

Public Sector Economies in Transition

By Sam Vaknin, Ph.D.

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In the previous article, we described the various methods developed in the West to cope with the ever-burgeoning public sector.

Yet, economies in transition everywhere in the world have learned a lesson the hard way: not everything that is Western - necessarily fits their needs. Many Western techniques, methods, systems and ways of thinking cannot be applied in Macedonia, for instance.

The public sector is a great burden on economies everywhere.

It is mostly financed by collecting taxes from individuals and businesses.

Taxes are re-allocation of economic resources. Taxes are nothing but money transfers from one group of citizens (the taxpayers) to other groups: to those who cannot pay taxes (such as children and the elderly) and to those who would not pay taxes, the tax evaders. Taxes are a penalty paid by the more productive and honest segments of society. Small wonder that taxes have a bad reputation in the West. They are considered to be both unjust and inefficient.

But taxes are both necessary and inevitable. There is no better way to finance the operations of the government and of the public sector.

The more taxes collected - the heavier the involvement of the state in the economy. This involvement is measured as a percentage of the GDP - the Gross Domestic Product. As we mentioned in our previous article, the figures are frightening: governments consume from 19% (Singapore, Hong-Kong) to 59% (France) of the products and services produced in the economy!

Research shows that public spending of tax money is 6 times less efficient than the same money invested by the private sector. The two sectors: the Private and the Public compete on the same, limited, amount of resources. Every Denar paid to the tax collector is one Denar less invested in the formation of new businesses and one Denar less invested in private consumption.

We can safely state that taxes inhibit economic growth and increase unemployment.

So the current mood in the West is anti big government and anti taxation.

People evade taxes. About 13 - 25% of the total capital in the world is "black" capital, upon which taxes were not paid. It is estimated that Macedonian firms and individuals hold more than 1 billion USD in undeclared cash - against an official figure of 200 million USD in circulation in the whole Macedonian economy.

People openly refuse to pay taxes and they take their governments to court on these issues.

Governments are doing their best to simplify procedures and tax returns (=the forms on which income is reported).

In fiscal theory, we differentiate between progressive and regressive taxes.

A progressive tax is one which is larger - the larger the income is. A millionaire in a progressive tax system will pay much more (as a percentage of his income) than his driver.

A regressive tax is one that totally unrelated to the level of income. Both the millionaire and his driver will pay the same percentage of tax if they buy a car, for instance.

Governments have become desperate. They introduce one rate income tax systems: all incomes are taxed at the same rate, regardless of their size. They are switching from taxes on income (which are socially progressive in nature) to taxes on consumption (such as VAT - Value Added Taxes) which are socially regressive in nature.

The overall goal is commendable: to lower the burden of taxation to less than 20% of the GDP.

But obtaining this goal means that Governments will have to reduce their involvement in the economy and cut back on services and on the public sector.

This is not a very clever idea for economies in transition.

The public sector in economies in transition could and should be privatized only after three conditions have been met:

First, the establishment of a strong private sector. Individuals and firms in the private sectors are the consumers of electricity, water and phone services. Without a strong customer base, it would be very difficult to sell the PTT, the electricity company or the water companies to any private investor in reasonable prices. The public sector must become profitable to be sold to the private sector (=to be privatized). A losing company is not worth anything to an investor, unless he thinks that he can turn it around and make it profitable. The best way to do this is to increase its sales to a loyal and sizeable group of clients.

The second condition: the de-regulation of prices and the abolition of subsidies.

The state must exit forgo all levels of intervention in the finances of the public sector. It must not fix the prices of its products and services and it must not subsidize it. Subsidies and tax incentives thwart and distort the true economic and financial picture. They hinder the proper and correct valuation of the public sector firm by prospective investors.

An investor must feel certain that he will be allowed to fix any price for the goods and services sold by the public sector firm that he is buying. This is the way to profitability and financial health. The government does not need to worry:

If the investor will charge too high a price - his clients will go to his competition.

But what if there is no competition? What if electricity is supplied by only one electricity firm (a monopoly)? Who will the client revert to if the prices that he is charged are much too high?

This, precisely, is the third condition:

The opening of the marketplace to competition, both domestic and foreign.

To cancel all laws, regulations, rules, precedents which inhibit or prohibit competition. To eliminate tariffs, quotas, permits, licences and controls (barring those which relate to public health and to the protection of the environment).

Why should Macedonia have only one PTT? Why not six providers?

Why not allow anyone to produce electricity and sell it to the electricity company? Why to have only one electricity company?

Subject to the right regulations concerning safety and financial wherewithal - everyone should be allowed to do anything. Economic history shows that competition provides better goods and services at much lower costs.

It also shows that the public sector is a potential hub of inefficiency and sometimes blatant corruption.

"Lean and Mean" is the name of the game in today's economic environment.

The Public sector is fat and sluggish. It has no right to continue to exist.

Even private sector enterprises are "downsizing" (cutting their labour force considerably).

But certain functions can scarcely be transferred to the private sector. These functions are inherently non-profitable and non-profit motivated. They are usually performed by municipal, local and regional authorities.

The municipal (local) and regional part of the public sector has five sources of income at its disposal:

It is empowered to collect taxes from individuals and from businesses - the size of which is normally linked to the (residential or office) space that they occupy.

It is allowed to collect fees and charges which are fixed and relate to the provision of services such as: water supply, sewage, sanitation, posting commercial signs, parking and toll roads).

It is authorized to levy fines on transgressors against municipal rules and regulations. The best known form of this kind of financing is the parking ticket.

Mainly in the USA, local authorities are permitted to sell municipal bonds ("Munis") to the public - through the Stock Exchange - and directly to institutional investors, such as pension funds.

The local authority which issued the bonds pays the bondholders from current income generated by tax revenues and from specific incomes generated to it by specific projects.

An example: a local authority wants to establish a water treatment facility.

It costs 100,000,000 USD. The Authority receives 60,000,000 from the government and sells 40,000,000 USD worth of bonds to the public via the stock exchanges.

Once the facility is built, it begins to supply water to the residents and to businesses. They pay for the water that they consume - and the income from the sale of the water goes to the bondholders. This income covers both the interest payable on the bond (=its coupon) and the money that the bondholders invested in the bonds themselves and which they have to recover.

* Lately, a new fashion is developing in public administration, called devolution.

It is the transfer of parts of the national budget directly to the local authorities or granting them the right to regulate their own fiscal (=tax) systems.

Devolution is a prime example of a mega-trend in human societies: that of the dismantling of Big Government. But this is subject for yet another article.

Sam Vaknin is the author of "Malignant Self Love - Narcissism Revisited" and "After the Rain - How the West Lost the East". He is a columnist in "Central Europe Review", United Press International (UPI) and ebookweb.org and the editor of mental health and Central East Europe categories in The Open Directory, Suite101 and searcheurope.com. Until recently, he served as the Economic Advisor to the Government of Macedonia.

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Digital City (Part 1 of 2)

By Theo Boshoff

The idea of a fully 'connected' and integrated digital city, with a plethora of online services for its citizens, sounds ultra-futuristic and like a pipe dream. The local telecoms and IT industry has its own views.

The **notion of a digital city**, where all citizens have access to public services through broadband Internet connections, has long since been in the minds of government and the private sector. The reality is that it is only now that developments in this space are coming to the fore. "The move is about government transforming and all about e-government bringing public services to citizens, but the uptake is slow," says Ashley de Klerk, public sector director at Microsoft SA. Like many others, Zolisa Masiza, councillor at Icasa, asks how the implementation of digital cities can be justified if government has not yet sorted out basic services, such as sanitation, running water and housing, for all citizens of the country.

Linked with this are the questions: Who will really benefit from this? Will it be possible to implement this dream if the most basic needs of citizens have not been met? And who will be responsible for making it happen? - thus making the debate a difficult one. Says country manager at 3Com

Johnathene Beyers-Clements: "The answer lies in public private partnerships (PPP) and a parallel strategy, whereby **both government and the private sector** look at resolving the issues of basic services simultaneously with establishing digital cities." She believes that public domain interest groups must lobby for the proliferation of community services, and notes that the private sector must drive this.

Faux pas

Beyers-Clements also adds that it would be a 'faux pas' if we do not exploit the idea of digital cities now, and says that, if attention is not given to this issue, it will again put SA far behind the rest of the world. "Following a linear approach would be a huge mistake. Digital cities would be an important catalyst to a total solution," she says. Referring to **President Thabo Mbeki's** state of the nation address, where he said that national government will look to local authorities to deliver national services to citizens, De Klerk says: "National government must take the leading role, but cities' major role is making it work." He adds that this is happening, and cites the cities of Cape Town, Tshwane and Johannesburg, where current digital city pilot projects are successfully running. He believes that local authorities are taking charge because they are very competitive, and want to build revenue by using infrastructure to create sustainable economies.

Alan Bacher, product manager at Internet Solutions' access division, says government first needs to put together a proper broadband policy and a national strategy. He notes that the US government is currently experiencing problems with broadband access because it did not do this, and says that SA must avoid this at all costs. Closely related to Bacher's point of view is that of Steve Nossel, regional enterprise business manager for Intel Middle East, Turkey and Africa. Nossel's view of government requires the

establishment of a dedicated ICT ministry to focus on the issues of technology and service delivery. "Government should maybe just look at other countries which have done this and see that it can work," he adds.

Dr. Andrew Hutchison, business manager: telecommunication services at T-Systems SA, says: "The driver for cities is the high cost of telecoms infrastructure that they are paying for. They can see the benefits in wireless infrastructures, but the current impediment is still regulations." However, he believes that government can achieve the objective of digital cities and delivering e-services to citizens.

Business development director at Storm Telecom, Dave Gale, says: "Leadership should come from municipalities. They should not lose sight of their own mandates and what they aim to achieve. Everyone talks about technology bridging the communication gap, but they should look at the socio-economic issues, with technology as an enabler."

Mark Baptiste, director for Cisco Systems, says: "I do not think that digital cities is an **empty promise by government**, but it is all about timing, if the timing is not right the business case will not work." He also believes that the private sector should educate government on possibilities, and how to go about achieving set goals. The majority of industry players are positive, and believe that this is not going to be an empty promise from government. It will take hard work, through partnerships, and it will not happen overnight, but it will happen, they believe.

Legislation

The issue of legislation has been a great focal point in the digital cities debate and how to get around it is a question that many have asked, but, says De Klerk: "It is not about getting around legislation, but finding legislation that is supportive. Legislation is important, but should not be prohibitive." Bacher believes in an open market, and says that local loop unbundling is the key to reaching that goal. He adds that co-operation between Telkom, the SNO, government and the private sector is the only answer for making digital cities and e-services a reality.

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