PUBLIC FINANCE: POLITICAL PHILOSOPHY, ECONOMIC THEORY AND PRACTICE

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ABSTRACT

This paper provides a holistic overview of public finance and the issues relating to its sustainability. It argues that a strategic approach recognises that public finance must be considered in its totality as well as in terms of the services and welfare benefits on which it is spent and the sources from which it is raised. It considers the impact of the 2007-09 credit crunch on the public finances and provides a checklist of strategic points to assess sustainability. This list assumes the need to be prudent with public finance and provides a useful framework by which to ensure adoption of a truly integrative, strategic and sustainable approach to public sector spending, taxation, borrowing and debt. In doing so, it makes clear that there is considerable scope for more effective and discriminating use of public finance.

ÖZET

Bu araştırma kamu maliyesine ve kamu maliyesinin sürdürülebilirliğini ilişkin konulara bütüncül bir yaklaşım sunar. Araştırma, kamu maliyesine stratejik bir yaklaşımın gerek konuyu tümüyle incelemesi, gerekse de harcamaların ve gelir kaynaklarının sağladıkları hizmetler ve yarıttıkları refah açısından irdelenmesi gerektiğini ileri sürer. Bu yazı, 2007-2009 kredi buhranının kamu maliyesine etkisini ele alır ve sürdürülebilirliği değerlendirecek stratejik ölçütlerin bir listesini de oluşturur. Söz konusu liste kamu maliyesi konusunda dikkatli davranmak gerektiğini varsayarken, kamu sektörü harcamalarına, vergilendirmeye, borçlanmaya bütünleyici, stratejik ve sürdürülebilir bir yaklaşım için yararlı bir çerçeve sunar ve aynı zamanda kamu maliyesinin daha etkin ve daha seçici uygulanması için kayda değer İmkânların varlığını ortaya koyar.

Introduction

Most people approach public finance from a particular perspective, whether service-specific policymaker or practitioner, discipline-specific student or academic, financial auditor and so on. However, it is essential to appreciate the extremely broad nature of public finance and the strategic issues underpinning it.

This paper attempts to provide a holistic overview of the topic. The aim is to help readers appreciate the broad multidisciplinary nature of public finance, the issues relating to its sustainability and to understand that it is not just a narrow budgeting issue. It is not confined within the boundaries of any one discipline or profession and is not simply about ensuring enough money for public services.

The Role of Public Finance and Political Philosophy

Public finance reflects the relationship between the citizen and the state. In turn, that relationship reflects a dominant political philosophy, whether Libertarian, Neo-Liberal or Collectivist. A summary of these three (rather reductionist) categories of political philosophy are summarized in Table 1.

The table makes clear that public finance can variously be concerned with three categories of citizen-state relationship. First, allowing autonomous citizens to exercise full individual responsibility for their own standard of living whilst remaining totally
free of state control (the Libertarian role of public finance). Second, enabling responsible citizens to have the potential to secure an adequate standard of living by affording them equality of opportunity in the market place (the Neo-Liberal role of public finance). Third, guaranteeing protected citizens adequate standards of living through direct state control of their everyday lives in terms of access to and outcomes from state provided services (the Collectivist role of public finance).

<table>
<thead>
<tr>
<th>Libertarian</th>
<th>Neo-liberal</th>
<th>Collectivist</th>
</tr>
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<tbody>
<tr>
<td>Classical liberal theory</td>
<td>Modern liberal theory</td>
<td>Civic theory</td>
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**Defining features**
- Autonomy of the individual
- Unregulated markets
- Negative rights only
- Laissez-faire state
- Capitalism
- Autonomy of the individual
- Modified markets
- Negative plus limited positive rights
- Enabling state
- Mixed economy

**Beliefs**
- The state is corruptible
- Taxation is confiscation
- Moral hazard/dependency culture
- No moral case for equality
- Private property rights are inviolable
- The state is a necessary evil
- Taxation for efficiency
- Equality of opportunity
- Property rights reflect policy aims
- Benevolent state
- Taxes for social aims
- Equality of outcome
- Property is theft

**General Implications**
- No Such Thing As Society
- Private enterprise guarantees rights
- Individuals are consumers not citizens
- Depend on charity & active citizen
- Weak Conception Of Society
- Modified Market Rights
- individuals are primarily consumers
- State Supplements Charity/Voluntary Action
- Society Emphasised
- State Confers Rights
- Citizens Firstly
- State Replaces Charity

**Implications for the public sector**
- Minimal State
- Enforces Only Negative Rights
- Private sector provision of public services
- Minimal welfare state (‘safety net’ only)
- Private insurance
- Heavily Constrained State
- Some Limited Positive Rights
- private or public sector provision
- conditional welfare state
- public plus private insurance
- Expansive State
- Full Positive Rights
- public sector provision
- unconditional welfare
- public insurance

**Implications for public finance**
- Minimal public finance
- Private spending replaces public spending
- Minimise ‘Burden Of Taxation’
- Regressive taxes
- Borrowing and public debt very limited
- restrained public finance
- seek additionality of public spending
- Tax ‘Bads’ Not ‘Goods’ For Efficiency
- Proportional taxes
- Borrowing/debt for efficiency purposes
- unrestrained public finance
- public replaces private
- Redistributive taxes for equity
- Progressive taxes
- Borrowing/debt for welfare

**Notes:**
1. The term ‘Libertarian’ is used to denote classical liberal theory in order to distinguish it from modern liberal theory, here referred to as ‘Neo-liberal’ in order to avoid confusion.
2. Freedom from coercion, interference, discrimination.
4. An economic system based on the private ownership of the means of production, distribution and exchange.
5. An economic system in which the public and private sectors coexist side-by-side.
6. An economic system in which the means of production, distribution and exchange are owned collectively by the community, usually through the state.
7. via system of justice: police, courts, prison etc.
8. to education, health care, culture etc.
9. social justice
10. for example, social security payments only payable to those in paid employment (work-based welfare)
11. ‘bads’ includes polluting activities (e.g. driving a car and disposal of household waste); ‘goods’ includes economically and socially productive activities such as work and investment.
The categorical summary in Table 1 makes clear that public finance is about much more than just money. It is about political philosophy and so reflects the constitutional and cultural relationship between individual citizens and their governments at national, regional and local levels. It reflects the rights and responsibilities of individual citizens, not just for their own livelihoods but also for those of their families, neighbourhoods and local, regional and national communities.

These political philosophies have different conceptions of economy, efficiency, effectiveness and equity. Table 2 provides a summary integration of these ‘4Es’ with the defining features, beliefs and implications of the three categories of political philosophy summarised in Table 1. That such terms are disputed may come as a surprise to the reader and yet their competing definitions have profound implications for the role of public finance.

<table>
<thead>
<tr>
<th>Table 2: Alternative Philosophical Interpretations of the 4Es</th>
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<tbody>
<tr>
<td><strong>Libertarian</strong></td>
</tr>
<tr>
<td>Efficiency</td>
</tr>
<tr>
<td>Very narrow concept: market efficiency.</td>
</tr>
<tr>
<td>Equity</td>
</tr>
<tr>
<td>Judged in terms of free market welfare outcomes: reward for effort and talent</td>
</tr>
<tr>
<td>Economy</td>
</tr>
<tr>
<td>Secured by restricting government intervention to safeguard only negative rights</td>
</tr>
<tr>
<td>Effectiveness</td>
</tr>
<tr>
<td>Best achieved by <em>laissez-faire</em>, freeing markets to maximise productivity and profits and relying on trickle down to poor groups of the benefits of economic growth</td>
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Although apparently purely ideological, these differing philosophical views are based on rational arguments about the impact (positive or negative, actual or potential) of public finance on society and economy. It is here that principles and pragmatism interact.

Propositions about what relative scale of public finance is appropriate in terms of national income (GDP) can only be understood and challenged by recourse to rational argument, both a priori and evidence-based. Those arguments revolve round whether there should be more or less state intervention (and therefore public finance) than is currently the case in a given country and, in particular, whether more state intervention
is beneficial or harmful to economy and society. They fuel the political debate underpinning elections at all levels of government. Ultimately, they boil down to deciding who should receive various forms and levels of state assistance, how effective is that assistance, and how should the voted-for public interventions in support of positive and/or negative rights be financed (see notes 7 and 8 to Table 1).

The apparent recent shift in the scale of public finance deemed acceptable by most developed countries reflects a move away from dominant Collectivist philosophies towards dominant Neo-Liberal approaches to the organisation of economy and society. Communist regimes have collapsed and socialism appears to be on the wane. Governments have increasingly adopted Neo-Liberal policies such as privatisation and conditional (i.e. work-based) welfare. These reforms to the nature and relative scale of public finance reflect an increasingly accepted view that, whilst it can deliver a more equal share of national income and wealth, a relatively large scale of public finance may actually reduce national prosperity. Such a reduction may not be in absolute terms but, instead, relative to what prosperity would have been in the absence of such a relatively high level of public finance. It would result if higher levels of income-support and taxation created substantial disincentives to self-support through productive employment and/or disincentives for companies to invest in the economic infrastructure.

Therefore, guaranteeing positive and negative rights to a fair share of the economic ‘cake’ may come at the cost of a smaller ‘cake’ or one that is smaller than it would otherwise have been. If so, then principle is tempered by pragmatism. Potentially significant tradeoffs between equity, efficiency, economy and effectiveness mean that the net benefits of additional public finance may be small, perhaps even illusory. Whether incremental changes in public finance have net benefits or net costs is the fundamental strategic issue. The fact that the Neo-Liberal political philosophy is increasingly dominant at a global level reflects a more questioning appreciation of the effectiveness of increased levels of state intervention, certainly of the traditional direct-provider tax-financed form.

Nevertheless, there is still a widespread belief that governments generally act in the ‘public interest’. That term is broad and vague enough to encapsulate changing perceptions of the 4Es and the changing balance of emphasis between them (see Table 2). As perceptions of what constitutes equity, efficiency, economy and effectiveness change, so governments have to reconfigure property rights in delivering objectives for those 4Es. Those property rights relate to negative and positive rights, not just to ownership of physical property. They include access to services such as health care and education. Property rights may therefore have to be reconfigured for equity reasons, for example ensuring that those in need of medical care have access to it irrespective of their age, ethnicity and ability to pay.
The Scale of Public Finance

There is a relatively high scale of public finance within West European countries, especially EU and Scandinavian countries. Moreover, that scale increased substantially over the last 40 years of the 20th century, in terms of both government expenditure/GDP ratios and tax/GDP ratios (Bailey 2004). After 1965 average public expenditure in OECD countries rose from just over a quarter of GDP to two-fifths.

These relatively high levels of public spending have been largely and increasingly accounted for by current expenditures, especially the growth of social security transfers, most notably in EU countries since the mid-1960s. Public sector services have generally only kept up with the growth of GDP.

OECD average current expenditure was less than a quarter of GDP in 1960. It rose to over a third of GDP by the mid-1970s and to 37% of GDP by 1981, thereafter fluctuating between 37 to 39%. It exceeded 50% of GDP over long periods in Belgium, Denmark, the Netherlands and Sweden. The ratios for South Korea and Mexico were below 20% in the 1990s and Japan was below 30% until 1998. European countries were below the OECD average before the mid-1970s (especially the EU) but above it thereafter with a rising trend (especially the EU). Non-European countries were below OECD average.

As regards capital expenditure, the OECD average was around 21% of GDP after 1960, displaying no rising trend. It reached a peak of 23.5% in 1973, never falling below 20%. European countries were below the OECD average (especially the EU). The EU accession countries (those joining in 2004 and 2007) were above the OECD average, as were the non-European countries. Some had smaller GDPS and capital expenditures were being used to foster economic growth.

The Neo-Liberal view is that the state is growing out of control, stifling work and enterprise by excessive regulation of the market economy, high taxes making work and enterprise less worthwhile and high welfare payments making work less worthwhile. Hence, the Neo-Liberal solution is to reduce government intervention in the public interest, leading to increased prosperity for all. These arguments became widely accepted during the 1980s and 1990s, reflecting increasing globalisation. They led to public policies aimed at rolling back the frontiers of the state or otherwise increasing the scope for private sector provision of public sector services.

Besides privatisation in the form of sale of state-owned assets and enterprises and conditional (i.e. work-based) welfare, governments increasingly adopted other Neo-Liberal policies, most notably use of private finance initiatives (PFIs) and public-private partnerships (PPPs) for the provision of public sector infrastructure and associated services, contracting out provision of public services to the private sector, etc.

Raising Public Finance

Spending public finance is only half the picture. The ways in which public finance is raised also has to be considered. Most public finance is raised from taxes and
revenues have generally been less than expenditures (Bailey 2004). They rose from a quarter to a third of GDP over the last 40 years of the 20th century, significantly less than the share of public expenditure within GDP noted above.

Personal income tax rose from 7% to 10% of GDP and social security contributions rose from 5 to 9%. Taxes on goods and services remained very stable at 7%. Property taxes remained just under 3% of GDP. Taxes on corporate income remained around 3%. The remaining 2% or so of tax revenues were raised from other taxes on capital gains, inherited wealth, land (as distinct from property), poll taxes (a fixed amount per capita), environmental (‘green’) taxes etc.

It is arguably the case that governments have found it too easy to raise tax revenues from socially and economically beneficial activities (i.e. employment) and have not made sufficient use of taxes on socially and economically undesirable activities (i.e. ‘green’ taxes on consumption and production creating pollution and congestion). Economic theory demonstrates that high taxes may create disincentive-to-work and disincentive-to-investment effects (Bailey 2002). If so, there is a limit on the additional benefits to be achieved by an ever higher relative scale of taxes within GDP.

Taxation is not the only source of public finance. Other sources include charges for services, borrowing, receipts from privatisation and sales of public sector assets, state lotteries, donations and bequests and payments ‘in kind’ (where developers of real estate donate constructed roads, schools and other infrastructure to local governments in whose jurisdictions the development takes places).

In principle, tax-based public finance is required for efficiency purposes for pure public goods such as national defence, the benefits of which are non-rival and non-excludable, and for rival but non-excludable mixed goods such as municipal or regional country parks (Bailey 2002). In these cases sustainable provision solely by means of private finance (i.e. market prices) is simply not possible because the providers of those services cannot recover payment from those who use or benefit from them. The resulting market failure means that these types of services can only be financed collectively by compelling citizens to make payments (i.e. pay taxes).

Such services require public finance to cover their costs if they are to be provided. However, they do not typify the majority of public services, only a minority. Most services provided by the public sector have the same characteristics as those provided by the private sector in terms of being rival and excludable in use, for example health care and education. Their costs are therefore capable of being recovered by charges, though there may be efficiency reasons for subsidising their provision, such as the wider benefits to economy and society of a well-educated labour force. Nevertheless, such wider social benefits typically only justify partial subsidy of costs in efficiency terms, not full subsidy. This property rights analysis makes clear that user-charges should be the primary (not residual) source of public finance.

In principle, equity issues can be resolved by a comprehensive system of means-testing (i.e. taking account of ability to pay by measuring the income and/or wealth of service users). Pursuit of greater equity via public services provided free at the point of
use may be at the cost of lost national output because of the consequently high levels of taxation. Provision of services free to all users, whether rich or poor, may mean that equity is achieved only at the cost of making the average citizen poorer than they would otherwise have been - the ‘diminished cake’ analogy.

Besides use of taxes and charges, governments can also borrow to raise public finance. Public sector borrowing within the European Union is restricted by the Stability & Growth Pact ceilings, deficits intended to be no more than 3% of GDP and gross public debt below 60% of GDP. This is intended to stabilize the value of the euro (Fingland and Bailey 2008). Not being within the eurozone, the UK adopts the ‘golden rule’ of public finance (governments should borrow only for capital, not current, expenditure) and the ‘sustainable investment rule’ (net public debt should be no greater than 40% GDP).

However, observance of these and other such prudential fiscal rules has been compromised by the 2007-09 credit crunch, in particular the use of public finance to rescue failed commercial banks and for expansionary fiscal policy intended to counter the global recession (Bailey and Asenova 2009). The International Monetary Fund (IMF) calculated the ratios of fiscal stimulus relative to GDP based on the initial measures announced by national governments in 2008 as: UK 1.5%, USA 4.9%, Japan 9.1%, Germany 3% and France 1.15%. The IMF later calculated that the additional measures taken in early 2009 increased the UK’s ratio to 19.8%, by far the highest ratio in the G20 countries (the USA’s rose to ‘only’ 6.8%). These ratios subsequently increased as further debt-financed measures were announced and as GDP fell further than expected.

The EU Stability and Growth Pact faces significant problems. In January 2009 the European Commission forecast 15 member states to be in breach of the Pact in 2009. It also forecast budget deficits to average 4.4% in 2010 and government debt to average 76% of GDP, both well above the Pact’s ceilings of 3% and 60% respectively.

Although still low compared with other EU countries, the UK’s net public debt exceeded 50% GDP in January 2009 and the International Monetary Fund forecast that UK public sector borrowing would reach 11% GDP.

**Structural Gaps in the Public Finances**

It was noted above that public expenditure in OECD countries has been persistently and significantly greater than tax revenues over the last four decades or so. This situation is referred to as a structural gap in the public finances. Structural gaps occur when the current generation is living at the expense of future generations of taxpayers. In such cases, current expenditures are financed by borrowing. OECD statistics reveal that many developed countries developed structural gaps after 1960 (Bailey 2004). They were disguised in the past by high inflation reducing the real values of public sector debt, by very low (sometimes negative) real interest rates on that debt and by privatisation revenues. However, they were highlighted by the sharp increases in
public sector borrowing during the 2007-09 credit crunch. The already existing structural gaps in the public finances of most developed countries were exacerbated.

Structural gaps are caused by the lack of symmetry between decisions to spend and to raise revenues. The theory is that the ‘logic of collective action’ results in chronic government failure. Put simply, public finance is characterised by the concentration of the benefits of public services on their users but the dispersion of the resulting costs across all taxpayers (including future generations). This creates a tendency for expenditures to exceed revenues, structural gaps in the public finances occurring irrespective of the overall political philosophy. However, they are inevitably greater for a Collectivist state than for a Libertarian state, a Neo-Liberal state being an intermediate case (see Table 1).

The current level of taxation could be increased but this could have adverse impacts on economic growth and therefore on the tax bases to which higher tax rates are applied. In such a scenario structural gaps re-emerge - so prevention is better than cure. Prevention of structural gaps can be pursued by restricting the role of the state to core functions, levying charges for public services whenever possible, borrowing only to finance economically productive capital expenditures that benefit future (as well as current) generations of taxpayers, and by maximising the scope for political devolution to more closely match willingness to pay taxes with decisions about service levels.

The last measure requires local and regional governments to be largely self-financing via local and regional taxation and user-charges. Contrary to this prescription, there is a general tendency for central governments to finance increasingly large proportions of regional and local government expenditures (Bailey 1999), thus destroying the symmetry between spending and finance and so exacerbating the tendency towards structural gaps.

The Optimal Level of Public Finance

The Libertarian, Neo-Liberal and Collectivist philosophies cannot themselves explain the rising trend in public finance within GDP because they only philosophise about negative and positive rights. They do not determine levels of entitlement to particular services. Nor do they consider how the economic, social and political restructuring that accompanies economic growth impacts upon negative and positive rights. Thus, the different political philosophies provide no practical guidance in respect of the optimal level of public finance, whether in absolute terms or relative to GDP.

Nevertheless, considering both halves of the public finance picture (in other words the combined effects resulting from both the raising and spending of money) makes clear that there is ultimately a limit on the additional benefits to be achieved by an ever higher relative scale of public finance. Most people would probably accept the notion that there is some level of spending where additional public finance for a particular service results in additional costs beginning to exceed additional benefits.
Thus, there exists an optimum level of public finance used to support a service, namely that at which the additional benefits just equal the additional costs.

Benefits include those conferred on society as well as on the individual service user. Costs include not just the direct financial costs but also any other (indirect) costs resulting from behavioural responses to high taxes and high levels of state intervention more generally. If the balance between those benefits and costs changes over time then so does the optimal level of public finance. Public finance should therefore be viewed in dynamic rather than static terms. What was judged right for times past is no guide to what is right for the present or will be for the future.

Almost inevitably, as public spending and revenue accounts for an increasing share of national income, the direct and indirect costs of ever-higher levels of public finance rise faster than the direct and indirect benefits it delivers. Ultimately, therefore, incremental costs exceed incremental benefits. Disincentive-to-work and disincentive-to-invest effects seem to increase with rising levels of taxation but diminishing marginal returns can be expected from increasing public expenditures and service levels. Hence, ultimately, incremental costs exceed incremental benefits.

This outcome can be postponed by cost containment and by securing net additionality of public finance, in other words by ensuring the cost-effectiveness of public spending (i.e. value for money). Cost containment requires a judicious mix of political, economic and administrative control over public spending. Political control requires effective democratic processes, an effective top-down process of priority setting, and accountability of service providers. Economic cost controls include payment at point of use, competition in the supply of services, and grant mechanisms for local governments and other public sector bodies that encourage control of costs. Administrative cost controls generally control inputs and processes, as distinct from outputs and outcomes. Maximising the additionality of public finance requires avoidance of deadweight loss (i.e. avoiding subsidising a level of activity that would have occurred even without public subsidy) and displacement of public funds to unintended uses.

Implementation of cost containment measures and ensuring the net additionality of public finance slows down the rate at which costs catch up with benefits. Nevertheless, at some point the combined effect of the aggregate of public expenditure and taxation may create a profound dependency culture. In other words, public finance must be considered in its totality as well as in terms of the services and welfare benefits on which it is spent and the sources from which it is raised.

A Strategy for Public Finance

Whatever the dominant political philosophy at any one point in time, a strategic approach to public finance attempts to maximise the benefits to be gained from both private choices and public choices. Such a strategic approach avoids the worst manifestations of market failure and also of government failure. An optimal outcome is
not static, however. As economic, social, cultural and other contexts change so there is a need to continually reappraise the financing, operations and outcomes of state activity. This ongoing reappraisal can be undertaken within the 4Es analytical framework. Strategic public finance is therefore necessarily dynamic and evolutionary, a perennial issue of public policy, practice, outcome and sustainability.

A strategic approach to public finance has to take account of the logic of collective action because it compromises the sustainability of public finance by leading to structural gaps in the public finances. A strategy for public finance has therefore to be developed independently of political philosophy so as to ensure sustainability. It will not be possible to satisfy objectives for the 4Es without sustainable levels of public finance.

The sustainability of arrangements for public finance can be judged in terms of the following checklist of strategic points. It is based on the 4Es and is intended only as a rather crude rule-of-thumb to assist a deeper strategic consideration of public finance. It cannot be used effectively without appreciating the broad multidisciplinary nature of public finance. Nevertheless, it highlights the diverse and wide-ranging nature of public finance and provides a useful framework by which to ensure adoption of a truly integrative, strategic and sustainable approach to public finance. It can also be used to identify the need for reform of the current system of public finance in any one country by drawing attention to strategic issues that may have been neglected thus far.

- Consider the possible impact on the constitutional relationship between the state and the individual whenever taking decisions about public finance.
- Bear in mind that successive cumulative changes in public finance can have potentially large positive and/or negative effects on society and the economy. It would be unwise only to be concerned with whether the net effect is positive because the net effect will be highly volatile if it is the residual outcome of two very large and unstable opposing gross effects.
- Be pragmatic and realistic about what can actually be achieved by public finance.
- Recognise that public finance need not be synonymous with public provision: the private sector can be used to deliver many public services.
- Pay attention to long-term trends in the four public finance/GDP ratios, so that the relative scale of public finance does not increase by default rather than by design.
- Maximise the net additionality of public expenditure, wherever possible using public finance to complement rather than replace private expenditure that would have taken place anyway.
Implement cost containment measures, there being considerable scope for reducing costs in the public sector without compromising service objectives.

Undertake more evaluation studies of the use and effectiveness of public finance in achieving clearly specified outcome objectives.

Undertake more international comparisons of raising and spending public finance to try to learn lessons and best practice from other countries.

Avoid competition-by-subsidy, e.g. for mobile industrial and service sector investments, essentially a zero-sum game at the expense of taxpayers.

Seek to improve the targeting of subsidy, avoiding middle-class capture of subsidy intended to benefit low-income groups.

Minimise the potential for the fraudulent use of public monies paid as social security, agricultural subsidies etc.

Shift the balance of taxation away from ‘goods’ to ‘bads’, avoiding as far as possible taxing socially beneficial activities generating incomes and wealth.

Minimise the scope and incentives for tax avoidance and tax evasion by simplifying tax structures and by avoiding punitive rates of tax.

Avoid fiscal drag by increasing tax thresholds and so tax bases each year in line with inflation of the relevant tax bases (e.g. by index-linking personal income tax thresholds to growth of earnings – linking them to retail prices still results in fiscal drag, albeit reduced, since earnings typically rise faster than prices).

Widen tax bases so as to be able to reduce tax rates for a given tax revenue, so minimising any disincentive-to-work and disincentive-to-invest effects.

Make use of a plurality of sources of public finance in order to minimise the adverse effects of any one source.

Make more use of user-charges, avoiding any adverse equity effects through the use of means-testing or exemptions and discounts for specific groups of user such as children and low-income groups.

Encourage income generation schemes within public sector bodies, for example in seeking sponsorship from the private sector for equipment and in encouraging donations and bequests. Such schemes should not compromise service objectives: they are a means to an end, not an end in themselves.

Reduce the need to borrow by requiring public sector organisations to keep inventories of the capital assets they own and to sell underused capital
assets, using the capital receipts to finance new infrastructural investments or to repay debt.

- **Consider how changes in public finance may affect peoples’ incentives to work and companies’ incentives to invest**, in particular considering how the combination of taxation and social security benefits affects decisions to work.

- **Make unemployment benefits conditional**, recipients having to undertake training for employment.

- **As far as possible, make social security budgets balance**, i.e. contributions equal to transfers.

- **Prevent the emergence of structural gaps in the public finances**, prevention being much less traumatic and more practical than cure.

- **Devolve public finance decisions to the lowest possible level of government** in order to match as far as possible the areas benefiting from services with the areas from which tax payments are collected.

- **Minimise the need to pay intergovernmental grants to lower tiers of government** by ensuring they have sufficient autonomous revenues and by using Robin Hood systems of fiscal equalisation.

- **Subsidise service users instead of service providers as far as possible**, for example by using vouchers to increase the scope for choice on the part of service clients.

Not all elements of this strategic checklist can be adopted immediately and some will most definitely require pilot tests (e.g. for user-charges and voucher schemes). Nevertheless, it is clear that there is considerable scope for more effective and discriminating use of public finance. Public finance is definitely not simply a matter of ‘tax and spend’ or vice versa.

Ultimately, whatever the political philosophy underpinning public finance, this checklist emphasises the need to use public finance sparingly and judiciously. Policy makers should always question the need for more public finance and consider whether ongoing expenditures are still as effective as they could be. Hence, the strategic checklist outlined above assumes the need to be prudent with public finance, not profligate. Only by adopting such an approach will the public finances be sustainable in the long term.

**Conclusion – the holistic nature of public finance**

Hopefully, the reader now appreciates the all-encompassing nature of public finance. It is not just about financial flows, about how to finance spending on services.
Even recognising the need to pay attention to raising as well as spending money, public finance is about much more than budgeting.

Instead, public finance is a manifestation of the interface between the state and the citizen. It reflects the dominant political philosophy in any one country and the consequent entitlements to state assistance as well as responsibilities for self-support. It supports pursuit of objectives in respect of equity, efficiency, economy and effectiveness. It impacts upon the rate or economic growth and so affects not just the distribution of income and wealth but also the absolute level of material standards of living.

Put simply, public finance is synonymous with public policy writ large. A strategic approach to public finance requires the analyst to take a holistic view, recognising that the whole is greater than the sum of the individual parts. Public finance has to be considered in the round, not just in the detail. Whilst policy makers, practitioners, and subject specialists usually consider only their particular specialisms, a strategic approach to public finance must be holistic, encompassing all the issues mentioned above. To neglect any one of them may lead to unintended and unwelcome outcomes and compromise the sustainability of public finance. Even though, in practice, reform of public finance may have to be incremental and gradual, those ongoing reforms should be in pursuit of a strategic sustainable vision in terms of what public finance can potentially deliver to the benefit of economy and society. Those who complain about ‘the dead hand of public finance’ have clearly failed to appreciate the vibrant, contentious and evolutionary nature of the subject. Rather than being dull and moribund, the study of strategic public finance is both fascinating and intellectually demanding.

References


