

Overview of Public Finance

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Key concepts, objectives, and institutional framework

1. Definition & Scope

- **Public finance** studies how governments raise revenue, allocate resources, and manage expenditures to achieve economic and social goals.
 - Encompasses **taxation, public spending, budgeting, public debt, and fiscal policy**.
 - Intersects with macroeconomics (stabilization, growth) and microeconomics (allocation, equity).
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2. Core Objectives

Objective	Description	Typical Policy Tools
Efficiency	Allocate resources where they generate the highest net social benefit; correct market failures (e.g., externalities, public goods).	Subsidies, Pigouvian taxes, regulation.
Equity	Distribute income and wealth fairly; provide a safety net for vulnerable groups.	Progressive taxation, social transfers, universal services.
Stability	Smooth economic fluctuations, control inflation, and maintain full employment.	Countercyclical fiscal policy, automatic stabilizers (unemployment benefits, progressive taxes).
Growth & Development	Foster long-term economic expansion and improve living standards.	Infrastructure investment, education & health spending, R&D incentives.

3. Major Components

3.1 Revenue (Fiscal Sources)

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1. Taxation

- *Direct taxes*: income tax, corporate tax, wealth tax, property tax.
- *Indirect taxes*: value-added tax (VAT/GST), excise duties, customs tariffs.
- *Design criteria*: equity, efficiency, simplicity, administrability, revenue adequacy.

2. Non-Tax Revenue

- Fees & charges (licensing, user fees).
- Dividends from state-owned enterprises.
- Grants & aid from other governments or international institutions.

3. Borrowing

- Domestic (government bonds, treasury bills).
- External (sovereign bonds, loans from multilateral banks).
- **Debt sustainability**: debt-to-GDP ratio, debt service coverage, fiscal space.

3.2 Expenditure (Public Spending)

Category	Purpose	Typical Programs
Current/Operating	Day-to-day functioning of government	Salaries, subsidies, interest payments
Capital/Investment	Build long-term assets	Infrastructure, schools, hospitals, R&D
Transfer Payments	Redistribution & social protection	Pensions, unemployment benefits, conditional cash transfers
Public Goods & Services	Non-excludable, non-rival goods	National defense, law enforcement, environmental protection

3.3 Budget Process

1. **Formulation** – ministries submit proposals; Treasury/Finance Ministry consolidates.
2. **Legislation** – parliament debates, amends, and adopts the budget (annual or multi-year).
3. **Execution** – Treasury releases funds; agencies implement programs; procurement follows transparent rules.
4. **Monitoring & Evaluation** – performance audits, fiscal reports, and mid-year reviews.

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5. **Accountability** – legislative oversight, public reporting, external audits (e.g., supreme audit institutions).
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4. Fiscal Policy Instruments

Instrument	Expansionary (stimulus)	Contractionary (tightening)
Tax cuts	Reduce rates, broaden base	Increase rates, narrow base
Increased spending	Infrastructure projects, social transfers	Cut discretionary programs