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A New View of the Economic Ability of the Government, Egalitarian Goods and GNP

Vladimer Papava
P. Gugushvili Institute of Economics of the Georgian Academy of Sciences, Tbilisi, Republic of Georgia

In modern economic theory several recognized theses may be called into question. This holds true, first of all, for factors of production and income from them, transfer payments and the problems of their inclusion in the Gross National Product (GNP).

In the article these problems are analysed on the basis of a well-known manual in economics by McConnell and Brue (1990). This is not because there is any conflict between our opinions but because the manual in question reflects the most established views on the problems mentioned.

Economic Ability of Government as Factor of Production

At present, economists of all trends (excluding Marxists) do not argue the point that income from product realization breaks up according to four factors making up income. According to general recognition, these factors (they are also called economic resources) are as follows: land, capital, labour and entrepreneurial ability. The first two refer to materials and the last two to human resources. In exchange for these factors the owners of the latter get corresponding income, in other words, each factor of production brings in income to its owner from product realization. According to the enumerated four factors of production, rental income, interest, wage and entrepreneurial profit are incomes received in exchange for their use. Although the process of dividing income from product realization into incomes according to factors of production (the problem has attracted a voluminous literature) seems quite clear, there are some doubts: whether all factors of production and corresponding incomes are taken into account.

The answer to the question, obviously, could be positive, if all interrelations between economic subjects were defined on the basis of the *laissez-faire* principle typical of the free market — pure capitalism.

If an entrepreneur takes on himself the initiative of including land, capital and labour resources into the common process of goods and service production, a government[1] assumes the initiative of the entrepreneurial activity regulation within the bounds of national economy; if an entrepreneur organizes production of certain goods and services, a Government organizes production of the whole mass of goods and services within the bounds of the national economy; if an entrepreneur makes a decision using innovations, taking on himself the risk of managing his own business, a Government makes decisions concerning the

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main routes of development of the whole national economy, uses innovations and takes on itself the risk in economic policy realization.

A great deal in modern economy and business development depends on what forces, right-wing or right-centristic, left-wing or left-centristic hold power in Government. For example, when in the USA and the UK the Conservatives came to power at the end of the 1970s and at the beginning of the 1980s, it assisted the economic activities in these countries, while under the Communists in the former USSR the market could exist, but mainly underground. Historically, since the time of the emergence of the first Government structures, they had the same either promoting or inhibiting influence on economy.

Therefore, the economic ability of Government may be regarded as the fifth factor of production.

Despite the adduced parallels, the resemblance between the entrepreneurial ability and the economic ability of Government is only formal, as internally there is a basic difference between them.

As an entrepreneur deals with materials (land, capital), so with human (labour) resources, which are pooled into the common process of production; as for Government, it pools mainly human resources — entrepreneurs within the bounds of the national economy.

Taking decisions in business management, an entrepreneur decides on company policy; whereas Government decisions have an influence on the policies of all companies which constitute the national economy.

Being an innovator an entrepreneur introduces new products, technologies, forms and methods of business organization; a Government, when functioning as an innovator, introduces, first of all, new forms and methods of financial-credit policy, new forms of Governmental organizational structures, etc.

The specific feature of an entrepreneur is that in managing business he takes the risk first of all on himself, without insurance, and gets proper "reward", depending on whether it was worth the risk.

Bankruptcy is, certainly, the most deplorable version of the latter. In managing the economy a Government also takes on itself a risk but of a slightly different nature: Government has no right to risk bankruptcy to such an extent as to self-destruct (there are some examples of this in history, but these are much fewer than the successful ones); as big an economic profit as possible is the most important reward for an entrepreneur for a non-insured risk taken on by him, while people from Goverment gain by victory in elections (their own victory or that of some political forces supporting them) to prolong their power for the next term.

If the economic ability of Government is a factor of production, it must produce a certain income. This income is at present called indirect business taxes (in particular, sales tax, value-added tax, excise tax, property tax, licence charges, custom duties). As is known, these taxes increase prices including incomes according to factors of production: of land, capital, labour and entrepreneurial activity. The increase in price is an income in exchange for the economic service of Government.

As reported by McConnell and Brue (1990, ch. 9) in modern economic literature, indirect business taxes are qualified as non-wages income, because

it is considered that Government does not make any contribution in exchange for revenue from these incomes.

Actually, as has been stated, Government provides the above mentioned services in exchange for revenues from the so-called indirect business taxes. Recognition of the economic ability of Government as a factor of production, in its turn, allows it to attach the status of Governmental profit to indirect business taxes (by analogy with entrepreneurial profit). This approach to indirect business taxes creates the necessity for changes in the methods of their accounting in corresponding macroeconomic indices, which will be discussed below.

When qualifying indirect business taxes as factorial income, a question may arise concerning the receipt of direct taxes by a Government in exchange for economic ability. In fact the latter are a part of other factorial incomes and are deducted from them after they have been taken by Government. Unlike direct taxes, indirect ones on business are at the Government's disposal directly in exchange for the above mentioned services, i.e. indirect business taxes as well as other factorial incomes are primary, while direct taxes are derivative incomes. It should be noted that the level of Governmental profit, i.e. income from indirect taxation, to a considerable extent, depends on the level of corresponding tax rates: they may both stimulate and hamper increases in Government profit, depending on the extent to which they stimulate or hamper legal business.

There are some well-known approaches in the history of economic ideas close to the idea expressed in the present work, the detailed analysis of which is given by Studenski (1961, ch. 13). As an example, in the 1920s and 1930s S. Kuznets suggested the idea of considering Government activities like entrepreneurial activities. According to his concept, taxes were interpreted as the prices exacted by Government for services provided to society, surplus of revenues as the profit or savings of Government, budget deficit as losses or expenses of Government. S. Kuznets had to renounce his view at the beginning of the 1950s, when the state budget deficit of the USA became large and permanent. Nor has this approach any proper basis from a purely theoretical point of view. It should be mentioned, in particular, that Government really takes the part of entrepreneur (in the enterprises in general use), and as a result Governmental as well as private enterprises can receive profit. But not all kinds of Governmental activities may be equated or even brought to an entrepreneurial level.

In summary, let us note that there are five factors of production: land, capital, labour, the entrepreneurial ability and the economic ability of Government; incomes from these factors are, correspondingly, as follows: interest, wages, entrepreneurial profit and Governmental profit.

Egalitarian Goods — Are Transfer Payments Productive Transactions?

According to the opinion established in economic theory, transfer payments are not connected with production. According to McConnell and Brue (1990, ch. 8) they only redistribute income and thus they appear as non-productive transactions.

But this problem may be viewed in a different way. The market mechanism results in great property inequality: owners of large capital, landlords, highly

paid persons, rich heirs possess considerable amounts of wealth. Besides them, there are the unemployed, aged, etc., whose incomes in the market system are either very small or non-existent[2]. The Goverment pays benefits to all those people through transfer payments. All these means are obtained from heavy taxes on people with high incomes. In this way, it can be said that the "Robin Hood effect" is created. What is the Government's motivation in this case?

If this is done to achieve socialist aims, it is unjustified because they cannot be realized, which has been proved theoretically by Hayek (1988) and practically in the East European countries, and the latest proof is the breakdown of the USSR.

Especially in Western Europe, the highly-developed countries of America, Asia and also in many non-communist countries, the above-mentioned activity is motivated to provide social security by overcoming poverty and decreasing inequality of income.

Modern, and even the most developed, societies disintegrate into separate social groups according to income level. The result is that there are the well-off as well as the poor. Unemployment is one of the undesirable results of the market among others. Because of the imperfection of international relationships wars break out in different parts of the world from time to time. Wars cause the survivors different problems (loss of health, time, etc.). We could easily continue listing similar groups of people. The market mechanism is unable to solve the economic problems of these social groups. The latter can cause social upheaval in aiming to redistribute wealth. Society is interested in avoiding such social cataclysms no less than in providing national defence or purity of environment.

Both national defence and purity of environment are public goods. It is possible to say that transfer payments resulting in public goods, are to my mind, of the egalitarian type.

Egalitarian good is a social security achieved by overcoming poverty and decreasing inequality of incomes. Creation of this good is based on the development of social insurance and benefits to war veterans and the unemployed, a state programme of free medical aid, state housing construction, etc.

Egalitarian good as well as national defence or purity of environment, is a non-competitive and non-excluded good. As stated by Pindyck and Rubinfeld (1989, ch. 17) it meets the criteria for determination of this or that good's affiliation to public goods.

As shown by Friedman and Friedman (1980), the market system and charity (no matter who realizes it, a person or a Government) are fully compatible, when, for example, 90 per cent of the population is willing to help the remaining 10 per cent, being at the lowest standard of living in payment of tax. But they are incompatible when 80 per cent of the population decide that only 10 per cent of the well-off people must support the 10 per cent who earn their living with difficulty.

Nobody is protected in the future from disablement, unemployment etc., not to mention old age. These are the main motivations of well-off people ready to help those with the lowest standard of living. We must note that, according to Sorokin (1959), in the history of the family there are no firm tendencies towards enrichment and impoverishment and that all these tendencies work in a specific period of time.

Overwhelming diligence in overcoming poverty by means of redistribution of incomes, not to mention production efficiency, may militate against social security. As mentioned by Friedman and Friedman (1980), that was experienced in England in the 1970s.

Therefore only reasonable redistribution of income carried out by Government secures social tranquillity, i.e. production of egalitarian goods as a form of social goods.

Proceeding from the fact that egalitarian goods are a form of social goods, expenses for the latter are productive. Consequently, transfer payments, to counterbalance the widespread view, are productive transactions according to their nature.

On Necessary Changes in National Economic Accounting

It is necessary to reconsider some indices of national accounting, by discussion of the economic ability of Government (as a factor of production) and egalitarian goods mentioned above. Let us consider, first, the problem of egalitarian goods as reflected in the (GNP) and national income (NI).

As shown above, egalitarian goods, owing to their nature, belong to the group of social goods. That means that egalitarian goods, like any other social goods, are purchased by Government. Therefore egalitarian goods as a form of social goods are to be included in GNP. As the experience of national economic accounting shows, this is not the case, unfortunately. Part of the egalitarian goods achieved, e.g. by state programmes of free medical aid and by state housing construction (thought to be a quasi-social good), is included in GNP.

The other part of it, achieved by transfer payments, is not included in GNP. As reported by McConnell and Brue (1990, ch. 9), this is based on the fact that they promote redistribution of incomes, "rebuilding" of personal consumption. Such interpretation loses its meaning as soon as a special form of social goods — egalitarian — is distinguished.

As noted above, acknowledgement of egalitarian goods predetermines the productive nature of expenses on them, in other words, transfer payments, forming egalitarian goods, are productive transactions.

Let us explain how transfer payments are included in GNP.

There are two kinds of transfer payments — Government and private. The first include payments for social insurance, benefit for unemployed and war veterans, etc. Private transfer payments consist of monetary allowances for students from parents, or one-time gifts from rich relatives, etc.

Thus part of the egalitarian goods in the form of transfer payments is created by Government purchases as well as personal expenses. Consequently, Government transfer payments have to be taken into account as part of Government purchases. As for private transfer payments, according to their

nature they are close to personal consumer expenses and have to be included with them. We should remember that private transfer payments are not personal consumer expenses and are included with the latter only, as mentioned above, according to their original nature.

If we consider that GNP in expenses is equal to GNP in income, then NI apart from other ingredients embraces Governement purchases as well. Consequently, the method shown above dealing with inclusion of transfer payments into GNP also applied to NI.

As shown by McConnell and Brue (1990, ch. 9), according to the established tradition, indirect business taxes, though included in GNP (calculated according to income), are thought to be the unearned income of Government; that is why indirect business taxes are not included in NI.

As shown above, the economic ability of Government is an independent factor of production, and indirect business taxes are just Government profit, i.e. income from this factor of production. Thus the inclusion of indirect business taxes as Government profit in GNP, calculated according to income, is quite natural. But, if one takes into consideration that NI is no more than a sum of aggregate factorial incomes (i.e. aggregate rent, aggregate interest, aggregate wage, aggregate entrepreneurial profit), then NI must also include aggregate Government profit.

To illustrate changes in the meaning of GNP and NI owing to the above listed problems, we would like to adduce as an example empirical material based on the experience of the USA (see Table I) from McConnell and Brue (1990).

The upper zero index of indices in Table I indicates that they belong to the widely-accepted value in national economic accounting procedures, while an asterisk shows that they belong to values suggested in the present article. The correlation between indications in Table I is as follows:

CNP^0 + transfer payments = GNP^*

GNP^* – amortization = NI^*

GNP^0 – amortization –indirect business taxes = NI^0

Variables	1982 $ billions	1983	1984	1985	1986	1987	1988
GNP^0	3166.0	3405.7	3772.2	4014.9	4240.3	4526.7	4861.8
Transfer payments	505.1	552.3	592.8	644.4	682.8	715.3	767.9
GNP^*	3671.1	3958.0	4365.0	4659.3	4923.1	5242.0	5629.7
Amortization	383.2	396.6	415.5	437.2	455.9	480.0	505.0
NI^*	3287.9	3561.4	3949.5	4222.1	4467.2	4762.0	5124.7
Indirect business taxes	264.4	289.6	328.2	343.6	347.3	368.0	392.7
NI^0	2518.4	2719.5	3028.5	3234.0	3437.1	3678.7	3964.3
$(GNP^*/GNP^0).100$	116.0	116.2	115.7	116.1	116.1	115.8	115.8
$(NI^*/NI^0).100$	130.6	131.0	130.4	130.6	130.0	129.4	129.3

Table I. Correlation of the Traditional Values of GNP and NI in the USA 1982-1988 and Those Suggested by the Author

Table I indicates that the difference between GNP^* and GNP^0 is of the order of 16, and between NI^* and NI^0 of the order of 30 per cent. Hence the new viewpoint suggested in the present work concerning some problems in economics produces a considerable discrepancy in the indices used in national economic accounting.

Notes

1. The term under investigation "Government" in economic literature, as a rule, means not only executive, but legislative and legal power as well. Thus the term "state" proves to be more correct. Without breaking established tradition, the term "state" is used in the article.
2. As reported by Friedman and Friedman (1980), the division of society into rich and poor is not the result of the market system alone. In the history of humanity many cases have been known when market restrictions led to the property stratification of society; mediaeval Europe, India before independence, the former USSR are examples of this.

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