2. Explain nature of the public sector and different levels of government.
[Learning Outcome b]

Public sector refers to the government and the services it gives to the people within its geographical boundary. In simple words, public sector means goods and services provided by the government to the public for their benefit, irrespective of their caste, creed (the beliefs) colour or affluence.

Services provided by the government are different in different countries; however, most commonly, public sector includes the police force, defence force, primary education, public transport and health care for the people of the country.

2.1 Difference between private sector and public sector

1. The Private Sector

The private sector is that part of an economy which is not owned or operated by the government. In other words, these are the organisations that are privately owned by individuals and companies. The various types of business organisation in the private sector are sole traders, partnerships and companies. For example, retail stores, real estate, professional services such as accountants, lawyers etc. usually operate in the private sector.

2. The Public Sector

The public sector, also referred to as the public body or public authority, is composed of industrial or commercials organisations that are owned and operated by the government. This includes federal, provincial, state, or municipal governments, depending on the Government structure of each country. Some examples of public sector in Tanzania are educational bodies, health care bodies, police and prison services, and local and central government bodies and their departments.

Test Yourself 1

Which of the following statements is true in respect of the public sector?

A Big companies own most of the assets
Government owns most of the assets
C A group of individuals owns most of the assets
An individual owns most of the assets

2.2 Role of the public sector

The role of the public sector covers a large spectrum of services for the people living in the country, which ranges from providing health care, water, electricity, good infrastructure, public transportation and sewage system to providing and ensuring security, peace and harmony for its citizens. The role of the public sector also includes responsibilities like taking care of government dealings by raising finance and utilising it for providing better public services and goods for the people of the country.

The public sector needs to aim at bettering the performance and accountability of the public institution. It is the role and function of the public sector to make constant efforts for development and improvements in the field of education, safety, healthcare and other areas of public interest. It is also important that the functions of the public sector are performed in an utmost ethical manner. Funds rose from the public by way of taxes and duties must be utilised and disposed of for the benefit of the public and for improvement of the country's economy.

In Tanzania, the public service is a national institution of excellence that has an important role in the abolition of poverty and acquiring a sustainable economic growth. In order to ensure economic growth and quality services of the priority sectors, Public Sector Reforms were implemented in Tanzania. The reform in this sector is an important initiative by the government in improving the quality of living, bringing stability and unity in the country, ensuring good governance and building the competitive economy which can respond well to internal and global development challenges.

1. Compare and contrast the different budget policies (balanced, deficit, surplus budgeting). [Learning Outcome a]

The word 'budget' is derived from the French word 'baguette', which means a leather bag. When the British Chancellor of the Exchequer used to carry the annual financial proposals in a leather bag to the House of Commons, he is said to "open" his budget i.e. holder of documents.

Definition

Government budget, in simple terms, means the economic document which contains the forecast by a government of its expenditures and revenues for a specific period of time.

A budget usually covers a period of one year, known as a financial or fiscal year, which may or may not correspond with the calendar year.

Tip

The budget in Tanzania is prepared and implemented on an annual basis and it runs according to the financial year (also called the fiscal year), rather than the calendar year. In Tanzania the financial year goes from 1 July – 30 June. The financial year is typically cited in terms of the year it began as well as the year it ended. For instance, the financial year that began 1 July 2012 and ended 30 June 2013 is referred to as "FY 2012/13."

(Source: http://www.policyforum-tz.org/files/EnglishUnderstandingtheBudgetProcessinTanzaniaCSOGuide_0.pdf)

The two key elements of any budget are the revenue and expenses.

In Tanzania, the Government gets revenue from two main sources – domestic revenue and foreign aid. Domestic revenue refers to revenue that is raised within the borders of a country – from taxes paid by citizens, duties on imports, profits from privatization, and various other fees.

The primary sources of domestic revenue are:

Tax revenue (main sources)
Customs duty
Value Added Tax (VAT)
Excise duty (imports and local)
Income tax
Non tax Revenue
User charges, e.g. school fees, water, medical charges, rents on government property
Dividends

In Tanzania, domestic revenue accounts for about 60% of the total Government budget.

The rest of the budget is mostly funded by foreign aid - grants and concessionary loans made by foreign governments as well as multilateral institutions such as the World Bank. The other side of the budget is expenditure - how the Government spends money. Analysing expenditure is critical for understanding Government's priorities, or choices. Since the amount of money that can be raised from domestic revenue and foreign aid is limited, the Government must choose how and where to spend it.

1.1 The budget process

A **budget process** refers to the process by which governments create and approve a budget.

The budget process comprises stages which feed into one another in a circular process. We can think of four main phases:

Budget formulation (Planning how to spend the money)
Debating and Approval of the Budget
Budget Execution (Spending the money)
Oversight and Control

The below diagram explains the budget process:

Explain the Sacrifices theory.
Explain the Ability to Pay Theory.

[Learning Outcomes b and c]

2.1 The Ability to Pay Theory

The "ability to pay" principle suggests **that people with higher incomes should pay more than those with lower incomes**. However the principle does not answer the question of how much more. Its policy implications are based on a diminishing marginal benefit of a dollar assumption: **the widely-accepted belief that the value of an additional dollar of income falls, as income rises,** i.e. a rich man values an additional dollar less than a poor.

The ability-to-pay approach treats government revenue and expenditures separately. Taxes are based on taxpayers' ability to pay; there is no quid pro quo. Taxes paid are seen as a sacrifice by taxpayers, which raise the issues of what the sacrifice of each taxpayer should be and how it should be measured. Potential measures of "equal sacrifice" include equal absolute sacrifice (each person's welfare declines by the same amount), equal proportional sacrifice (each person's welfare declines by the same proportion), and equal marginal sacrifice (each person's "displeasure" from taking away an additional dollar is the same).
Equal absolute sacrifice would suggest proportional taxation if the marginal benefits of a dollar of income fell proportionally with income.

Example

Based on the above principle, if James earns $25,000 and Jack earns $5,000 during 20X3 and John values a dollar approximately a fifth as much as James, then for every dollar one collects from John, one collects $5 from James.

In the above example, the principle implied a proportional tax system.

If the marginal benefit of a dollar diminishes, but at a fairly slow rate, a regressive tax system could also be consistent with the principle, while if it diminishes at a faster rate, a progressive tax would be appropriate.

An alternative measure of sacrifice is **equal proportional sacrifice**. This method is much more likely to justify a progressive tax system, but it too depends on how fast the value of an additional dollar declines with income. There are many reasonable functional forms that do not support progressivity.

The equal marginal sacrifice principle **suggests steeply progressive taxes that will collect the least valued dollars in the economy**. The result also uses the assumption that the **value of a dollar falls as income rises**. Under this principle, in contrast with the previous two cases, the progressivity does not depend on the rate with which the value declines.

Thus, without further information on the nature of welfare and the exact standard to be used, **the ability to pay criterion does not necessarily justify regressive, proportional, or progressive taxes**. The **equal marginal sacrifice principle suggests an extreme degree of progression**

2.2 The Sacrifice Theory

This theory emerged from discussions of "ability to pay" theory in which taxes paid are seen as a sacrifice by taxpayers. Although it is now decidedly going out of fashion, the many variants of the "sacrifice" approach are similar to a subjective version of the "ability-to-pay" principle.

Under this doctrine, ability to pay is assumed to increase as incomes increase, and the objective is to impose taxes on a basis that would involve "equal sacrifice" in some sense. Tax payers should make equal sacrifices in contributing to the cost of the government activity. However there is disagreement about whether there should be equal absolute sacrifice, where the rich and the poor should suffer the same absolute decline in utility; Equal proportional sacrifice where the proportional loss of utility as a result of taxation should be equal for all taxpayers; or equal marginal sacrifice where the immediate loss of utility as a result of taxation should be equal for all taxpayers. This will entail the least aggregate sacrifice (the total sacrifice will be the least).