

# **Tashkent State University of Economics**

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## **Treasure system of Uzbekistan**

**Lecture#2: The economic basis for government activity**

Tashkent

# Government

- ▶ organizations of individuals
  - ▶ particular set of institutions and people
- ▶ authorized by formal documents
  - ▶ legally empowered
- ▶ make binding decisions on behalf of a particular community
  - ▶ externally: war, trade, border control, ...
  - ▶ internally: tax, education, health, welfare, ...

# Good Governance

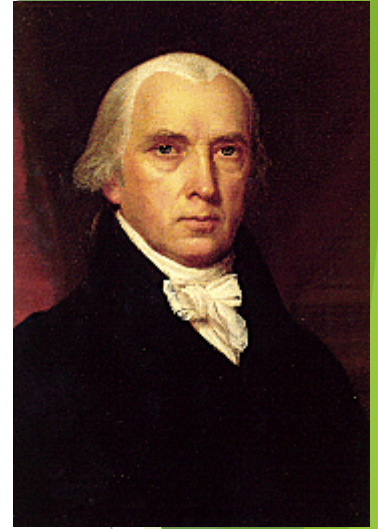
- ▶ Rule of law
  - ▶ government can take no action that has not been authorized by law
  - ▶ citizens can be punished only for actions that violate an existing law
- ▶ Property rights
- ▶ Regulatory regime
- ▶ Macroeconomic policies
- ▶ Absence of corruption

# Government's Power

- ▶ Power
  - ▶ ability to get people or groups to do what they otherwise would not do
- ▶ Government's power
  - ▶ to develop institutions
  - ▶ to carry out policies
  - ▶ sometimes unpopular
  - ▶ has to be sufficiently strong

# Government's Power

- ▶ sufficient power
- ▶ constrained power
- ▶ Madison: oblige the government to control itself
- ▶ restraints to check arbitrary and corrupt behavior by the government
- ▶ Key: building effective political institutions



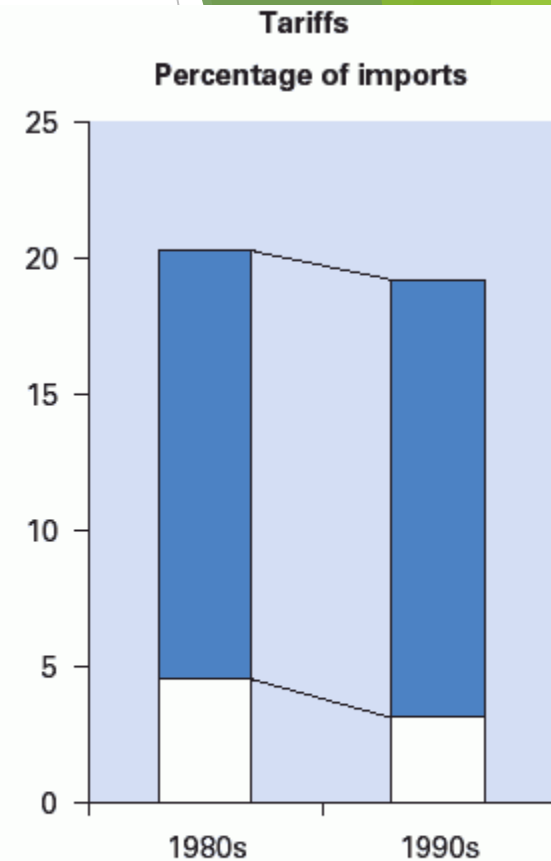
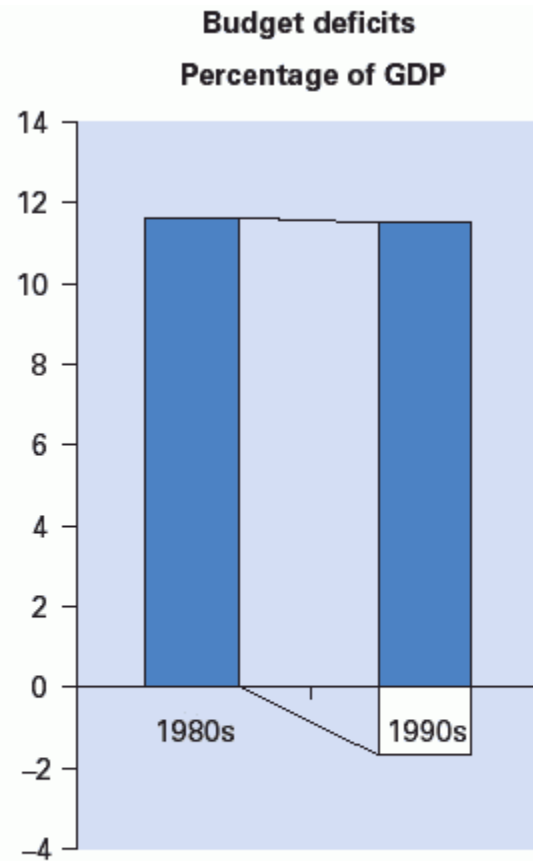
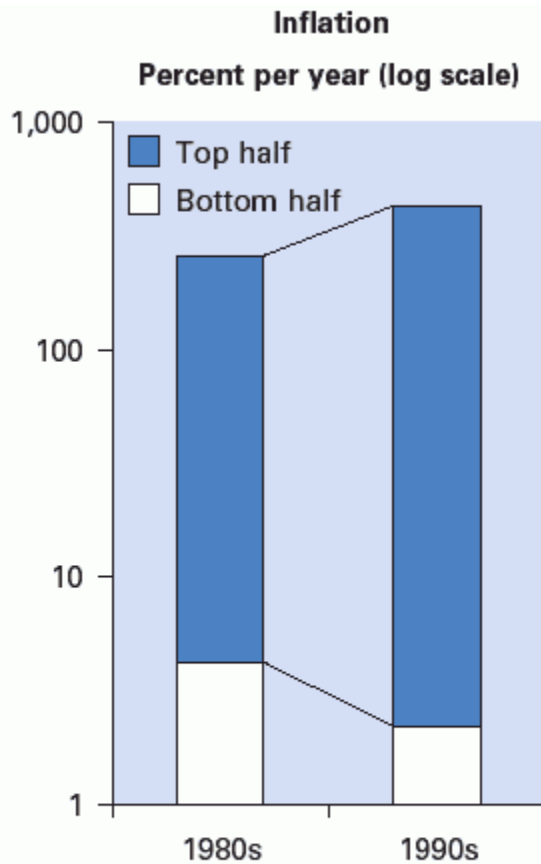
# Political Institutions

- ▶ Organizations, individuals, and agencies
- ▶ Electoral rules
  - ▶ single-member district and first-past-the-post
  - ▶ proportional representation system
- ▶ Constitutional rules
  - ▶ division and limit of power
  - ▶ between branches of government
  - ▶ between central and local governments

# Political Institutions

- ▶ Constrain arbitrary exercise of power by politicians and bureaucrats
  - ▶ delineate property rights between state and private sector
  - ▶ enforce property rights
  - ▶ influence competition in political process
  - ▶ hold public officials accountable for their actions

# Economic Policy Outcomes



*Note:* The labels top half and bottom half refer to the averages of the top half and bottom half respectively in a sample of 85 industrial and developing countries for which all three variables are available for the 1980s and 1990s.

*Source:* World Bank data.

# Economic Policy Outcomes

- ▶ Political institutions play important role
- ▶ Resolve redistribution conflict from economy policies
- ▶ Three examples of policy choices
  - ▶ budget deficit
  - ▶ financial market
  - ▶ trade policy

# Budget Deficit

- ▶ Difference between revenue and expenditure
- ▶ Government influence on budget
  - ▶ muster political support for **taxation**
  - ▶ resist demands for expansion of **spending**
- ▶ Political institutions of budget procedures
  - ▶ balanced budget rules
  - ▶ power of finance ministry

# Balanced budget rules

- ▶ are more likely to be effective if
  - ▶ voluntarily adopted
  - ▶ impose hard constraints
  - ▶ difficult to reverse
  - ▶ effectively enforced by
    - ▶ a credible third party or
    - ▶ higher level government

# Influence of Electoral Rules

- ▶ Minority (**coalition**) governments tend to have higher budget deficit than majority government
- ▶ States with systems of **proportional representation** tend to have higher budget deficit than states with majoritarian systems.
- ▶ Budget deficit tends to rise in **election year**

# Financial market regulation

- ▶ Influence of political institutions
  - ▶ independent financial regulatory agencies
    - ▶ central bank independence
  - ▶ checks and balances in political process
- ▶ Among developing countries, central bank **independence** doesn't seem to affect inflation outcomes

# International trade liberalization

- ▶ Government's trade policy influenced by domestic political conflict between **gainers** and **losers** from trade liberalization
- ▶ Industries that tend to have tariff **protection**
  - ▶ industries in decline
  - ▶ industries that are highly unionized
  - ▶ make substantial campaign contributions
  - ▶ more geographically dispersed

# Corruption

- ▶ Exercise of public power for private gain
- ▶ has large costs for economic development
- ▶ undermines well-functioning markets
  - ▶ a tax that distorts competition & lower returns
  - ▶ a barrier to new entries in market competition
  - ▶ subvert state's legitimacy
  - ▶ weakens state capacity to provide institutions to support markets

# Causes of corruption

- ▶ Distorted policy environment (opportunity)
- ▶ Weak judiciary (credible threat to punish)
- ▶ Poor civil service management
- ▶ Low public sector pay (not evident)
- ▶ Other factors
  - ▶ Openness to international trade
  - ▶ Complexity of regulatory environment
  - ▶ High and variable inflation

# Political institutions

- ▶ Political institutions can help reduce the **opportunities** and **incentives** for corruption
  - ▶ Restrain politicians from arbitrary actions
  - ▶ Hold politicians accountable for their action
- ▶ Decentralization
- ▶ Electoral rules
- ▶ Press freedom
- ▶ Civil society

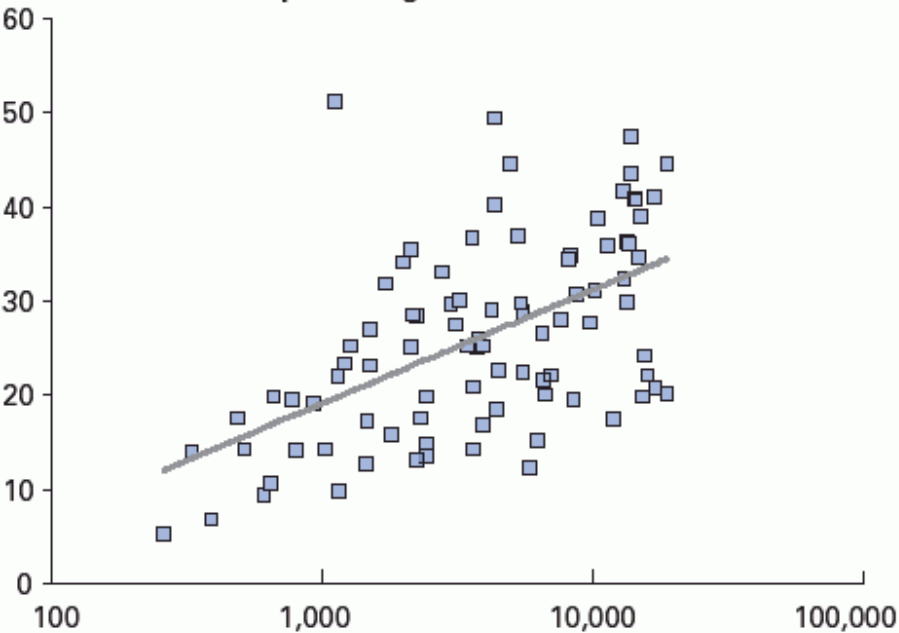
# Taxation institutions & policies

- ▶ Tax provides the state with resources to build market-supporting institutions
- ▶ Weak tax collection institutions lead to disproportionate reliance on tax revenue from more **visible** and **easier** sources
  - ▶ international trade
  - ▶ large firms

# Tax collection institutions

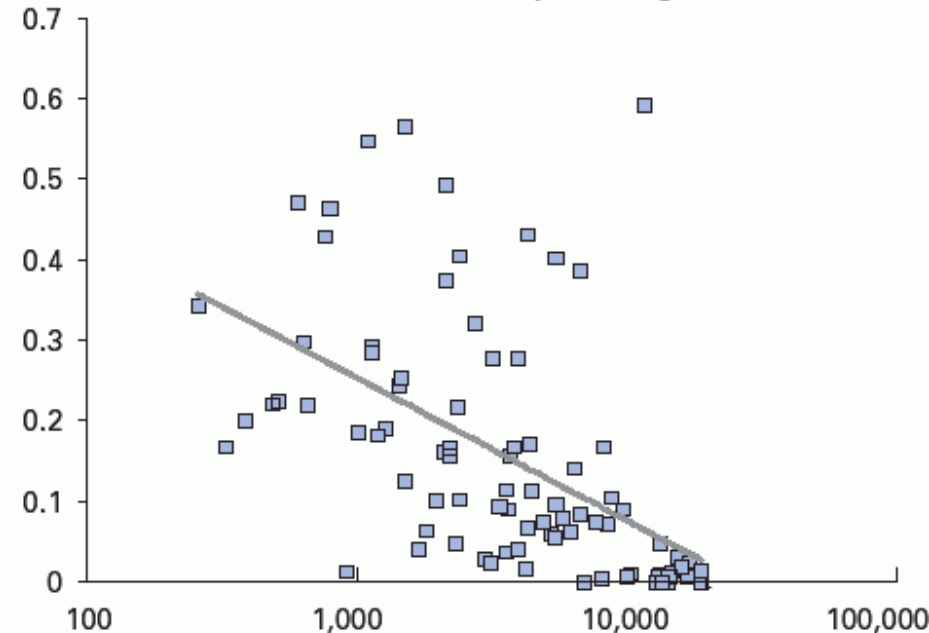
- ▶ Poor countries tend to have weaker tax administration & higher reliance on tariffs

**Tax revenue as a percentage of GDP**



Real GDP per capita in 1985 PPP-adjusted dollars (log scale)

**Taxes on international trade as a percentage of total taxes**



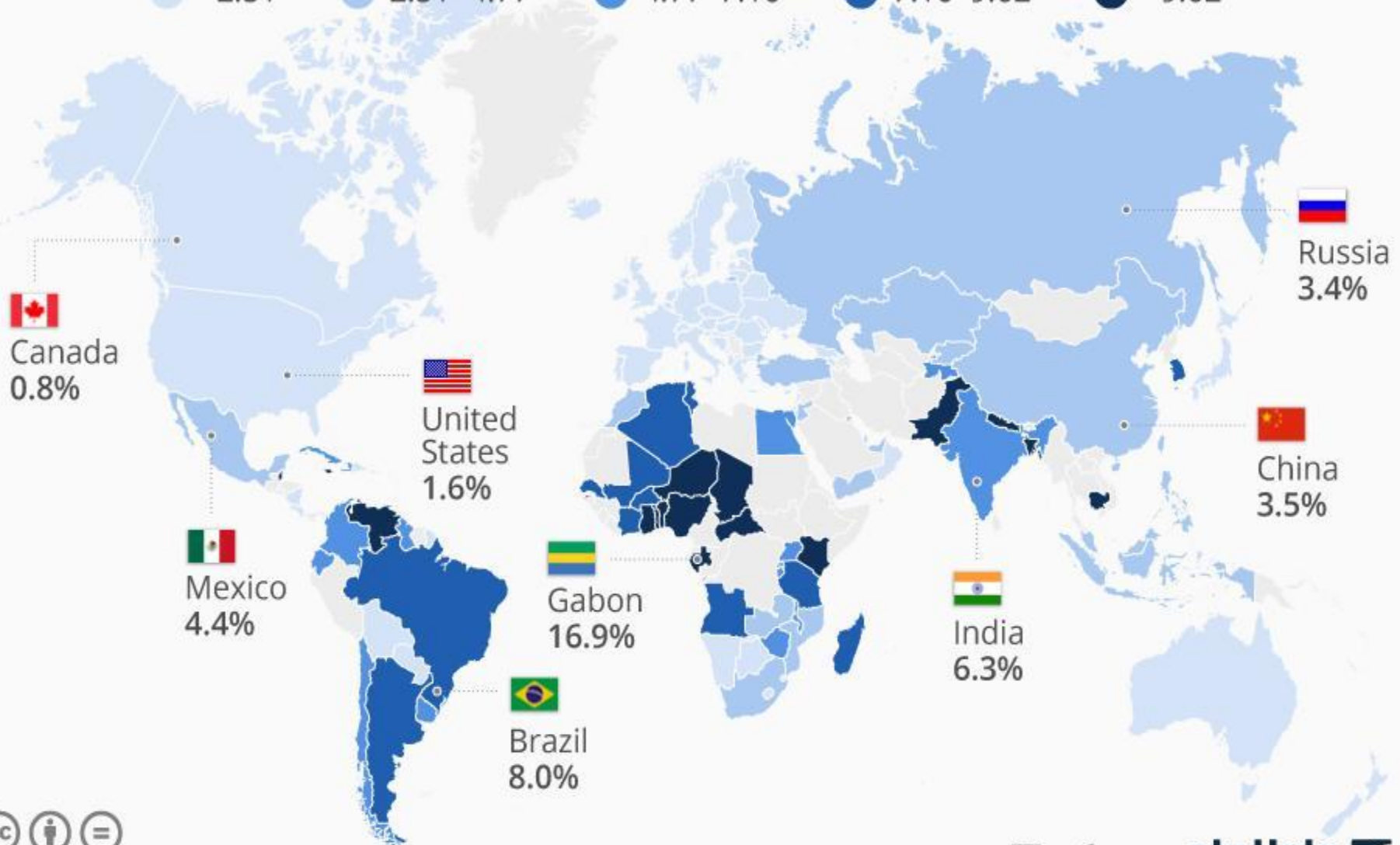
Real GDP per capita in 1985 PPP-adjusted dollars (log scale)

*Note:* PPP stands for purchasing power parity.

*Source:* International Monetary Fund, Government Finance Statistics.

# Where Global Tariffs Are Highest And Lowest

Average weighted tariff rate applied across all products in 2016 (%)



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Source: World Bank

# Conclusions

- ▶ Political institutions matter
- ▶ Good governance is essential to economic development
- ▶ Effective State
  - ▶ plays a catalytic, facilitating role
  - ▶ encourage and complement the activities of private businesses and individuals