

Introduction to Public Finance

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Key concepts, objectives, and the institutional framework that guide government fiscal activities.

1. What Is Public Finance?

Aspect	Description
Definition	Study of how governments raise revenue (taxes, fees, borrowing) and allocate/expend resources to achieve economic and social objectives.
Scope	• Revenue generation (taxation, non-tax revenue) • Public expenditure (goods, services, transfers) • Public debt management • Fiscal policy and budgeting
Distinctive Feature	Focus on collective welfare and market failures rather than profit maximization.

2. Core Objectives of Public Finance

Objective	Why It Matters	Typical Instruments
Economic Efficiency	Allocate resources where marginal benefit = marginal cost.	Corrective taxes (Pigouvian), subsidies, regulation.
Equity (Distributional Justice)	Reduce income/wealth disparities and provide a safety net.	Progressive taxation, social transfers, public services.
Economic Stability	Smooth out business-cycle fluctuations, control inflation, maintain full employment.	Counter-cyclical fiscal policy, automatic stabilizers.
Growth Promotion	Create conditions for long-term productivity and investment.	Infrastructure spending, education, R&D incentives.
Public Goods Provision	Supply goods/services that markets under-provide (defence, law enforcement, street lighting).	Direct government provision, public-private partnerships.

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3. Government Revenue Sources

Category	Examples	Key Features
Taxation	• Income tax (personal, corporate) • Consumption tax (VAT/GST, sales tax) • Property tax • Excise duties (fuel, tobacco)	Main source; designed for efficiency, equity, and revenue adequacy.
Non-Tax Revenue	• Fees & licenses • Dividends from state-owned enterprises • Royalties (natural resources) • Fines & penalties	Often smaller share; can be earmarked for specific programs.
Borrowing	• Domestic bonds (Treasury bills, gilt-edged securities) • External loans (multilateral institutions, foreign governments)	Increases fiscal space but creates debt service obligations.
Grants & Transfers	• Intergovernmental transfers (federal to state) • Foreign aid	May be conditional; influence policy priorities.

4. Public Expenditure Categories

Type	Description	Typical Examples
Current (Operating) Expenditure	Day-to-day spending on salaries, maintenance, subsidies.	Public sector wages, healthcare services, education operating costs.
Capital (Investment) Expenditure	Spending on assets that provide services over many years.	Roads, bridges, airports, schools, hospitals, digital infrastructure.
Transfer Payments	Cash or in-kind benefits without direct goods/services in return.	Pensions, unemployment benefits, welfare assistance, scholarships.

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Type	Description	Typical Examples
Subsidies	Financial support to lower the price of a good/service or to encourage production.	Agricultural subsidies, renewable? energy incentives.

5. The Budget Process

1. **Formulation** – Ministries prepare spending proposals; revenue forecasts are prepared by the finance ministry.
2. **Legislative Approval** – Budget bill debated and passed by parliament/legislature.
3. **Implementation** – Treasury