

Types of taxes

1 Proportional taxes, whereby as income rises, the proportion of income paid in tax remains the same; the tax rate is therefore constant.

2 Progressive taxes are those that when income rises, the proportion of the total paid in taxes increases; the average rate of taxation will therefore be lower than the marginal rate.

3 Regressive taxes are those that as income rises, the proportion of total income paid in tax falls. Hence, the average and the marginal rates of taxation are falling.

Subsidies

- ▶ Another form of government intervention in the market is through the provision of subsidies. **These are direct payments made by governments to the producers of goods and services.**

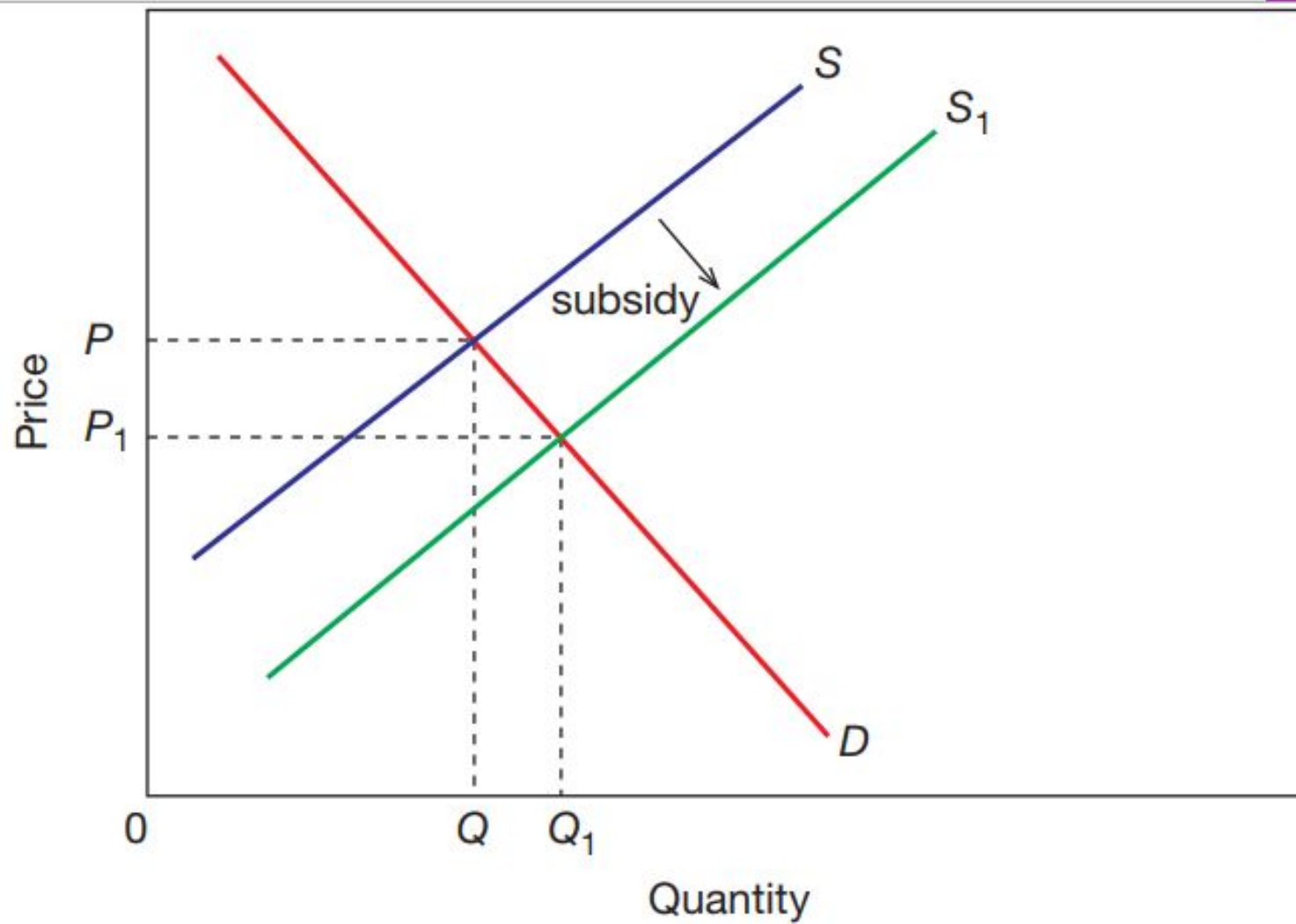


Figure 3.7 The effects of introducing a subsidy

Governments pay money to producers and may be done for many reasons including:

- ▶ to keep down the market prices of essential goods**
- ▶ to encourage greater consumption of merit goods**
- ▶ to contribute to a more equitable distribution of income**
- ▶ to provide services that would not be provided by the free market**
- ▶ to raise producers' income, especially in the case of farmers**
- ▶ to provide an opportunity for exporters to sell more goods**
- ▶ to reduce dependence on imports by paying subsidies to domestic producers of close substitutes.**

Transfer payment

- ▶ **Transfer payments** are payments from tax revenue that are received by certain members of the community
- ▶ Payments tend to transfer income from those able to work and pay taxes to those unable to work or in need of assistance. Examples include:
 - old age pensions
 - housing allowances
 - child benefits
 - unemployment benefits
 - food coupons

Direct provision of goods and services

- ▶ A further way of reducing inequalities in society is for the government to provide certain **important services free of charge to the user**. Such services are financed through the tax system.

Nationalization

- ▶ **Nationalization is the process by which governments take a private business into public ownership**

There are some very relevant economic arguments to support nationalization.

These include:

- ▶ It makes sense for certain **strategic services and activities** to be in the hands of the public sector. This is particularly true of railways, bus services, airports and electrical and water supplies.
- ▶ There is also **a long-standing socialist view** that such services are for the benefit of the public and should therefore be in the public sector.
- ▶ There is little sense in duplicating certain services like railways and water supplies, largely because of the **high costs of establishing** that provision.
- ▶ Any **profits** made will be returned to the business and reinvested **for the benefit of the public.**
- ▶ Employees feel **a sense of ownership** and work hard to ensure financial viability.
- ▶ Nationalized industries will be more likely to provide **loss-making services for social reasons.**

Privatization

- ▶ In a simple sense, privatization refers to a change in ownership of an activity from the public sector to the private sector.

The reason for privatization:

- ▶ a deliberate commitment to **reduce government involvement** in the economy
- ▶ to **widen share ownership among the population** and among the employees of the privatized companies
- ▶ benefits for consumers in the form of **lower prices, wider choice and a better quality product or service**
- ▶ the sale of nationalized industries has generated **substantial income for government** over a long period of time. For example in UK, this has been estimated to be £70–80 billion
- ▶ privatized companies can be successful in raising capital, lowering prices and cutting out waste; they are **more efficient** than state-owned operations.

Home Work

For any one country, consider each of these activities:

- water supply
- rail transport
- telephone services.

1) Establish whether these activities are operated by the government or private sector businesses.

2) If government-owned, how might the private sector help to improve the economic efficiency of these activities?

3) Why in this country might the government not wish to pursue a policy of privatization?