PUBLIC FINANCE-TOPIC-5

BENEFIT PRINCIPLE,
SACRIFICE PRINCIPLE
ABILITY TO PAY THEORY,
& LAFER CURVE

SOME OTHER IMP POINTS.

Benefit principle was initially developed by Knut Wicksell (1896) and later prof. Lindahl (1919).

According to this principle, the burden of tax on people should be proportional to the amount of benefit it received from the use of public goods and services provided by the government.

According to him, there is a contractual relationship between the government and people. This theory is also known as contractual theory.
Assumptions-

There are two tax payers.

One social good.

Distribution of income is constant..

.BENEFIT RECEIVED THEORY

Given by Seligman.
2. ABILITY TO PAY THEORY.

This theory given by Seligman. (Pigou)

Contribution by Pigou, Edgeworth, and Kaldor.

Taxes are charged according to the ability to pay of taxpayer.

The marginal utility of rich people are low and they have higher capacity to pay.

This is related with progressive taxation system.
There are four factors which influence the taxes -

1. Income
2. Property
3. Consumption expenditure
4. Size of family
3. SACRIFICE PRINCIPLE’S

Given by Richard Musgrave.

Three sacrifice principles

1. Equal absolute sacrifice
2. Equal proportional sacrifice
3. Equal marginal sacrifice
1. **EQUAL ABSOLUTE SACRIFICES**

It is most regressive in nature.

Total loss of utility or total sacrifice of all tax payer should be same.
2. EQUAL PROPORTIONAL SACRIFICES

It is less regressive in nature.

Taxes should be proportional of the income.
3. Equal Marginal Sacrifices

It is **progressive** taxation system.

This principle also called **least aggregate sacrifice principle**.

Total sacrifice of all tax payer should be **lowest**.

Acc. To Pigou it is ultimate principle of taxation.

Total sacrifice of **all tax payer would be minimum**.

Marginal sacrifice of all tax payer should be **same**.
1. EQUAL ABSOLUTE SACRIFICES

It is most regressive in nature.

Total loss of utility or total sacrifice of all tax payer should be same.
Mathematical Terms for Sacrifice Principle.

1. Equal absolute sacrifice = $U(Y) - U(Y-T)$

1. Equal proportional sacrifice = $\frac{U(Y) - U(Y-T)}{U(Y)}$

1. Equal marginal sacrifice = $\frac{U(Y-T)}{(Y-T)}$

Y - income.
T - taxes.
$U(Y)$ - total utility attain from income.
$U(Y-T)$ - utility attain from disposable income.
4. Lafer Curve

L-C developed by Arthur Lafer.

Lafer curve shows the relationship between tax rate and tax revenue.

Taxable income change with change in tax rate.

0% and 100% of tax rate give zero revenue to the govt..
5. TAXABLE CAPACITY

It is the amount of money that can be raised through taxation without causing burden.

It is also known as degree of taxation.

6. HORIZONTAL EQUITY

Equal treatment to similar income group.

When equals are not treated equally.

7. VERTICAL EQUITY

Unequal treatment to unequal income group.

When non-equal treated equally.
§ PRINCIPLE OF PUBLIC FINANCE.


This concept also known as principle of maximum social advantages.

Revenue collected and spent by state should maximum welfare.

Prof Pigou called it – principle of least aggregate sacrifice or Principle of maximum aggregate welfare.
9. CANONS OF TAXATION.

Given by Adam Smith

Four important canons of taxation.

1. Canon of equity or benefit..

2. Canon of certainty.

3. Canon of convenience.

4. Canon of economy.
PUBLIC FINANCE-TOPIC-6

INCIDENCE OF TAXES, IMPACTS OF TAXES IN DIFFERENT MARKET CONDITIONS

OTHER PUBLIC FINANCE IMP. TOPICS.