

FISCAL POLICY

Public goods
*(would not be provided
by the private sector)*

Street lighting, flood defences

Merit goods
*(would be underproduced
by the private sector)*

Education and health

**Government
expenditure**

**Redistribution of
income and
wealth**

Minimum wages, unemployment benefit

**Regulation of
economic activity**

Corruption, military, media control, health and safety

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Tax burden
Tax drift

Proportion of national income
taken in taxes

Direct taxes

Income tax, national insurance
capital gains tax, council tax
corporation tax

Taxation

Progressive

Direct taxes – because the proportion of
tax increases as income rises

Indirect taxes

VAT, excise duties on fuel, alcohol
tobacco, car tax; TV licence

Regressive

Indirect taxes – because the proportion
of tax decreases as income rises

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Taxation affects the demand side and the supply side of the economy

Demand

Rise in income tax – reduce disposable income
reduce consumer spending

Rise in corporation tax – reduce post-tax profits
reduce share dividends, reduce investment

Rise in VAT or Excise duty – increase the price of
goods, reduce consumer spending (NB elasticity)

Supply

Rise in income tax – reduce post-tax income,
increase hours worked, increase national output,
reduce incentive to work

A rise in corporation tax – reduce investment, reduce
productive capacity, increase tax drift

Rise in VAT or Excise duty – increase in prices,
increase firms' costs, reduce productivity (NB exports
excluded from VAT and Excise duty). NB Tax drift.

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Indirect taxation

FOR

Changes in indirect taxes change the pattern of demand for particular goods and services (France – restaurants).

Indirect taxes will not distort the choice between work and leisure (higher direct taxes may encourage workers to reduce their hours of work)

Indirect taxes are difficult to avoid. Some workers can evade paying direct taxes by trading in cash and not declaring their income)

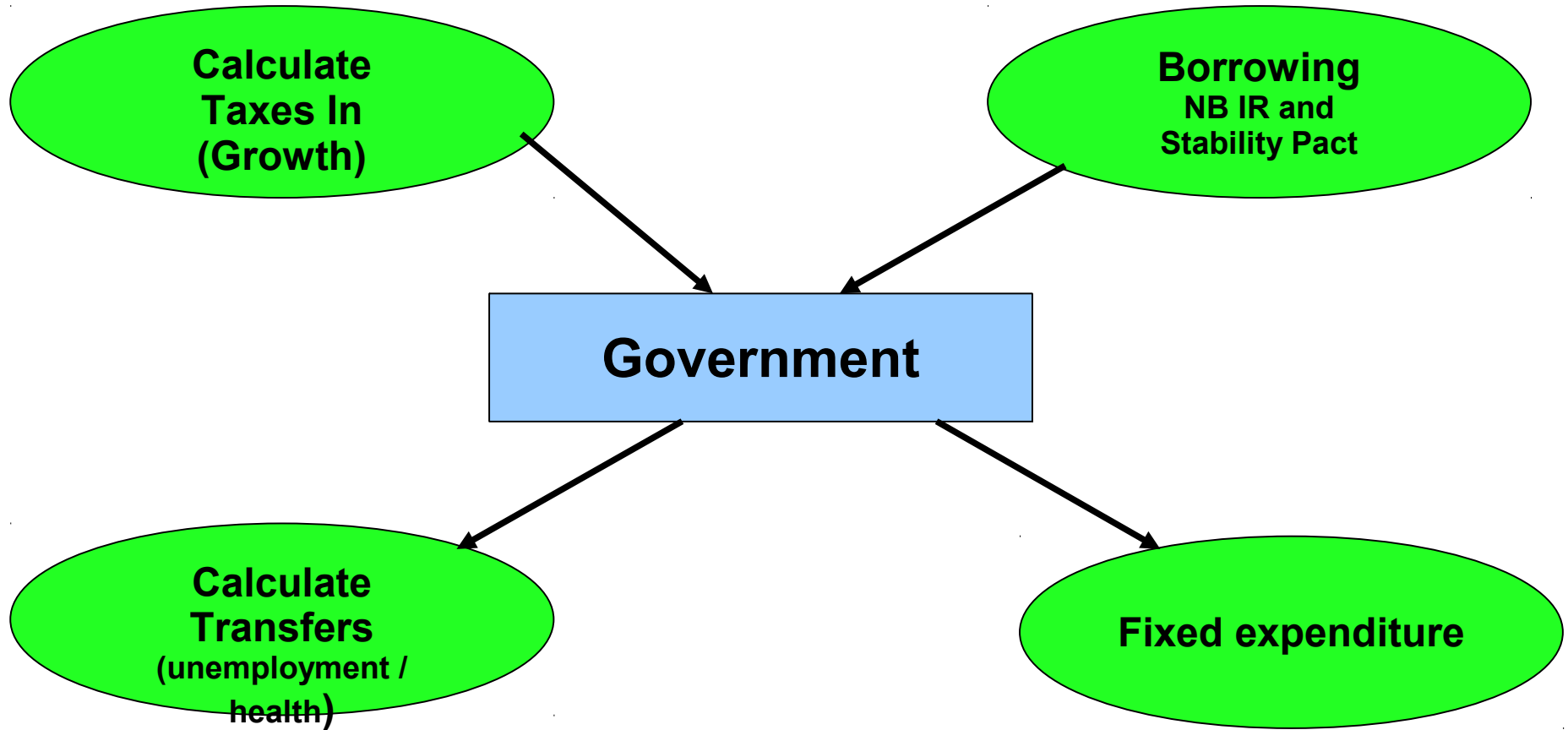
AGAINST

Indirect taxes increase the price of goods and services. This will increase firms' costs and cause cost-push inflation.

Revenue streams are highly volatile. In a boom when expenditure is high, revenue grows rapidly; conversely in a recession when expenditure falls sharply, so will the revenue (NB same or worse for direct taxes?)

Many indirect taxes have regressive effects and will therefore widen the gap between rich and poor

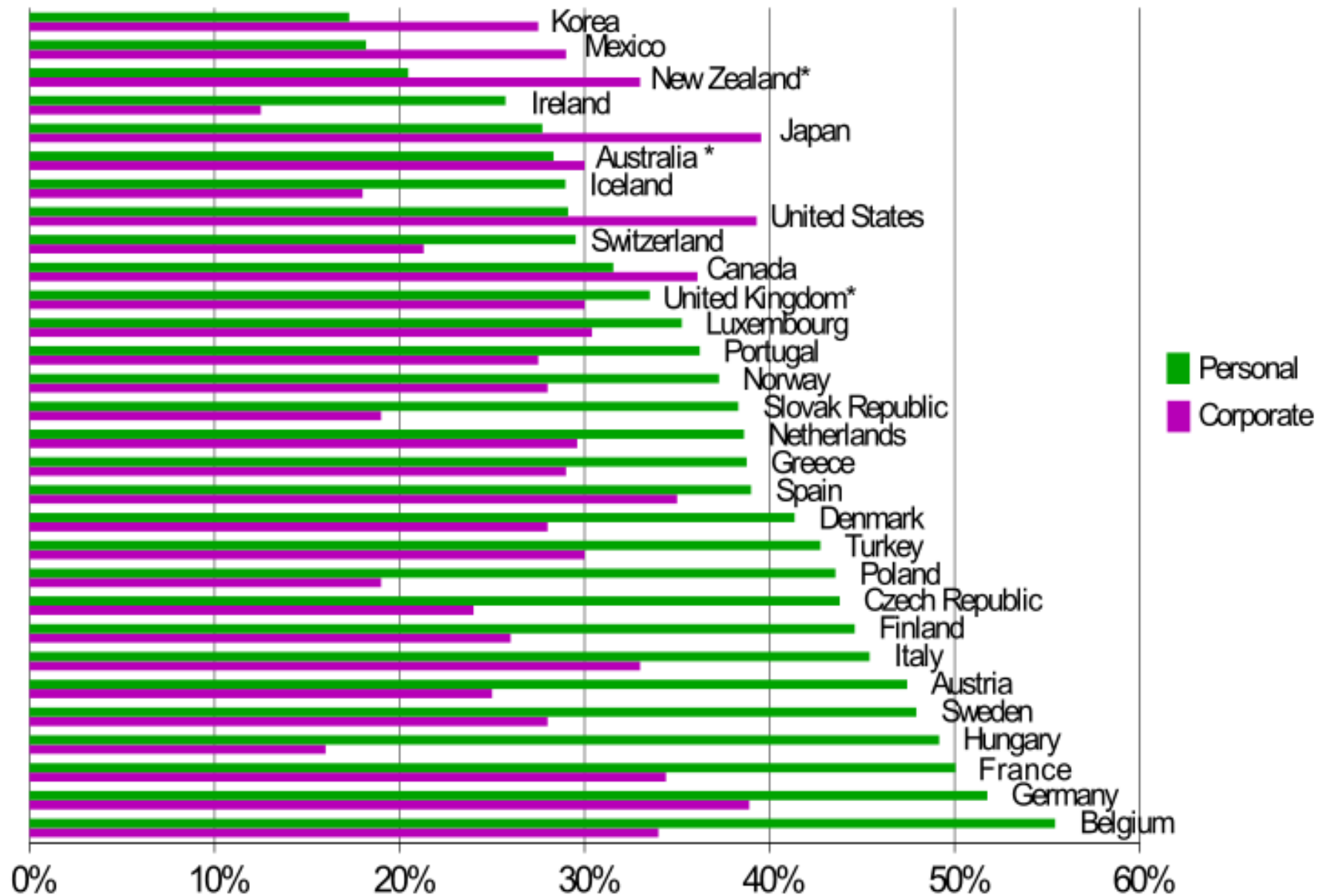
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NB Tax time lags

Takes time to recognise demand is too high or too low
Takes time to vote and implement appropriate policy
Takes time for the policy to work (depending on tax)

Mean Income Tax Rates in the Year 2005 as a Percentage of Income by Country



Graph 2 **Top statutory personal income tax rate**
 2007 income, in %

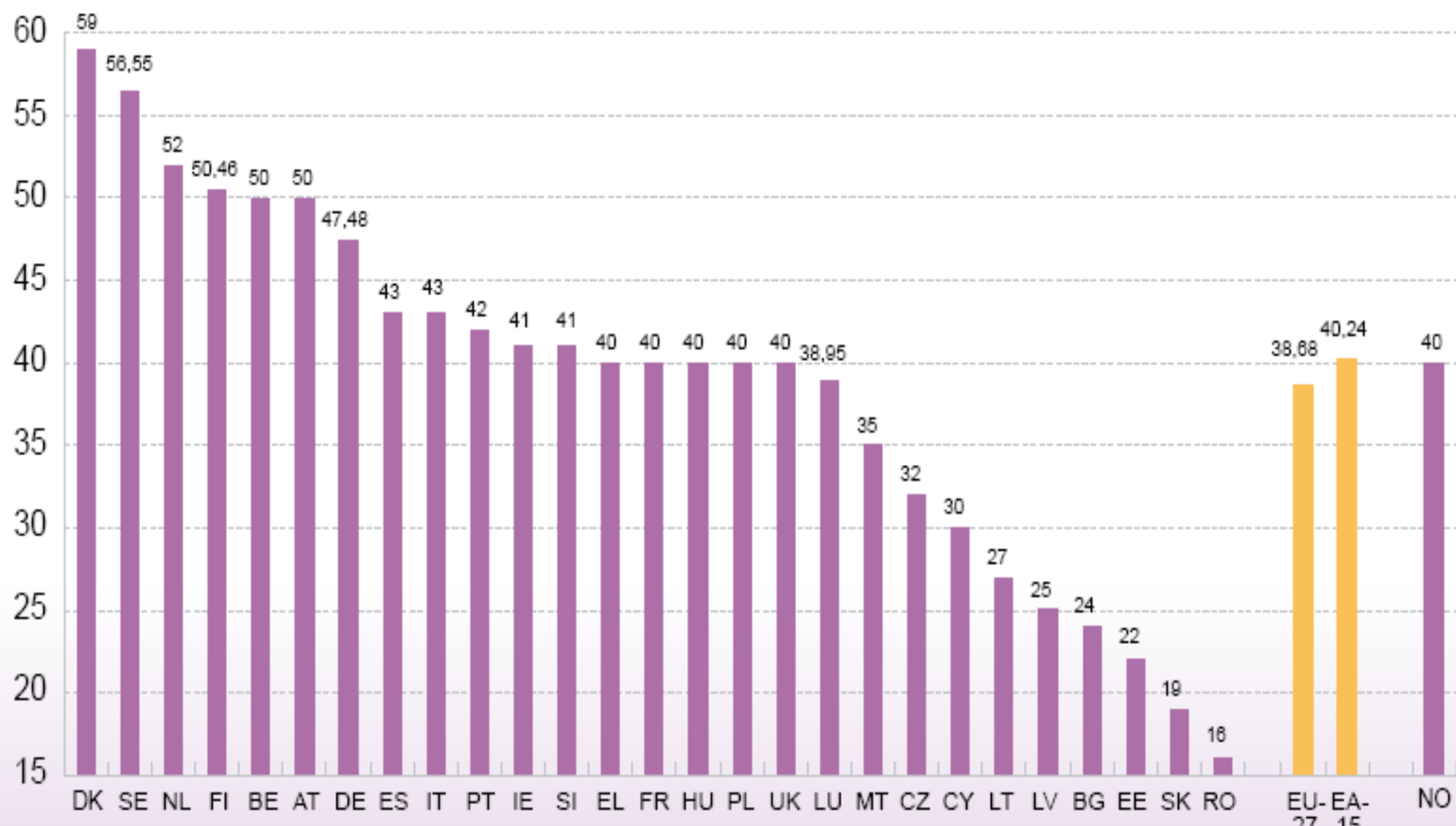
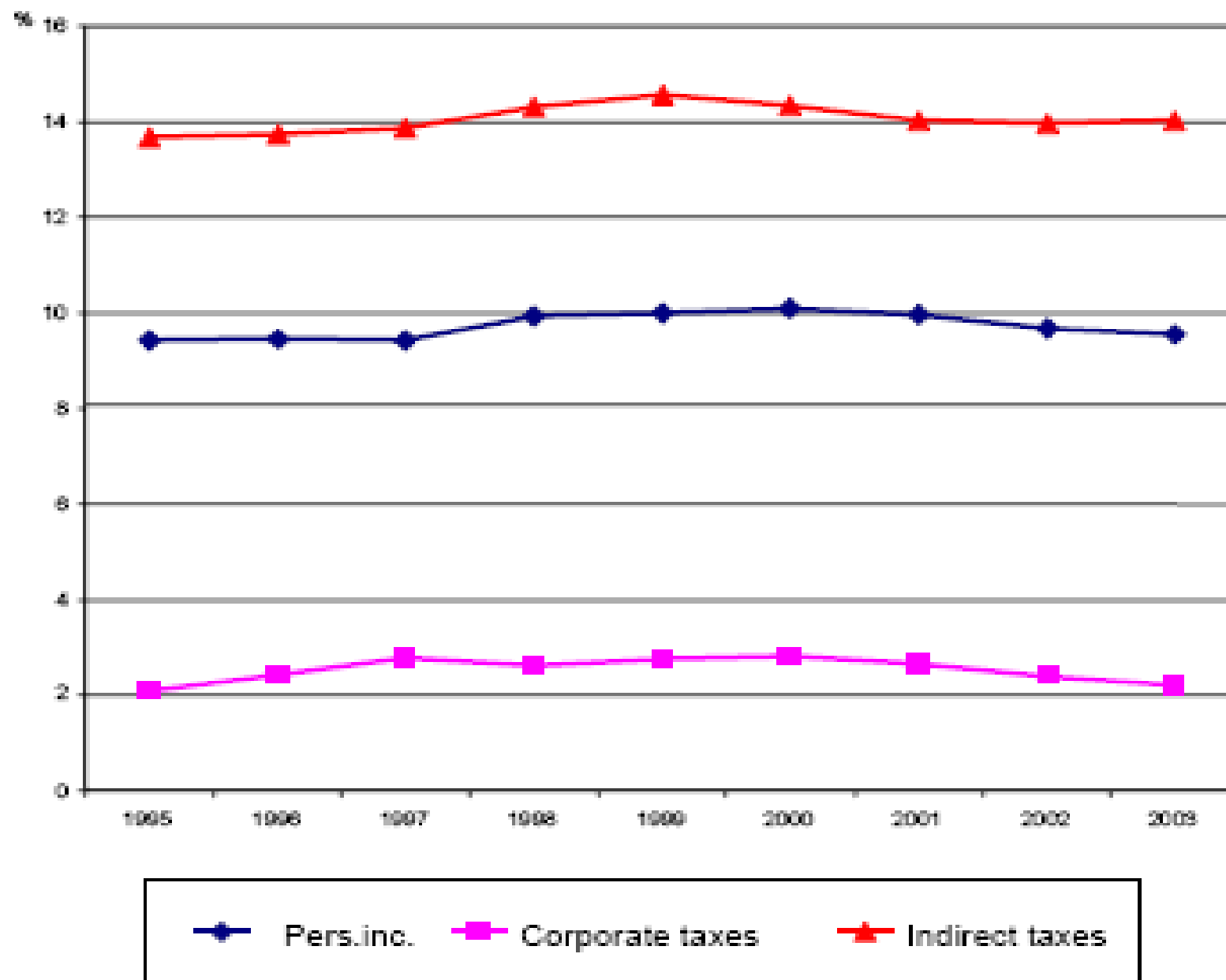
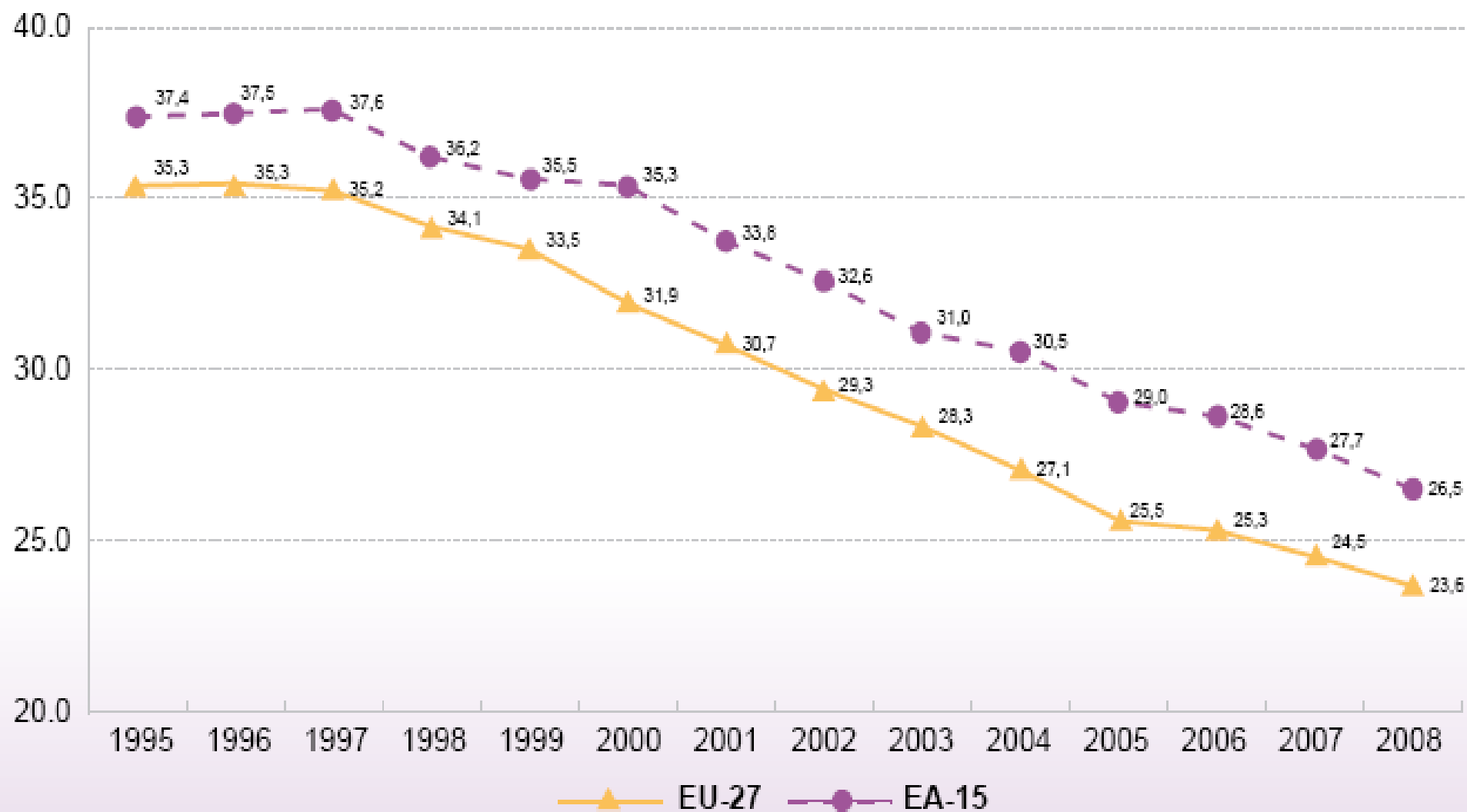


Chart 2: Indirect, personal income and corporate taxes (EU25, % of GDP)



Graph 3 Development of adjusted top statutory tax rate on corporate income

1995-2008, in % (arithmetic averages)



FISCAL POLICY

Who should pay?

1. National defence
2. Unemployment
3. Health system
4. Education
5. National energy system
6. Train network

1. Provide a train system for ESSCALand – how, where and why?
2. Provide an energy system for ESSCALand – how where and why?
3. Provide a motorway system for ESSCALand – how where and why?