PUBLIC FINANCE – I

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Meaning

•Fiscal Economics was traditionally referred to as Public Finance.

•The term ‘Fiscal’ was derived from an Italian word ‘fisc’ meaning ‘treasury’.

•PF or FE in this context means income & expenditure of Governments & their multi-various roles in controlling financial matters in the country.

Definition

> “Public Finance is one of those subjects which lie on the border line between economics & politics. It is concerned with the income & expenditure of public authorities & with the adjustment of one with the other” – Dalton

Public Finance & Private Finance

Similarities

- Both deal with income & expenditure
- Money is spent for satisfaction of wants
- Both will have to borrow in case expenditure exceeds income
- Budgeting is done in both cases
- Scarce means - unlimited wants – choice difficult in both.

Dissimilarities

Private Finance

- Money is spent for personal satisfaction
- Scope of revenue/operation is very limited
- Expenditure is adjusted to income
- Secrecy is maintained
- Borrowing is limited
- Surplus budget
- Tries taking up short gestation period projects
- Micro problem
- Follows 'market principle'

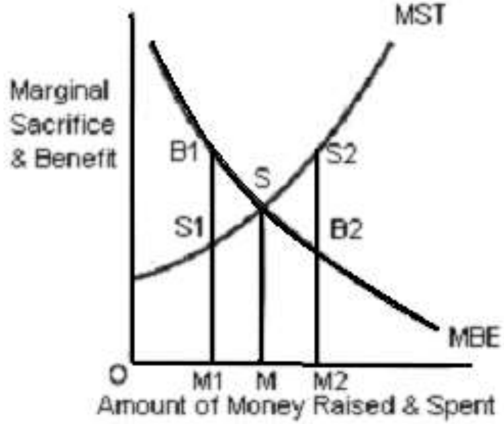
Public Finance

- Money is spent for collective satisfaction
- Scope is very large & is increasing
- Income is adjusted to expenditure
- Transparent
- Borrowing may be unlimited
- Deficit budget is preferred
- Takes up long gestation period projects
- Macro problem
- Follows the principle of 'quid pro quo'

Principle of Public Finance

•It means the fundamental rule which should determine the fiscal policy of the State.
•This principle is known as: The Principle of 'Maximum Social Advantage' or 'Maximum Social Welfare'.
•It was popularised by Dalton & Pigou.
•Classical economists like Adam Smith, J.B. Say, Alfred Marshall, etc. thought public expenditure to be unproductive & taxes to be evil.
•But, Dalton & Pigou counteracted it & said that the State should collect revenue & spend the money so as to maximum the welfare of the people.
•When the State imposes taxes, it creates some disutility.
•When State spends or makes public expenditure, some utility is created or gained.
•The objective of the State should be to minimise the disutility & maximise the utility.
• "Public expenditure in every direction should be carried just so far, that the advantage to the community of a further small increase in any direction is just counter-balanced by the disadvantage of a corresponding small increase in taxation or in receipts from any other source of public income. This gives the ideal total both of public expenditure & public income" - Dalton.
•Dalton called it the principle of 'Maximum Social Advantage'.
•Pigou called it the principle of 'Maximum Aggregate Welfare'.
•Musgrave advocated certain Principles of PF.
•We shall discuss Dalton's views in detail.

Attainment of Objectives
There are 2 approaches: Subjective & Objective.
❖**Subjective Method:**
•Use of psychological factors such as sacrifice, utility & benefit.
•The government taxes the people & makes expenditure, i.e., people will have to give some sacrifice so that they can get some benefit.
•In order to get more benefit more taxation is regarded.
•So, the government taxes the people till the marginal sacrifice is equal to the marginal benefit.
•At this point the net benefit of the people will be maximum.



MST = Marginal sacrifice due to tax; MBE = Marginal benefit of expenditure; S = Point of maximum social advantage; B_1S_1 represents that there are more benefits than sacrifices & so taxes can be levied upto point S; S_2B_2 represents more sacrifices than benefits & so taxes should be reduced upto point S.
•However, utility, sacrifice & benefit are psychological concepts & cannot be put into practical use, therefore Dalton developed an objective method.

Objective Method

1.There are some tests involved in this method which have to be satisfied. The tests are:-

•Non-Economic Test (or Protection Test)

•It refers to maintenance of the society & protection from external aggression & internal disturbance.

2. Economic Tests (divided into 4)

A. Production Test

➢Improvement in production

➢Improvement in the organisation of production

➢Change in the composition of production

B. Distribution Test

(i)Reduction in inequalities of income

(ii)Reduction in fluctuations of income between different periods

C. Stability & Full-employment Test

D. Provisions of Future Test