**Merit Goods:**
The concept of merit goods is introduced as a result of public and private goods. The term 'Merit Goods' is defined as those goods representing the aggregate values, circumstances, culture, environment and social behaviour of the society. Then it becomes the duty of the government to provide these goods.

Merit goods may be public or private, but the provision of merit goods may lead to distort the choices of individuals. But as these goods represent the preferences of so many people, hence, they are called as 'merit goods'.

In case of merit goods, efforts have been made to establish a relationship between public and private goods, which are generally opposite to each other. The government has to manage in such a manner that the individual choices of the society may not be affected.

It is being observed that the merit goods are being introduced at governmental level in the countries like Iran and Saudi Arabia. As in these countries adulterer is given death sentence. While in Western countries, the merit goods are being brought forward with the help of legislation, referendum, budget policy, media and educational development. Here the prostitution is being discarded because of the spread of AIDS.

Thus merit goods motivate the people to defend their own interests as well as their countries also.

**Externalities:**
Externalities are those activities that affect others for better or worse; without those others paying or being compensated for the activity. Externalities exist when private costs or benefits do not equal social costs or benefits. The two major species are 'external economies' and 'external diseconomies':

**External Economies:** External economies are those economies which accrue to each member firm as a result of expansion of the industry as a whole. Expansion of an industry may lead to the availability of new and cheaper raw materials, tools and machinery, and to the discovery and diffusion of a superior technical knowledge. Moreover, with the expansion of an industry, certain specialised firms may come into existence which work up its waste products. The industry can sell them at a good price. The entry of new firms enlarging the size of an industry may enable all firms to produce at lower cost. There is every possibility of external economies to be reaped when a young industry grows in a new territory.

There are various types of external economies that are broadly classified into three categories discussed as below:

(a) **Economies of Concentration:** These economies relate to advantages arising from the availability of skilled workers, the provision of better transport and credit facilities,
stimulation of improvements, benefits from subsidiaries, and so on. Scattered firms cannot enjoy such economies. These are the advantages of a localised industry. Such economies are of special importance in the countries like India and Pakistan which has not yet been fully industrialised.

(b) Economies of Information: These economies refer to the benefits which all firms engaged in an industry derive from the publication of trade technical journals and from central research institutions. In a localised industry, research and experiments are centralised. Each individual firm need not incur expenditure on research. It can draw such benefits from common pool.

(c) Economies of Disintegration: When an industry grows, it becomes possible to split up some of the processes which are taken over by specialised firms. For example, a number of cotton mills located in a particular locality may have the benefit of a separate calendaring plant.

External Diseconomies: When an industry expands, the firms enjoy external economies. But too much expansion will result in greater external diseconomies than external economies. As a consequence, the cost of production goes up instead of falling.

It is common experience that, when an industry in an industrial centre expands, there is a keener competition among the firms for the factors of production and the raw materials. As a consequence, the prices of raw materials and of the factors production go up. All firms have now to pay higher wages, higher rents and higher rates interest besides higher prices for the raw materials. Suitable labour ceases to be available; and capital also becomes scarce. The result is that, with the expansion of an industry the costs of production go up instead of falling. Too much expansion of industries may cause other social costs, like pollution, use of very cheap (even harmful) materials in food / medical products, etc.

The main point is that the additional factors of production, the employment of which becomes now necessary, are less efficient and they are obtained at a higher cost. It is in this manner that diseconomies result as an industry expands.

Policies to Correct Externalities: What weapons the government can use to combat inefficiencies arising from externalities? The governments today combat externalities using either direct controls or financial incentives to induce firms to decrease harmful externalities or to increase beneficial activities. The government steps to restrain pollution and other harmful activities arising from external diseconomies are:

1. Government Programmes:
   (a) Direct Controls, i.e., through social regulations or direct regulatory controls, usually enforced by the Federal Department of Environmental Protection.
(b) Market Solution, i.e., through economic incentives instead of direct regulatory controls. One of the approaches may be to charge 'emission fees' which would require the firms to pay a tax on their pollution equal to the amount of external damage. This in effect internalised the externality by making the firm face the social costs of its activities.

2. Private Approaches:
(a) Negotiation and the Coase Theorem: A startling analysis by Chicago's Ronald Coase suggested that voluntary negotiations among the affected parties would in some circumstances lead to the efficient outcome. Coase's analysis does point to certain cases where private bargains may help alleviate externalities - namely, where property rights are well defined and where there are only a few affected parties who can get together and negotiate an efficient solution.

(b) Liability Rules: A second approach relies on the legal framework of liability laws or the tort system rather than direct government regulations. Here, the generator of externalities is legally liable for any damages caused to other parties. Thus, if you are injured by a negligent driver, you can sue for damages. Or, if, through negligence, a company causes illness to its workers, the workers can sue the company for compensation.

Public Finance and Private Finance:
Similarities:
(a) Both have to balance their incomes and expenditure;
(b) Both try to maximise the benefit with the minimum use of resources;
(c) Both have to borrow to bridge gap between their current revenue and current expenditure; and
(d) Both can increase their income by increasing their investment expenditure.

Differences:
(a) Adjustment of Income and Expenditure: For an individual, there is a general note: "Cut your coat according to your cloth". But a government first settles the dimension of the coat and then proceeds to arrange for the cloth required. In other words, the individuals have to adjust their expenses according to their income. Whereas, the public enterprises adjust their incomes according to their expenses, which is, however, not always true.

On the whole, we can say that there is a real difference in approach towards the finance of an individual and that of a government. The government first calls for an estimate of expenditure from the various departments, settles the total expenditure, and than levies the taxes accordingly.

(b) Budgeting: For the public authorities, the unit of time for the budget is one year. But the individual attaches no special sanctity to the period. He need not balance his budget by a particular date or during a given period.
(c) **Internal Borrowing:** In their resources, a government and an individual differ. When hard-pressed, a government can borrow both at home and abroad, i.e., it can raise either an internal loan or an external loan or both. But the only way open to an individual is external loan. There can be no internal loan for an individual.

(d) **Deficit Financing:** There is another source of income open to a government, i.e., deficit financing. A government can obtain more money by printing more currency notes. An individual cannot print his/her own currency note to be acceptable in the market.

(e) **Different Objectives:** An individual tries to maximise his satisfaction or profit from the consumption or production from a given amount of resources. Whereas the theme objective of a government to maximise the social welfare. The government spends money in order to attain the level of maximum social benefit. Further, the governments seek to achieve full employment, an equitable distribution of income and rapid economic growth or economic stability through their fiscal operations. But these objectives have no counter-parts in individual finances.

(f) **Deliberate and Changes in Finance:** For an individual, big and deliberate changes either in income or in expenditure are not so easy. But governments are in better position to make big and fundamental changes in the scheme of public income and public expenditure for future prospects.

(g) **Provision for the Future:** In the matter of providing for the future, a government is much more liberal and far-sighted. Governments spend large amounts of money on schemes of afforestation, public works or social security schemes, and developmental projects which will ensure in future, faster and stable economic growth, more social welfare, more employment opportunities, etc. The individual, on the other hand, may be anxious to reap quick returns. Human life is so uncertain that some individuals discount the future at a very heavy rate.

(h) **Surplus Budgeting:** A prudent individual must spend less than he earns. He must have a surplus budget. But for a state, it depends on the economic situation in the country. Deficit budgeting during times of a depression may stimulate effective demand. On the other hand, during periods of inflation, the emphasis is on surplus budgeting so as to reduce the level of effective demand.

(i) **Individual Finance is Concealed:** An individual, for security reason, may conceal his income or wealth. Whereas a government annually publishes its budgetary policy revealing national income, expenditure, resources in use, etc. This shows the strength of an economy and the capability of nation as a whole.

(j) **Coercive Authority:** The private individual lacks the coercive authority which a government has. A government has simply to pass a law and compel the citizens to pay a tax or subscribe to a compulsory loan (i.e., a compulsory deposit), but an individual cannot do raise his income in this way.