

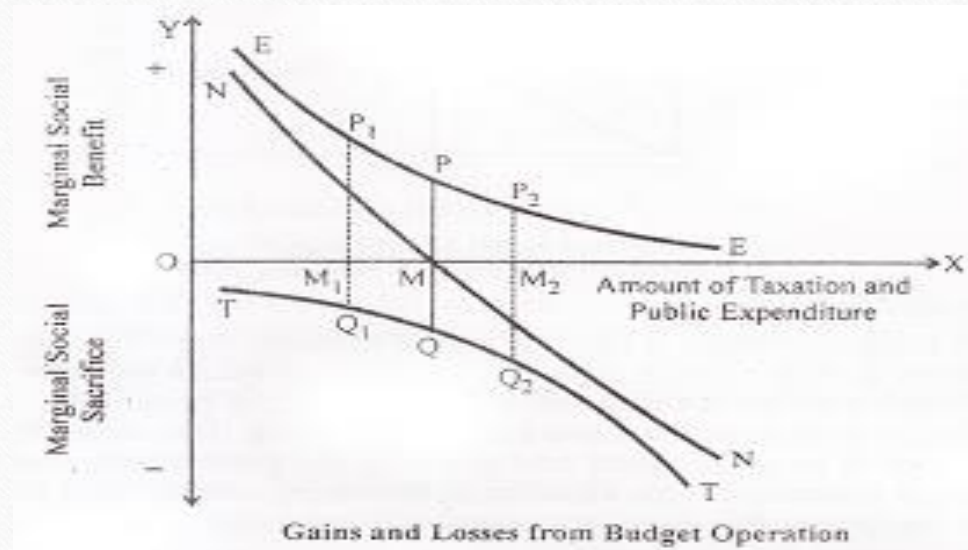
# Principle of Maximum Social Advantage

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Part IV

# Principle of Maximum Social Advantage

- Musgrave's Explanation of Principle of Maximum Social Advantage:
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- Explained through following figure:



# Principle of Maximum Social Advantage

- In the above diagram, the 'Amount of Taxation and Public Expenditure' is measured on the X-axis, and on Y-axis, the 'Marginal Social Benefit' (MSB) is measured in the upward direction and the 'Marginal Social Sacrifice' (MSS) is measured in downward direction.
- The 'Curve EE' indicating the marginal social benefit of successive units of public expenditure, allocated optimally between different public uses, slopes downwards from left to right due to diminishing marginal utility of social benefit.
- The 'Curve TT' indicating the marginal social sacrifice of successive units of taxation imposed, slopes upward from left to right due to increasing marginal disutility or social sacrifice.

# Principle of Maximum Social Advantage

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- The 'Curve NN' measures the net benefit derived from successive additions to the public budget (by way of taxation and public expenditure) and is arrived by deducting TT from EE.
- ❖ **Determination of Optimum Size of Budget:**
  - Equilibrium or optimum amount of taxes and public expenditure will be OM, where, the NN curve cuts the X-axis at point M.
  - At this point, marginal social sacrifice is equal to marginal social benefits i.e. marginal net benefits are zero so that total amount of social benefits will be maximum.

## Principle of Maximum Social Advantage

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- Any point before M, net social marginal benefit is positive implying that total social benefit will increase, hence, government should increase the budget.
- Any point after M, the net marginal social benefit becomes negative, hence, total social benefit will decrease. Therefore, the government should reduce its budget.

# Principle of Maximum Social Advantage

## ■ Limitations:

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- The principle is an important principle of public finance, however, suffers from following limitations:
  - The principle is based on law of diminishing marginal utility which itself suffers from various limitations like cardinal measurability of utility etc.
  - Assumption of balanced budget has its own limitations. Deficit or surplus budget is also sometimes recommended to stabilize the economy.

# Principle of Maximum Social Advantage

## ■ Conclusion:

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- Despite these limitations, the principle provides an important guideline for the public authorities and give answers to following important questions related to government activities.
- Determination of optimum size of the budget.
- Determination of optimum amount of the taxation.
- Determination of optimum amount of the public expenditure.
- Distribution of tax burden on different users.
- Allocation of public resources on different uses.

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