1. WHAT IS PUBLIC FINANCE?

In simple terms, public finance is the study of finance related to government entities. It revolves around the role of government income and expenditure in the economy.

Prof. Dalton in his book Principles of Public Finance states that "Public Finance is concerned with income and expenditure of public authorities and with the adjustment of one to the other".

Prof. Otto Eckstein writes "Public Finance is the study of the effects of budgets on the economy, particularly the effect on the achievement of the major economic objects growth, stability, equity, and efficiency."

By this definition, we can understand that public finance deals with income and expenditure of government entity at any level is it central, state or local. However in the modern day context, public finance has a wider scope – it studies the impact of government policies on the economy.

2. THE SCOPE OF PUBLIC FINANCE

Prof. Dalton classifies the scope of public finance into four areas as follows –

PUBLIC INCOME

As the name suggests, public income refers to the income of the government. The government earns income in two ways – tax income and non-tax income. Tax income is easy to recognize, it's the tax paid by people of the country in the form of income tax, sales tax, duties, etc. On the other hand non-tax income includes interest income from lending money to other countries, rent & income from government properties, donations from world organizations, etc. This area studies methods of taxation, revenue classification, methods of increasing government revenue and its impact on the economy as a whole, etc.

PUBLIC EXPENDITURE

Public expenditure is the money spent by government entities. Logically, the government is going to spend money on infrastructure, defense, education, healthcare, etc. for the growth and welfare of the country. This area studies the objectives and classification of public expenditure, effects of expenditure in different areas, effects of public expenditure on various factors such as employment, production, growth, etc.

PUBLIC DEBT

When public expenditure exceeds public income, the gap is filled by borrowing money from the public, or from other countries or world organizations such as The World Bank. These borrowed funds are public debt. This area of public finance explains the burden of public debt, why it is necessary and its effect on the economy. It also suggests methods to manage public debt.

FINANCIAL ADMINISTRATION

As the name suggests this area of public finance is all about the administration of all public finance i.e. public income, public expenditure, and public debt. Financial administration includes preparation, passing, and implementation of government budget and various government policies. It also studies the policy impact on the social-economic environment, inter-governmental relationships, foreign relationships, etc.

Economic Stabilization:

Now, a day's economic stabilization and growth are the two aspects of the Government economic policy which got a significant place in the discussion on public finance theory. This part describes the various economic policies and other measures of the government to bring about economic stability in the country.

3. FUNCTIONS OF PUBLIC FINANCE

There are three main functions of public finance as follows –

THE ALLOCATION FUNCTION

There are two types of goods in an economy – private goods and public goods. Private goods have a kind of exclusivity to themselves. Only those who pay for these goods can get the benefit of such goods, for example – a car. In contrast, public goods are non-exclusive. Everyone, regardless of paying or not, can benefit from public goods, for example – a road.

The allocation function deals with the allocation of such public goods. The government has to perform various functions such as maintaining law and order, defense against foreign attacks, providing healthcare and education, building infrastructure, etc. The list is endless. The performance of these functions requires large scale expenditure, and it is important to allocate the expenditure efficiently. The allocation function studies how to allocate public expenditure most efficiently to reap maximum benefits with the available public wealth.

THE DISTRIBUTION FUNCTION

There are large disparities of income and wealth in every country in the world. These income inequalities plague society and increase the crime rate of the country. The distribution function of public finance is to lessen these inequalities as much as possible through redistribution of income and wealth.

In public finance, primarily three measures are outlined to achieve this target –

- A tax-transfer scheme or using progressive taxing, i.e. in simpler words charging higher tax from the rich and giving subsidies to the low-income
- Progressive taxes can be used to finance public services such as affordable housing, health care, etc.
- A higher tax can be applied to luxury goods or goods that are purchased by the high-income group, for example, higher taxes on luxury cars.

THE STABILIZATION FUNCTION

Every economy goes through periods of booms and depression. It's the most normal and common business cycles that lead to this scenario. However, 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 time of depression and surplus budgeting during the time of boom helps achieve the required economic stability.