# CHAPTER 8

# PUBLIC FINANCE

## 8.1. INTRODUCTION

According to eminent economists, the public finance is a very important subject-matter for the government, planning authorities, and academicians which is mainly related to the advanced study of public revenue, public expenditure, financial administration and public welfare. Its basic applications are for the government of the country which has to perform a number of functions in the wider interests of the public and the country. The words "public finance" also refers to public economics where both of these words are supposed to be synonyms of each other. The importance of public finance has been acknowledged by the statesmen of all the countries of the world since ancient period in varied forms of its applications. In the modern era, public finance is a vital organ of administrative set-up in every country and it cannot be discarded anywhere in the world.

The modern economists opine that the application of public finance is inevitable in all the countries of the world. Therefore, public finance analysis has its unique importance in the academic circle in particular. A brief account of public finance analysis may be as follows :—

### 1. CONCEPT

The concept of public finance can be described elaborately by taking into account the main definitions of public finance given by eminent economists as follows :—

**(1) Dalton**—"Public Finance is one of the subjects that lie on the border line between Economics and Politics. It is concerned with the income and expenditure of public authorities and with the adjustment of one to the other."

**(2) Bastable**—"Public Finance deals with the expenditure and income of public authorities of the state and their mutual relation as also with financial administration and control."

**(3) Chapman**—"Public Finance is that part of political economy which discusses the ways in which government obtains revenue and manages them."

**(4) Carl C. Plehn**—"Public Finance is the science which deals with the activities of the statesmen in obtaining and applying the material means necessary for fulfilling the proper functions of the state."

**(5) Armitage Smith**—"The investigation into the nature and principles of state expenditure and state revenue is called Public Finance."

**(6) Findlay Shirras**—"Public Finance is the science which is concerned with the manner in which public authorities obtain their income and spend it."

**(7) Harold Groves**—"Public Finance is a field of inquiry that treats of the income and outgo of governments (federal, state, and local). In modern time this includes four major divisions : public revenue, public expenditure, public debt and certain problems of the fiscal system as a whole, such as fiscal administration and fiscal policy."

In the light of these main definitions of public finance, an essence of the derived concept of public finance is that it is a science which deals with the principles and practices of public revenue, public expenditure and public debt of public authorities, *i.e.* the governments of centre & state and their local bodies. Besides, it deals also with the related problems to the public revenue and public expenditure of the public authorities which includes financial administration and control.

**2. SUBJECT-MATTER**

The economic views of many authorities on public finance particularly Harold Groves are of great worth for the economists in specifying the subject-matter of public finance. In brief, it can be divided into five parts as follows :—

**(1) Public Revenue**—This part deals with different sources of public revenue, classification of public revenue, classification of taxes, canons of taxation, taxable capacity, impact of taxes, incidence of taxes, shifting of taxes, taxation problems, comparative analysis of various forms of public revenue, allocation of tax burden on tax payers, etc.

**(2) Public Expenditure**—This part deals with various overheads of public expenditure, classification of public expenditure, principles of public expenditure, comparison of different overheads of public expenditure, effects of public expenditure on various sectors of an economy, problems and remedies of public expenditure, etc.

**(3) Public Debt**—This part deals with the causes of public debt, methods of public borrowings, public debt management, classification of public debt, comparison of debt and taxes, comparison between internal and external borrowings, methods of redemption of public debt, effects of public debt on economy, problems related to public debt, etc.

**(4) Financial Administration**—This part deals with the preparation, sanctioning, and auditing of budget, publication of budget for public information, methods of financial administration, control and problems releated to the budgetary operation, etc.

**(5) Fiscal Policy and Economic Stabilisation**—This part deals with the use of fiscal measures to bring economic stability and growth in an economy, effect of public fund policy on economy, problems related to fiscal policy measures, etc.

**3. NATURE AND SCOPE**

The main definitions of public finance of the economists Dalton, Bastable, Chapman, Carl C. Plehn, Armitage Smith, Findlay Shirras and Harold Groves are very important in throwing light on the nature and scope of public finance. Some economists are of the view that public finance is a science which studies the principles of public revenue, public expenditure, public debt, and financial activities of financial administration of the government, *i.e.* public authorities which are meant for promoting the social welfare in the society. The raising of public incomes and funds and utilisation of public funds in various priority based sectors of society in accordance with the budget planning and also the justification of public finance operations are major studies in public finance. Some economists have further viewed that public finance is a normative science because it includes the study of application aspects of the principles of social welfare wherein principle of maximum social welfare propounded by Dalton is of vital significance. The disutilities of public expenditure and public sacrifices on account of tax levies are compared and optimal solution to the maximisation of social welfare problem is determined on the basis of principle of equilibrium. It helps in finding viable solutions to the practical problems of public finance operation related to incurrence of public expenditures and accruing of public revenues (particularly tax levies). Thus, it provides justification of public finance operations of public authorities and suggestive guidelines to the public authorities for maximising social welfare regarding their public finance operations. Hence, it is also supposed to be a normative science. In the realm of ethics, the public finance is a positive and normative science.

The scope of public finance is quite vast in the modern economies. The government's financial and administrative activities have enlarged upto very significant extent. It owes public welfare responsibilities and also the burden of national defence system lies on the government of a country. Under such a situation, public financial operations of the central, state, and local governments have become very large which are studied in public finance. The comparative analysis of public revenues, public expenditures, financial activities of public authorities, role of public debt in public finance operations, impact of public finance operations on various sectors of economy, optimal utilisation of public funds, maximisation of social welfare, etc. are various scopes of public finance in the present economies of the world.

## 4. PUBLIC FINANCE AND PRIVATE FINANCE

According to the economists the comparison between public finance and private finance is of vital importance. A brief account of this comparison between both of these sciences may be as follows :—

**Similarities**—There are certain common features between public finance and private finance as follows :—

**(1) Common Objective**--Both of these sciences have common objective, *viz.* the satisfaction of human wants. The only difference between these sciences is that public finance is concerned with the satisfaction of social or collective wants whereas private finance is concerned with the satisfaction of personal wants.

**(2) Common Constituents**—Both of these sciences have common constituents, *viz.* receipts, expenditures, debt, and financial administration. The economic stability problem is common to both of these sciences. The public finance deals with economic stabilisation problem throughout the length of country whereas private finance deals with economic stabilisation problem within an individual unit (person/firm).

**(3) Common Maximisation Goal**—Both of these sciences have common maximisation goal. The public finance deals with the efforts of maximising social welfare with the help of applying the principle of maximum social advantage whereas private finance deals with the efforts of maximising total satisfaction of consumer and producer with the help of applying the law of equimarginal utility and law of equimarginal productivity (law of substitution).

**(4) Common Problem of Adjustment and Economic Choices**—Both of these sciences have common problem of adjustment of income and expenditure and the problem of economic choice as both of these sciences are concerned with the satisfaction of unlimited wants with the limited resources at their disposal.

**(5) Common Surplus/Deficit Problem**—Both of these sciences have a common problem of surplus/deficit in their budgets in a given period. Either there may be a surplus of income over and above expenditure or there may be a deficit of expenditure over and above income in their budgets in a given period. If income exceeds expenditure, then there is surplus budget in a given period. On the contrary, if expenditure exceeds income, then there is deficit budget in a given period. In case of deficit budget, both of these sciences have to do deficit financing in their budgets by borrowings, *i.e.* debts but the nature of public and private borrowings differ to each other.

**(6) Inflationary Effect**—Both of these sciences are affected by the existing magnitude of inflation in the economy. The public and private budgets are affected by this inflation state of an economy.

**Dis-similarities**—There are certain dis-similarities between public finance and private finance which may be described as follows :—

**(1) Adjustment between income and expenditure**—The adjustment ways of public finance and private finance between income and expenditure are different to each other. In public finance, the public authorities first try to estimate their expenditure and then proceed for realisation of receipts, *i.e.* incomes through various sources of public revenue. On the other hand, the adjustment way is just reverse way of public finance in private finance. In the case of private finance, an individual first tries to estimate his limited and fixed income and then proceeds for his planning of his expenditure according to his income.

**(2) Income Source**—The income source of public finance is public revenue. There are various sources of public revenue, *viz.* taxable income (direct taxes and indirect taxes), administrative income (fees, licence fees, special assessment fees, fines and penalties), grants and gifts, public utility service prices, interests from banks and financial institutions, lotteries, ownership forfeiture, public funds, bonds, securities, issue of currency notes and coins, etc. The public authorities can have public revenue amount upto their unlimited desired extent. This is not possible in the case of private finance. The main sources of individual incomes are sale of service—personal service or service of his property etc. The incomes sources of private finance are limited because an individual has no right of earning income through taxes and issuing of currency notes and coins.

**(3) Objectives**—The objective of public finance is to maximise social utility and social welfare by a consciously planned public finance policy in the long-run. On the other hand, the objective of private finance is to maximise the total satisfaction of an individual where an individual has to judge the things by introspection as utility is subjective.

Thus, there are public expenditures according to the principle of maximum social advantage but there are private expenditures according to the law of equimarginal utility (*i.e.* law of substitution).

**(4) Credit Power**—Public Finance has unlimited credit power. Public authorities can have borrowings upto unlimited extent from internal and external sources. Private finance has limited credit power. An individual can have borrowings upto limited extent for a given period from the available limited sources.

**(5) Note-issue Authority**—The government has monopoly power of note issue. It is the sole note issuing authority in the country. Public expenditures can be met by issuing notes according to the needs. The deficit financing of public budget is possible by the government by issuing note in the country. This is an added advantage in public finance.

An individual has no such note-issuing authority. Therefore, private finance depends upon the available limited sources of individual income. The private expenditures can be met only through individual income.

**(6) Income Flexibility**—There is high income flexibility in public finance. The government can easily raise public funds and other public revenues from many sources of public revenue. This is not possible in case of private finance. There is low income flexibility in the private finance because the available sources of individual income are very much limited and scarce.

**(7) Guiding principle**—The public finance is guided by the budget principle whereas the private finance is guided by the market principle. The public finance operations are motivated by public welfare whereas the private finance operations are motivated by profit.

**(8) Publicity and Audit**—In public finance, the financial transactions are not preferred to be kept confidential. Rather, the public budget proposals and allocation of different resources to different heads in public plans are given wide publicity. The public accounts are subject to audit and inspection. On the other hand, the financial transactions are generally kept confidential in private finance and their publicity is avoided. The private accounts are often not subject to audit and inspection.

**(9) Nature of Budget**—The surplus public budget is supposed to be not good in the sense that the government could not spend the available public revenue in a proper way in public welfare programmes. It is a symbol of inefficiency of the government in the area of public expenditures. The deficit of public budget is supposed to be good for social welfare and development but it is not good in a broader sense because it creates inflation in an economy which may be harmful after certain extent. The balanced public budget is supposed to be best for maximising social welfare and regulating unwanted economic activities in the country. On the other hand, surplus private budget is a symbol of an individual's efficiency. Savings of an individual is supposed to be good for the contingency expense purpose.

**(10) Coercive Methods**—In the case of public finance, the government can use coercive methods for accruing public revenue from its various sources whereas an individual cannot use coercive methods for realising his income from the different sources of individual income.

**(11) Nature of Expenditure**—In the case of public finance, the government cannot avoid or postpone public expenditures in general practice but an individual can avoid or postpone private expenditures easily in the case of private finance.

## 5. IMPORTANCE

According to the economists the public finance occupies a place of vital importance for an over all economic development and maximisation of national welfare in the country. The essence of the importance of public finance can be easily acknowledged from its three

For

B. Com. I Sem II & M.Com IV Sem.

Business Economics & Public Finance

Meaning, definition, subject matter, Scope of Public Finance

Difference between Public Finance and Private Finance

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