

Public Finance – meaning, Role and importance of Public finance - functions of the government – Differences between public finance and private finance

PUBLIC FINANCE

Every Government has to perform different functions and for this purpose it requires funds. These funds however are contributed by the every citizen of the country. The contribution may be less or more but it is necessary. Thus Public Finance deals with “Why Government takes money how it gets money and where it spends money?”

Distinction between Public and Private Finance:

Individual and states are similar in that they

1. Both require resources
2. Both have to maximum results from their resources.
3. Both attempts to get the best out of all items of expenditure.

There are, however, some important differences between private and public finance: They are

	Public Finance	Private Finance
1	State’s proposed expenditure determines its income.	Income determines its expenditure
2	A public authority can vary the amount of its income and expenditure within limits	An individual can not change his income and expenses easily.
3	A state is always repay its funds to people in services and does not save the funds.	After meeting the needs, individual prefers for saving the income.
4	State budgets are generally for one year	For individual there is no fixed period of time. The income expenditure is continuous.
5	The state budget is public	It is kept a secret.
6	State can issue paper Currency to meet its Expenditure.	It is not possible for individual

Importance of Public Finance

Every body realizes necessity of money. The importance of money is too much not only for individual but for state (Government) also. The state has to perform number of

functions for which money (funds) is required. In developing countries like India, Government is performing many important functions like education, industrial and agricultural developments but lack of funds is one of the constraints. For beginning of any function funds (finance) is must and in view of this the public finance nowadays has vital importance. Its importance can be easily understood from the **functions of the Government**. They are

- 1) Allocative Function: It refers to the process by which total resource use is divided between private and social goods by which the mix of social goods is chosen, this is done by the budgetary policy.
- 2) Distributive function: The budgetary policy also affects the distribution of income in the community. The tax and expenditure measures are adopted to modify the existing distribution with a view to reducing economic inequalities.
- 3) Stabilization function: The budgetary policy can also be used to maintain a high level employments reasonable degree of price level stability, an appropriate rate of economic growth and stability in the balance of payment.

Apart from these, public finance is important because it is an effective instrument of state control over the economy. The study of public finance is especially important for the under developed countries as management of state finances is essential to break the vicious circle of poverty.

Public revenue – meaning, major and minor sources of public revenue

PUBLIC REVENUE

The expenditure of the Government has to be met from the revenue that is accrued by the Government from various sources.

Sources of revenue

The functions of Government are very important and extensive which require heavy expenditure. Government has to undertake important functions like defense (internal and external), Social welfare, education, health, industry, agriculture. For all of these a huge amount of funds is required.

The major sources of revenue for the Government are in the form of Taxes and Prices while the minor sources are Fees, Special assessment, Escheat, Grants, gifts donations, tributes and indemnities.

Major Sources:

1. **Tax:** A compulsory contribution imposed on the public. (Details discussed in the next chapter)
2. **Price:** A price is the payment for a service of business character, for example, charges for travelling on railways. The price is different from fee. The fee is for public interest. You can escape a price by not purchasing the said service / commodity.

Minor Sources:

1. **Fee:** It is also a compulsory payment but made only by those who obtain a definite service in return from the government. The fee covers the part of the cost of service provided to the consumer / client. The licence fee, however, is much more than the cost of service and there is not much of a positive service in return.
2. **Special Assessment:** This is a compulsory contribution, levied in proportion to the special benefit derived, to defray the cost of a specific improvement to property undertaken in the public interest. Suppose the government build a road or bridge or provide mass transport system or makes suitable sewerage and water supply arrangements, all the property will appreciate in value. The State has the right to levy a special tax on the owners of land or property known as ‘special assessment’.
3. **Rates:** They are levied by the local bodies, municipalities and district boards for local purposes. They are generally levied on immovable property of the residents, but not necessarily for any special improvements effected or special benefits conferred.
4. **Escheat:** It refers to the property that is claimed by Government of the deceased without successors or will.
5. **Tributes and indemnities:** Tributes are paid by the conquered countries. Indemnities are paid for any damage done to the country by way of war of aggression.

Tax – meaning, classification – direct and indirect taxes, methods of taxation - proportional, progressive, regressive and degressive taxation, Agril taxation – other types of taxation, VAT.

Seligman defines tax as a compulsory contribution from a person to the state to defray the expenses incurred in the common interest of all, without reference to special benefit conferred.

METHODS OF TAXATION

1. Proportional & Progressive Tax: A proportional tax is one in which, whatever the size of income, same rate or percentage of tax is charged.

On the contrary, progressive tax refers to the tax system in which the rate of tax increases with the increase in income. It is based on the principle ‘higher the income, higher the tax’.

2. Regressive & Degressive Tax: A tax is said to be regressive when its burden falls more heavily on low-income earners / poor than the high-income earners / rich. It is opposite of progressive tax.

A tax is called degressive when the higher income does not make a due sacrifice, or when the burden imposed on them is relatively less. This tax may be progressive up to a certain limit beyond which a uniform rate is charged.

CLASSIFICATION OF TAXES:

Specific Tax, Advolarem Tax & VAT: A specific tax is according to the weight of the commodity. An advolarem tax is according to the value of a commodity. Value Added Tax(VAT) is levied on businessmen on all the processes carried out by them.

Direct & Indirect Tax: Direct tax is one which is paid by the person on whom it is charged. The examples of direct taxes are income tax, wealth tax, etc.

On the contrary, the indirect tax is paid by one person and its burden is fallen on other, generally the consumer. The examples of indirect taxes are sales tax, central excise duty, custom duty, recreational tax, etc.

Agricultural Income :Agriculture income is exempt under the Indian Income Tax Act. This means that income earned from agricultural operations is not taxed. The reason for exemption of agriculture income from Central Taxation is that the Constitution gives exclusive power to make laws with respect to taxes on agricultural income to the State Legislature. However while computing tax on non-agricultural income agricultural income is also taken into consideration.

As per Income Tax Act income earned from any of the under given four sources meant Agricultural Income;

- (i) Any rent received from land which is used for agricultural purpose:
- (ii) Any income derived from such land by agricultural operations including processing of agricultural produce, raised or received as rent in kind so as to render it fit for the market, or sale of such produce.
- (iii) Income attributable to a farm house
- (iv) Income earned from carrying nursery operations is also considered as agricultural income and hence exempt from income tax.