

PUBLIC FINANCE

12.1 Definition of Public Finance

The relationship and management of public revenue and expenditure is called 'Public Finance'. In terms of Economics, public finance means government's fiscal policy governing its decisions relating to levy taxes, raising debts and making public expenditure. It also includes steps taken by the government to manage and regulate aforesaid activities.

In other words, government's fiscal policy describes the ways and means of its revenues and the expenditures to regulate economic activities in the country. In short, public finance is study of relationship between public revenue and expenditure.

12.2 Similarities and Differences Between Private and Public Finance

It has been stated earlier that public finance is the study of relationship between public revenue and public expenditure. It is related with the principles as to how the government will generate its resources (revenue) and how these resources will be spent according to the government's priorities. Contrary to it, private finance is concerned with the study of personal income and expenditure of individuals and the principles followed by them to create a balance between their private incomes and expenditure.

Comparative study of public finance and private finance reveals a number of similarities and differences between them, as discussed below:

Similarities Between Private and Public Finance

Following are the similarities between these types of finances:

1. Both, the Government and the individuals have limited revenue resources and therefore their basic objective is to explore the means and ways to get maximum utility from these limited resources.
2. Both, the Government and the individuals need loans to maintain a balance between their income and expenditure. Therefore, both of them obtain loans to meet their expenditure.
3. Both, the Government and the individuals make investments to increase their resources and means of income.

Differences Between Private and Public Finance

Private finance differs with public finance on the following grounds:

1. Balance between Revenue and Expenditure

An individual spends money according to his earnings and, therefore, has control over his expenditures. Contrary to this, the Government does not have much control over its revenues and expenditures. It is so because the Government, firstly, prepares estimate of its development expenditures and then sets targets for collection of

revenue to meet its estimated expenditure. It is because the Government faces a lot of difficulties for maintaining a balance between its revenue collection and expenditure.

2. Budget Period

There is no fixed length of period for the budget of an individual person, who prepares its budget for income and expenditure depending upon the periodicity of his income. It may be weekly, fortnightly or monthly etc. However, the Government plans its income and expenditure on yearly basis and therefore prepares its budget annually.

3. Future Needs

Common persons tend to save their income to meet their future obligations for themselves and their families only. Contrary to this, the Government invests its income on development projects not only to meet current demands but also to keep in view the future needs of the masses. In other words, an individual spends his money for his own personal needs and obligations, whereas the Government spends for the welfare of the public at large.

4. Getting Loans

When required, an individual may borrow money from his friends, relatives or banks etc but cannot take loan from himself. It means that he can borrow money from external resources only. However, the Government can borrow money from external and internal resources. Internal resources refer to the country's commercial banks and financial institutions etc whereas external resources mean international financial organizations such as World Bank and International Monetary Fund, International Finance Corporation etc. Further, an individual has to face a number of difficulties for getting loan from banks/financial institutions as against the Government that can get finances easily.

5. Deficit Policy

In case if Government expenditures exceed its income, the Government can make up the deficit by levying more taxes and/or increasing money supply through printing of new currency. However, an individual can neither impose more taxes nor can print currency.

6. Publicity of Revenue and Expenditure

An individual hesitates to disclose his true income, expenditure and savings to others, due to various reasons such as tax evasion, business jealousy etc. However, the Government makes detail of its incomes and expenditure by using all available sources of media (newspapers, television, radio). The main purpose of this advertisement is to keep common man informed of the public expenditure and revenue.

12.3 Definition of Budget

Budget is an estimate of Government's revenue and expenditure for the ensuing financial year. Budget is a schedule which explains Government's assessment for its revenue and expenditure, with item-wise breakdown of sources of income and detail of

expenditure. Pakistan's budget covers a period of one year, starting from 1st July of current year to 30th June of the next year such as (July 01, 2008 to June 30, 2009).

In other words, budget is a scheme of revenue and expenditure for a particular year, supported by numbers and facts. In case if government estimated expenditure exceeds its expected revenue, it is called a 'Deficit Budget' and if government's expected income exceeds its estimated expenditure, it is termed as a 'Surplus Budget'. When Government's expected revenue equals to its estimated expenditure, it is said to be a 'Balanced Budget'.

12.4 Public Revenue

Following are the important contributors to the revenue of the Government of Pakistan:

1. Taxes

Taxes are the major source of revenue for a Government. Taxes mean compulsory payments made to the Government. Taxes are calculated at prescribed rates on the income of individuals and businesses. The Government adopts various ways and means to collect taxes. Following are some of them:

- i. Significant part of taxes is collected in the form of import and export duties and related levies
- ii. Excise duty is another important part of taxes. It is imposed on goods manufactured in the country.
- iii. Direct taxes imposed on the incomes and certain properties of individuals also add to the Government revenue.
- iv. In addition to the above, the Government generates its revenue through other taxes including various surcharges, sales tax etc.

2. Price

It refers to that part of the Government revenue that it generates by sale of its goods/assets and/or by providing its services to the private sector. For example, amount received by the Government by selling timber from forests and lease/sale of state land etc.

3. Fee

Fee is a mandatory payment to be made in return for some services/benefits to the general public. Examples of such kind of revenue are radio/television license fee, driving license fee, arms license fee etc.

4. Fines and Penalties

These are also considered a part of public revenue. These are charged as a consequence of a violation/non-compliance with a rule/law, such as penalty/fine for non-observing traffic rules or for an act considered as offence under the law (kite flying using prohibited strings) etc.

5. Miscellaneous Revenues

The Government also collects revenue from means in addition to the above mentioned sources. These other sources include royalties, grants and gifts from foreign governments/organizations etc. All these resources are used for collective social welfare of the general public.

12.5 Public Expenditure

Following are the major components of expenditure of the Government:

1. Defence

The Government has to spend a major portion of its revenue to strengthen national defense and integrity. For this purpose, expensive modern arsenal and military equipment has to be purchased from other countries. Defence expenditure is one of the major part of the government spending.

2. Debt Servicing

The Government has to borrow from foreign governments or financial institutions to make up its budgetary deficit. These loans are interest based which go on increasing with the lapse of time. The Government has to pay interest as well as principal amount of the loan, which eats up a major portion of its revenue.

3. Courts

There is well established judiciary system in the Country to ensure supremacy of law and order and to pass on justice to the general public. The Government spends a fair portion of its revenue on judiciary for greater public welfare.

4. Administration

The Government has to engage people to manage its affairs so that it can work for public welfare, maintain law and order in the country, implement its development projects, ensure provision of facilities/comforts of life to the general public. For these purposes, the Government has to pay its employees and also has to provide necessary facilities for efficient discharge of their duties.

5. Miscellaneous Expenditure

In addition to the above, the Government spends considerable amount to provide basic amenities of life to the general public, such as education, healthcare, drinking water, communication network, and provision of food/daily-use items at affordable prices etc. Such public welfare activities/projects utilize a lot of the Government revenue.

12.6 Public Debt

Main and basic objective of a Government is to make progress in each and every field, to raise standard of living of its people and to ensure prosperity for the whole nation. However, scarce resources are the major obstacle in its way to economic development and prosperity. In such circumstances, the Government has to resort to loans from foreign government and financial institutions. These borrowing of the

Government are known as 'Public Debt'. In other words, public debt is the money borrowed by a Government to make up its deficit. Therefore, public debt comprises all loans obtained by a Government to finance its requirements including defense, trade/commerce, exploration of natural resources and social development projects/activities etc.

Generally, a Government has to obtain loans for the following reasons:

1. To make up the budgetary deficit.
2. To meet emergency requirements such as rehabilitation of flood victims or relief for the People of earthquake affected area or other natural calamities.
3. To complete development projects.
4. To accomplish social welfare activities and schemes.
5. To cover the deficit in the balance of payments.

12.7 Exercise

Q.1: Each statement has four possible options. Tick (✓) the best one:

1. Under public finance, the Government estimates its revenue and expenditure for:
 - a. one year
 - b. one month
 - c. two years
 - d. six months
2. Under public finance, the Government can cover the budgetary deficit by:
 - a. increase in production
 - b. increase in revenue
 - c. printing of currency notes
 - d. decrease in money supply

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. In finance, individuals cut their coats according to their clothes.
2. The Government its annual revenue and expenditure.
3. is a compulsory payment.
4. Budget is also called as
5. Pakistan's budgetary period starts from July 01 of current year to of next year.

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Budget duration	General public	
Source of public revenue	Direct deduction	
Do not disclose income	Wrong parking	
Income tax	One year	
Fines	Taxes	

Q.4: Answer the following questions in three sentences:

1. What is meant by public finance?
2. What is meant by private finance?
3. Write two points of difference between public finance and private finance?
4. Write down names of any five sources of public revenue?
5. What is meant by public debt?

Q. 5: Answer the following questions in detail:

1. Differentiate between public finance and private finance.
2. Describe similarities between public finance and private finance.
3. Explain sources of public revenue.
4. Write down major heads of public expenditure.
5. Write notes on the following:
 - i. Budget
 - ii. Public debt