16.Public finance - public revenue - public expenditure; taxation - principles of taxation.

PUBLIC FINANCE

Public finance deals with the rising up of revenue and incurring expenditure by the public authorities. Dalton defines public finance as the science that is concerned with the income and expenditure of public authorities and the adjustment of one to the other. The basic role of public authorities is to mobilize resources through taxes, loans, etc. and utilize these resources for accelerating economic growth and also for bringing about the desired redistribution of income and wealth in the country.

i) Public Revenue

Public revenue is the income of the Government (central Government, state Government and local bodies). Government revenue can be classified into (a) tax revenue, and (b) non-tax revenue.

a) Tax Revenue: Taxes are compulsory contribution levied by the state for meeting expenses in the common interests of all citizens. Tax revenue can be classified into: (1) direct taxes and (2) indirect taxes.

1. Direct Taxes: A tax is said to be direct, if the tax payer bears the burden of the tax. He cannot shift the burden to any other person. E.g. income tax, wealth tax and gift tax.

Advantages: i) It varies according to the ability to pay and

ii) Cost of tax collection is low.

Disadvantages: i) Tax rates are fixed arbitrarily by the government and

ii) There is a possibility of tax evasion.

2. Indirect Taxes: Indirect tax is shifted by the payer to others. If sales tax is imposed on sugar, the producer or dealer who pays it passes it on to the next buyer and ultimately the burden is borne by the consumer. E.g. Sales tax

Advantages: i) It is more convenient, i.e., those who consume the commodity alone need to pay the tax.

ii) No tax evasion is possible.

Disadvantages: i) Every consumer, rich or poor, pays the tax at the same rate.

ii) Cost of tax collection is very high.

3. Customs duties: This refers to imposing of import or export duties on goods coming into or going out of the country respectively. The importers or exporters who pay such duties would shift the burden of the tax on the consumers. A duty is said to be **Specific** when it is imposed according to a standard of weight or measurement, E.g. 50 paise per metre of cloth or one rupee per 40 kg of wheat etc. The duty is called ***ad valorem***, when it is imposed according to value of the commodity. E.g. 100 per cent on the value of motor cars or television sets.

b) Non-Tax Revenue

It includes receipts such as fees for education and public health, fines, profits from public sector undertakings, income from public lands, forest, mines, etc. The central government also receives interest on loans from state governments.

1.Fee: It is a compulsory contribution made by those who obtain a definite service in return, E.g. Tuition fee, court fee, etc. In short, fee is charged for a specific service that is rendered primarily in public interest.

2. A license fee, however, is much more than the cost of service and there is not much of a positive service in return.

3. Fine: The court can impose fines for any default or irregularity or violation of law.

4 Price: A price is paid by an individual for a specific service rendered to him by the state. Many public sector undertakings realize revenue from the sale of their goods and services, E.g. Sale of petrol, traveling charges in railways, etc. The main characteristic of price is that it is a payment made by those who want to use that particular service. A fee is collected in the public interest where as a price is the payment for a service of business character. A tax is paid for a common benefit whereas fees and prices are paid for specific benefits.

5.Grant: They are given by a higher-level institution to a lower level institution. E.g. Central Government provides grants to state Government.

6.Gift: They are received from either government or private institutions or individuals. Gifts are also received from foreign governments.

c) Social and Economic Objectives of taxation are:

i) Reduction of inequalities in income and wealth.

ii) Increasing economic growth.

iii) Stabilization of prices.

d) Methods of Taxation: Taxes may be proportional, progressive, regressive and digressive.

1) Proportional Taxation: Whatever be the size of income, same rate or same percentage of tax is charged. The tax rate remains same, but the tax amount increases as the person's income increases. If the tax is levied at 10 per cent on income, a person who earns Rs.1,00,00 a year, will pay Rs.10,000 as tax, while a person who gets Rs.50,000 per year will pay Rs.5,000 as tax.

2) Progressive Taxation: In this case, the rate of tax increases with the increase in income. If a person earns Rs.50,000 per annum, he will pay a tax of 10 percent, i.e., Rs.5,000, while a person whose income is Rs.1,00,000 per year will pay a tax of 15 per cent. i.e. Rs.15,000.

3) Regressive Taxation: It is quite opposite of the progressive taxation. It implies higher rates of tax for lower income groups and lower rates of tax for higher income groups.

4) Digressive Taxation: A tax may be at a progressive rate upto a certain limit or level of income, beyond which a uniform rate is charged.

e) Canons of Taxation

The characteristics or qualities, which a good taxation should possess, are described as canons of taxation. Adam Smith has given the following four canons of taxation:

1) Canon of equality: The amount of tax must be in proportion to the ability of the tax payer, i.e., progressive taxation should be followed.

2) Canon of certainty: The time of payment, the manner of payment, and the quantity to be paid should be made clear to the tax payer well in advance and arbitrary fixation of taxes should not be there.

3) Canon of convenience: Tax payment should be made convenient to the tax payer. The time of payment and the manner of payment should be made convenient to the tax payer. Land revenue can be paid in installments after the harvest of crops.

4) Canon of Economy: Cost of tax collection should be very low. Cost of tax collection should be a small portion of the actual amount of tax collected.

f) Other canons of Taxation:

5) Canon of Productivity: A few taxes, which bring larger revenue, are better than many taxes which bring a very small revenue.

6) Canon of Elasticity: As needs of the state increase, the revenue should also increase. Some of the taxes should be capable of yielding more revenue when financial resources are needed very urgently to the Government, E.g. Income tax.

7) Canon of Simplicity and Flexibility: Tax system should be very easy to understand and it should be adjusted to new economic conditions.

ii) Public Expenditure

The expenditure incurred by public authorities is called public expenditure. Public expenditure has to provide not only social welfare but it has also to ensure economic stability and economic growth.

a) Canons of Public Expenditure: The following are the rules or canons that should guide the public authorities in the administration of public expenditure.

1) Canon of Maximum Benefit: Public expenditure should promote the maximum welfare of the society as a whole.

2) Canon of Economy: Unnecessary expenditure and wastage of financial resources should be avoided.

3) Canon of Sanction: The public expenditure has to be sanctioned by a competent authority before it is actually incurred.

4) Canon of Elasticity: It should be possible to the government to vary the expenditure according to the need or circumstances.

5) Canon of Surplus: Public expenditure should be always kept well within the revenue of the state so that a surplus is left at the end of the year. Government should avoid deficit budget in which public revenue is less than the public expenditure.

6) Promotion of Economic Growth and Stability: Public expenditure should promote economic development and economic stability directly and indirectly.

E. INTERNATIONAL TRADE

International Trade arises simply because countries differ in their demand for goods and in their ability to produce them. On the demand side a country may be able to produce a particular good but not in the quantity it requires. For example the crude oil production in India is less than the demand. In contrast, in gulf countries crude oil production is more than their demand. On the supply side, resources are not evenly distributed throughout the world. One country may have an abundance of land; another may have skilled labour force. These factors cannot be transferred easily from one country to another. Because these factors are difficult to shift, the alternative, i.e., moving goods made by those factors is adopted. If the terms of trade are appropriate, a country can specialize in producing those goods in which they have the greatest comparative advantage, exchange them for the goods they require from other countries. Thus, international trade arises. International Trade enables countries to obtain the benefits of specialization of other countries and improves the standard of living for all. It is obvious that, without international trade, many countries would have to go without certain products. By expanding the market, international trade enables many countries to go in for large-scale production. International trade increases competition and thereby promotes efficiency in production.

i) Balance of Payment: The Balance of Payment (BOP) is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time. The aim is to present an account of all receipts from goods exported, services rendered and capital received by residents of a country, and payments for goods imported, services received and capital transferred by residents of the country.

ii) Balance of Trade (BOT)

The difference between the value of commodities exported and value of commodities imported is known as the balance of trade. The main purpose of keeping these records (balance of payments and balance of trade) is to inform Government of the international economic position of the country and to help it in reaching decisions on the monetary and fiscal policies on the one hand, and trade and payment related matters on the other.

Chapter: 7 Questions for Review:

1.Choose correct answer from within brackets:

i) National income is a ________ (flow/fixed) variable.

ii) Share of agriculture and allied activities in national income if India is ________ (31, 41, 51) per cent.

iii) There is ________ (direct/indirect) relationship between value of money and price level.

iv) Inflation is ________ (sustained/sporadic) rise in prices over a long period of time.

v) ________ (Wealth tax/Sales tax) is an example of direct tax.

vi) Income tax is imposed based on the principle of ________ (progressive/regressive taxation.

II. Differentiate the following:

i) Gross National Product and Gross Domestic Product.
ii) Per capita income/personal income.
iii) Demand-pull and cost push inflation.
iv) Walking inflation and galloping inflation.
v) Monetary measures and fiscal measures of inflation control.
vi) Direct taxes and indirect taxes.
vii) Progressive taxation and regressive taxation.
viii) Balance of trade and balance of payment.

III Write short notes:

i) Measurement of national income.
ii) Difficulties in the measurement of national income.
iii) Functions of money.
iv) Quantity theory of money.
v) Different types of inflation.
vi) Canons of taxation.
vii) Causes, consequences and control measures of inflation.
viii) Public finance.
ix) Canons of public expenditure.

***