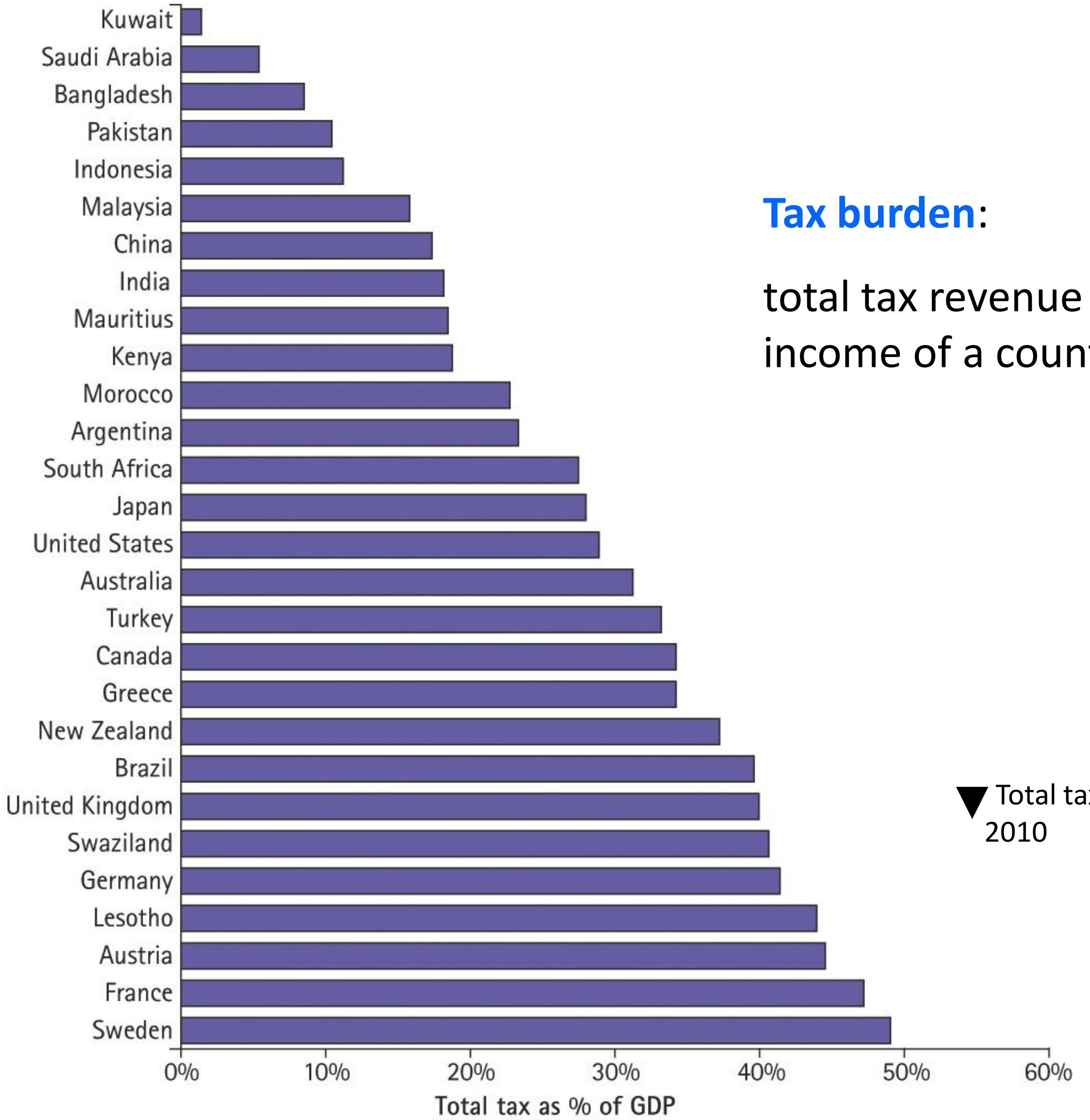
# Taxation

# Financing public expenditure

- **Borrowing** from the private sector
- **Rents** from publicly owned buildings and land
- **Admission charges**, for example from public museums and monuments
- **Revenue** from the sale of some public services such as postal services and public transport
- **Proceeds** from the sale (or privatization) of government-owned industries and other publicly owned assets
- **Interest charges** on government loans to the private sector and overseas governments
- **Taxes** on incomes, wealth and expenditures

# Tax burdens vary




**Tax burden**:

total tax revenue as a proportion of the national income of a country

▼ Total taxation as a percentage of GDP, selected countries 2010

# How taxes are used

- To raise revenue (e.g. The government will have more to spend.
- To manage the <u>macroeconomy</u>
- To reduce income inequality after tax
- To discourage spending on imports (e.g. Tariffs placed on foreign goods)
- To discourage the consumption and production of harmful products (e.g. Cigarettes and alcohol)
- To protect the environment

Increase in income tax rates raises $3 billion

Tax cuts to boost employment and growth

America's soft drinks industry battles proposals to tax sugary sodas

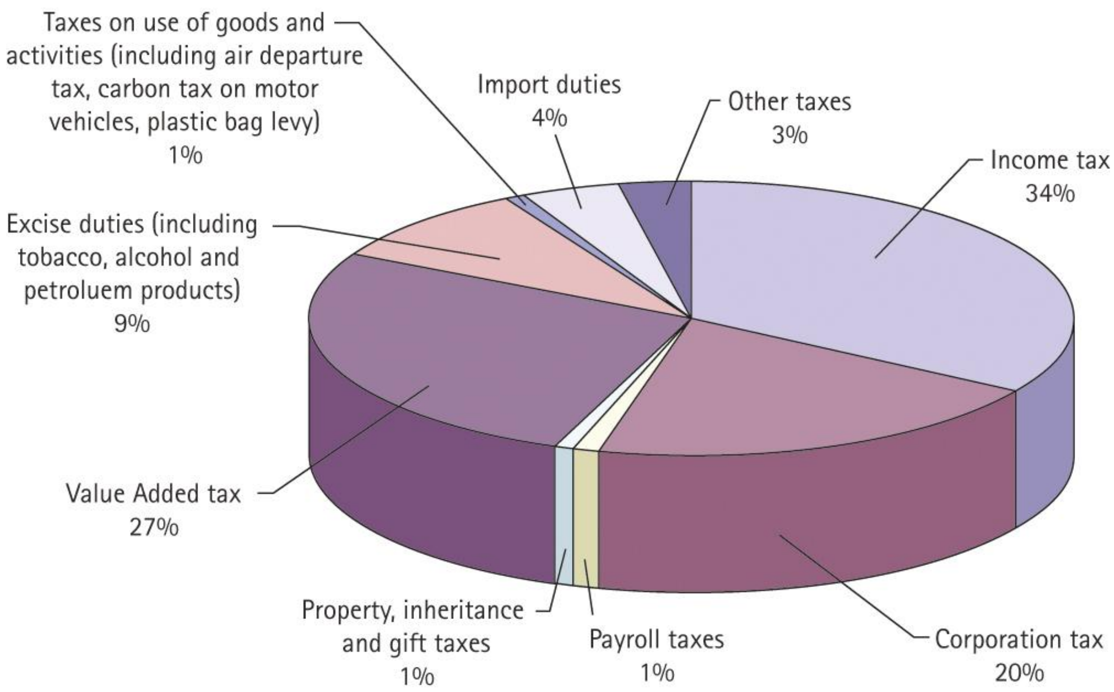
India introduces carbon tax on coal producers

# Designing a tax system

- Progressive, regressive or proportional?

| **Annual income $** | **Progressive tax** **% of income taken in tax** | **Regressive tax** **% of income taken in tax** | **Proportional tax** **% of income taken in tax** |
|---|---|---|---|
| $5,000 | 0 | 30% | 20% |
| $20,000 | 10% | 25% | 20% |
| $50,000 | 20% | 20% | 20% |
| $100,000 | 40% | 15% | 20% |

# Types of tax




▲ Revenue by source and type of tax, South Africa 2010-11

**Direct taxes** are taken directly from individuals or firms and their incomes or wealth.

The burden of a direct tax falls directly on the person or firm responsible for paying it.

**Indirect taxes** are taxes taken indirectly from incomes when they are spent on goods and services.

Indirect taxes may also be called expenditure taxes or outlay taxes.

# Direct taxes

- **Personal income tax**
- **Corporation (or profits) tax**
- **Capital gains tax**
- **Wealth (e.g. inheritance and property) tax**

| Advantages of direct taxes | Disadvantages of direct tax |
|---|---|
| • They are a major source of tax revenue<br>• Many are progressive and help to reduce inequalities in incomes after tax<br>• They take account of people’s ability to pay | • Income taxes can reduce work incentives<br>• Taxes on profits can reduce profit available to entrepreneurs to re-invest in their businesses<br>• High tax rates can cause tax evasion |

# Indirect taxes

- **Value added tax (VAT)**
- **Excise duties**
- **Import tariffs**
- **User charges**



| Advantages of indirect taxes | Disadvantages of indirect tax |
|---|---|
| • They are cost effective to collect<br>• A wide tax base. Anyone who buys goods and services will pay some indirect taxes<br>• They can be used to discourage consumption and production of harmful products | • The cost of collecting taxes falls to businesses<br>• They are regressive<br>• Tax revenues are less certain because they depend on spending patterns<br>• They add to price inflation |

# Balancing the budget

In **the Budget** a government sets out its plans for public spending and raising tax revenues for the financial year ahead

## Budget deficit

**Public expenditure** **Tax revenue**

## Budget surplus

**Public expenditure** **Tax revenue**

An **expansionary fiscal policy** will increase a budget deficit or reduce a budget surplus

A **contractionary fiscal policy** will reduce a budget deficit or increase a budget surplus

# Balancing the budget

- What would happen to the budget if the government followed an expansionary fiscal policy?
- Or a contractionary fiscal policy?
- IS this a simple thing to solve? What are the pitfalls?