UNIT – III

Public finance: nature and the MSA

Meaning · Public v private · Dalton · Musgrave

Explanatory Lecture Slides

Economic Theory & Public Finance · Major-3 · Semester III

ECONOMIC THEORY & PUBLIC FINANCE

LEARNING OBJECTIVES

Topics covered in this unit

01 **Define public finance**

02 **Distinguish public and private finance**

03 **State Dalton’s principle of maximum social advantage**

04 **Name Musgrave’s three functions**

05 **Place merit, public and common goods**

06 **Connect to the Indian constitutional fisc**

How this unit is organised

01	02	03	04	05	06
Meaning	Public v private	MSA (Dalton)	Musgrave	Kinds of goods	Indian fisc

Meaning and scope

Public finance is the study of the State’s income, expenditure, debt and financial administration.

- Smith treated it as the last book of the Wealth of Nations; now it is a field of its own.
- Scope: public revenue, public expenditure, public debt, fiscal administration, federal finance.
- Positive (what the Budget did) and normative (what it should do).

Meaning and scope

FOUR BOXES

- Revenue.
- Expenditure.
- Debt.
- Administration.

NORMATIVE

- Who should pay, who should receive.

Public finance v private finance

The State can compel (tax); a household cannot. The State may spend first and tax later; a household that does that is bankrupt. The State's aim is social advantage, not private profit.

- A 10-mark table: compulsion, credit, surplus/deficit, secrecy, motive, bankruptcy.
- The State can print (seigniorage) — a household cannot. That is the last row of the table.

Public finance v private finance

STATE

- Compel.
- Spend then tax.
- Social aim.

HOUSEHOLD

- Earn then spend.
- Private aim.
- Can go insolvent.

Dalton — maximum social advantage

Keep taxing and spending until the marginal social sacrifice of the last rupee of tax equals the marginal social benefit of the last rupee of spend.

- MSS = MSB at the optimum. A diagram with two curves is the 10-mark.
- Limits: measurement of ‘social’ sacrifice/benefit; politics; federal splits; future generations (debt).

Dalton — maximum social advantage

RULE

- MSS = MSB.

ATTACK

- Unmeasurable.
- Ignores distribution of whose MSS.

Musgrave’s three functions

Allocation (public goods), distribution (equity), stabilisation (Keynesian G and T against cycles).

- A modern 6-mark. India: allocation (defence, courts), distribution (PDS, tax progressivity), stabilisation (Budget + RBI together).

Musgrave’s three functions

ALLOCATION

- Goods markets will not supply.

STABILISATION

- G and T as demand tools.

Public, merit, common-pool

Public goods: non-rival, non-excludable (defence, a clean Supreme Court). Merit goods: the State wants you to consume more than you would (school, vaccine). Common-pool: rival but hard to exclude (fish, spectrum).

- Free-rider is why we tax. Merit goods are why we subsidise. Common-pool is why we regulate (wildlife, spectrum auction).

Public, merit, common-pool

PUBLIC

- Defence.
- Street lighting.
- Judiciary.

MERIT

- Primary education.
- Vaccination.

The Indian constitutional fisc

Art. 265 (no tax except by law), 110 (Money Bill), 112 (AFS), 266 (Consolidated Fund), 267 (Contingency), 280 (Finance Commission), 292–293 (borrowing).

- A lawyer’s public-finance map is these articles. Quote two in every 16-mark.

The Indian constitutional fisc

MUST	ALSO
• 265. • 112. • 280.	• 110. • 266. • 292.

Musgrave's three functions

Allocation (public goods), distribution (equity), stabilisation (Keynesian G and T against cycles).

- A modern 6-mark. India: allocation (defence, courts), distribution (PDS, tax progressivity), stabilisation (Budget + RBI together).

LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

In re Special Reference No. 1 of 1964 (Keshav Singh)

AIR 1965 SC 745

Legislature’s money-power sits inside constitutional limits — privilege is not a blank fisc.

CASE

Union of India v Mohit Minerals

(2022) 10 SCC 700

GST Council recommendations and the federal fisc — public finance as cooperative federalism.

CASE

Jindal Stainless v State of Haryana

(2017) 12 SCC 1

Entry-tax / Art. 304 — the State’s revenue power against the free-trade clause.

STATUTE / SECTION MAP

Provisions & materials to quote

Art. 265	No tax except by authority of law.
Art. 112	Annual Financial Statement.
Art. 266	Consolidated Fund of India / State.
Art. 280	Finance Commission.
Art. 110	Money Bill — the Lok Sabha’s special fisc.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 Define public finance. Distinguish it from private finance.

Q2 Explain Dalton’s principle of maximum social advantage. What are its limitations?

Q3 Explain Musgrave’s allocation, distribution and stabilisation functions.

Q4 What are public goods? How do they differ from merit goods?

BEFORE YOU CLOSE THE FILE

Unit recap

1. Public finance = State’s T, G, debt, administration.
2. Compel / spend-first / social aim — the three contrasts.
3. Dalton: MSS = MSB; then criticise measurement.
4. Musgrave’s three functions in one sentence each.
5. Always two articles: 265 and 112 or 280.