Public Finance: an overview

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What is public finance?

- Study of finance related to government entities
- Management of country’s public revenue, public expenditure and public debt
  - Public revenue:
    - Tax resources: Direct tax & Indirect tax
    - Non-Tax resources
  - Public expenditure:
    - on infrastructure, defense, education, healthcare, etc. for the growth and welfare

What is public finance?

- Public debt:
  - Public expenditure exceeds public income
  - Gap (Deficit) occurs
  - Bridged by borrowing money
    - from the public, or
    - from other countries or
    - world organizations such as The World Bank. These
    - Such borrowed funds are public debt
  - Public finance explains the burden of public debt, why it is necessary and its effect on the economy
  - Also suggests methods to manage public debt

Functions of public finance

1. The allocation function
2. The distribution function
3. The stabilization function

The allocation function

- Two types of goods in an economy:
- Private goods: Exclusive - only those who pay can get the benefit of such goods Example – a car, a house.
- Public goods: Non-exclusive - everyone, regardless of paying or not, can benefit from public goods – example: public roads; parks; maintenance of law & order; Defence; public health, etc.
- Allocation function studies:
  - how to allocate public expenditure most efficiently
  - to reap maximum benefits
  - with the available public wealth

The distribution function

- Disparities of income and wealth in every country
- Such income inequalities increase the crime rate
- The distribution function of public finance is to lessen these inequalities as much as possible through redistribution of income and wealth
- Three measures
  1. A tax-transfer scheme or using progressive taxing

  [In simpler words charge higher tax from the rich and giving subsidies to the low-income]
  2. Progressive taxes used to finance public services such as affordable housing, health care, etc.
  3. A higher tax applied to luxury goods or goods purchased by the high-income group, for example, higher taxes on luxury cars

The stabilization function

- Economy goes through periods of booms and depression
- Normal and common business cycles lead to such scenario
- These periods cause instability in the economy
- The objective of the stabilization function is
  - To eliminate or at least reduce these business fluctuations and its impact on the economy
  - Policies such as deficit budgeting during the depression and surplus budgeting during the boom helps achieve the required economic stability

Similarities between public & private finance

- Rationality: Both the government & the individual try to maximize wealth
  - Any irrational behaviour— either by the government or y the individual spell disaster to individuals, and to the society as a whole
- Scarcity of resources
- Need to borrow
- Repayment of borrowed funds

Difference between the public & the private finance

POINTS OF DIFFERENCE	PUBLIC FINANCE	PRIVATE FINANCE
Objectivity	Promote society's welfare	Private consumption
Adjustment	Income to expenditure	Expenditure to income
Budget	Often deficit	Often balanced
Resource option	More	Less
Openness	Transparent	Secrecy
Size	Macro	Micro

Thank you