

MACROECONOMICS -

Government Budget & The reasons for government spending and taxation

By Kru P'Da and Kru P'Eve Knockout.Economics

Overviews

1. Government budget
2. The reasons for government spending and taxation



1. Government Budget

Government Budget

The relationship between government revenue and spending

Budget deficit

gov.spending > gov.revenue

- Government needs to borrow money to fund deficit
- National debt ↑

Budget balance

gov.spending = gov.revenue



- No change in national debt

Budget surplus

gov.spending < gov.revenue

- Government has more reserve to pay for debt
- National debt ↓

2. The reasons for government spending and taxation

The reasons for government spending	The reasons for taxation
 <p>1. To achieve government aims e.g. to increase employment</p> <p>2. To provide public goods e.g. road, national defence</p> <p>3. To provide merit goods e. g. education, healthcare</p> <p>4. To help vulnerable people e.g. unemployed benefit</p>	 <p>1. Tax on income to redistribute income from rich to poor</p> <p>2. Tax on demerit goods to discourage the consumption</p> <p>3. Tax on pollution to raise cost to firm and encourage them to reduce externality</p> <p>4. Tax on imports to encourage the consumption of domestic goods</p>

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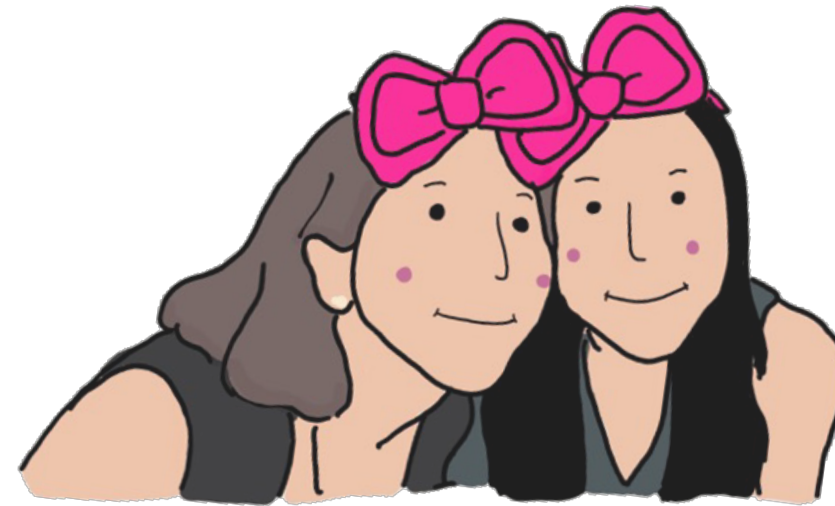
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MACROECONOMICS -

Exercise : Government Budget & reasons for government spending and taxation

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Exercise: MCQ

1.) When is it said to government budget surplus?

A when the value of exports is greater than the value of imports

B when economic growth in the country is greater than other countries

C* when tax revenue to government is greater than government expenditure

D when government impose higher tax rate on goods and services

Exercise: MCQ

2.) Which combination of government spending and tax revenue could lead to budget deficit?

	Government spending (\$ billion)	Tax revenue (\$ billion)
A	15,900	15,990
B	15,000	15,000
C	16,900	17,900
D	17,900	15,000

Exercise: Essay

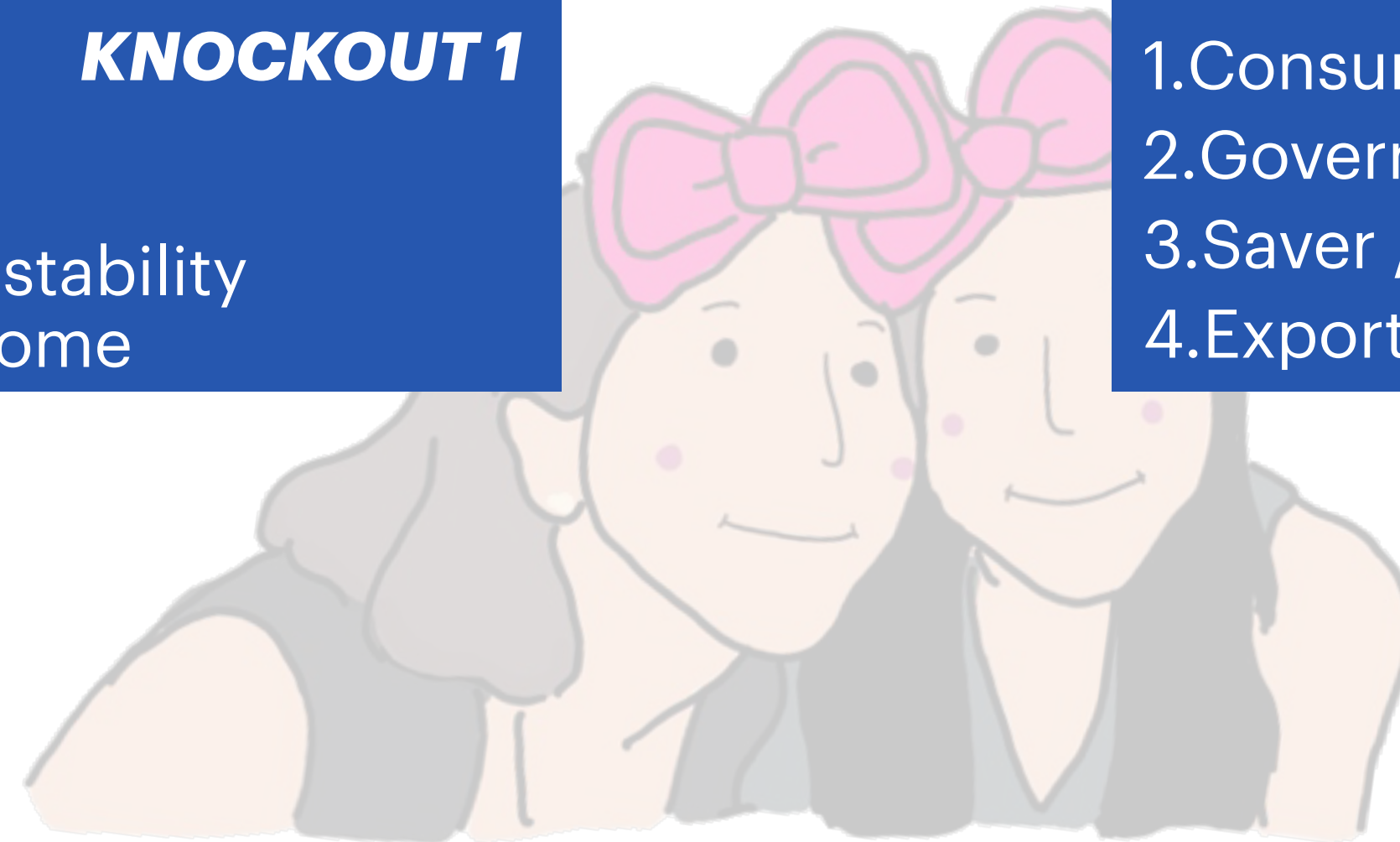
1.) Explain 2 reasons why do governments impose tax. [4]

1.Economic growth
2.Low unemployment
3.Price stability
4.Balance of payment stability
5.Redistribution of income

KNOCKOUT 1

1.Consumer, worker // producer, MNCS
2.Government // tax payer
3.Saver // borrower
4.Exporter // Importer

KNOCKOUT 2



Exercise: Essay

1.) Explain 2 reasons why do governments impose tax. [4]

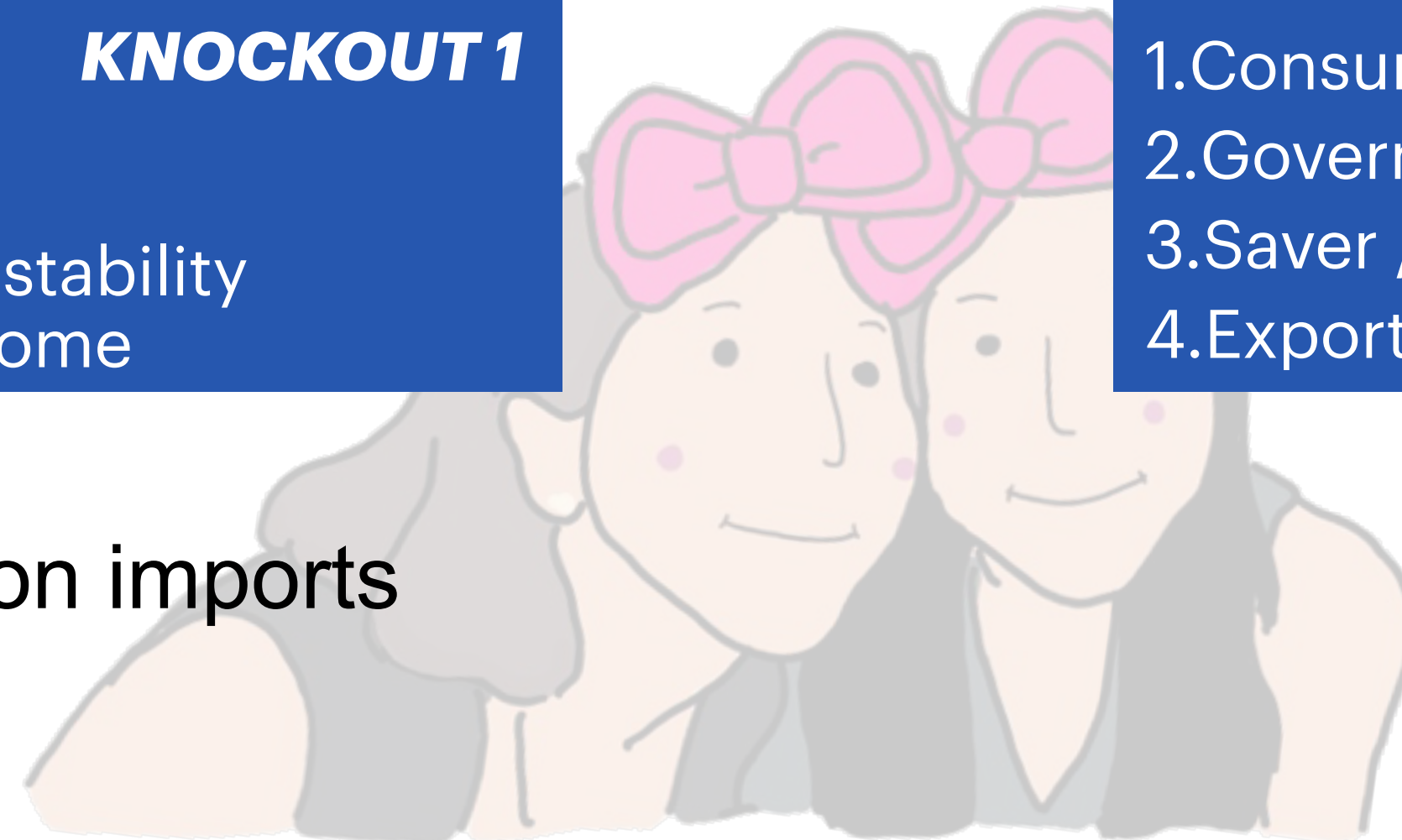
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KNOCKOUT 2

Tax : tax on income, pollution imports



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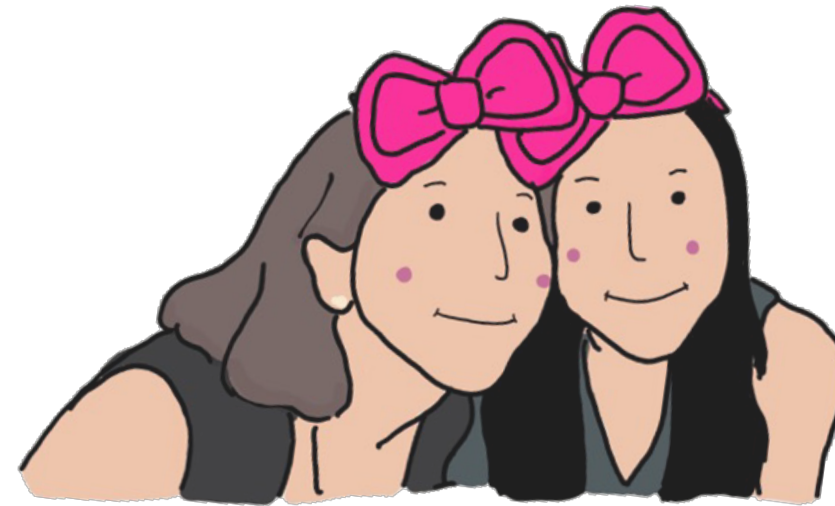
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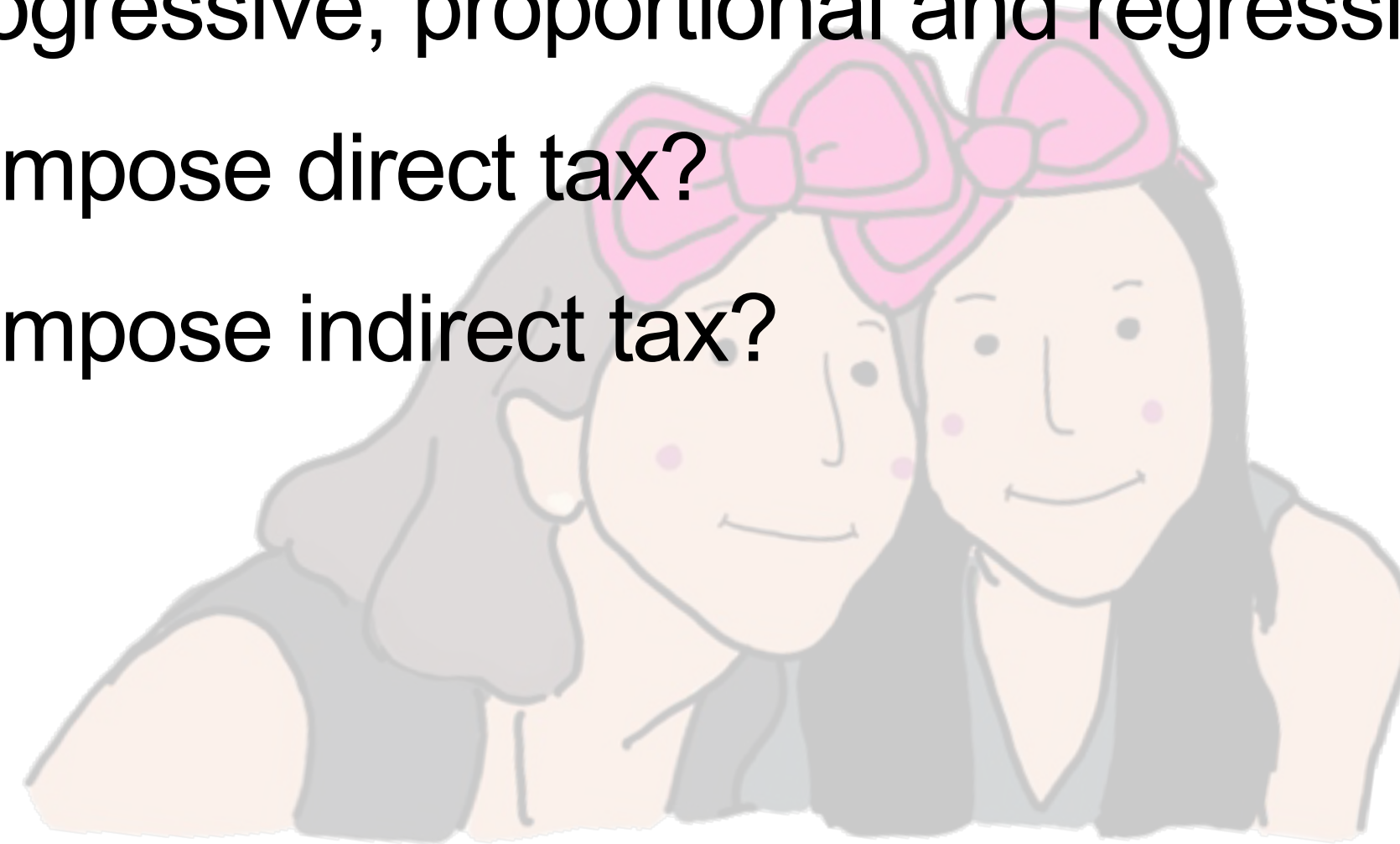


MACROECONOMICS - Categories of taxes

By Kru P'Da and Kru P'Eve Knockout.Economics

Overviews

1. Categories of taxes : direct tax and indirect tax
2. Categories of taxes : progressive, proportional and regressive tax
3. Why does government impose direct tax?
4. Why does government impose indirect tax?



1. Categories of taxes : direct tax and indirect tax

Categories of taxes : direct tax and indirect tax

Categories of taxes	Direct tax	Indirect tax
Meaning	Tax on income and wealth	Tax on spending or expenditure
Example	Income tax Corporate tax Capital gain tax Inheritance tax	Tax on petrol VAT 7 % Tax on alcohol Tax on imports

2. Categories of taxes : progressive, proportional and regressive tax

Categories of taxes : progressive, proportional and regressive tax

Categories of taxes	Progressive tax	Proportional tax	Regressive tax
Meaning	The proportion of income paid tax rises as income rises	The proportion of income paid tax stay the same as income rises or falls	The proportion of income paid tax rises as income falls
Example	Income tax	Flat tax e.g. 10% of any income	Tax on goods such as petrol, VAT 7%
Diagram			

3. Why does government impose direct tax?

Reasons for imposing direct tax

1. To redistribute income and wealth	<ul style="list-style-type: none">➔ Direct tax is progressive tax which mainly falls on rich people.➔ Tax revenue can be used to help poor.
2. To reduce inflation	<ul style="list-style-type: none">➔ Income tax reduces disposable income and ability to spend.➔ It reduces spending, AD and inflation.
3. To to reduce trade deficit	<ul style="list-style-type: none">➔ Income tax reduces disposable income and ability to spend.➔ It reduces spending on imports and trade deficits
4. To receive tax revenue	<ul style="list-style-type: none">➔ Government can use tax revenue to provide public goods and merit goods

Limitation of direct tax

1. Income tax **reduces incentive to work**, resulting in lower economic growth.
2. Corporate tax **discourages MNCs** to invest in the country, resulting in lower job creation.
3. High direct tax can cause **tax avoidance**, resulting in lower tax revenue.

4. Why does government impose indirect tax?

Reasons for imposing indirect tax

1. To discourage the consumption of demerit goods	➔ Imposing tax on demerit goods makes the prices higher and reduces the consumption.
2. To reduce imports	➔ By imposing tariff, it discourages the consumption of imports and encourages the consumption of domestic goods.
3. To receive tax revenue	➔ Government can use tax revenue to provide public and merit goods.

Limitation of indirect tax

1. Indirect tax increases price level and it can cause **Inflation**.
2. A rise in price of goods and services **reduces purchasing power and living standards**.
3. Indirect tax is **regressive tax** which tax mainly falls to poor people, resulting in **income inequality**.

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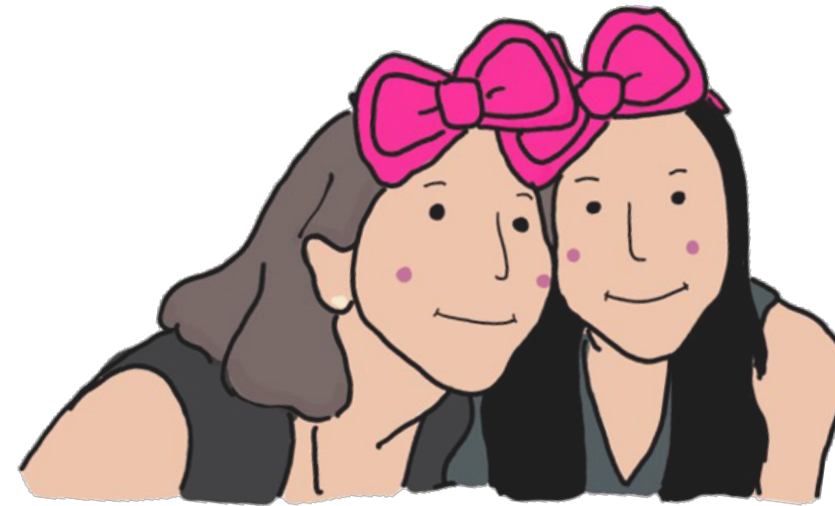
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MACROECONOMICS -

Exercise : Categories of taxes

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Exercise: MCQ

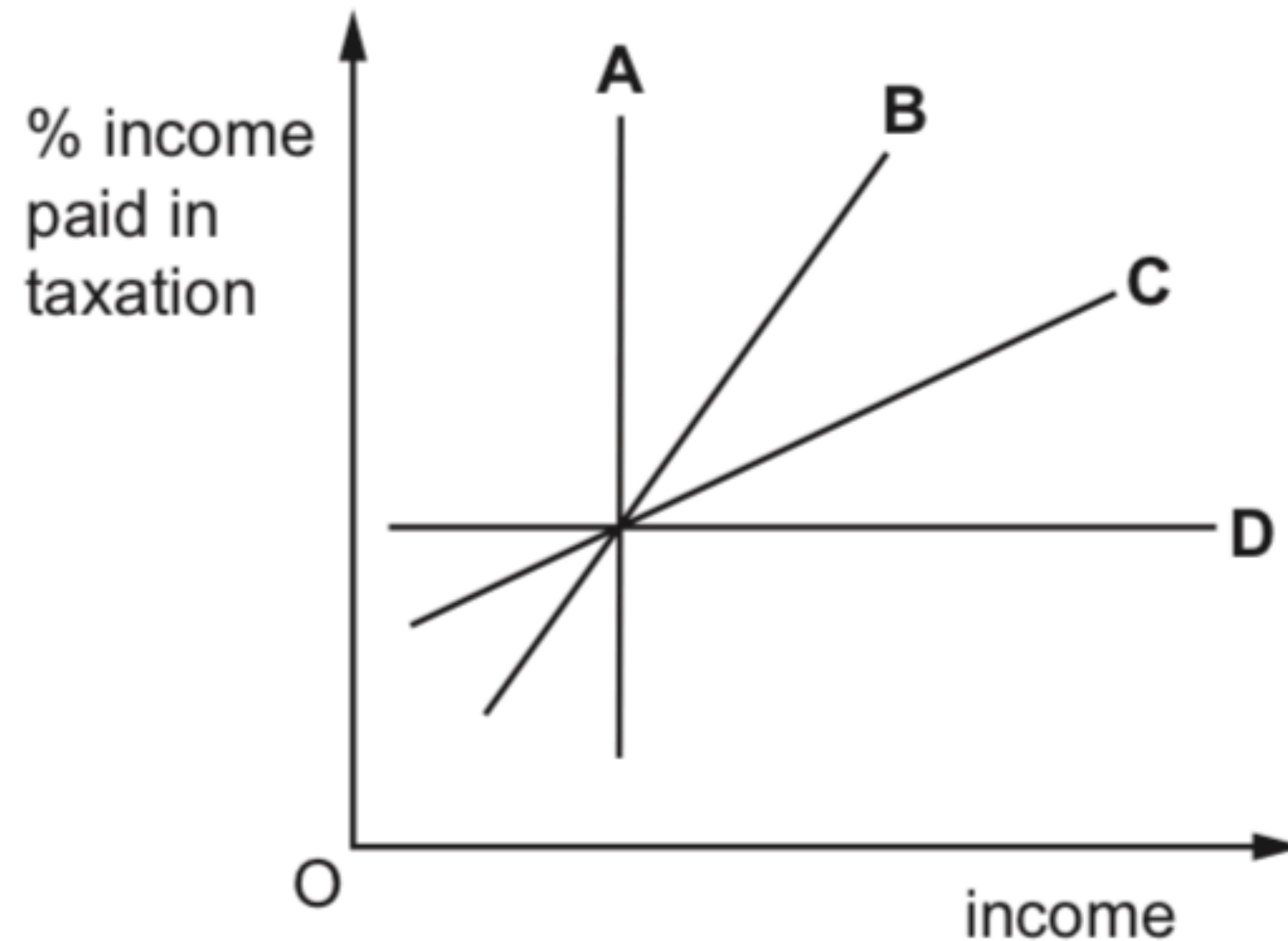
1.) What can be concluded from the table which shows the tax paid at different levels of income.

Income (\$)	Amount of tax (\$)
5000	500
6000	600
7000	800
8000	950

- A. Progressive at all levels of income
- B. Proportional at all levels of income
- C. Proportional at lower incomes, regressive at higher incomes
- D. Proportional at lower incomes, progressive at higher incomes*

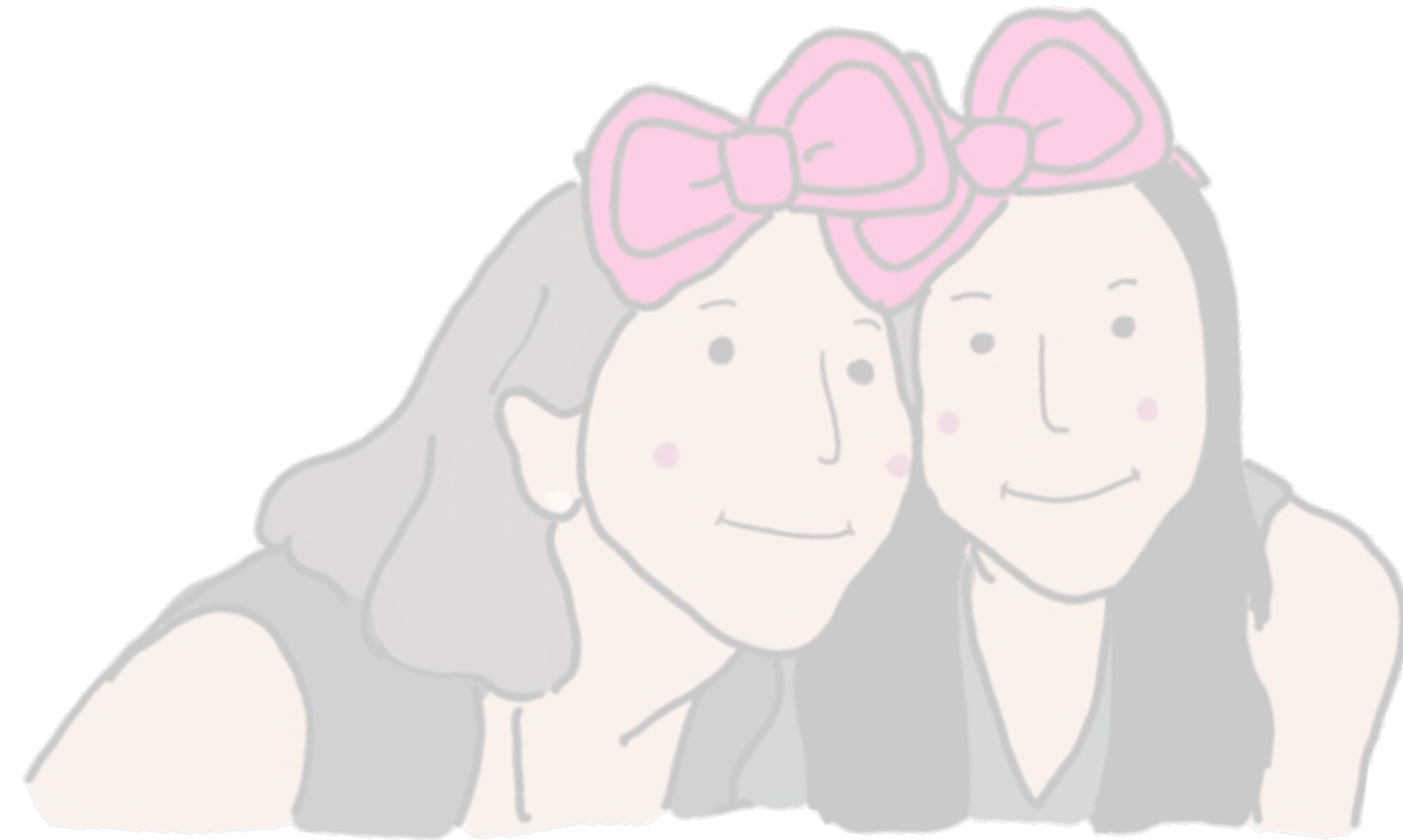
Exercise: MCQ

2.) The diagram shows the percentage of income paid in taxation and income level. Which line represents a proportional tax?



Exercise: Essay

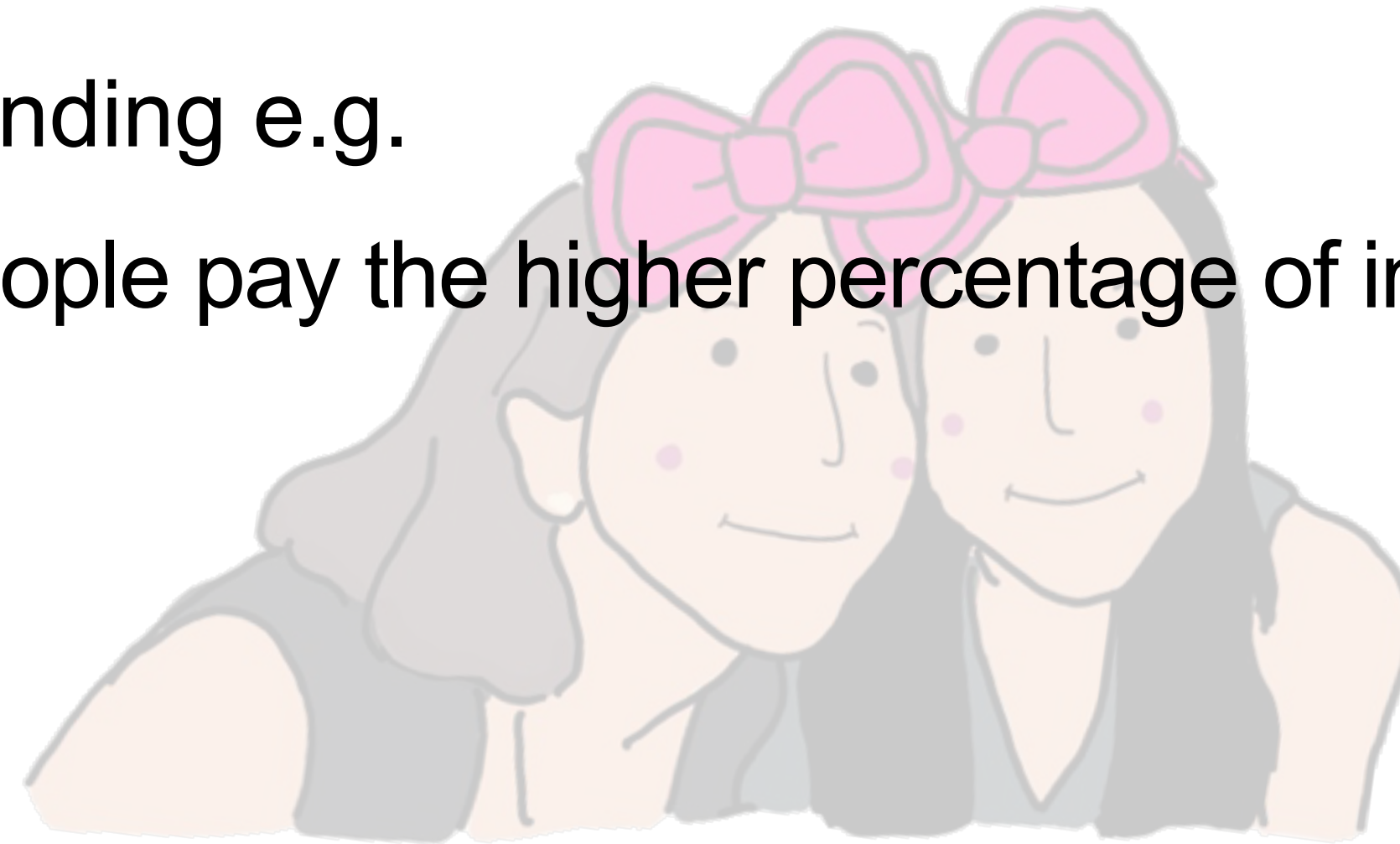
1.) Describe what is meant by regressive indirect tax? (4marks)



Exercise: Essay

1.) Describe what is meant by regressive indirect tax? (4marks)

- Indirect tax : tax on spending e.g.
- Regressive tax : poor people pay the higher percentage of income in tax than rich people.



Exercise: Essay

2.) Discuss whether an economy will always benefits from increasing direct tax rates. [8]

1.Economic growth ***KNOCKOUT 1***
2.Low unemployment
3.Price stability
4.Balance of payment stability
5.Redistribution of income
6.Reducing pollution & resource waste

1.Consumer, worker // producer,MNCS
2.Government // tax payer
3.Saver // borrower
4.Exporter // Importer ***KNOCKOUT 2***

Should increase direct tax rates ..

Should not a increase direct tax rates ..



Exercise: Essay

2.) Discuss whether an economy will always benefit from increasing direct tax rates. [8]

1. Economic growth
2. Low unemployment
3. Price stability
4. Balance of payment stability
5. Redistribution of income

KNOCKOUT 1

1. Consumer, worker // producer, MNCs
2. Government // tax payer
3. Saver // borrower
4. Exporter // Importer

KNOCKOUT 2

Should increase direct tax rates ..

- Lower inflation
- Lower import expense
- Redistribution of income
- Government gains higher tax revenue

Should not increase direct tax rates .. Check knockout 1&2 :

- Reducing economic growth,
- Reducing employment
- Reducing incentive to work for workers
- Reducing incentive to invest for MNCs



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