

Graham C Hockley

# PUBLIC FINANCE

An Introduction



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# Preface

This book continues with the same format as the author's earlier *Monetary Policy and Public Finance* but has been completely rewritten to take account of the many and substantial changes that have taken place in both the monetary and fiscal fields.

The unhappy financial history of the first part of the 1970s, leading to the 'lifeboat' operation of the Bank of England and extensive changes in monetary control, is detailed.

On the fiscal side there has been a great number of changes. Many have been of mere detail but there has been a number of substantial changes such as the abolition of selective employment tax (SET), the introduction of value-added tax (VAT), and the replacement of estate duties by a capital transfer tax. There are also substantial, though temporary, North Sea oil and gas revenues flowing in. These changes have not, unfortunately, led to many deletions in the list of faults in the tax structure: there is still a formidably complex tax structure that is far from equitable.

Chapter 2 ('The financial system') and Chapter 12 ('The social services') are additions. Also new is a substantial section (Chapters 19, 20 and 21) which looks at local government and regional finance. Chapter 19 deals with the present reorganised structure of local authorities and their revenue and expenditure. Chapter 20 looks at the issues involved in central/local relations, the types of fiscal arrangements that can be made, and has a considerable section on the important issues involved in equalisation. Chapter 21 considers local-government and regional-government sources of finance together: a common-sense but seldom-followed practice. It finishes with a discussion of the rating system.

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Finally, as is proper, the last word goes to a woman — my wife — whose encouragement and forbearance greatly eased my task.

# Introduction

This book is intended as an introduction to a university course in public finance and for use of students who are studying for professional examinations. Also, I hope, it will be intelligible, and of interest, to the general reader. In public finance most of us judge from a purely personal standpoint: a good tax is a tax that is paid by somebody else; wise government spending is spending that benefits oneself; correct monetary policy is regulation that protects one's own interests. The multitude of voices raised on almost every aspect of public finance, each claiming right on its side, but frequently each seeking its own ends, tends to drown out general considerations.

*Essentially, a study of public finance is an attempt to break away from this Babel, to see through arguments based on the interests of this or that group, and attempt to establish rational principles on which policy can be based.*

The scope of a public finance course is ill-defined. Government spending and revenue are central to it, but there is considerable overlap with monetary policy. The Government can, after all, merely create money to pay for the goods and services it requires, or it can borrow from its citizens as well as taxing them. This book takes the view that it is impossible to have a very realistic understanding of public finance matters without some understanding of the operation of the monetary system.

Part I is therefore devoted to the monetary system. Chapter 1 discusses the nature and attributes of money, how it affects the economy, and the value of money. The following chapters deal respectively with the financial system, the Bank of England, the discount market and the commercial banks. These institutions have a unique and long-established relationship with each other. Following this is a description of other financial institutions which in recent years have transformed much of the financial scene. Our concern is not so much with the detailed working of these institutions

but with obtaining an understanding of their interrelationships and how they form the monetary system. Chapter 7 draws the previous discussion together in looking at the implications for monetary policy of a Budget surplus or deficit. This chapter therefore provides many of the links between the sphere of public finance and that of money, which will be taken up and developed later in the book.

A description of the monetary system, it will be clear, is a description not of a static framework but of an evolving structure. The rapidity with which change can take place is indeed one of the remarkable things about the collection of institutions labelled the 'British Monetary System'. As with many rapidly changing things, the spice of controversy is never far away.

Part II introduces the public finance section with four chapters which briefly outline how government expenditure and revenue have changed in this century. This background is essential for an understanding of the system as it exists today. In this context policy can be discussed from two angles: one approach is to look at reasons for government expenditure and its change over time; the other approach is to concentrate on ways of ensuring that expenditures, given that the decision to spend has been made, are wisely and not wastefully applied. This book has a number of things to say, relevant to this latter and important question, particularly on simplification of the system of tax and benefits, which could lead to large savings. But the detailed parliamentary and administrative procedures, and statistical techniques, that attempt to ensure efficiency in this narrow sense have been considered outside the scope of this volume. Changes up to November 1978 have been incorporated.

Chapter 12 looks at the system of social services. Payment for the bulk of social services is by means of a separate assessment. This, for most people, is at a proportional rate, with no allowance for differences in taxpayers' circumstances except for a distinction between employed and self-employed persons. This is contrasted with the elaborate provisions of the income-tax system. National Insurance benefits and supplementary benefits are given together with their overlap with the tax system.

Chapter 13 is a key chapter, setting out the accretion principle of income. This concept is used thereafter as a yardstick to evaluate the current system of taxes and benefits which is detailed in the following chapters. Chapters 19, 20 and 21, as outlined in the Preface, deal with local and regional finance. The National Debt raises complex monetary and fiscal issues, which are examined in Chapter 22. Chapter 23 gathers previous threads and looks at some alternative ways in which the system can evolve.

Part III does not attempt a detailed assessment of the use of policy in the post-war period: this has been well covered in recent publications; but it outlines the problems of using monetary and fiscal policy to control the economy.



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