SYNOPSIS

1.1 INTRODUCTION

Public Finance is a study of income and expenditure of a government. It studies the income raised through revenue and expenditure incurred or spent on the activities of public authorities. Income and expenditure of the government are regulated through marginal adjustments so as to give the maximum public benefit. The term 'public authorities' connotes all sorts of governments though they differ in their functions, operations, sources of income and objectives of expenditure. Further, it relates to the raising and utilisation of their resources. In a narrow sense, they differ widely as concerned to the magnitude of areas and population which they govern, the nature of functions which they perform, different objects as well as different methods adopted to achieve the so called objectives in the form of income, revenue or purposes of expenditure and financial relations with other public authorities at national level or at international level. In a broad sense, these distinctions are only secondary. Basically, there is a difference in the Central or Federal, State and Local Governments.

In the modern era, the various governments all over the world have entered and are entering into a number of public projects for the economic and social security of their citizens such as railways, post & telegraphs, dams, heavy electrical, atomic energy projects etc. Moreover, with the adoption of planning in almost all the countries, the scope of state activity has considerably expanded. In this way, with the gradual expansion of the functions of the modern governments, the total public expenditure is increasing at a very rapid rate. On the other hand, the total expenditure and revenue of a government are much larger than the revenue and expenditure of a single man or single economic and social organisation. Thus various tools of public finance can be utilised as an instrument for bringing about the desired economic and social changes in a country.

1.2 ORIGIN OF PUBLIC FINANCE

The origin of public finance is traceable in the origin of the modern welfare state. Either due to necessity or due to man being by nature a political animal some form of governmental organisation has existed ever since man passed beyond the most primitive stage of development. In short, the origin of public finance is deep rooted in antiquity.

Public Finance in the Ancient and Medieval periods. Public Finance and its various aspects did not exist in the ancient periods. But remarks of Kalidasa, one of the greatest poets of the world, are relevant in this regard. He had remarked once, "It is only for the good of the people that the king collects taxes from them just as the sun draws moisture from the Earth only to give it back a thousand fold." Kalidasa's remarks thus compared public finance to the sun and the economy to the earth. Since then the science of public finance has travelled thus far and its importance has grown manifold. Despite increasing relevance and growing importance of the Public Finance, the remarks of Kalidasa still vibrate with the same intensity and context in which these were made in the ancient times. They very much explain the nature and scope of Public Finance. Hence the public finance studies the collection of revenue from the public and its spending for the welfare of the public.

In the medieval times, the public finance did exist and it was referred to fondly as 'Patrimonial Finance' in sharp contrast to what exists in the modern economics as 'Contributory Finance'. The kings used to exhibit paternalistic overtones in the conduct of the affairs of their kingdoms. In Germany, financial advisors appointed by the princes, called cameralists, too exhibited paternalistic attitude of the state by conceiving the state as a huge family with a grand estate of the kingdom as its property. There was virtually very thin line drawn between the 'welfare of the people on one hand and 'welfare of the state on the other.

Thus the science of public finance travelled from grabbing the etherial overtones in the ancient past to the paternalistic undercurrents of the feudal era, thus laying down a strong edifice of the public finance in the modern economics.

Discussion of the various aspects of the public finances has thus a long history. Adam Smith's well-known book An Enquiry into the Nature and Causes of the Wealth of Nations popularly known as The Wealth of Nations is exclusively devoted to the discussion of "The Revenues of the Sovereign or Commonwealth", "the sources of the general or public revenue of the society, and 'public debts'.

Besides Adam Smith, David Ricardo in his book The Principles of Political Economy and Taxation, published in 1817, devoted ten chapters to the discussion of the problems of taxation. Chapter VIII 'On Taxes' discusses the general effects of taxes while the remaining chapters deal with the effects of particular taxes such as those on rent, houses, profits, wages etc. Ricardo discussed the problem of public debt in his Essay on the Funding System.

In the same say, J.S. Mill, with whom the period of English classical economists ended, devoted sufficient space to the discussion on public finance in his well-known work Principles of Political Economy published in 1848. Seven chapters of book V of the Principles are devoted to the discussion of general principles of taxation, classification of taxes into direct and indirect taxes, effects of various taxes and the various problems of national debt. In short, the classical economists recognised the importance of public finance and divided the subject matter of public finance into state or government revenue, expenditure and debt aspects.

However, as a subject public finance lacked systematic discussion at the hands of the classical and the neo-classical economists and it received scant attention in the Marshall-Edgeworth era. It is evident from the fact that Alfred Marshall's well-known work Principles of Economics does not have any connected discussion of the problems of taxation. He has devoted sufficient pages in the different sections of the book developing the various aspects of the theory of taxation. Francis Ysidro Edgeworth also thought that the pure theory of taxation was concerned only with the laws of incidence and the principle of equal sacrifice. By the time the older discipline of the Political Economy was displaced, systematic discussion of public finance as a subject had almost disappeared from the important works of the great economists.

The corollary of this development was seen in the publication of books specially devoted to public finance. Charles F. Bastable's Public Finance was published in 1892 while Hugh Dalton's Principles of Public Finance first appeared in 1922. Following these works appeared Pigou's work entitled Public Finance in 1928. Since then, several significant studies have been made on the subject of public finance.

1.3 MEANING OF PUBLIC FINANCE

To understand the meaning of public finance, it is pre-requisite to have some knowledge of the words 'public' and 'finance. The word 'public' is a collective term which stands for the collection of individuals. In a wider sense, it refers to all the members of a community. The ordinary meaning of the term 'finance is money resource ie. coins or notes in a specified area (generally a country). In Public finance, the world 'public' is used in a narrow sense whereas the word 'finance is used in its wider sense.

1.3.1 Definitions

"Subject which is concerned with the income and expenditure of public authorities and with the adjustment of the one to the other."

Prof. Dalton

"Public Finance deals with the finance of the public as an organised group under the institution of the government. It, therefore, deals only with the finance of the government." **Phillip E. Taylor**

"Public Finance is the study of the principles underlying the spending and raising of funds by public authorities." **Prof. Finaly Shirras**

"Public Finance constitutes a study of the monetary and credit resources of the State." **J.K. Mehta**

"The complex problems that centre around the revenue expenditure process of government is referred to traditionally as public finance...." In other words, "the subject-matter of public finance is logically, though not solely concerned with the financial aspects of the business of government." **Richard A. Musgrave**

"Public finance deals with the provision, custody and disbursement of the resources needed for the conduct of public or government functions." **H.L. Lutz**

"The government means of allocation are accomplished through the budgetary practices of taxing and spending." **Prof. B.P. Herber**

In fact, the science of public finance studies and analyses the effects of government budgetary practices of taxing and spending as: (a) allocation of scarce productive resources, (b) distribution of income and wealth, (c) economic stability and full employment, (d) economic growth.

1.4 SCOPE OF PUBLIC FINANCE

By now, we have learnt that public finance is the study of the income and expenditure of the state. Thus, we can easily infer that it is as old as the state itself. Adam Smith, the father of Political Economy, is credited with having first started a systematic discussion on public expenditure.

"The main content of public finance consists of the examination and appraisal of the methods by which governing bodies provide for the collective satisfaction of wants and secure the necessary funds to carry out their purposes." **Mrs. Ursula Hicks**

"It deals only with the finances of the government. The finances of the government include the raising and disbursement of government funds. Public finance is concerned with the operation of the public treasury. Hence, to the degree that it is science, it is a fiscal science, its policies are fiscal policies, its problems are fiscal problems. "

Prof. P.E. Taylor

There is no denying the fact that the science of public finance deals with the finances of the state. But in public finance, we not only study the activities of the state as the want satisfying activities; but also study the financial implications and other aspects of such activities. As we know, a state, especially the modern one, has to perform manifold functions and for the performance of these functions funds are needed. So, the scope of public finance is the study of collection of these funds and their allocation to various branches of activities.

Thus, the scope of public finance may be summarised as under:

1. Public Revenue
2. Public Debt
3. Public Expenditure
4. Financial Administration

1.4.1 Public Revenue.

Public revenue concentrates on the methods of raising public revenue, the principles of taxation and its problems. In other words, all kinds of income from taxes and receipts from public deposit are included in public revenue. It also includes the methods of raising funds. It further studies the classification of various resources of public revenue into taxes, fees and assessment etc. Then, we study the principles which should govern the public revenue and various methods of raising it. Briefly, it deals with the canon of taxation. Taxation is the main item of public finance.

1.4.2 Public Expenditure.

In this part of public finance we study the principles and problems relating to the expenditure of public funds. This part studies the fundamental principles that govern the flow of Government funds into various streams. Then comes the study of method of actual expenditure of government funds on different items. We also study the classification of public expenditure on different bases. We also study theoretical set up of different criteria and the latest trends which have emerged in the public expenditure and try to find out the factors which were responsible for the latest trends.

1.4.3 Public Debt.

In this section of public finance, we study the problem of raising loans, Public authority or any Government can raise income through loans to meet the short-fall in its traditional income. The loan raised by the government in a particular year is the part of receipts of the public authority. But now the question is as to why these loans should not be included in public revenue. It is because the revenue raised by the public authorities are not to be paid back but the loans raised by the government within and without the country are always subject to repayment. This part of public finance also studies the reasons for which the loan is raised, the source of the loan, the method in which raised, the interest and the method of repayment. Thus, it examines the problem related to raising and repayment of loans.

1.4.4 Financial Administration.

Now comes the problem of organisation and administration of the financial mechanism of the Government. In other words, under financial or fiscal administration, we are concerned with the Government machinery which is responsible for performing various functions of the state. The budget is the master financial plan of every government. In the budget, anticipated revenue and expenditure are estimated le. the schedule of activities to be undertaken and the ways of financing these activities. The important matter related with the financial administration is the execution presentation and passing of the budget. The whole procedure of preparation of the budget, presentation of the budget, execution and evaluation of the budget, all these aspects fall in the subject-matter of financial administration.

From the above discussion, we can say that the scope of public finance is not static, but dynamic which is continuously widening with the change in the concept of state and its functions of the state. As the economic and social responsibilities of the state are increasing day by day, the methods and techniques of raising public income, public expenditure and public borrowings are also changing. In view of the changed circumstances, it has been given more responsibilities in the social and economic fields.

1.5 PUBLIC FINANCE AND RELATIONSHIP WITH OTHER SCIENCES

Public finance is a social science. It deals with the behavior of human and society as a whole. Thus, public finance has close relationship with different branches of social science which deal with human and society behavior. Therefore, it is curious mixture of economics, political science, history, psychology, ethics and law, and statistics etc.

1.5.1 Public Finance and Economics:

According to Dalton, public finance stands on the border line between economics and politics. From this, it is clear that public finance is closely associated with economics. The following points may establish the relationship between public finance and economics:

- Economics is a science which deals with the administration of scarce resources to satisfy unlimited human wants, thus, public finance is a subject which deals with the satisfaction of unlimited public wants by the state.

- Many problems of public finance are the subject matter of the economics such as taxation, shifting of resources from private hands to governments, incidence of tax burden etc.

- Fiscal policy of the government is very important aspect of public finance and has occupied a special significance in the study of economics since the great world depression of 1930.

- Various problems involved in public finance are solved with help of the principles of economics such as maximum social advantage equally and justice in taxation equal distribution of income and wealth.

1.5.2 Public Finance and Politics:

There is a close association between public finance and politics. As discussed earlier about the thought of Hugh Dalton who puts it as a subject on the border line between Economics and Politics, it is evident that the affairs of public finance is never going to hold its existence in the absence of the concept of state. The public finance deals with the study of activities allied to the financial affairs of the government. Government is a political entity which takes the decision regarding its financial policies and their execution. Public budgeting is an inevitable part of public finance. Aaron Wildavsky a great political economic scholar in his academic work "Public Finance Review" in 1961 suggested that budgetary decision making is largely political, rather than based on economic conditions. Thus, the political set up of the government has considerable impact upon public finance. Therefore the politics and its laws provide the frame work which reflects the laws of economics in order to discover the laws of public finance. The definition of public finance given by Dalton in which he has argued about politics as another end by which public finance stands, deals it's significant relationship with political science.

1.5.3 Public Finance and History:

Public finance is not as closely associated with history, as it is with economics and politics. History is the compilation of past events and the past experiences in the sphere of empire, emperor and public. In case of public finance, the history represents worthwhile and valuable information regarding public finance policies, the governmental activities, need of the state, duties of the state and the way the proved beneficial or wasteful. We find Chanakya and his excellence back in the history when he discussed about the concept of political economy. In fact every government in the past had to nourish the state and its people, either it had been democratic, autocratic, communist, monarchy or aristocratic. The history nourished the mechanism of raising funds and making expenditure on public and state welfare in different fashion. The history includes origin of the concept and the journey of its development as a discipline. We know very well that the concept of public finance and its subsidiaries begun to groom out remarkably since second half of the seventeenth century. Coming across the history, we come to know the shape and nature of public finance.

The fiscal policies of the government in past play vital role in making the history of public finance:

1.5.4 Public Finance and Psychology:

There is an intimate relationship between public finance and psychology.

Public finance studies human problems regarding different aspects of public activities concerned to the financial management through revenue earning and expenses, which ultimately depends upon human behaviour. Psychology is the discipline that includes the study of human behaviour. Therefore, the study of public finance would be more effective and purposeful when it is combined with the knowledge of psychology.

1.5.5 Public Finance and Ethics & Laws:

There is also an association between public finance, and ethics and laws. Different welfare schemes and financial problems of the government, such as, equity and justice in taxation transfer of wealth from rich to poor, and progressive taxation etc. require the involvement of judgments which are deeply concerned with ethics. Further public finance needs different laws and regulations in order to formulate and implement the public finance policies, thus, the legal frame work of the country provides the basis on which taxes are levied and collected, and public funds are allocated.

1.5.6 Public Finance and Statistics:

The relationship between public finance and statistics is accurate as 'Public Finance' is concerned with the collection of data concerned to revenue, expenditure and debts. Public finance depends upon correct, relevant and scientific data which establish its relationship with statistics. The past statistics of public finance (i.e. financial figures concerning budget estimated, amount disbursed on different heads, effectiveness and impact result) helps in formulating budget policy. The public budget itself is full of statistical data. Therefore, different methods of data collection, data analysis, statistical tools and techniques are used for the purpose. Statistical interpretation is required for forecasts and drawing conclusions. Thus, public finance is closely related with statistics.

Thus, it is quite clear that, the scope and wideness of public finance is not limited to subject specific, such as, either just economics or political science, but is also concerned and related somehow with the other disciplines to some extent. If those subjects are not put to be discussed along public finance, the healthy discussion or analysis in any circumstances would be almost impossible.

1.6 DISTINCTION BETWEEN PRIVATE AND PUBLIC FINANCE

Generally, the word 'finance is loosely used for both the public and private finance. By private finance, we mean the study of the income, debt and expenditure of an individual or a private company or business venture. On the other hand, public finance deals with income, expenditure and borrowings of the government. There are both similarities and dissimilarities in governmental financial operations as compared to the monetary operations of private businessman. An individual is interested in the utilisation of labour and stal at his disposal to satisfy social wants, In short, both private finance and public finance have almost the same objective of satisfaction of human wants. Again, private finance stresses individual gains whereas public finance attempts at promoting social welfare of the whole community. These two view points are correct to a greater extent only because

1.6.1 Similarities

Let us first of all examine the similarities between public finance and private finance.

1. Same Objective. Both the individual and the state have broadly the same objective viz, the satisfaction of human wants, Private finance is concerned with personal wants, welfare of the entire community.

2. Based on Rationality. Both kinds of finances are based on the concept of rationality. The individual is tempted by circumstances to act foolishly and irrationally, the government is also subject to whims in regard to decision of an individual. The decisions of government may also be unwise leading to destabilisation of the economy.

3. Both have to repay their Loans. Both in private and public finance, borrowing becomes essential, when the current income falls short of the proposed expenditure. An individual borrows from different sources like relatives, banks etc. to meet his personal requirements. Moreover, like the individuals, the state has to borrow from the public institutions and individuals. These borrowings of the state aim at accelerating the rate of development of the economy. But it is obligatory to repay the debt in both the cases.

4. Both have limited Resources. Both the private and public sectors have limited resources at their disposal and both the sectors always endeavour to make optimum use of their resources. In other words, both face the problem of adjustment between income and expenditure i.e. unlimited ends with minimum resources. Consequently, none of the two is capable of raising its expenditure beyond a certain limit.

5. Efficient Management. Private as well as public finance need efficient management and administration. In the event of the collapse of an efficient administration, both are compelled to face dire consequences in their financial matters.

The above facts clearly make a point of similarities between the public and private finances. However, despite these similarities, glaring differences between the two forms of finances are found.

1.6.2 Dissimilarities

The dissimilarities between the private and public finance are quite sharp in the matter of motives, methods of finance and extent of resources.

Following are some of the main differences between the public and private finance.

1. Adjustment of Income and Expenditure. Generally, public authorities have a different approach as regards to the adjustment of income and expenditure. An individual attempts to adjust his expenditure to his income while public authorites adjust their income to their expenditure.

"While an individual's income determines his expenditure, a public authority's expenditure determines its income." Prof. Dalton

2. Different Motives of Expenditure. Another important difference exists between private and public finance as regards the motive of expenditure of individuals and the government. The modern government exists for the welfare of the community and not for any particular individual or group of individuals. The individuals think of earning profits for themselves but there is no such apprehension on the part of the government. Generally, the government follows the motto of no profit no loss.

3. Nature of Resources. There is a difference between private and public authorities as regards the nature of resources. The resources at the disposal of the individual are limited, but those of the public authorities are enormous. They can draw upon the entire wealth of the community, by using force, if necessary. No tax-payer can deny to pay taxes if he is liable to pay them.

4. Principle of Equi-Marginal Utility. For an individual, it is easy to plan his expenditure on the basis of the law of equi-marginal utility. But it is very difficult for the government. An individual is free to base his expenditure on various commodities and services in the sense of utility and spend his money to the point where the marginal utilities of the commodities become equal.

5. Compulsory Character.

"Another characteristic of public expenditure is its compulsory character". Prof. Findlay Shirras

The public authorities cannot avoid or postpone certain expenditures. On the other hand, in the case of individual, it is quite possible to do so. The expenditure on defence is of compulsory nature. Besides, state can force people to consume a particular variety of cloth, wheat and other commodities on the fixed price. But it cannot be done in the case of private individuals and business concerns.

6. Coercive Authority. There is a difference in public finance and private finance in respect of degree of their coercive authority. Private individuals can never use force to get their revenue, while public authority can realise its revenue by using many coercive methods. Suppose a person who is liable to pay the taxes, does not pay income-tax, he can be prosecuted in the Court of Law or he can be penalised by the way of increasing the burden of tax. In other words, no individual can refuse to pay taxes, if he is liable to pay them.

7. Budgeting Differences. There is a difference between public and private finance in the matter of their budgeting. Firstly, an individual business house believes in surplus budget (i.e. in spending less than the income). They consider deficit budget (spending more than income) most undesirable. The government may find it useföl to have a deficit budget for several years especially during the period of war or economic development. To an individual, surplus budgeting is good as it implies saving. Individual saving is a virtue since only through saving one accumulates capital and becomes rich. The public authority, on the contrary, may or may not go in for surplus budgeting. They may bring about a surplus either through a high level of taxation

or through a low level of expenditure, both of which may not be liked by the general public.

8. Long-term Considerations. Another fundamental difference is found between private and public finance in the matter of the provision made for the future by a private individual and public authorities. Investment of private companies or individuals is found liberal in those fields of business where returns are quick and immediate. But the government is never influenced by such considerations. The government is the guardian and custodian not only of the present generation but of the future generation also. It always adopts the approach of far-sightedness. So, certain expenditure of public authority is made for future as well as for the present.

9. Secrecy and Adult. Private businessman generally believes in the philosophy of secrecy and does not like to show his financial affairs to others. On the other hand, the government gives the greatest publicity to its budget proposals. In fact, publicity strengthens the public credit. Public is entitled to know, criticise the policy matter of the government. Press is also free to comment on it.

1.7 IS PUBLIC FINANCE A POSITIVE OR A NORMATIVE SCIENCE?

Public finance faces a burning controversy whether it is a positive science or a normative science. Different opinions can be mentioned in favour of any branch of the subject. Let us make a detailed case to have a clear idea of the subject.

1.7.1 Public Finance-as a Positive Science

During the ancient period, no weightage was attached to the subject as there was complete absence of government control, no unification of the people and no common etonbe performed faith efforts were made to achieve any car with minimum functionsblic sector. by the government, in other words, there was complete absence of public sector. Private sector thenente in other words the these sircumstances, public finance was confined only to revenue, expenditure process of the governments. According to Prof. A.R. Prest classical scholars were divided on the question of subject-matter of public finance into revenue, expenditure and debt aspects.

The neo-classical economists, of course, do not lay much emphasis on the subject of public finance. However, a systematic study was made by Prof. Bastable. Later on, Dalton defined as it was concerned with income and expenditure of public authorities and with the adjustment of one to the other. Similarly, other modern economists like Lutz, Care C. Plehum, Phillip E Tayler, Harold Liroues etc. also defined the concept in a traditional fashion. As a positive economics, they are concerned as to how public authorities have collected revenue, how they make public expenditure and how both are administered. They are least interested to know how revenue and expenditure of the public authroity affect, or will affect the social and economic aspects of life. In other words, the study of effects of fiscal operations or budgetary process were not considered and outrightly rejected the normative aspect of the subject.

1.7.2 Public Finance-as a Normative Science

After the great depression of 1929-30, radical changes took place in the world economy JM. Keynes in his, "General Theory of Employment, Interest and Money" has greatly influenced the economic activities and the level of employment has become an integral part of the subject of public finance. Saying good-bye to old version of "Laissez faire (Supply creates its own demand), new functions were assigned to state. Keynes demonstrated that it was through fiscal activities of the state to increase employment and to maintain the same at a high level. Specific arguments were extended in favour of the public sector. Thus, some economists accepted public finance as a normative science.

Thus, various definitions given by modern scholars are true which explain the efforts of fiscal operations. They are Musgrave, Brownlee and Allen, Herber, Shirras etc. who consider subject matter of public finance as a normative science. Actually, they have broadened the scope of public finance. They include not merely revenue and expenditure process of the government but also the effects of fiscal operations upon the fiscal and economic aspects of the economy. Musgrave argued that the fiscal problem is pure and simple. It should not be confused with alien considerations of social and economic policy.

Again, in the field of taxation, public expenditure, borrowing and deficit financing government can do a little with the help of adding value judgment. In other words, it means that the effects of fiscal operations are not only explained but it can also be assessed as to what extent they are good or bad. Actually, it is the welfare aspect of the subject, which makes public finance a normative science. The principle of maximum social advantage is the guiding principle of public finance.

"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 advantage of corresponding small increase in taxation or in receipts from any other source of public income", Dr. Hugh Dalton

Hence, public finance cannot ignore the version of 'what ought to be which even neo classical economist Robbin left it untouched. Robbin always treated economics as positive science. On the contrary, public finance has been recognised as a normative science Therefore, fiscal operations are used to check fluctuations in trade cycle, reduce unemployment and under-employment, help equal distribution of income and wealth, capital accumulation, economic stability with growth and to reduce regional disparities

1.8 ROLE OF PUBLIC FINANCE IN DEVELOPING AN ECONOMY

The study of public finance is acquiring an important place in the modern economic analysis. The functions and responsibilities of a state are changing day by day. The days of laissez faire have gone. In those days, the primary aim of the state was to raise funds so as to meet the financial requirement for the maintenance of law and order. According to this philosophy, almost all economic decisions were guided by the market forces demand supply which would act as an invisible force. The role of the government was not to interfere with the working of the market forces but only to maintain itself and to create the necessary administrative, judicial and police set up. But now a days every government wants to secure social welfare for the country. The economic responsibility of the government is increasing.

"The basic principle of public finance is that of maximum social advantage". Dalton

Thus activities of public finance can be extended to all aspects of life of an individual as well society as a whole.

Now, everybody feels that public finance operations should contribute to the maximisation of social and economic well being of the people. It simply consists of maximisation of production and its equal distribution to provide equal opportunities for all to make development. Public finance operations such as contra-cyclical budgeting, grants and subsidies, public borrowing, taxation and well planned expenditure system help to secure maximisation of production and equitable distribution. Briefly, we can say that public finance operations are made for the promotion of investment, maintenance of economic stability, promotion of economic growth and equal distribution of wealth in the developed and under-developed countries.

In short, public finance can accelerate the economic development in many ways such as increasing the rate of saving and investment, promoting economic stability, securing equal distribution of income and wealth.

1.8.1 Now, let us highlight the role of public finance as below:

1. To Increase the Rate of Saving and Investment. In underdeveloped countries there is lack of financial resources and it is the main bottleneck in the economic progress of the country. There are many factors responsible for reducing savings and increasing consumption. The increasing population is the main force among them. The people belonging to high income group spend much of their income on conspicuous items. This has further demonstrative effect. Moreover, a large part of savings is utilised in unproductive items like hoarding, gold, jewellery etc. To check this consumption of unproductive channel, the commodities of conspicuous consumption should be highly taxed. High taxes should also be imposed on personal income and

corporate income. Here, both direct and indirect taxes become indispensable in the absence of sufficient voluntary saving.

"Taxation, therefore, remains the only effective financial instrument for reducing private consumption and investment and transferring resources to the government for economic development." The Economic Bulletin for Asia and the Far East Estates

2. To Secure Equal Distribution of Wealth and Income. Unequal distribution of Income and Wealth is the basic problem of the underdeveloped countries. The rich are getting richer and richer while the poor are becoming poorer and poorer. This situation hinders the economic development of these countries. To some extent, progressive taxation in direct taxes and heavy taxation on luxury goods can help to bring equality in the distribution of income and wealth. The government can make investment in various fields to raise the income of the poor. Consequently, it would increase in the volume of output and employment. Simultaneously, redistributive role of fiscal measures, equal opportunities and balanced regional development programme contribute to raise the level of national income. Moreover, Income-elastic tax system can play a major role in equal distribution of wealth. For this purpose, it is necessary that the tax structure should be flexible.

3. To Counteract Inflation. The imbalance between demand for and supply of real resosates may lead to inflation to underdeveloped countries. Inflation ruins the entire economic structure of the nation and the process of economic development in these countries comes to stand sti It is, therefore, economic growth and stability which are the main objectives in the underdeveloped countries. In other words, the choice should not

only be between growth and stability bu inter-relationship between them can help to achieve the desired results. Furthermore, in order to check inflation, budgetary policies can be used by the government. Progressive taxation-direct taxes and commodity taxes should be imposed. Taxes on articles of conspicuous consumption should be imposed. Similarly, special anti-inflationary methods can be taken to meet the challenge.

4. Full Employment and Economic Growth. In the modern times, the states are welfare states and their main aim is to provide work to their citizens and raise their standard of living In developing countries, the governments try to create the condition of full employment, these countries, the governments work for high standard of living and the rate of economi growth is also accelerated. The nation's economic policies can help in attaining the goal of full employment and rapid economic development. Capital Formation. We know that development entirely depends on the rate of capital formation in the country. The first and foremost aim of public finance is to promote capital formation.

"For an undeveloped country all economic policies and measures in the initial stages must concentrate on production and fiscal policy should act as a tool of capital formation." Dr. Baljit Singh

Capital formation can be increased through an effective and well-planned taxation policy.

"For economic development, it is not the aim of public finance to bring about reduction in inequalities of incomes but its aim is to increase that proportion of the income which goes into capital formation." R. Nurkse

6. Planned Economic Development. In underdeveloped/developing countries the productive resources are limited in quantity as well as quality. Public finance provides valuable help in the planned economic development of the country. The entire machinery of planning works through the mechanism of public finance. The principles of public finance have importance in the sphere of rapid economic planning because both these activities of the state are closely related.

7. Reduction in Economic Inequalities. Another problem of underdeveloped or developing countries is the unequal distribution of income and wealth. Public finance, therefore, has an important role to play in this context. For example, the Government can impose heavy taxes on the richer sections of the society and spend the income so received on providing cheap food, cheap housing, employment, free medical aid etc. for the poorer sections of the society.

8. Optimum Utilisation of Resources. Underdeveloped or developing countries face the problem of non-utilisation or even destruction of the scarce and limited resources. The solution of this fundamental problem lies in the optimum utilization of available resources. This is possible by adopting proper monetary and fiscal policies.

9. Public Finance and Economic Life of the People. The economic life of the people is greatly influenced by the activities of the government. Various taxation policies are introduced to influence the productive activities of the people. The government spends its revenue to provide better amenities to the common masses. On one side, the government introduces financial policies so that the gap between the income of the individual may come down. On the other, it imposes high taxes on the luxurious

commodities. It discourages the use of goods like liquor and other intoxicating goods by imposing heavy taxes. They, in turn, help to discourage the anti-social activities. Simultaneously, the government can give tax relief on certain goods to push their production.

1.9 IMPORTANCE OF PUBLIC FINANCE

Public Finance had little importance in the 19th century. The reason was that the government in those days did not intervene in economic affairs. Adam Smith, Ricardo etc. Were the ardent supporters of Laissez-faire Policy and believed in the minimum possible state interference in the affairs of the public. During the 20th century, public finance has come to the forefront on account of the new concept of 'Welfare State. Modern Governments do not confine themselves to maintenance of law and order only. On the contrary, they actively intervene in economic matters.

"Finance is not mere arithmetic, without sound finance no sound government is possible and without sound government no sound finance is possible." James Wilson

Hence, the importance of public finance has increased vastly in recent years.

1.9.1 The importance of public finance is evident from the following:

1. Expansion of State Activities. From the time the state came into being as an organised institution, the importance of public finance is constantly increasing day-by-day. The reasons for such an increase are two-fold. Firstly, the activities of the state are not confined to looking after the security of life and property against foreign aggression only. As social life became more complex, the state found it necessary and possible to take upon itself some

further obligations such as those of protection against internal disorders, regulation of trade and commerce, development of industry, planned economic development of the country. Secondly, there are political reasons for the increasing importance of public finance. There has been the gradual drift of public sentiment from capital economy to socialist economy. With the growth of the duties and functions of the state, the study of public finance has naturally attained particular significance and importance of public finance is thus constantly increasing in modern times.

2. Growing Use of Money. Another reason for the increasing importance of public finance has been the growing use of money and particularly of credit in modern times. With the increasing use of money in all the spheres of life, all functions of the state came to be performed through this medium. With the widening of state activities, separate department of public finance came into being.

3. Reduction in Economic Inequalities. Public finance can play a vital role in reducing economic inequalities which is the cause of dissatisfaction, class-struggle, poverty etc. The state can levy heavy taxes on richer sections of society and thereby spend the income so received on providing food, cheap housing, free medical aid etc. for the poorer sections of the society. Similarly, heavy taxes can be imposed on the use of harmful commodities, such as harmful drugs, wine, opium, hashish etc.

4. Emergence of Generalised Services. The importance of public finance has also increased due to emergence of generalised services which can be performed more conveniently, efficiently at the minimum cost. Such services are education, health, social security and protection from certain uncertainties. The need for

such generalised services is increasing day-by-day, increasing significance of the public finance in turn.

5. Increases Employment. Public finance can play crucial role in increasing employment which is the burning problem of almost all the countries of the world. The Government provides grants, subsidies, grant exemption from excise duty, sales tax etc. to employment-oriented cottage and small-scale industries. Unbalanced budget is also an indispensable measure of increasing volume of employment during depression.

6. Importance in Underdeveloped Economies. Public finance has also assumed great importance in underdeveloped economies. Today, there is the majority of nations which are backward or underdeveloped. The vicious circle of poverty has encircled the economies of these nations in the form of low per capita income, low standard of living, low saving, low investment and capital formation, all-round poverty, mass unemployment and further, slow rate of economic growth. Public finance can play vital role in increasing capital formation, savings, incomes, standard of living, national and per capita income, employment, planned economic development, prosperity and rapid reduction in poverty.

7. Importance in Developed Countries. It is generally accepted that the main problem of industrial or high income economies, ie. developed countries, is stability in business conditions with all-round rapid progress in the economy. Therefore, fiscal policy has assumed effective means of stabilisation in developed countries. They have no other alternative except option of correcting the fiscal policy.

8. Importance in Developing Countries. The basic problem of a developing country is rise in capital formation and rapid economic growth.

"Fiscal policy has a great and positive role in the context of rise in capital formation and rapid economic growth in a developing country like India." Raja Chelliah

Fiscal policy is, thus, regarded as the most powerful weapon of control which the state can wield, Capital accumulation can be done by adopting a positive taxation policy.

9. Useful in Social Field. Public financce plays an active role in organising and directing social welfare programmes, uplifting of backward classes, controlling consumption of harmful commodities, removing social inequalities etc.

From the above study, we can conclude the discussion on the importance of public finance with the similar views of Prof. Colin Clark.

"Those who are working in the field of public finance- are not merely technicians and administrators. They are playing an essential part in determining the future of their country." Prof. Colin Clark

1.10 PUBLIC FINANCE IN UNDERDEVELOPED COUNTRIES

The objectives of fiscal policy are more or less the same in developed and underdeveloped countries. It is true that there is almost a basic difference between advanced and underdeveloped economies. In developing countries, the chief motto of the government is to encourage production in order to fight the grave problems of unemployment, price-hike and to check the problem of poverty.

"It is now not only accepted but expected that government should take strong positive action to faster development."A.R. Prest

In an underdeveloped economy, on the other side, there is scarcity of productive resources and paucity of capital formation and investment. Some economists argue that fiscal policy may not be effective in an underdeveloped economy as the economic and financial institutions are not so well developed.

But truly, fiscal policy has a positive role to play in an underdeveloped economy as stated under:

(a) Firstly, the state is called upon to play a prominent role in promoting economic development especially through control and regulation of economic life. It is seen that fiscal policy is the most powerful weapon which the state can employ to promote economic development.

(b) Secondly, capital accumulation is the key problem of an underdeveloped country and this can be done through taxation.

"It is believed that public finance assumes a new significance in the face of the problem of capital formation in underdevelopled countries." Nurkse

(c) Lastly, under democratic planning, fiscal policy plays crucial role as financial plan is as much important as physical plan and the implementation of the financial plan will obviously depend upon the uses of fiscal measures.

Hence, public finance has assumed a great importance and is increasing day-by-day. For that reason, the State has started performing manifold functions. In such economies, to push capital formation, State authorities adopt various measures such as curtailing of expenditure on public work and compulsory saving schemes etc. These measures are also useful to check the inflationary trend.

"Over a wide range inflation can be effective as an engine of forced saving". Prof. Ragnar Nurkse