Public Expenditure

Multiple Choice 1

- Fiscal policy involves changes in both
  a) the budget balance and the balance of payments
  b) interest rates and the supply of credit
  c) the money supply and the exchange rate
  d) government spending and tax revenue

✓ Can you explain your answer?

Multiple Choice 2

- Which one of the following is an example of expansionary fiscal policy?
  a) A reduction in interest rates
  b) An increase in the budget deficit
  c) An increase in the money supply
  d) An increase in tax rates

✓ Can you explain your answer?

Multiple Choice 3

- All other things being equal, a substantial cut in the rate of income tax in the short run is most likely to reduce
  a) inflation
  b) unemployment
  c) spending on imports
  d) the government budget deficit

✓ Can you explain your answer?

Multiple Choice 4

- Which one of the following is the best example of fiscal policy having a direct supply-side effect?
  a) An increase in the money supply leading to greater output
  b) A reduction in income tax boosting consumption and the supply of consumer credit from banks
  c) A reduction in interest rates boosting investment and the productive potential of the economy
  d) Government expenditure on retraining schemes increasing factor mobility

✓ Can you explain your answer?

4.5.1 Public expenditure	a) Distinction between capital expenditure, current expenditure and transfer payments b) Reasons for the changing size and composition of public expenditure in a global context c) The significance of differing levels of public expenditure as a proportion of GDP on: o productivity and growth o living standards o crowding out o level of taxation o equality
4.5.2 Taxation	a) Distinction between progressive, proportional and regressive taxes b) The economic effects of changes in direct and indirect tax rates on other variables: o incentives to work o tax revenues: the Laffer curve o income distribution o real output and employment o the price level o the trade balance o FDI flows
4.5.3 Public sector finances	a) Distinction between automatic stabilisers and discretionary fiscal policy b) Distinction between a fiscal deficit and the national debt c) Distinction between structural and cyclical deficits d) Factors influencing the size of fiscal deficits e) Factors influencing the size of national debts f) The significance of the size of fiscal deficits and national debts

UK Government Spending

How government spending and taxation can affect the pattern of economic activity

- Public expenditure entails government spending to pay for the needs of society such as health, education, infrastructure etc.

- We can distinguish between:
- Current expenditure – short-term spending on day to day running of the country e.g. wages, consumables etc.
- Capital expenditure – long-term spending on assets e.g. hospitals, schools, roads, infrastructure etc.
- Transfer payments are a redistribution of income for which no good or service is provided in return e.g. benefit payments

Reasons for the changing size and composition of public expenditure in a global context

- Changing incomes, such as demand for many state-provided services is income elastic
- Changing age distributions – ageing populations in many developed countries result in increased demands on healthcare
- Changing expectations – new technology in services such as health and education results in increased expectations
- The financial crisis – this has led to an increased proportion of public expenditure being spent on debt interest in many countries.

Undesirable outcomes of public expenditure

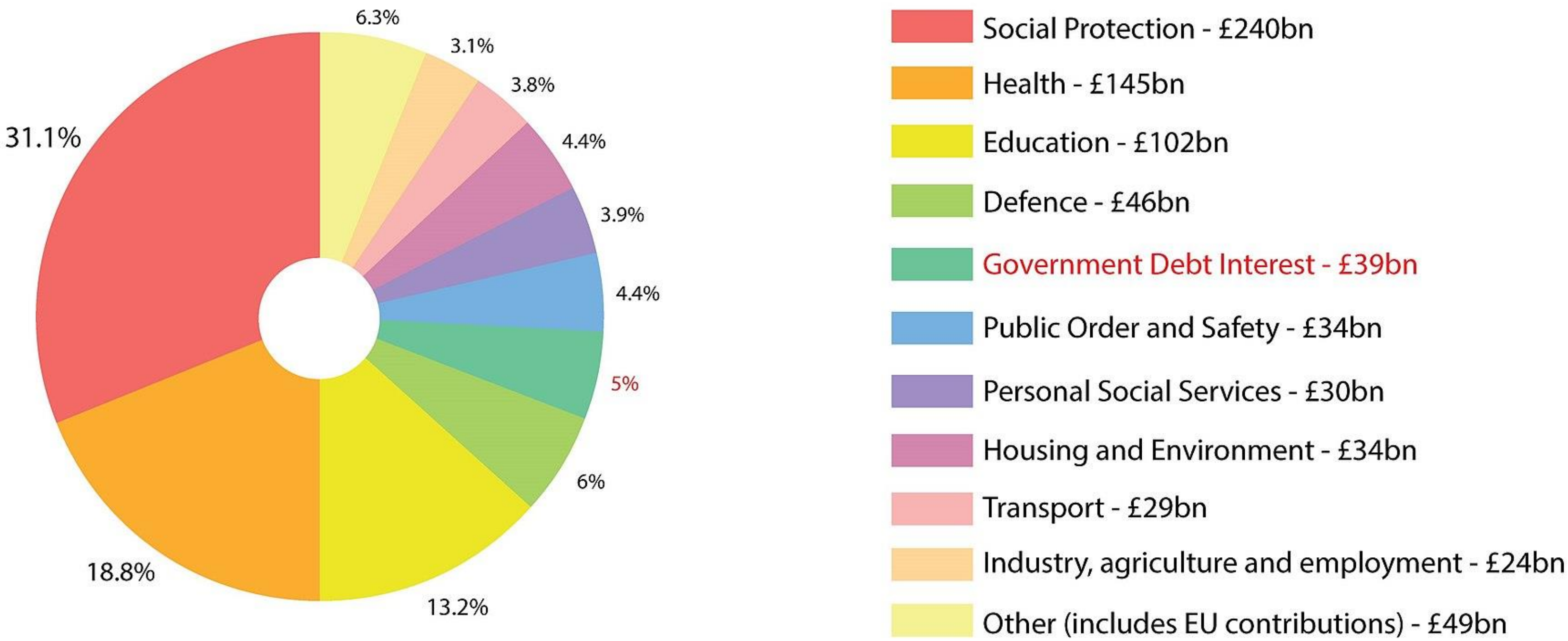
- Crowding out – two types may be identified: resource or financial crowding out.
- Resource crowding out occurs when the economy is operating at full employment and the expansion of the public sector means that there is a shortage of resources in the private sector.
- Financial crowding out arises when the expansion of the state sector is financed by increased government borrowing. This causes an increased demand for loanable funds which drives up interest rates and crowds out private sector investment.

Undesirable outcomes of public expenditure

- Low productivity and a low rate of economic growth – this occurs because the state sector is not motivated by the profit motive and so there may be little incentive to increase efficiency.

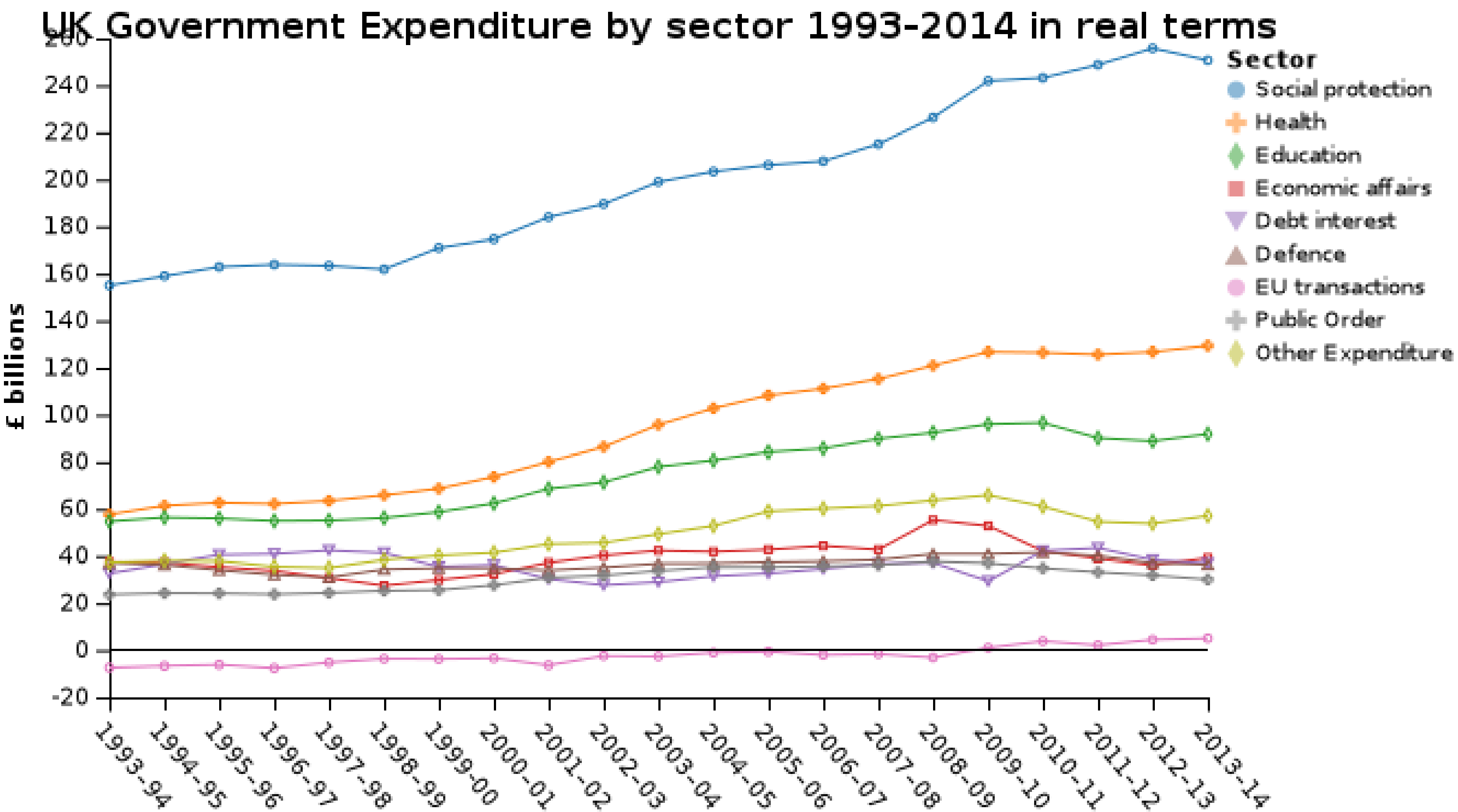
- An increase in the national debt – if there were successive years in which there was a budget deficit, this would increase the size of the national debt. In turn, this would result in increased interest payments on the national debt in the future which may mean that less public expenditure is available for spending on public services such as new schools and hospitals. On the other hand, if there is increased public expenditure on infrastructure, transport, the health service and on education

United Kingdom 2016-17 Government Expenditure



Expenditure figures taken from page 5, *Budget 2016*. 16 March 2016, HM Govt

Total 2016-17 Government Expenditure: £772 billion


UK Government Expenditure by sector 1993-2014 in real terms
£ billions
260
240
220
200
180
160
140
120
100
80
60
40
20
0
-20
1993-94
1994-95
1995-96
1996-97
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
Sector
Social protection
Health
Education
Economic affairs
Debt interest
Defence
EU transactions
Public Order
Other Expenditure