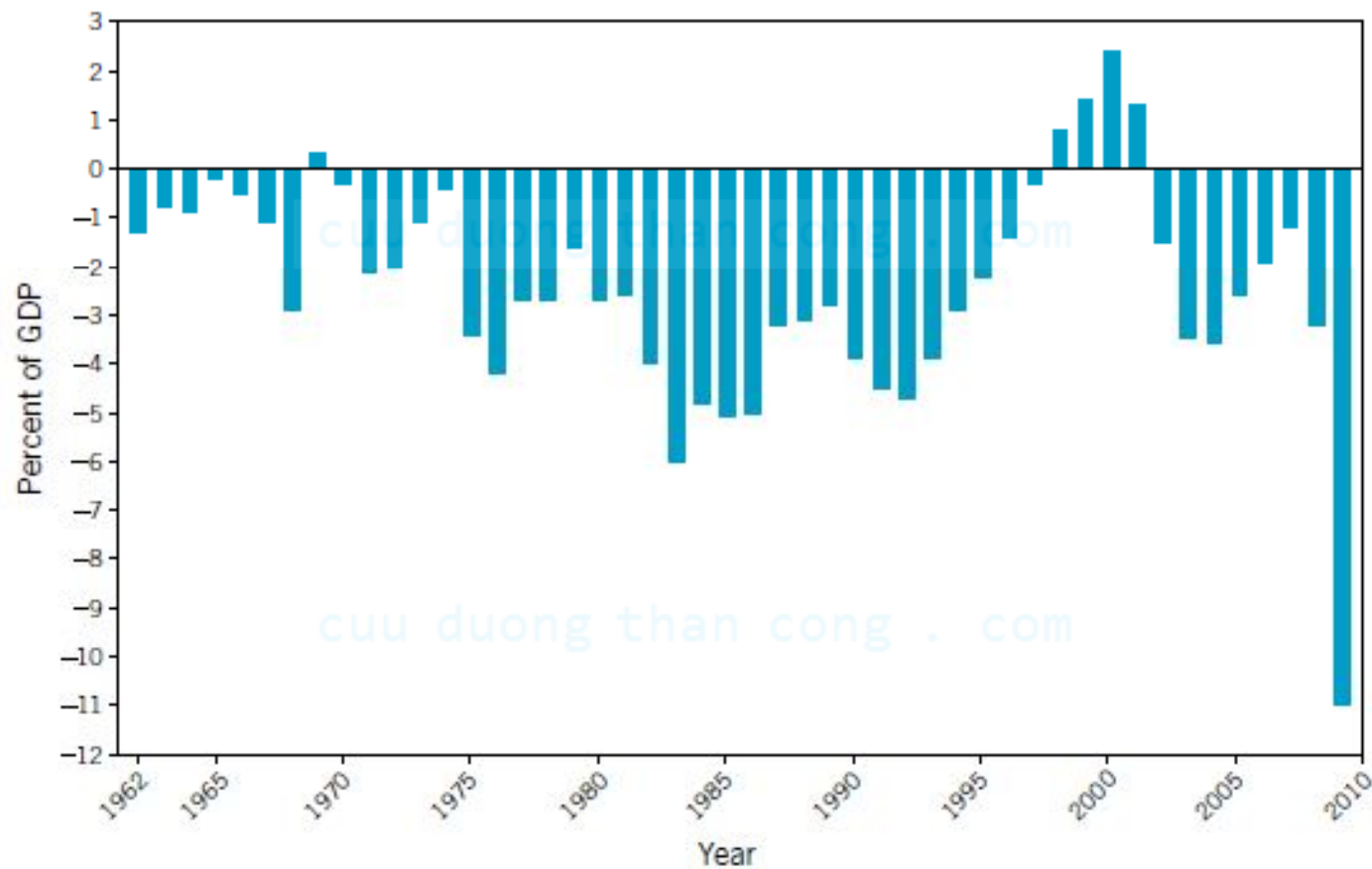
- The government budget balance is the difference between government revenues and government expenditures.
- The government budget balance could be in:
 - **Surplus:** when the government collect from taxes and other sources more than they spends.
 - **Deficit:** when the government spends more than they collect from taxes and other sources
 - **Balanced:** when government spending matches government revenues.

Vietnam government budget balance, 1999-2010



SOURCE: WWW.TRADINGECONOMICS.COM | ASIA DEVELOPMENT BANK

The US Federal budget balance, 1962-2009



Source: U.S. Department of Commerce, Bureau of Economic Analysis. Deficit for 2009 is an estimate.