

The Principle of Maximum Social Advantage

Introduced: British economist Hugh Dalton.

The Principle states:

The state should collect revenue and spend the money so as to maximize the welfare of the people. When the state imposes taxes, some disutility is created. On the other hand, when the state spends some money, there is gain in utility. The state should so adjust revenue and expenditure that surplus of utility is maximised and disutility is minimised.

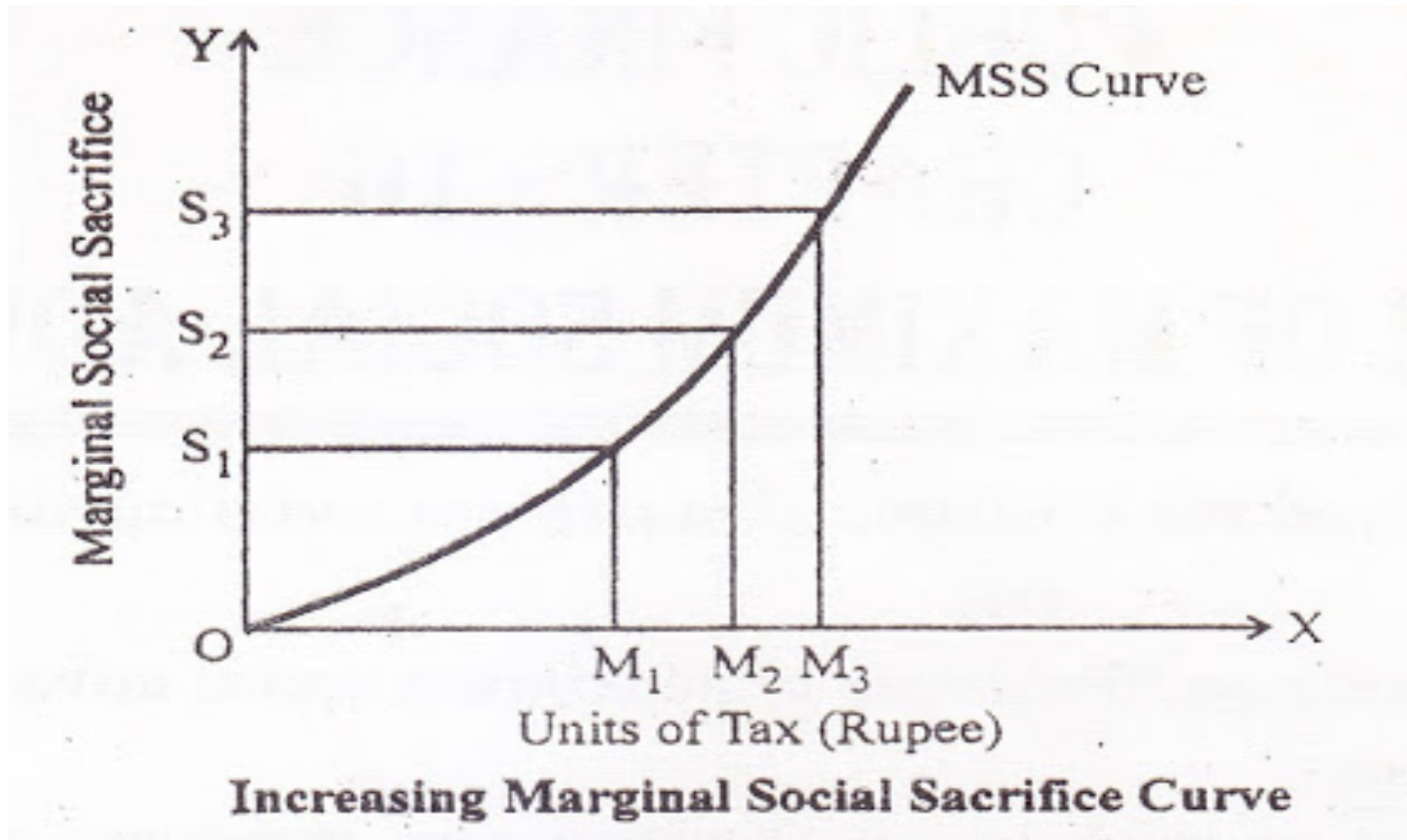
Marginal Social Sacrifice (MSS)

Definition:

The amount of social sacrifice undergone by public due to the imposition of an additional unit of tax. Every unit of tax imposed by the government taxes result in loss of utility.

Dalton: *The additional burden (marginal sacrifice) resulting from additional units of taxation goes on increasing. Every additional unit of taxation creates greater amount of sacrifice on the society.*

Marginal Social Sacrifice (MSS)



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The above diagram indicates that the Marginal Social Sacrifice (MSS) curve rises upwards from left to right. This indicates that with each additional unit of taxation, the level of sacrifice also increases.

When the unit of taxation was OM_1 , the marginal social sacrifice was OS_1 , and with the increase in taxation at OM_2 , the marginal social sacrifice rises to OS_2 .

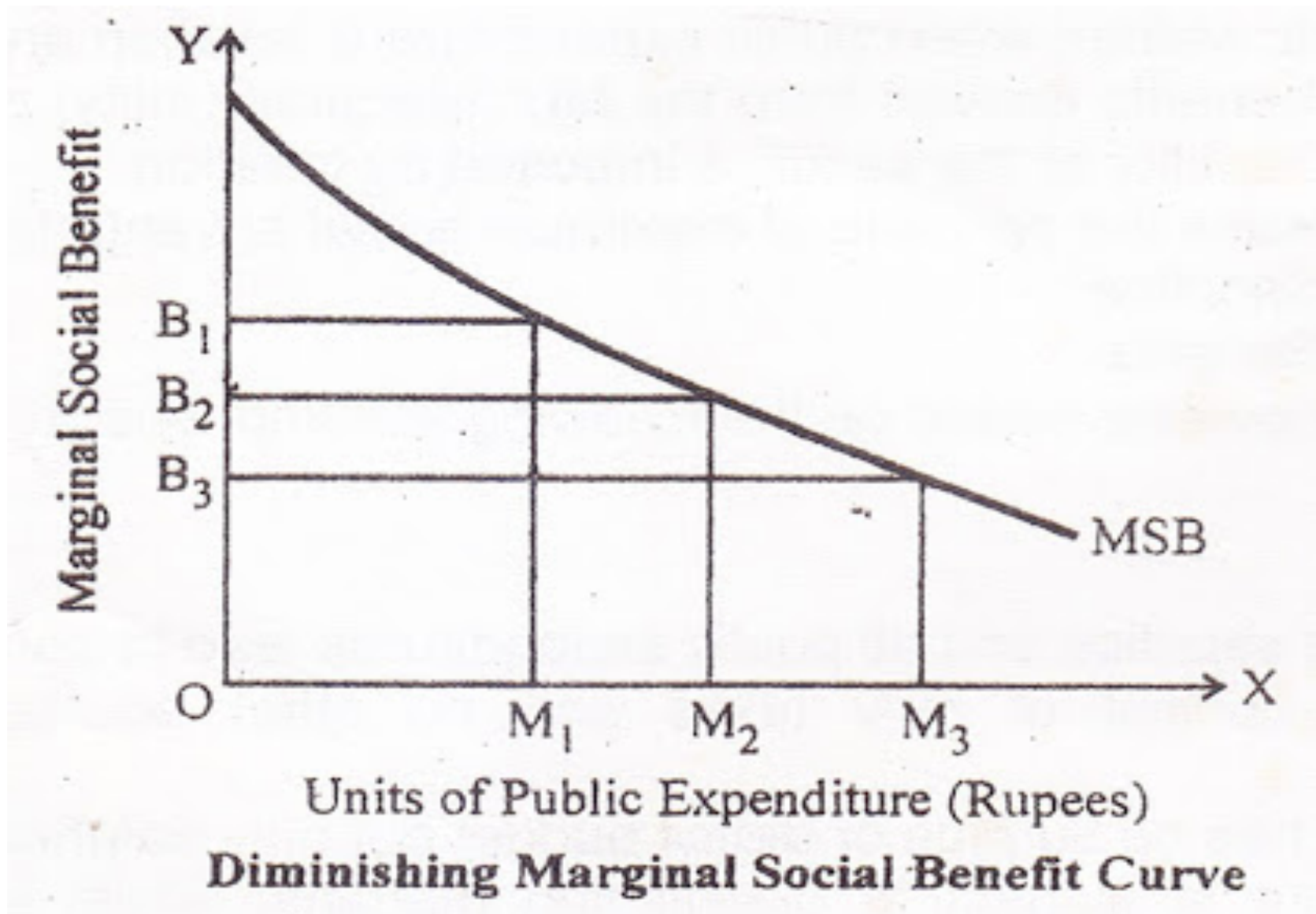
Marginal Social Benefit (MSB)

Definition:

The benefit conferred on the society, by an additional unit of public expenditure.

Just as the marginal utility from a commodity to a consumer declines as more and more units of the commodity are made available to him, the social benefit from each additional unit of public expenditure declines as more and more units of public expenditure are spent.

Marginal Social Benefit (MSB)



Marginal Social Benefit (MSB)

In the above diagram, the marginal social benefit (MSB) curve slopes downward from left to right. This indicates that the social benefit derived out of public expenditure is reducing at a diminishing rate.

When the public expenditure was OM_1 , the marginal social benefit was OB_1 , and when the public expenditure is OM_2 , the marginal social benefit is reduced at OB_2 .

The Point of Maximum Social Advantage-

Social advantage is maximised at the point where marginal social sacrifice cuts the marginal social benefits curve. This is at the point P. At this point, the marginal disutility or social sacrifice is equal to the marginal utility or social benefit. Beyond this point, the marginal disutility or social sacrifice will be higher, and the marginal utility or social benefit will be lower. Before this point, the marginal utility or social benefit is more than marginal disutility or marginal sacrifice.

Conclusion

Maximum Social Advantage is achieved at the point where the marginal social benefit of public expenditure and the marginal social sacrifice of taxation are equated, i.e. where $MSB = MSS$.

This is the optimum limit of the states' public finance activity. Thus, public expenditure should be incurred upto the point where the marginal utility due to public expenditure is just equal to the marginal disutility due to taxation of public income.

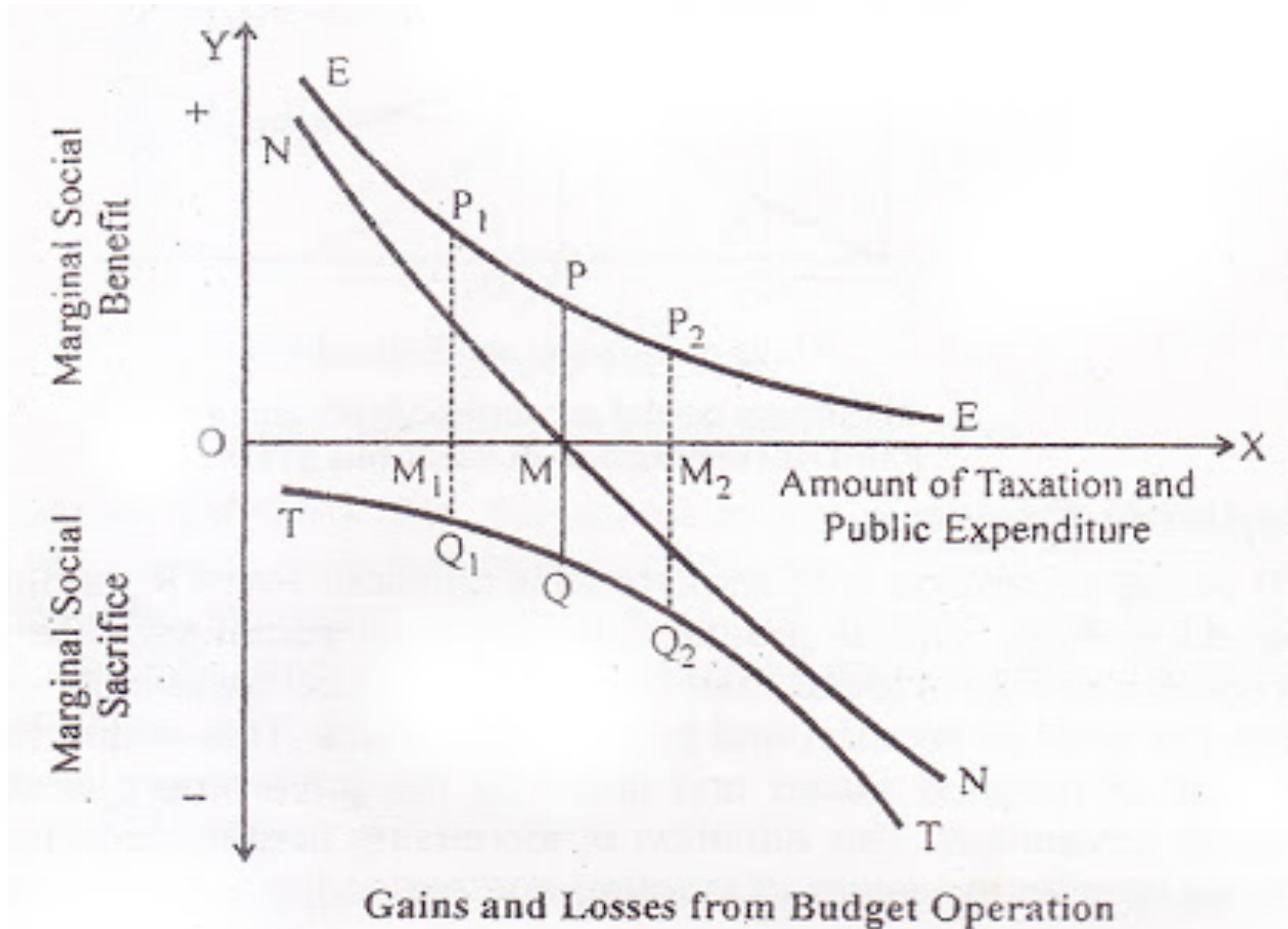
Musgrave's Views:

According to Musgrave, Dalton has proposed two principles of budget policy.

(1) resources should be so distributed among different public uses so as to equalise the marginal return of satisfaction for each type of outlay.

(2) public expenditure should be pushed to the point where the satisfaction lost from the last unit taken in taxes and the marginal satisfaction derived in public and private sector is equalised.

Musgrave's Views-



Musgrave's Views-

According to Musgrave, suppose the marginal utility of successive unit of public expenditure, allocated optimally between public uses, is shown by line EE in the figure and the marginal disutility of taxes imposed is shown by line TT. The line NN is obtained by deducting TT from EE and measure the benefits derived from successive additions to public budget. The optimum size of budget is determined at OM where marginal net benefits are zero.

Conclusion-

The optimum size of budget is given by the point where marginal net benefit is zero. This point corresponds to the point of maximum social advantage as at this point $MSB = MSS$.

Tests of MSA-

1. Preservation of community-

The duty of the govt. Should be to preserve the community against internal disorders and external attacks. It creates confidence and promotes economic life of its citizens.

2. Improvements in Production-

Increase in productive power so that large product per worker shall be obtained- to achieve minimum waste of economic resources- improvement in pattern of production

Tests of MSA-

3. Improvement in Distribution-

The inequalities of income, resulting due to unearned income, should not be tolerated while the skills and efforts may be justified and suitably rewarded.

4. Stability and Full Employment-

The social advantage to the community can be increased if economic stability and full employment level is achieved.

5. Provisions of Future-

Individuals give more importance to the present than to the future and, therefore, the responsibility of the state has double responsibility of looking after the interests of the present as well as future generations.

Limitations of MSA-

1. Difficult to put into practice-

Utility being subjective in nature, creates a great obstacle for the state to balance marginal utility and disutility.

2. Utility is not measurable-

Utility cannot be measured quantitatively.

Limitations of MSA-

3. It ignores macro system-

Disutility caused to the tax-payer is micro problem, whereas, marginal utility gained is a macro concept.

4. Highly unrealistic restrictions-

The argument that govt. should not have surplus or deficit budget is highly unrealistic.

5. Welfare State-

Modern states are not police states but are welfare states and have to plan certain projects.