"COPY THE NOTES, DIAGRAM AND CALCULATIONS WILL BE DRAWN WHEN SCHOOL RESUMES ".

PUBLIC FINANCE AND FISCAL POLICY:

Objectives

By the end of this topic, students should be able to;

- Define public finance and fiscal policy
- Explain the role of public finance and fiscal policy
- Describe the principles of taxation
- Classify taxes
- State and explain the problems of taxation and possible solutions of taxation in developing countries
- Define public debt and explain the principles of public borrowing and debt management.
- Compare debt financing and taxation financing ways of financing government expenditure.
- Describe the National budget and government expenditure as instruments of economic and social policy.

Public finance is a section of macro economics which is concerned with public revenue and expenditure. It's a section concerned with various sources of government revenue and different areas where the state spends revenue so as to achieve objectives for development.

Public finance is therefore concerned with;

1. Collection of public revenue and identifying the different sources of public revenue. **Public revenue** is the income that accrues to government from different sources.
2. Public expenditure, which is concerned with the different ways in which public revenue is spent by government.
3. Financial administration which is concerned with government budget, government (National) budget is the estimate of government expected revenue and planned expenditure in a given financial year.
4. Public debt as a major source of finance of the government budget in less developed countries. When the government spends more than it receives, it runs a *deficit* Budget. Governments finance deficits by borrowing money. Deficit spending—that is, spending funds obtained by borrowing instead of taxation—can be helpful for the economy as an economic stabilization tool.
5. The Fiscal policy.

The sources of public revenue;

There are alternative sources from which government is able to mobilize revenue from internal and external sources;

- Government commercial enterprises. Revenue is earned from government commercial activities in different fields of economic activity such as mining and processing.
- Through compulsory saving. This is where members of the public are required to make compulsory periodic deposits of part of their earnings in pension funds and others like insurance premiums for future benefit. This money may be currently availed to government to finance its expenditure.

- Fees charged by government for its services to the public. A Fee is a quid pro quo payment for a service rendered. Examples of government services on which fees are levied include vehicle registration and passport fees, birth certificate fees among others.

- Licenses. These are documents of authorization issued by government to individuals to engage in specified economic activity such as hunting and fishing, and lumbering. Licenses must be paid for therefore a source of revenue to government.
- Fines collected and assets forfeitured penalty from law breakers. Examples of such fines include parking and traffic offence fines, and court costs levied on criminal offenders.
- Gifts, grants or donations and other contributions forwarded to government from friendly countries and individual organisations.
- Through disinvestment and sale of state assets. This is where government sells off its shares in government business enterprises and state assets to private investors and gets revenue in return.
- By borrowing money from both internal and external sources.
- The market dues collected from market vendors are a major source of revenue for local governments in developing countries.
- Taxation. Taxes are non-quid pro quo compulsory payments by individuals or legal entity on whom the tax is levied to government authority.
- Surplus income realized from national lotteries organized by the government.
- Rent. Rent is the regular payment made by tenants of government property for the right to occupy or use the property for example, ground rent on leased land.
- Concessions, and royalties collected by the state when it contracts out the right to profit from some good or service to a private corporation. Examples are contracts for extraction of natural resources as minerals, timber, petroleum and natural gas, or marine resources collected privately under license from state-owned lands.
- Tolls. A charge for the use of a service such as roads and bridges.
- Rates. A levy by local authorities on property within that locality. It is based on a fixed ratable value of the property.

TAXATION:

Refers to a process of compulsory transferring of funds from the public to the central government or local authority as a source of finance irrespective of the exact amount or service in return.

Taxes are compulsory payments levied by a government authority on either an individual's income or property.

A tax is described as a non-quid pro quo compulsory payment to government since it is payable irrespective of the exact value of service rendered to the tax payer. A tax is not a voluntary payment or donation, but an enforced contribution to legislative authority.

NOTE:

Distinguish between a tax and a fee.
Distinguish between quid pro quo & non quid pro quo payments.

REASONS FOR TAXATION:

1. **To raise public revenue:**
   The revenue raised out of taxes is used by the government for recurrent and development expenditure.
2. **Decrease income inequality in the country:**
   Progressive taxation is used to narrow the gab between the rich and the poor.
3. **To protect home infant industry and other countries.**
   Import duties are increased to protect the local infant industries from unfair competition from foreign industries.
4. **To improve the B.O.P position in the country.**
   This is through increasing import duties to restrict the amount of imports so as to decrease the excessive expenditure abroad.
5. **To restrict production and consumption of undesirable goods.**
   Such products are taxed highly so as to market them very expensive and discourage their consumption.
6. **To influence resource allocation in the country.**
   Taxes are decreased on the activities where there is a need to increase resource allocation in the country and are increased on activities that are considered non-essential in the country.
7. **To control inflation:**
   Inflation is controlled by using direct taxes. An increase in tax helps to reduce people's disposable income hence controlling demand full inflation.
8. **To control monopoly powers:**
   The super normal profits of monopolists are taxed either by way of a lump sum or specific tax. This helps to decrease the powers of over exploiting the consumers.
9. **To stimulate economic growth and development:**
   By restricting volume of imported goods to create market for local goods.
10. **To decrease the burden of borrowing:**
11. **Used as a means of forced savings e.g. NSSF**

Taxation has both positive and negative effects on the economy

Positive effects of taxation;

1. Taxation helps to reduce the income gap between the rich and the poor, this is achieved through progressive taxation of people's incomes and wealth, and or through differential taxation on goods and services; by imposing heavy taxes on goods consumed by the rich, and low or no taxes on goods consumed by the poor hence redistributing income from the rich to the poor leading to an equitable distribution of income and wealth.
2. Taxes are a means of acquiring revenue needed for government expenditure.
   Government is able to raise by levying direct and indirect taxes.
3. Import duty protects local industries from harsh foreign competition which helps to promote industrialization of local industries.
4. Taxation helps to improve the balance of payment position through imposing high taxes on imports so as to discourage importation thereby reducing foreign exchange expenditure hence correcting the balance of payments deficit.
5. Taxation discourages production and consumption of demerit goods when high taxes are imposed on production and consumption of such goods; taxation on production of goods raises production costs of those goods which discourages their production, taxation also reduces the spending power of individuals which forces them to reduce their consumption expenditure on those goods on which high taxes have been levied.

6. Direct taxation helps to control demand pull inflation through reducing disposable income by imposing taxes on individual incomes.
7. Taxes regulate monopoly powers by imposing high taxes on super profits of monopolists.
8. Taxes influence the level of economic growth by giving tax incentives which encourage investment and production.
9. Taxes influence resource allocation through differential taxation; resources are reallocated from highly taxed activities to less taxed activities.
10. Taxes promote hard work among people. Tax payers are forced to work harder in order to be in position to meet their tax obligation as well as maintain their standard of living before tax.

Negative effects of taxation;

1. Heavy Taxation discourages savings. This is because individuals are left with little money to save after tax.
2. High corporation taxes discourage investment since they reduce profits of firms and lower the enthusiasm to invest.
3. Heavy taxation reduces welfare of the people by reducing the level of consumption expenditure since high taxation on incomes and goods reduce disposable income and purchasing power of individuals respectively.
4. Heavy and highly progressive taxation discourages effort and initiative because high incomes earned from extra effort is all paid in tax, which results into low level of economic growth.
5. Heavy indirect taxes encourage illegal activities because people attempt to avoid paying high taxes.
6. High indirect taxes are inflationary. Since they result into hiking of market prices of goods on which they are imposed.
7. High Taxation leads to misallocation of resources as entrepreneurs divert resources from highly taxed activities to non-productive activities.
8. Heavy taxation creates resentment among people which erodes political popularity of government.
9. High taxation reduces benefits from trade due to the fall in the volume of trade.
10. Regressive taxation worsens income inequality in the country.
11. Taxation lowers the standard of living of the people because it reduces the amount of goods and services they can buy due to reduced spending power.

PRINCIPLES OR CANONS OF TAXATION:

1) **Certainty**: A good tax is one who's base, time of payment, amount to be paid are known to be tax payer.
2) **Convenience**: This is when and how to pay tax, it should be convenient to the tax payers.
3) **Equity /fairness**: A good tax system should be fair i.e. proportional to the tax payer's income.
4) **Neutrality** or **impartiality**: It should not discriminate money tax payers.
5) **Simplicity**: A tax should be simple and straight forward, understandable to both the collector and the payer.
6) **Economy** or **efficiency**: Cost of collection should be low, i.e. not exceed 5% of the revenue.
7) **Elasticity** or **flexibility**: The tax should change according to the prevailing conditions i.e. high during an economic boom.
8) **Productivity**: A good tax should be able to encourage effort and initiatives and should not discourage investment.
9) **Diversity/comprehensiveness:** It should have a wider source or base.

10) **Consistency:** Should be in line with national economic objectives, especially in allocation of resources.
11) **In built stabilizer:** It should have stability influence on the economy e.g. B.O.P and price stability.
12) **Non double taxation:** No income base must be taxed.

The four canons of taxation according to Adam Smith are;-

- Equity
- Certainty
- Convenience
- Economy.

FORMS OF TAXES:
These are to forms of taxes i.e. Direct and Indirect tax.

1. **Direct taxes:**

These are taxes that are levied by the central or local authority directly on income or property of individuals and the incidence of the tax rests on the tax payer concerned and cannot be shifted to other individuals.

TYPES OF DIRECT TAXES:

1. **Personal income tax;**
   This is tax charged on the income of individuals, household and firms e.g. PAYE
2. **Surcharge:**
   This is a form of direct tax that is imposed on very high income earners as an additional charge to raise government revenue and decrease income inequality in the country.
3. **Company or corporate tax**:
   This is a tax levied on the gains profits of companies.

4. **Capital gains tax:**
   This is the tax levied on financial assets whose values have appreciated from the time of their purchase to the time of their sale.
5. **Gift tax**: This is the tax levied on the gifts given to individuals or companies.
6. **Land tax**: This is a tax imposed on the ownership of land to break land monopoly.
7. **Graduated tax**: This is a tax levied by the government on the citizens according to their incomes and is based on the principle that everybody able bodied male adult should pay the tax.
8. **Capital levy**: This is a tax imposed on privately owned wealth.
9. **Estates duty or Death duty**: This is a tax imposed on the property of the deceased and is paid by the one who takes over the property when the transfer is being made it is systems called the capital transfer tax.

a) They are simple to understand and implement because a proper assessment is done by paying the tax.
b) They enable the government to raise revenue for her expenditure:
c) It is used by the government to re-distribute income i.e. through the use of a progressive tax the rich are taxed more than the poor which helps to decrease the economic gap.
d) They are used to fight inflation in the country. The high taxes charged help to decrease people’s disposable income hence decreasing aggregate demand and controlling demand through inflation.
e) They are flexible in nature i.e. the government can increase or decrease the amount of the taxes according to the performance of the economy.
f) The incidence of the tax is very clear i.e. the tax burden falls on the person the tax has been imposed and can not be shifted to another person.

g) It is easy to estimate the government tax revenue because the rates are fixed by a given period of time which facilitates government planning.
h) They are convenient to the tax payer i.e. the taxes are paid when the income is got e.g. employees pay PAYE at the end of the month after getting their salaries.
i) Direct taxes are equitable in nature i.e. people with low income levels pay taxes that are less than people with high income levels also people with the same income level pay the same tax.
j) It is easy to determine the people to be exempted from paying a tax unlike the indirect taxes.

Disadvantages of direct taxes:

i. High corporate taxes decrease profits which discourages production, re-investment and hinders the expansion of the firm.
ii. Direct taxes discourage hard work and productivity especial when they are progressive in nature.
iii. They are always an inconvenience to the tax payer when they are paid in lumpsum.
iv. They decrease the level of savings and consumption since the high taxes decrease people's disposable income.
v. They result into political resentment and sabotage leading to the unpopularity of the government.
vi. They are difficult to assess fairly because most of the tax payers are dishonest.
vii. They are expensive to collect, this is mainly because people are scattered all over the country and others are under subsistence production.
viii. The tax burden falls on very few individuals who have the income and are honest since majority are poor and unemployed.
ix. They can be inflationary in nature since high taxes may force workers to demand income high wages causing cost push inflation.

Indirect taxes:

These are taxes that are levied on goods and services in an economy and the incidence of the tax can be shifted by the tax payer to other people. They are **a.k.a.** out lays.

Types of Indirect taxes.

1. **Lumpsum tax:**
   This is a tax charged on the output of the firm at the end of the production period.
2. **Specific tax:**
   This is a tax charged as a fixed percentage per unit of output but not on the value of the output e.g. per metre, litre, etc.
3. **Advalorem tax:**
   This is a tax charged as a percentage basing on the value of the out put.
4. **Turnover tax:**
   This is a tax charged on the sales of retailers. This is sometimes called purchase tax.
5. **Excise duty:**
   This is a tax levied on home made goods and services.
6. **Consumption tax:**
   This is a tax charged on goods and services consumed by an individual.
7. **Commodity transaction levy:**
   This is a tax paid when one spends money, it is charged as a stamp duty.
8. **Octroi tax:**
   This is a tax charged on goods passing through a region to another.
9. **Sumptuary tax:**
   These are taxes charged on the consumption of commodities that are considered to be dangerous to human health to discourage their consumption.
10. **Customs duty:**
    These are taxes levied either on imports or exports

Import duty is a tax levied on commodities entering the country.

Export duty is a tax levied on goods exiting the country.

REASONS FOR IMPORT DUTY:

a. To protect the infant industries from foreign competition.
b. To raise revenue.
c. To control imported inflation.
d. To check on the importation of consumer goods.
e. To reduce the balance of payment.

ADVANTAGES OF INDIRECT TAXES:

i. They are difficult to avoid and evade since they are imposed on goods and included in the price of the commodity.
ii. They are easy to collect because they are levied on the commodities and producers and sellers deposit the returns to the government.
iii. They are used to protect people's health and morals especially the sumptuary tax.
iv. They are more convenient to the tax payer because they are only paid when one purchases a commodity.
v. They help to stabilize the balance of payment position of the country e.g. the import duty discourages excessive importation.
vi. They have a wider tax base since they are levied on the variety of commodities. This helps to increase the tax revenue of the country.
vii. They are flexible in nature i.e. can be increased or decreased depending on the government requirement.
viii. Import duties can be used to protect infant industries against foreign competition.
ix. They are not discriminative since they are paid by everyone who consumes.
x. They are not a disincentive to effect and initiative since they are not felt directly by the consumers.

DISADVANTAGES OF INDIRECT TAXES:

i. They do not follow the principle of equity i.e. both the poor and the rich pay the same tax.
ii. They are inflationary in nature i.e. they increase the cost of production which results into cost push inflation.
iii. They discourage production and employment especially when imposed on final products which increases their prices thus decreasing their demand and causing unemployment.
iv. They lead to malpractices like smuggling especially where there is poor book keeping by the traders. Therefore the revenue id difficult to determine which affects planning.
v. They lead to misallocation of resources where they are shifted from production of highly taxes products to the production of less taxed products even if they are not essential to society.
vi. High import duties discourage inflow of goods from other countries leading to scarcity of such commodities which affects the standard of living of the people.

VALUE ADDED TAX:

This is the tax levied at each successive stage as a fixed percentage on the value gained by all goods and services. It is charged as a percentage of the difference between output value and the input value at each stage of production.

TERMS USED UNDER VAT:

a. Zero rated goods:
   These are commodities which are liable to pay VAT but the rate is 0%.
b. Exempt goods.
   These are goods on which traders are not supposed to pay tax and incase the tax is paid, it is refunded at a later stage.
c. Tax concession:

This refers to any favourable condition given by the government to investors during taxation, they include:-

i. Tax invoice:

This is a document that shows specific details of transaction and the different activities that have been taxed.

The tax invoice is always required to support claims for refund in case the tax payer was not supposed to pay.

ii. Tax liabilities:

This refers to the amount of money a tax payer is expected to pay in a given period of time e.g. in a given year.

iii. Tax havens:

Refers to a region or a country which offers low tax rates with an aim of attracting foreign investors.

ADVANTAGES OF VAT:

1. It helps to check on double taxation since it is levied at every successive stage.
2. It minimizes tax evasion because of the limited loopholes.
3. It encourages book keeping which promotes efficiency among the traders.
4. Reduces corruption since payment is made directly on the account of the tax payment.
5. It is economical because of the less expenses involved.
6. There is a possibility of tax credit this is where a registered trader is allowed to use the VAT revenue for system before submitting it to the URA.
7. It is not a disincentive to resource allocation because the tax burden can be shifted to the consumers.

DISADVANTAGES OF VAT:

a) It is complicated to understand hence causing a lot of resistance.
b) It decreases the economic welfare of people by decreasing their purchasing power.
c) It is inflationary in nature. Producers increase prices for the products in response to VAT.
d) High rates of VAT scare way investors leading to limited capital inflow.
e) It involves a lot of costs advertising VAT.
f) It is a disincentive to consumption since it is paid by people who buy goods.

TAX AVOIDANCE AND TAX EVASION:

Tax avoidance is the ability of the tax payers to exploit the loopholes or weaknesses in the tax system and he pays less or no tax at all. While
Tax evasion is the deliberate refusal by the tax payer to pay tax assessed/ levied on him or her.

REASONS FOR TAX EVASION IN UGANDA

i. Low income levels, the poor always evade taxes because they do not have the capacity to pay.
ii. Inadequate information about the taxes, most Ugandans do not have enough information about the uses of taxes and they have no justification to pay.
iii. Discontent about government provision of services.
iv. Unfair assessment and the poor methods of tax collection.
v. High levels of smuggling in the country, some traders evade taxes especially import duties because they know there are weaknesses in tax officials especially at the boarders.
vi. Inefficiency on the side of the government during tax assessment and collection.
vii. Desire by some people to retain all their earnings as profits especially traders.
viii. Existence of political instability in some parts of the country which don't allow people to settle down to produce so as to be able to pay tax.
ix. High levels of corruption among the tax officials that sometimes guide the tax payers on how to evade and avoid taxes.

x. Opposition to the government where the population tends to sabotage government policies including paying tax.

THE TAX BASE:

This is the entity on which a tax is levied. These include ones income, wealth, land and other economics activities.

REASONS FOR LOW TAX REVENUE IN LDCS:

1. Low levels of economic activities hence a small tax base.
2. High rates of tax evasion and avoidance.
3. High levels of tax concessions to attract foreign investors e.g. tax holidays, tax exemptions etc.
4. Low levels of income leading to low savings and investment thus a narrow tax base.
5. High levels of corruption and embezzlement by individuals involved in tax collection and assessment. Most of the tax revenue is embezzled by tax collectors.
6. High costs involved in tax assessment and collection.
7. Inadequate information mainly about people's wealth. Most people do not reveal their in and it becomes difficult for the government to determine the tax level.
8. Existence of a large subsistence sector. It's hard for the government to raise tax revenue from the people involved in the informal and subsistence sector.
9. Existence of a small industrial sector in the country.
10. Lack of enough political will by the people. Such people are always discouraging others from paying tax especially the opposition.
11. Existence of political instability in the country therefore people are not settled down to produce hence creating a narrow tax base.
12. Poor infrastructure e.g poor roads which makes some areas inaccessible.
13. High levels of unemployment and therefore a small remains to be able to pay the tax.
14. Limited trained personal to assess and collect the tax.
15. High population growth rate leading to high dependence burden hence narrowing the tax base.
16. Limited diversification of economic activities hence limiting the number of sectors to be taxed by the government.

PROBLEMS FACED BY TAX COLLECTORS IN UGANDA

a) High level of tax evasion and avoidance.
b) Shortage of skilled man power.
c) The low taxable capacity.
d) Poor infrastructure.
e) High rates of corruption and embezzlement of funds.
f) Political instability in some parts of the country.
g) Political interference i.e. government interfering in issues of URA.
h) Resistance from the public against tax payment.
i) Difficulty in identifying taxable sources.
j) Frequent changes in employment income.
k) The narrow tax base.

WAYS OF IMPROVING TAX REVENUE IN UGANDA.

i. Diversifying the economy to widen the tax base.
ii. Restricting smuggling by strengthening the anti smuggling unit.
iii. Improving political climate to enable people settle down, participate in production and generate income.
iv. Encouraging investment especially in the industrial sector to increased production and output.

v. Developing social, economic infrastructure e.g. construction of roads to make many areas accessible for taxation.
vi. Fighting corruption and embezzlement so as to increase the subsistence sector and increase the number of sectors that pay tax.
vii. Encouraging commercialization so as to decrease the subsistence sector and increase the number sectors that pay tax.
viii. Fighting corruption and embezzlement so as to decrease leakages in the tax collected.
ix. Reducing tax concessions that are given to the private investors especially the foreign investors in the country.
x. Creating a conducive environment so as to encourage investment in the country which increases production and the level of employment.
xi. Promoting better services to the public using the tax revenue collected so as to encourage people to continue paying tax.

TAXABLE CAPACITY.
This is a term used in reference to either an individual or a nation.

Taxable capacity of an individual is the extent to which a tax payer is able to pay a tax assessed on him/her and yet remains with enough disposable income to enable him live a descent life to which him and his family are accustomed.

Taxable capacity of a nation refers to the extent to which a government can levy taxes without causing adverse effect to the tax payer. Or the extent to which the government levies taxes without producing or causing socially, politically and economically harmful effects.

DETERMINANANTS OF TAXABLE CAPACITY OF AN INDIVIDUAL:
i. Wealth of an individual.
ii. Number of dependants.
iii. Employment status of an individual.
iv. Official expenditure of an individual.

DETERMINANTS OF TAXABLE CAPACITY OF A NATION
i. Wealth of a nation.
ii. Popularity of the government.
iii. Benefits derived from the government.
iv. Nature of taxes imposed i.e. are they accepted or rejected.
v. Level of income distribution.
vi. People's attitude towards tax payment.
vii. Employment levels in the country.
viii. Tax rates imposed, high tax rates lead to tax evasion and low taxable capacity.
ix. Political atmosphere / climate.
x. Level of monetization of the economy.

TAX RATES:
This refers to the percentage of tax on either income or expenditure power of an individual.

The tax rate can either be progressive, proportional, regressive or digressive tax.

PROGRESSIVE TAX:

This is the one whose rate increases with increase in income level. Or spending power of an individual i.e. the higher the income the higher the percentage deducted as a tax i.e. PAYE

Progressive tax is the system of taxation where the tax rate increases with increase in taxable income of an individual.

ADVANTAGES:

i. It increases government revenue.
ii. It helps in decreasing income inequality.
iii. It enables people to pay according to their ability.

DISADVANTAGES:

i. It's a disincentive to hard work.
ii. It discourages savings because tax rate increases as income increases.
iii. It tends to discourage both local and foreign investors.
iv. It causes resistance and resentment from the rich.

PROPORTIONAL TAX:

This is the tax whose rate remains constant irrespective of change in income of spending power of an individual.

ADVANTAGES

a. Encourages savings and investment.
b. Encourages hard work.
c. It's easy for every one to calculate and understand since the percentage is constant.
d. Makes the government unpopular.

DISADVANTAGES:

a. Increases income inequality because the poor and the rich are taxed at the same rate.
b. It is less productive inform of revenue raised by the government.
c. The burden is bigger on the low income groups as to the high income earners.

REGRESSIVE TAX:

This is the tax whose tax rate declines as the taxable income increases i.e. the percentage of the tax is higher on the low income earners and low on the rich.

EFFECTS:

i. Widens income inequality.
ii. Creates low tax revenue.
iii. Encourages hard work since the rich pay a lower rate.
iv. Doesn't make the government unpopular among the rich.

DEGRESSIVE TAX:

This is the one whose rate increases with increase in income up to a certain point beyond which the tax rate remains constant irrespective of the change in income.

EFFECTS:

i. It increases government revenue especially when still progressive.
ii. It decreases income inequality when still progressive.
iii. It exploits the poor when proportional.
iv. It discourages savings when progressive.

Illustration

INCIDENCE, IMPACT AND EFFECT OF A TAX:

Tax impact refers to the initial resting point of the tax i.e. the person company or transaction on which the tax is imposed by the government. However the individual may not shift the tax either backward or forward.

Forward shifting of a tax is where the tax payer transfers the tax burden to the consumer through increasing prices e.g. to retailer who increases prices for commodities after a tax is levied.

Backward shifting of a tax is where the tax that has been levied i.e. the ultimate person to bear the tax burden after it has been imposed.

INCIDENCE OF A TAX

This refers to the final resting point of the tax has been levied i.e. the ultimate person to bear the burden after it has been imposed.

Effect of the tax:

Refers to the repercussions of the tax on work, effort, investment, AD, economic growth, etc.

Dead weight tax:

Is a tax which when imposed causes the tax payer to abandon the activity which forms the tax base.

Tax burden is what is finally felt by a person who pays the tax at the last stage of distribution.

How the Producer and the consumer share the tax incidence.

Sharing of the tax incidence between the producer and consumer depends on the price elasticity of demand of the commodity.

1. If its inelastic:

   If demand for the commodity is price inelastic, the consumer takes the biggest portion of the tax and the producer takes a small proportion as illustrated below;-

2. If demand is elastic:
   The producer takes a bigger portion of the tax and the consumer takes a smaller portion as illustrated.

3. If demand is unitary.

4. If demand is perfectly inelastic:

5. If demand is perfectly elastic:

REASONS INCOME ITS NECESSARY TO LEVY DIFFERENT FORMS OF TAXES:

a. To widen the tax base in order to raise more tax revenue for development purposes.
b. To touch the wealth of individuals who are not taxed on monetary income levels e.g. property owners, landlords, etc.
c. To influence resource allocation so as to promote efficiency.
d. To cover up for the uncertain revenue sources.
e. To compensate for the loss of revenue through tax evasion and avoidance.

f. To help the government fulfill many of her obligations so as to minimize dependence on foreign sources or revenue.
g. To promote equitable income distribution especially using direct taxes and not depending on indirect taxes alone.
h. To minimize disincentives to hard work through charging indirect tax.
i. To achieve some desirable economic and social goals e.g. controlling inflation decreasing imports, solving balance of payment problems, etc.

REFORMS TO REDUCE HEAVY RELIANCE ON INDIRECT TAXES.

1. Introduction of new direct taxes e.g. land tax.
2. Increasing the present income tax rates to raise more revenue from direct taxes.
3. Promoting proper record keeping so that all taxable businesses can pay the direct taxes.
4. Expanding the individual sector by encouraging investment in the country.
5. Decreasing the level of unemployment by training people in relevant skills.
6. Decreasing the subsistence sector and commercializing the economy.
7. Fighting corruption by decisively dealing with corrupt individuals and making them pay back the embezzled money.
8. Fighting income inequality by taxing the rich more than the poor.

REASONS FOR THE REENT INCREASE IN TAX RETURNS IN UGANDA

1. Increased level of individual development which was led to increase in the corporate tax.
2. Agricultural modernization which has led to increased productivity and improved taxable capacity of the farmers.
3. Improved tax administration by URA which has led to decreased tax evasion and avoidance hence realizing more tax revenue.
4. Liberalization of the economy which has increased production, expanded the tax base and therefore more tax revenue is realized.
5. Increased employment levels which has resulted into more incomes of the people.
6. Improved political climate which has made many areas settled to produce and pay tax, it has also eased tax assessment, administration and collection.
7. Improved infrastructure which has improved transport and communication for both the tax payers and officials.
8. Increased commercialization of the economy which has decreased the level of the sub- sector and increased the producer's income.
9. Increased diversification especially the export sector which has widened the tax base.
10. Decreased corruption which has decreased the amount of money that leaks out the system.
11. Privatization of the economy which has resulted into efficiency of the privatized enterprises hence making them more efficient to earn more income and pay tax.

SUBSIDIES:

These are payments by the government to cover part of the costs involved in production or consumption.

ADVANTAGES:

a. Decreases prices for the final goods leading to improved welfare of the consumer.
b. Decrease the cost of production.
c. They attract increased investment in the sectors that are subsidized.
d. They increase employment opportunities as investment expands.
e. Decrease income inequality especially when put on goods consumed by the poor.
f. They attract public support especially when most of the essential goods are subsidized.
g. They help to protect home infant industries.
h. They enable the poor to purchase goods which would have been expensive for them.

DISADVANTAGES:

1. They increase government expenditure both in subsidizing the consumers and the producers.
2. They decrease the tax base since the producers are subsidized in the production process.
3. They discourage hard work since consumers expect to be supported by the government.
4. They increase government tax for some sectors to raise revenue to subsidize the poor.
5. Increases the need for foreign aid so as to raise revenue to give subsidize.

FISCAL POLICY

Refers to the deliberate government policy to use taxation, and government expenditure programs to regulate the level of economic activities.

OBJECTIVES OF THE FISCAL POLICY:

1. To obtain price stability. This involves decreasing the rate of inflation or and deflation by regulating the amount of money in circulation through increasing taxes on income and decreasing government expenditure to control demand pull inflation.
2. To increase the rate of economic growth through influencing production levels.
3. To obtain and maintain fair income distribution, this is done through a progressive tax system and spending more on projects that support the poor.
4. To protect the domestic infant industries this is done through protecting these industries against foreign competition by increasing import duties on the finished products and increasing government expenditure to support the infant industries.
5. To improve balance of payment position. This is by decreasing the export duties and subsidizing the export sector to increase the level of capital inflow while at the same increasing import duties to decrease foreign exchange expenditure on imports.
6. To raise government revenue, achieved through taxation and borrowing.
7. To improve socio-economic infrastructure, achieved through increased government expenditure on infrastructure and increased borrowing to support heavy projects.
8. To increase employment opportunities, achieved through increased government expenditure on development projects.
9. To decrease poverty levels and increase the quality of life of the population. This is done mainly through increasing government expenditure on projects that generate income for the poor people.
10. To attain balanced regional development. This is through increasing government expenditure on regions considered to be back wards.
11. To discourage consumption of demerit goods
12. To influence investment levels through tax relief.
13. To achieve the desired political objectives.
14. To control monopoly through taxation.
15. To influence resource allocation.

PUBLIC DEBT AND NATIONAL DEBT.

Public debt refers to the total borrowing by the central government, local authorities and public corporations both within and outside the economy.

A national debt refers to the total borrowing by the central government both within and outside the economy.

Or

A national debt refers to what the central government owes to citizens lenders both within and outside the economy.

TYPES /FORMS OF PUBLIC DEBTS

a. **Internal debt**

Refers to the total borrowing from within the economy by the central government, local authority, and public corporations e.g. by selling of securities.

b. **External debt:**

Refers to the total borrowing from outside the economy by the central government, local authorities and public corporations.

c. **Reproductive/self liquidating debt:**

Is the one where borrowed funds are invested in productive activities which generate income that can be used to pay the interest and the principle.

d. **Dead weight debt/Non self liquidating:**

This is the one where the borrowed funds are allocated to non-production activities that cannot generate income to service the debt.

e. **Funded debt:**

This is a long term debt for which there is no redemption date but the borrower keeps on paying interest on the principle.

f. **Unfunded /floating debt:**

This is a short term debt whose time of repayment is known and specified.

g. **Short term debt:**

This is the one whose repayment is done within a period of 1 year.

h. **Medium term debt:**

This is the one whose repayment period is in less than 10 years

i. **Long term debt:**

Repayment period is over 10 years.

j. **Soft loan:**

This is the one on which a low interest rate is charged and a long grace period is given.

k. **Hard loan:**

This is the one on which a high interest rate is charged and a short period of grace is given.

l. **Consul loan:**

This is a type of public debt where repayment has been postponed due to agreed terms between the lender and the government that is borrowing.

CAUSES OF PUBLIC DEBT/ REASONS FOR BORROWING:

1. To raise revenue for providing services to the population/ debt financing.
2. To cover the savings – investment gap. Borrowing is necessary in order to supplement the local savings so as to meet the investment needs of the country.
3. To fill the foreign exchange gap/ to finance the B.O.P deficit in the short run. Countries with low earnings from exports and excessive expenditure on imports face a foreign exchange gap therefore its necessary to borrow for the country to be able to import what it cannot produce.
4. To cover the manpower gap, there is inadequate local skilled manpower and therefore the need for importation of foreign expatriates and funds to pay them.
5. To close the technology gap, the borrowed funds are used for importing advanced technology in order to facilitate production in the country.
6. To avoid the negative effects of increasing taxes in the country in the short run.

7. To overcome disasters and other emergencies like famine, floods.
8. To cover a deficit in the government budget. This is common where government expenditure exceeds expected government revenue in a given financial year.
9. To finance development projects that require huge sums of money. Such projects cannot be funded using revenue raised from taxes we necessitates borrowing e.g. construction of dams, roads.
10. To repay interest and principle of the old debts. This involves borrowing from a cheaper source in order to repay outstanding debts that were sourced from an expensive source.
11. To supplement the tax revenue because of the narrow tax base. low developed countries raise little revenue from taxes which can only be supplemented through borrowing.
12. To decrease money in circulation. Borrowing is used as a tool of restrictive monetary policy where money is withdrawn from circulation through selling of securities, bonds, etc.
13. To achieve and maintain a given level of employment.
14. To sustain the market by leaving citizens with adequate disposable income.

PROBLEMS ASSOCIATED WITH PUBLIC DEBTS.

1. It increases problems of external economic dependence.
2. It worsens the balance of payment problems due to excessive expenditure abroad in form of paying the borrowed funds and interest.
3. The repayment of the external debts limits the capital accumulation levels in the country because of excessive capital outflow.
4. It shifts the burden of clearing the debt to the future generations.
5. Some loans are accompanied by unfavourable conditions e.g. dictating the project to be financed or employing expatriates from the lending countries etc. sometimes this may not be the priority of the government.
6. Internal borrowing decreases aggregate demand which discourages investment in the country.
7. It encourages laziness because of expecting assistance from other countries.
8. During the repayment of the loan, the government is increased to cut down her internal expenditure leading to low standards of living in the country.
9. External borrowing is inflationary in nature especially where the funds are allocated to consumption expenditure; this increases money supply which increases a demand hence demand pull inflation.
10. Failure to return the borrowed resources makes the government unpopular.

Revision questions:

i. Distinguish between the funded debt and an unfunded debt.
ii. Explain the merits and demerits of borrowing.

PUBLIC DEBT MANAGEMENT

This is the process of obtaining, utilizing and repayment of the public debt. It is the action of the monetary authority to regulate the size and structure of the outstanding debt.

OBJECTIVES OF PUBLIC DEBT MANAGEMENT

a. To mobilize external resources.
b. To make investment attractive.
c. To influence the prevailing interest rate.
d. To minimize the cost of servicing of debt by the tax payer.

TERMS USED UNDER PUBLIC MANAGEMENT

1. Debt contracting
   This refers to obtaining a loan from the lender.
2. Debt servicing: This means paying interest on a loan.
3. Debt redemption: This is the repayment of the whole debt in form of the principle and the interest.

4. Debt retirement: This is the time when the debt must be paid by the borrower.
5. Years of Grace: This is the period between getting a loan and when debt servicing begins.
6. Interest rate loans: This is a loan given with favourable conditions e.g. very long time of grace and very low interest rate.
7. Debt financing: This means financing government expenditure through borrowing.
8. Debt conversion: This involves borrowing from a cheaper source to clear the debts that was caused by the previous regions due to political misunderstanding etc.
9. Redeemable debts: This is one where the total amount borrowed and interest should be paid within a specific period of time.
10. Unredeemable debts: This is one on which interest is paid without repayment of the initial amount borrowed.

METHODS OF DEBT REPAYMENT:
1. Raising revenue from taxation.
2. Negotiation for a debt relief (debt waiver). This is especially for the long outstanding debts.
3. Using foreign exchange reserves kept by the central bank.
4. Selling public enterprises to raise revenue. This involves selling local and foreign investments e.g. through privatization or disinvestment.
5. Selling government securities like bonds and treasury bills.
6. Using profits raised from government investment e.g. export of electricity.
7. Using grants or gifts from foreign resources.
8. Using a sinking fund. This is a fund set a side by the government for the purposes of using it to clear debts. It accumulates year after year.
9. Debt conversion.
10. By using a surplus government budget where the expected revenue is greater than the government's planned expenditure in a financial year.
11. Debt repudiation a deliberate refusal to pay the debt or money owed to the lender.

Note: Distinguish between debt financing and taxation financing.

Debt financing refers to the financing of government expenditure using borrowed funds while taxation financing refers to financing the government expenditure using money raised from taxes.

ADVANTAGES OF DEBT FINANCING OVER TAXATION FINANCING.

a. Borrowing does not have a negative political effect like making the government unpopular while taxation can make a regime unpopular.
b. It's sometimes easier and quicker to raise revenue from borrowing than taxation which makes it hard to raise revenue.
c. Borrowing helps to realize large sums of money at a go compared to taxes where revenue is limited and collected in bits.
d. It supplements tax revenue that tends to be low because of the narrow tax base.
e. Through borrowing the government makes use of both foreign and domestic sources in raising revenue compared to taxation that only raises internal revenue.
f. Debt financing does not involve costly methods of production compared to tax financing where collection is expensive.
g. Borrowing doesn't have a depressing effect on the economy compared to taxation which disposes people's disposable income.
h. The burden of paying the borrowed funds is not felt in the short run because it's always transferred to the later generation yet the burden of taxation is always felt in the short run.

REASONS WHY UGANDA'S PUBLIC EXPENDITURE HAS INCREASED.
1. Because of the need to provide services to the increasing population e.g. education.
2. High expenses incurred in constructing infrastructure e.g. roads, railways.

3. Corruption and embezzlement of funds allocated to various sectors.
4. Debt servicing.
5. Big number of government employees i.e. paying them wages.
6. High expenditure on subsidizing producers and consumers.
7. The need for strong regional co-operation which requires of country to contribute towards regional development.
8. High importation of goods and services instead of capital goods.
9. Financing of natural calamities.
10. Due to the democratization process e.g. elections.
11. Administrative costs e.g. increased number of districts.
12. Because of employing expatriates who have are paid highly.
13. Frequent wars.
14. The large cabinet.
15. Many embassies

WAYS OF REDUCING UGANDA'S PUBLIC EXPENDITURE.

1. Directing expenditure to priority sectors e.g. agriculture, industry, etc.
2. Retirement of civil servants and demobilization of the army.
3. Creating peace to cut down expenditure on war.
4. Negotiating for debt cancellation so as to decrease the debt burden.
5. Introduction of cost sharing e.g. in public universities, hospitals, etc.
6. Privatization of public enterprises to decrease the burden of the government.
7. Training local manpower to decrease dependence on or of expatriates.
8. Encouraging family planning to decrease the dependence burden on government.
9. Restrictions on importation especially for luxurious commodities.
10. Reducing government departments e.g. the size of the cabinet, districts, etc.
11. Decentralization and decrease expenditure at national level.
12. Controlling of wages.

WAYS OF EXPRESSING A PUBLIC DEBT.

The debt burden is expressed as a percentage of different variables e.g. total population, total labour force, total tax revenue, etc. the internal debt is expressed as.

a. The percentage of the total public debt to the total population of the country.
   i.e. $\frac{\text{Total public debt}}{\text{Total population}} \times 100$

b. The percentage of the total public debt to the total labour force of the country
   I.e. $\frac{\text{Total Public debt}}{\text{Total labour force}} \times 100$

c. The percentage of the total public debt to the total labour force of the country
   I.e. $\frac{\text{Total public debt}}{\text{Total tax revenue}} \times 100$

d. The percentage of the total public debt to the total GNP of the country I.e. $\frac{\text{Total public debt}}{\text{Total GNP}} \times 100$

e. The percentage of the total public debt to the total foreign exchange earnings
   I.e. $\frac{\text{Total public debt}}{\text{Total foreign earnings.}} \times 100$

THE NATIONAL BUDGET

This is a statement showing an estimate of revenue the government intends to raise and how it plans to use that revenue in a financial year.

It is an estimate of expected government revenue and estimated government expenditure in a financial year.

CONTENTS/COMPONENTS OF THE GOVERNMENT BUDGET/NATIONAL BUDGET.

1. An outline of estimated government revenue.
2. An outline of estimated government expenditure in a financial year.
3. An indication of the sources of government revenue e.g borrowing, taxation.
4. An indication of the main areas of expected government expenditure in the financial year.
5. A review of the previous achievements in the various sectors of the economy.
6. An indication of changes in prices of various products and resources.
7. The balance of payment of the country.
8. An indication of changes in taxes to be paid in the financial year.
9. The total gross domestic products and per capita income of the country.
10. The economic growth rate in the country and the desired growth rate in the next financial year.
11. The rate of inflation.
12. The exchange rate in the country.
13. The performance of various sectors and ways of improving such sectors performance.
14. Expected foreign funding i.e. the total amount expected from loans and grants.
15. The clear indication of government's role in the public sector compared to the role of the private sector.

OBJECTIVES OF THE NATIONAL BUDGET

a. To decrease unemployment by creating more employment opportunities.
b. To improve the rate of economic growth through encouraging investment. Developing infrastructure etc.
c. To protect home infant industries against competition from foreigners.
d. To improve the balance of payment position of the country through planning to increase exports and to decrease the import expenditure.
e. To control inflation in the country.
f. To raise revenue for providing social services through putting in place taxes and identifying other non-tax sources.
g. To decrease income inequality in the country through progressive taxation or subsidizing the poor.
h. To discourage the consumption of harmful products.
i. To re-allocate resources to essential areas from the non-essential sectors of the economy.

ROLE OF THE NATIONAL BUDGET IN AN ECONOMY

1. It helps to influence the level of investment/ resource allocation and promote economic growth. Attractive investment policies are put in place during the budget to attract high investment in the country e.g. tax holidays, tax concessions.

2. It helps to protect domestic infant industries/ firms against competition. This is done through increasing the import duties and subsidizing the infant firms so that they can grow and compete favourably.
3. It's used to increase employment opportunities in the country. The budget identifies various projects to be invested in so as to increase employment opportunities e.g. agriculture, infrastructural development, etc.
4. Helps to reduce income inequality in the economy. This is through encouraging income redistribution policies like progressive taxation, subsidizing the poor.
5. It helps to improve the balance of payment position of the country. This is by decreasing the imports to save the scarce foreign exchange and encouraging large scale production for the export market.
6. Used to protect the economy from inflation/ helps in attaining and maintaining price stability. This is by encouraging production of goods and services to avoid scarcity in the economy.
7. Helps to manage public debts.
8. Enables the government to raise tax revenue for her expenditure.
9. It helps to influence balanced regional development in the economy. During the budget, the government fairly allocates resources to facilitate development of different regions.
10. It's used as a tool of attracting public support especially when it shows better performance in the previous years and the government promises to do better.
11. Used to attract inflow of resources coming from out e.g. foreign Aid
12. Helps in reducing economic dependency.
13. Helps in regulation of government expenditure.
14. Helps to discourage consumption of harmful/ demerit/undesirable products.

THE BALANCED AND UNBALANCED BUDGET.

A balanced budget is one where estimated government revenue is equal to the estimated government expenditure in a given financial year while

An unbalanced budget is one where estimated government revenue is either greater or less than the estimated government expenditure in a given financial year.

NB: An unbalanced budget can either be a surplus or deficit budget.

A surplus budget is one where the estimated government revenue is greater than the estimated government expenditure.

A deficit budget is one where the estimated government revenue is less than the estimated government expenditure.

CAUSES OF PERSISTNENT BUDGET DEFICITS IN UGANDA.

1. Existence of political instability in the country causing high military expenditure on equipment, etc.
2. The narrow tax base
3. Low taxable capacity.
4. Persistent high levels of corruption and embezzlement
5. High administrative expenses on civil servants and politicians.
6. Limited non tax sources of revenue.
7. High expenditure on unproductive activities like celebration.
8. High/ rising costs on infrastructure development.
9. Weak tax administration.
10. Persistent/ heavy debt servicing and repayment of principle.
11. Frequent natural disasters that require heavy emergency funding.
12. Heavy expenditure on external commitments.
13. Over ambitious planning.

METHODS OF FINANCING A DEFICIT BUDGET

a. Borrowing internally and externally.
b. Appealing for grants and donations.
c. Disinvestment mainly through privatization of local and foreign enterprises.
d. Printing and issuing money.
e. By special assessment.
f. Use of compulsory savings e.g. NSSF
g. Through national lottery.

STEPS TO DECREASE BUDGET DEFICITS IN UGANDA.

a. Improving the political climate so as to increase investment and production.
b. Putting in place policies to restrict high population growth rate through family planning.
c. By widening the tax base and taxable capacity of the country.
d. Fighting corruption and embezzlement through enforcing strict laws.
e. Developing industries to increase the export value and earn more foreign exchange from exported products hence earning more from abroad.
f. Encouraging progressive taxation to raise revenue from the rich.
g. Widening non tax sources of revenue.
h. Improving the level of technology to increase efficiency in production.
i. Diversification of the economy to increase production.
j. Widening market through regional economic integration like EAC, COMESA.
k. Improving the level of infrastructure to allow investments.
l. Fighting inflation to attain price stability.
m. Further privatization of public corporations.
n. Encouraging commercialization to increase production.
o. Strengthening the tax administration.
p. Decreasing expenditure on politicians and civil servants.

REASONS WHY THE GOVERNMENT DELIBERATELY PLANS FOR AN UNBALANCED BUDGET.

1. **Deficit budget.**
   - To encourage investment in the country, private investors are attracted to undertake investment in areas where the government is unable to cover because of the deficit.
   - To be able to get foreign aid from donor countries.
   - To increase AD and stimulate production through encouraging people to increase the level of resource exploitation.
   - To avoid the negative effects of taxation.
   - To win political support for the existing government.
   - Ensure price stability by increasing production of scarce goods.
   - Encourage increased resource exploitation for economic growth and development.
   - Encourage employment opportunities by planning to develop under developed projects.
   - To close a deflationary gap or decrease recession.
2. **Surplus budget.**
   - To give foreign aid to poor countries.
   - To accumulate reserves in form of gold or foreign Exchange reserves.
   - To invest in securities of capital nature both within and outside the country.
   - To decrease the amount of money in circulation by decreasing government expenditure.
   - To check on inflation in the country by cutting down government expenditure or by increasing taxes on income.

Note:

1. Distinguish between recurrent expenditure and capital expenditure.

   Recurrent expenditure refers to the day to day spending of government aimed at maintaining existing capacities e.g. wages, rates, rent, interest on national debt etc. while **Development expenditure** is expenditure by the government on capital goods/ investment estimated projects for purposes of expanding / creating capacities to generate more goods and services e.g. setting up hospitals, schools and other forms of infrastructure.