The Principle of Maximum Social Advantage

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The Principle of Maximum Social Advantage

This theory was propounded by 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)

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

When the unit of taxation was OM1, the marginal social sacrifice was OS1, and with the increase in taxation at OM2, the marginal social sacrifice rises to OS2.

Increasing Marginal Social Sacrifice Curve
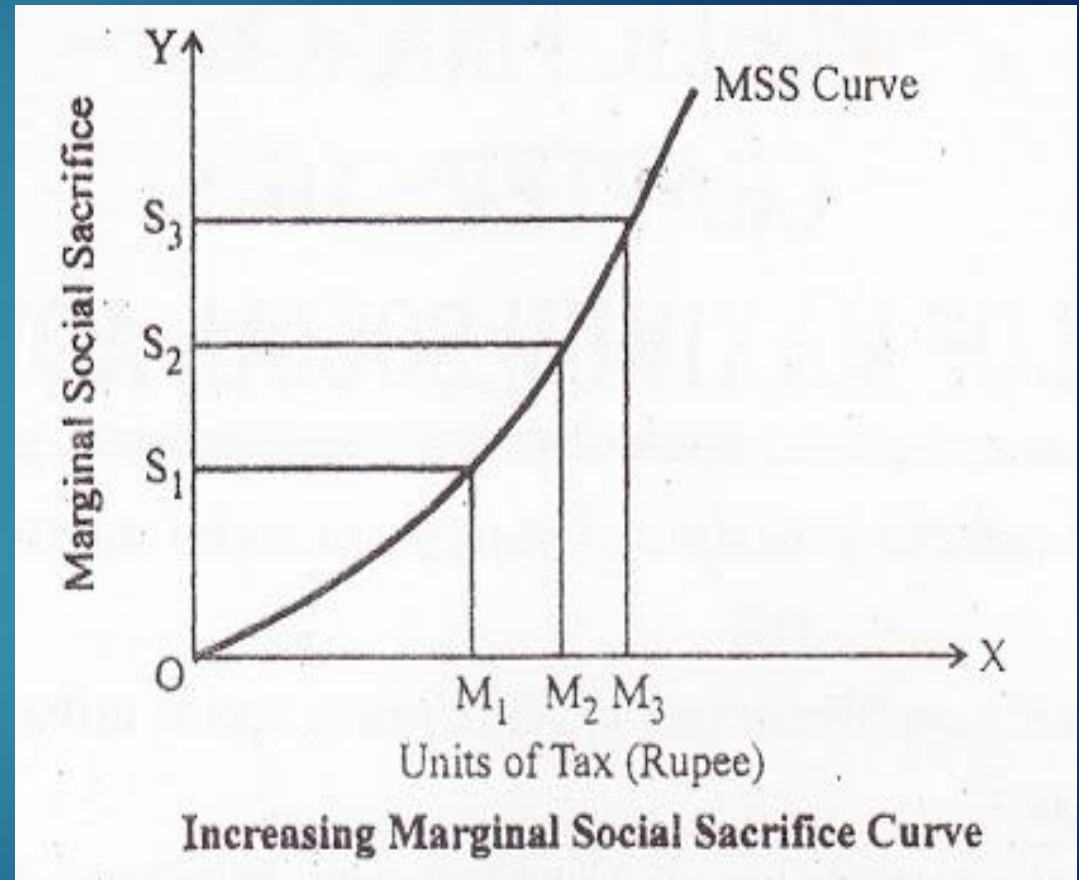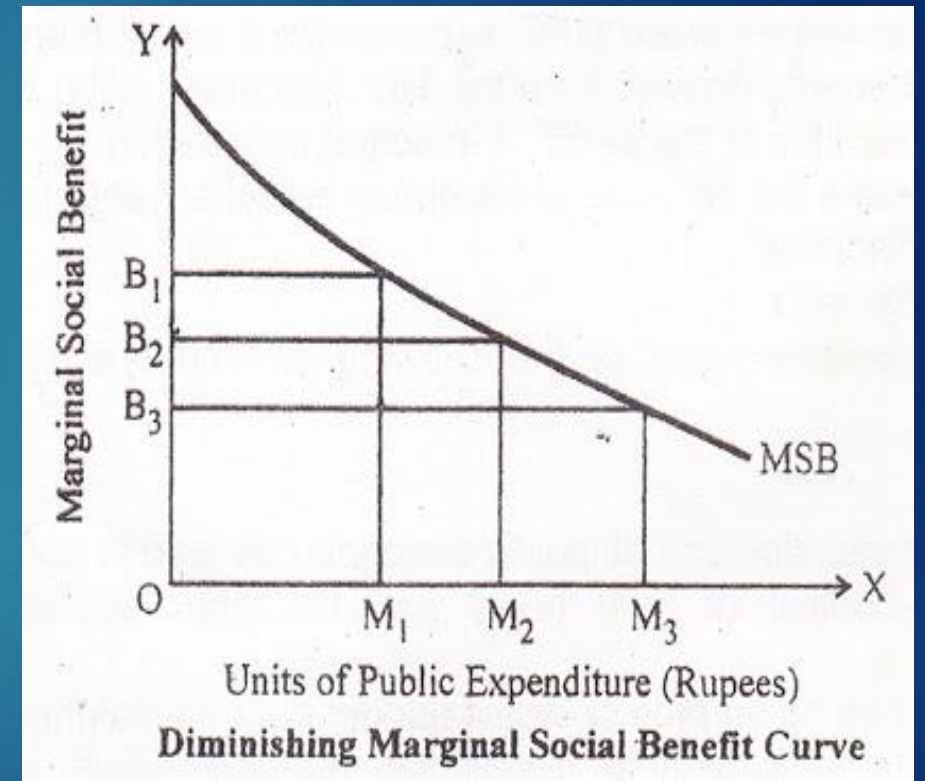
Marginal Social Benefit (MSB)

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
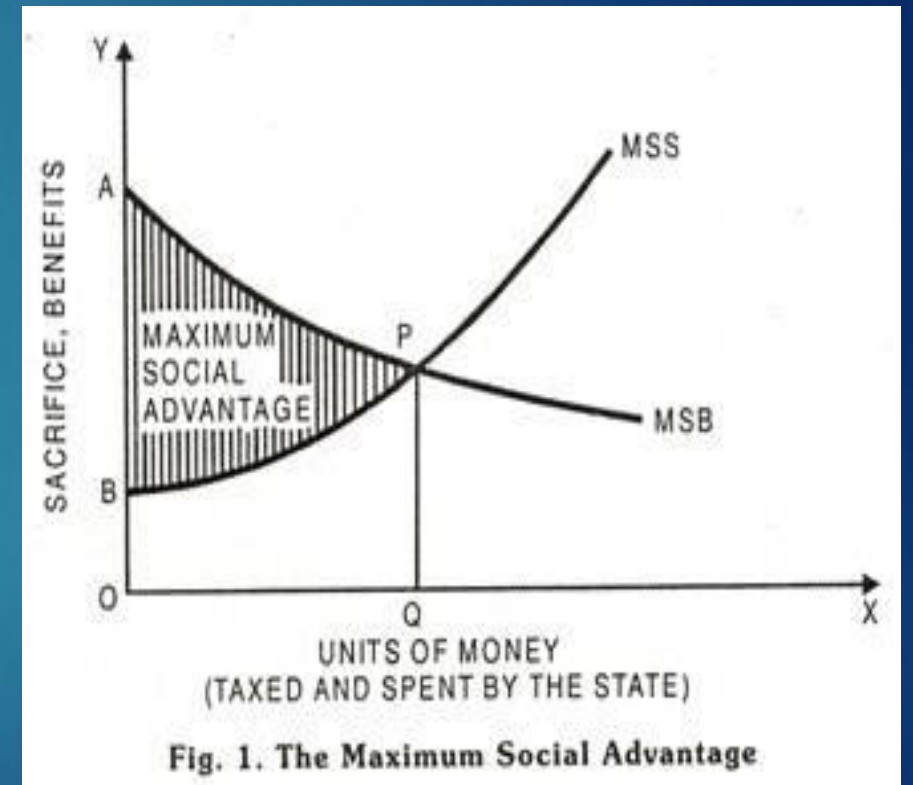
Marginal Social Benefit (MSB)

In the 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 OM1, the marginal social benefit was OB1, and when the public expenditure is OM2, the marginal social benefit is reduced at OB2.

Diminishing Marginal Social Benefit Curve

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.

Fig. 1. The Maximum Social Advantage

The Point of Maximum Social Advantage

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 up to the point where the marginal utility due to public expenditure us 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:

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.

Gains and Losses from Budget Operation
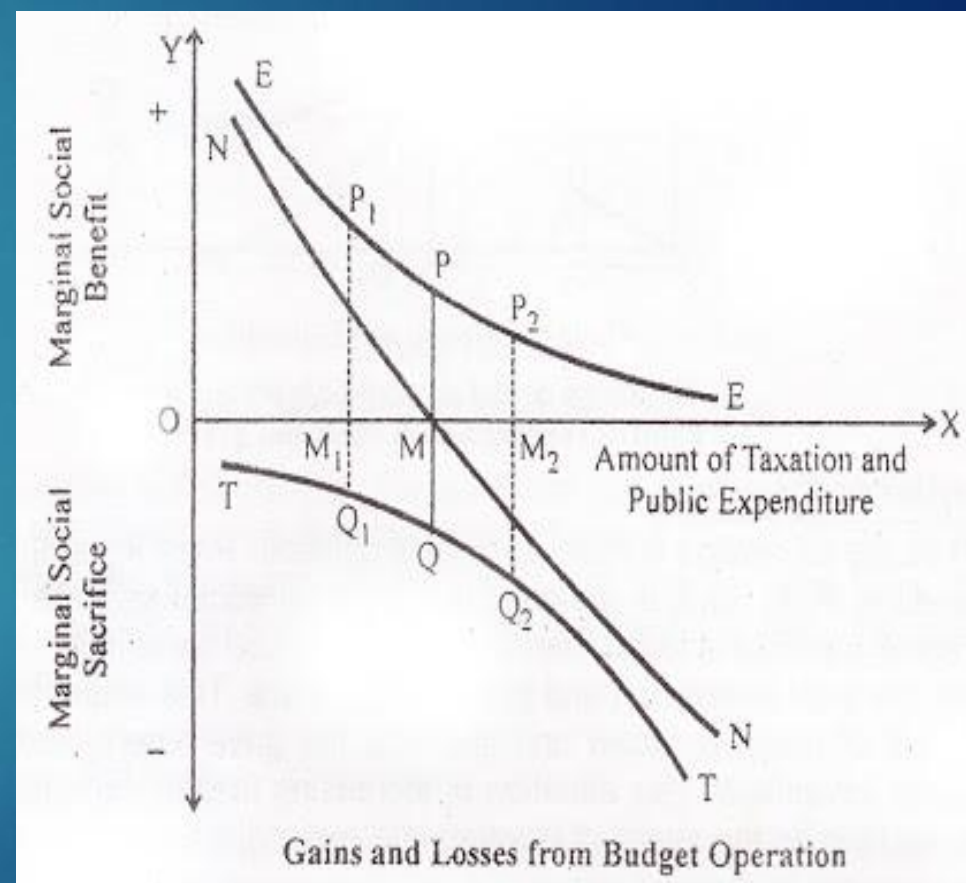
Conclusion

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.

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.

▶ **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.