WISEMEN PEACOCK HYPOTHESIS

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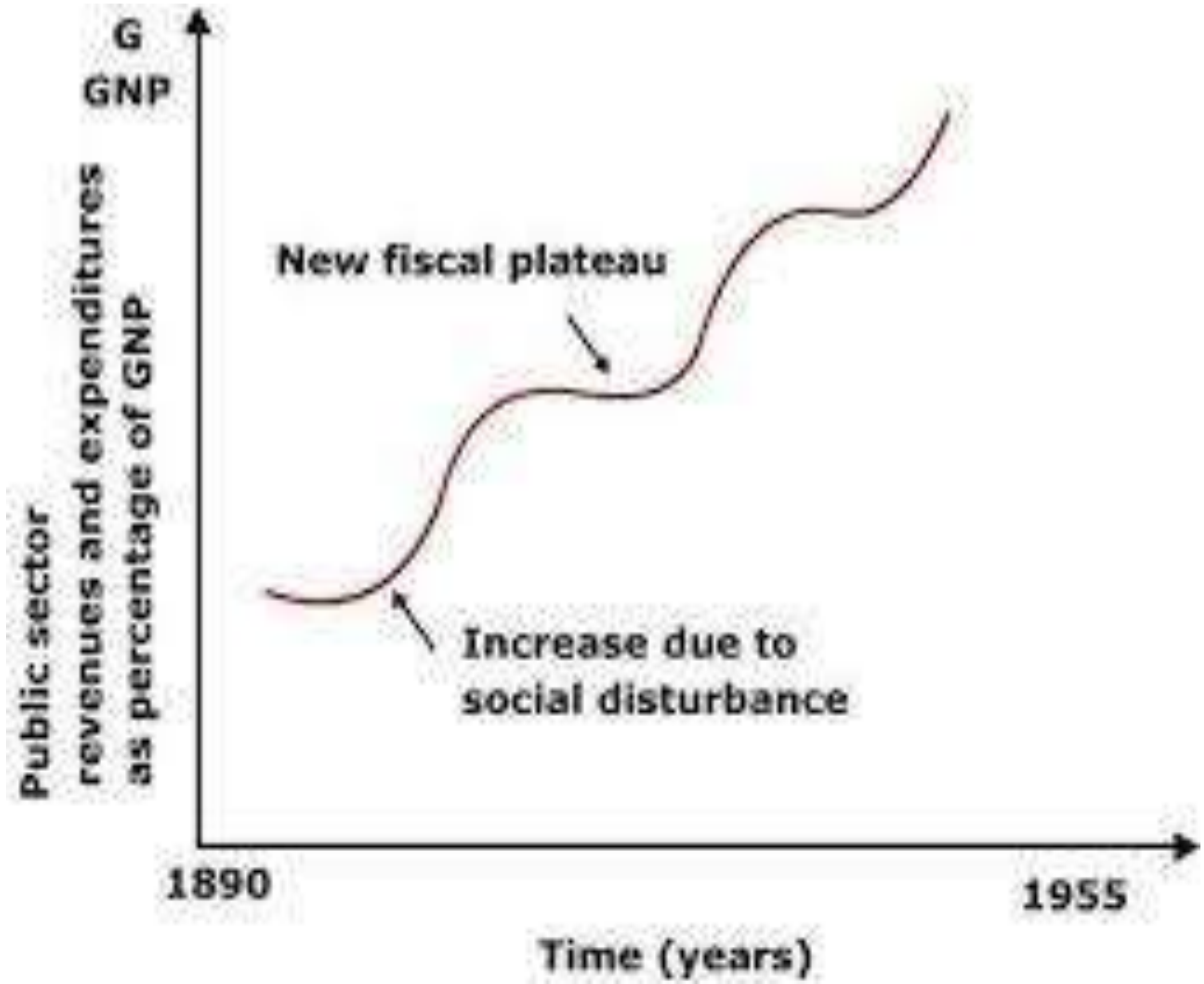
II MA ECONOMICS

WISEMEN-PEACOCK HYPOTHESIS

- The Peacock-Wiseman hypothesis, also known as the "Ratchet Effect," is an economic theory proposed by Alan T. Peacock and Jack Wiseman in the 1960s
- This empirical study done in the case of Great Britain using the data from 1890 to 1955

- Wisemen peacock focused on the pattern of public expenditure and concluded that public expenditure does not increase in a smooth and continuous manner, but in jerks or step like fashion.

- This hypothesis suggests that government spending tends to increase over time in response to crises or significant events but rarely decreases to pre-crisis levels once the crisis has passed.


G
GNP
Public sector revenues and expenditures as percentage of GNP
New fiscal plateau
Increase due to social disturbance
1890
1955
Time (years)

They gave three separate concepts to justify the hypothesis

- Displacement effect
- Inspection effect
- Concentration effect

DISPLACEMENT EFFECT

- When a social disturbance occurs the government raises taxes to increases revenue and increases public expenditure to meet social disturbance.

- This creates a displacement effect by which low taxes and expenditure are replaced by higher tax and expenditure levels.

- After the disturbance ends,the newly emerged level of tax tolerance makes the people willing to support higher level of public expenditure since it is capable of bearing heavier tax burden than before.

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- As a result, the new level of public expenditure and public revenue stabilize but are soon destabilized by another new disturbance which causes another displacement effect.

INSPECTION EFFECT

- Even if there is no new disturbance there is no strong motivation to return to lower level of taxation as the increased revenue can be used to support a higher level of public expenditure.

- Therefore government expands its fiscal operations partly due to disturbance and partly due to disturbance and partly due to disturbance and partly to expand economic activity and take up new functions that were early neglected.

CONCENTRATION EFFECT

- When an economy is experiencing economic growth there is a tendency of central's economic activities to grow at a faster rate than that of state and local government's activities.
- This is known as concentration effect. It is related to the political set up of the country

THANK YOU

PUBLIC ECONOMICS

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PAUL SAMEULSON

- His 1954 paper, "The Pure Theory of Public Expenditure," introduced a concept of public goods.
- Samuelson formalized the analysis of goods that are non-excludable and non-rivalrous, where one person's consumption does not reduce availability to others, and people cannot be effectively excluded from use.
- He proposed that the efficient provision of a public good occurs when the sum of MRS between the public good and a private good across all individuals equals the MRT of the public good into the private good.

Marginal rate of substitution (MRS):

Represents how much of a private good an individual is willing to give up to obtain an additional unit of a public good.

Marginal Rate of Transformation (MRT):

Indicates how many units of a private good must be forgone to produce an additional unit of a public good.

This condition underscores the necessity of aggregating individual valuations and preferences for public goods to determine the optimal level of provision, which differs from private goods.

IMPLICATIONS FOR PUBLIC POLICY

- It Highlights the need for collective action or government intervention to efficiently allocate resources to public goods, given their unique characteristics.

- It Emphasizes the problem of free-riding in voluntary contributions to public goods, where individuals benefit without contributing to the costs, potentially leading to under provision.

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- It Supports the role of government in taxing and providing public goods to overcome market failures associated with public goods provision.

- Samuelson’s theory is a cornerstone of public economics, influencing how economists and policymakers understand and approach the provision of public goods.

- The principles outlined by Samuelson continue to guide economic theory, public policy, and the study of externalities and government intervention in the economy.

RICHARD MUSGRAVE

- **Richard Musgrave** is the father of Public Economics.
- In 1959, Musgrave theorised **three functions for public expenditures.** In his paper **" Voluntaryexchange theory of public economy"**

1) **Allocation Function:** He emphasized the importance of government provision of goods and services that the market cannot efficiently provide due to their non-excludable and non-rivalrous nature.

2) **Distribution Function:** He argued for the taxes and government spending as tools to adjust the distribution of wealth, addressing inequalities that arise from market operations.

3) **Stabilization Function:** Musgrave highlighted the government's responsibility to stabilize the economy, managing inflation, unemployment, and economic growth through fiscal and monetary policy. ***This function is critical for maintaining economic stability and promoting a healthy economic environment.***

MUSGRAVE'S INFLUENCE ON PUBLIC ECONOMICS:

- Musgrave's work expanded the field beyond the traditional focus on taxation and government expenditure to include a comprehensive view of the government's economic roles.
- He provided a theoretical foundation for understanding and designing fiscal policy, influencing how governments think about taxation, public spending, and budgeting.
- Musgrave emphasized that economic policies should not only be efficient but also equitable, integrating social goals into economic decision-making.

THANK YOU