

## **Quadrant II – Transcript and Related material**

Programme: B. Com.

Semester: IV

Subject: Economics

Paper Code: IDG 105

Paper Title: Public Finance

Unit 1: Introduction to Public Finance

Module Name: The Principle of Maximum Social Advantage

Module No: 2

Name of the Presenter: Mr. Ram Gaonkar

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### **Outline of the e-module**

- The principle of maximum social advantage
- The Dalton's version of principle of maximum social advantage

### **Learning Outcomes**

At the end of the session, a student will be able to understand: -

- How state can bring maximum aggregate welfare by the use of his resources.
- Applied to determine the level of tax and expenditure to attain optimum benefit.
- Attainment of maximum social advantage

## **THE PRINCIPLE OF MAXIMUM SOCIAL ADVANTAGE**

One of the important principles of public finance is the so – called Principle of Maximum Social Advantage explained by Professor Hugh Dalton. Just like an individual seeks to maximize his satisfaction or welfare by the use

of his resources, the state ought to maximize social advantage or benefit from the resources at its command.

The principles of maximum social advantage are applied to determine whether the tax or the expenditure has proved to be of the optimum benefit. Hence, the principle is called the principle of public finance. According to Dalton, “This (Principle) lies at the very root of public finance”

He again says “The best system of public finance is that which secures the maximum social advantage from the operations which it conducts.” It may be also called the principle of maximum social benefit. A.C. Pigou has called it the principle of maximum aggregate welfare.

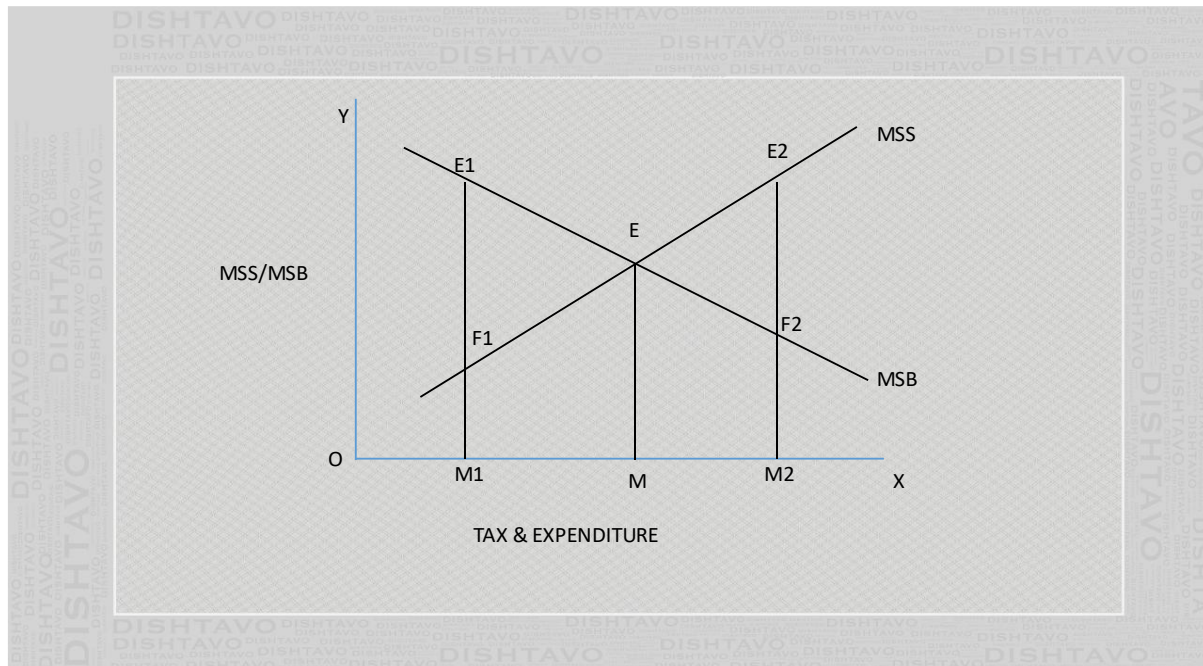
Public expenditure creates utility for those people on whom the amount is spent. When the volume of expenditure is small with a slighter increase in it, the additional utility is very high. As the total public expenditure goes on increasing in course of time, the law of diminishing marginal utility operates. 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. Taxation, on the other hand, imposes burden on the people. 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. The best policy of the government is to balance both sides of fiscal operations by comparing “the burden of tax” and “the benefits of public expenditure”. The State should balance the social burden of taxation and social benefits of Public expenditure in order to have maximum social advantage

Attainment of maximum social advantage requires that;

- a) Both public expenditure and taxation should be carried out up to certain limits and no more.
- b) Public expenditure should be utilized among the various uses in an optimum manner, and
- c) The different sources of taxation should be so tapped that the aggregate sacrifices entailed is the minimum.

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

## Diagrammatic Representation



The curves MSS and MSB show the marginal social sacrifices of taxation and marginal social benefit of public expenditure respectively. MSS curve slopes up words since taxation increases marginal social sacrifices. MSB curves slopes down wards showing that public benefit goes on declining with every increase in public expenditure. The ideal point of financial operations is where the governments collect 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 OM2 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 counter balanced by the disadvantage of a corresponding increase in taxation or in receipts from any other source of public income. This gives the ideal public expenditure and income”.