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UNIT-I

THE PRINCIPLE OF MAXIMUM SOCIAL ADVANTAGE

One of the important principles of public finance is the principle of maximum social advantage explained by the well known **British economist Professor Hugh Dalton**. Just like an individual seeks to maximize his satisfaction or welfare by the use of his resources, the state seeks to maximize social advantage or benefits from the resources at its command. The fiscal operations of the state should therefore be determined by the principle of maximum social advantage. The state should always keep this principle in view while raising revenues for incurring expenditure on various heads.

The modern state influences almost all the sections of the community through its fiscal operations. On one side it levies taxes on certain sections and on the other, it spends its revenue on providing amenities to other sections of the community. Taxation imposes a burden on the people and so when the volume of taxation becomes high, every further increase in taxation increases the burden of it more and more. People undergo greater sacrifices for every additional unit of taxation. Taxation involves a certain amount of social burden on those sections on whom it is levied and so we may call this as social sacrifice made by the taxed people. Public expenditure, on the other hand, confers benefits on those sections on whom it is incurred, which may be called as the social benefit of public expenditure. Public expenditure creates utility for those people on whom the amount is spent. When the volume of expenditure is small with a slighter increase in it, the additional utility is very high. As the total public expenditure goes on increasing in course of time, the law of diminishing marginal utility operates. People derive less of satisfaction from additional unit of public expenditure as the government spends more and more. That is, after a stage, every increase in public expenditure creates less and less benefit for the people. The fiscal operations of the State, therefore, involve both social sacrifice and social benefit simultaneously. The principle of maximum social advantage requires that the revenue and expenditure of the state should be managed in such a way that maximum net advantage accrues to society, taking

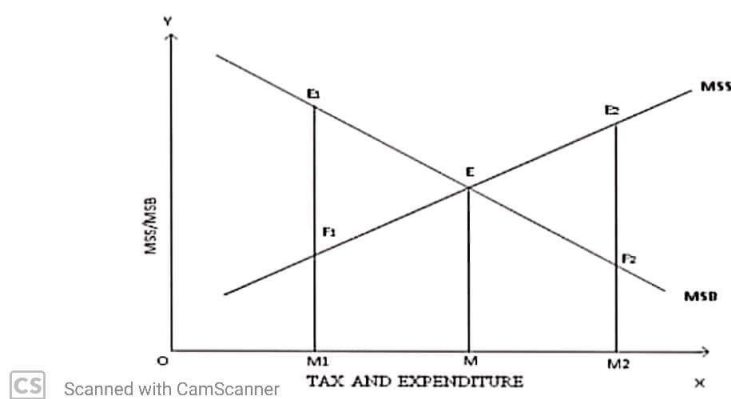
into account the social sacrifice involved in taxation and the social benefit flowing from public expenditure. The state should balance the social burden of taxation and social benefits of Public expenditure in order to have maximum social advantage. **The state will secure maximum social advantage when its fiscal operations maximize the surplus of social benefit (flowing from public expenditure) over the social sacrifice (resulting from taxation).**

The state should continue with its fiscal operations so long as the social benefit exceeds the social sacrifice because thereby the community shall be the net gainer. But the state should not proceed beyond the point where the social sacrifice equals the social benefit. In case it does so, the net social advantage shall be less than the maximum. The net social advantage shall be maximum only at the point where the social sacrifice equals the social benefit.

According to Dalton, maximum social advantage is at a point where the **Marginal Social sacrifice (MSS)** of taxation and **Marginal social Benefit (MSB)** of public expenditure are equal. The point of equality between MSS and MSB is referred to as a point of maximum social advantage or least aggregate social sacrifice.

Musgrave calls Dalton's principle has "**Maximum Welfare Principle of Budget Determination.**" He puts that the optimum size of the budget is determined at a point where **Net Social Benefit (NSB)** of fiscal operations to the society becomes zero. The NSB is the difference between MSB and MSS (**NSB=MSB - MSS**). Musgrave represented Dalton's principle of MSA with some slight differences.

Diagrammatic Representation



The curves **MSS** and **MSB** show the marginal social sacrifice of taxation and marginal social benefit of public expenditure respectively. **MSS curve** slopes upwards since taxation increases marginal social sacrifices. **MSB curve** slopes downward showing that public benefit goes on declining with every increase in public expenditure. **The ideal point of financial operations is where the government collects OM taxation from the society and uses it for public expenditure. At this point, MSS is exactly equal to MSB (Point E) at OM 1, MSS is M1 F1 which is less than MSB (M1 E1) thus depicting a loss of welfare to the society (E1 F1). Similarly the government is collecting OM 2 taxation to finance larger public expenditure. The MSS is higher than MSB by E2 F2. So the ideal level of taxation and expenditure is at OM.**

According to **Dalton** "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 counterbalanced by the disadvantage of a corresponding increase in taxation or in receipts from any other sources of public income. This gives the ideal public expenditure and income".

Criticism of the principle of of Maximum Social Advantage: This principle is, undoubtedly of great theoretical significance but several difficulties crop up when it is translated into actual practice, so it has little practical value. It has been criticized on the following grounds:

- 1. Non-measurability of Social Sacrifice and Social Benefit.**
- 2. Non-applicability to Borrowings.**
- 3. Public Finance: An Instrument for Economic Stabilization.**

Dalton's Objective tests of Evaluating Social Advantage: Dalton suggested these objective tests for judging social advantage out of the the fiscal operations of the State. In a way, these tests amounted to practical suggestions by Dalton for maximizing the social advantage

Following are the objective tests of social advantage given by Dalton:

- 1. Maintenance of Peace and Order in the Country.**
- 2. Increase in Production.**

3. Reduction in Economic Inequalities.

4. Reduction in Economic Fluctuations.

5. Promotion of Economic Growth and Full Employment.

6. Provision for Future Generations.

These tests, no doubt may give rise to difficulties when applied in actual practice. Nevertheless, it should be the responsibility of the State to satisfy them as best as it can through its fiscal operations with a view to attain maximum social advantage.

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