Note on Public Finance

Public finance is a field of economics concerned with paying for collective or governmental activities, and with the administration and design of those activities. The field is often divided into questions of what the government or collective organizations should do or are doing, and questions of how to pay for those activities. The broader term, **public economics**, and the narrower term, **government finance**, are also often used.

The proper role of government provides a starting point for the analysis of public finance. In theory, private markets will allocate goods and services among individuals efficiently (in the sense that no waste occurs and that individual tastes are matching with the economy's productive abilities). If private markets were able to provide efficient outcomes and if the distribution of income were socially acceptable, then there would be little or no scope for government. In many cases, however, conditions for private market efficiency are violated. For example, if many people can enjoy the same good at the same time (non-rival, non-excludable consumption), then private markets may supply too little of that good. National defense is one example of non-rival consumption, or of a public good.

"Market failure" occurs when private markets do not allocate goods or services efficiently. The existence of market failure provides an efficiency-based rationale for collective or governmental provision of goods and services. Externalities, public goods, informational advantages, strong economies of scale, and network effects can cause market failures. Public provision via a government or a voluntary association, however, is subject to other inefficiencies, termed "government failure."

Under broad assumptions, government decisions about the efficient scope and level of activities can be efficiently separated from decisions about the design of taxation systems (Diamond-Mirlees separation). In this view, public sector programs should be designed to maximize social benefits minus costs (cost-benefit analysis), and then revenues needed to pay for those expenditures should be raised through a taxation system that creates the fewest efficiency losses caused by distortion of economic activity as possible. In practice, government budgeting or public budgeting is substantially more complicated and often results in inefficient practices.

Government can pay for spending by borrowing (for example, with government bonds), although borrowing is a method of distributing tax burdens through time rather than a replacement for taxes. A deficit is the difference between government spending and revenues. The accumulation of deficits over time is the total public debt. Deficit finance allows governments to smooth tax burdens over time, and gives governments an important fiscal policy tool. Deficits can also narrow the options of successor governments.

Public finance is closely connected to issues of income distribution and social equity. Governments can reallocate income through transfer payments or by designing tax systems that treat high-income and low-income households differently.

The "Public Choice" approach to public finance seeks to explain how self-interested voters, politicians, and bureaucrats actually operate, rather than how they should operate.

Government spending:

Economists classify government expenditures into three main types. Government purchases of goods and services for current use are classed as government consumption. Government purchases of goods and services intended to create future benefits--- such as infrastructure investment or research spending--- are classed as government investment. Government expenditures that are not purchases of goods and services, and instead just represent transfers of money--- such as social security payments--- are called transfer payments.

Government operations:

Government operations are those activities involved in the running of a state or a functional equivalent of a state (for example, tribes, secessionist movements or revolutionary movements) for the purpose of producing value for the citizens. Government operations have the power to make, and the authority to enforce rules and laws within a civil, corporate, religious, academic, or other organization or group. In its broadest sense, "to govern" means to rule over or supervise, whether over a state, a set group of people, or a collection of people.

Income distribution

- Income distribution - Some forms of government expenditure are specifically intended to transfer income from some groups to others. For example, governments sometimes transfer income to people that have suffered a loss due to natural disaster. Likewise, public pension programs transfer wealth from the young to the old. Other forms of government expenditure which represent purchases of goods and services also have the effect of changing the income distribution. For example, engaging in a war may transfer wealth to certain sectors of society. Public education transfers wealth to families with children in these schools. Public road construction transfers wealth from people that do not use the roads to those people that do (and to those that build the roads).
- Income Security
- Employment insurance
- Health Care

Financing government expenditures:

Government financing can be achieved by taxes, government borrowing, asset sales, or seigniorage. How a government chooses to finance its activities can have important effects on the distribution of income and wealth (income redistribution) and on the efficiency of markets (effect of taxes on market prices and efficiency). The issue of how taxes affect income distribution is closely related to tax incidence, which examines the distribution of tax burdens after market adjustments are taken into account. Public finance research also analyzes effects of the various types of taxes and types of borrowing as well as administrative concerns, such as tax enforcement.

Taxes

A tax is a financial charge or other levy imposed on an individual or a legal entity by a state or a functional equivalent of a state (for example, tribes, secessionist movements or revolutionary movements). Taxes could also be imposed by a subnational entity. Taxes consist of direct tax or indirect tax, and may be paid in money or as *corvée* labor. A tax may be defined as a "pecuniary burden laid upon individuals or property to support the government [. . .] a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government [. . .] whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name."

Debt

Governments, like any other legal entity, can take out loans, issue bonds and make financial investments. Government debt (also known as public debt or national debt) is money (or credit) owed by any level of government; either central government, federal government, municipal government or local government. Some local governments issue bonds based on their taxing authority, such as tax increment bonds or revenue bonds.

As the government represents the people, government debt can be seen as an indirect debt of the taxpayers. Government debt can be categorized as internal debt, owed to lenders within the country, and external debt, owed to foreign lenders. Governments usually borrow by issuing securities such as government bonds and bills. Less creditworthy countries sometimes borrow directly from commercial banks or international institutions such as the International Monetary Fund or the World Bank.

Most government budgets are calculated on a cash basis, meaning that revenues are recognized when collected and outlays are recognized when paid. Some consider all government liabilities, including future pension payments and payments for goods and services the government has contracted for but not yet paid, as government debt. This approach is called accrual accounting, meaning that obligations are recognized when they are acquired, or accrued, rather than when they are paid.

public finance tends to analyse the implication of government taxation and expenditure in a given year

Seigniorage

Seigniorage is the net revenue derived from the issuing of currency. It arises from the difference between the face value of a coin or bank note and the cost of producing, distributing and eventually retiring it from circulation. Seigniorage is an important source of revenue for some national banks, although it provides a very small proportion of revenue for advanced industrial countries.

Public Finance in Socialist Economies

Public finance in centrally planned economies has differed in fundamental ways from that in market economies. Some state-owned enterprises generated profits that helped finance government activities. The government entities that operate for profit are usually manufacturing and financial institutions, services such as nationalized healthcare do not operate for a profit to keep costs low for consumers. The Soviet Union relied heavily on turnover taxes on retail sales. Sales of natural resources, and especially petroleum products, were an important source of revenue for the Soviet Union. In Venezuela, the state-run oil company PSDVA provides revenue for the government to fund its operations and programs that would otherwise be profit for private owners. In various mixed economies, the revenue generated by state-run or state-owned enterprises are used for various state endeavors.