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DISSERTATION

Presented in Partial Fulfillment of the Requirement for
the Degree Doctor of Philosophy in the Graduate
School of the Ohio State University

By

William Leroy Henderson, B. Sc., M.A.

The Ohio State University
1962

Approved by

Advisor
Department of Economics
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CHAPTER ONE

Introduction

Public or Government Finance

The finances of government include the raising and disbursements of government funds. Public finance is concerned with the operation of public fisc. Hence the degree that public finance is a science, it is the fiscal science; its policies are fiscal policies; its problems are fiscal problems. Although government activities affect the private economy in many ways, the economic effects stem from or are a function of the raising and disbursement of funds by government. The raising and disbursement of government funds by no means constitute a narrow field of problems.

The study of these problems is a study of economics from the point of view of government, or the influence of certain types of government policy upon the economic affairs of individuals.

1

A government or state is an organization based upon force in the sense that in any final test the will of the organisation, however determined prevails over the will of particular members or other organizations. E. R. Rolph and G. F. Break, Public Finance (New York: Ronald Press Company, 1961), p. 11.

2Ibid., pp. 33-48.
The Nature of Taxes and the Taxing Process

In terms of financial contributions to government, taxes are the most important of the various classes of revenue receipts.  

Seligman's definition of a tax as a "compulsory contribution from the person to a government to defray the expenses incurred in the common interest of all without reference to special benefits conferred," serves as a starting point in the consideration of the nature of taxes.

The following facts are "necessary" conditions in any analysis of tax measures in an economy.

(1) Taxes are paid out of income, and eventually out of the income of individuals. The only exception is the capital levy where taxes exceed income and are paid out of capital. (2) Taxes may or may not finally rest upon the person who pays the tax to government. (3) Taxes have some effect or repercussion in the economy.

The economic significance of these necessary conditions can be determined only by an investigation of who actually bears a tax and what the economic effects of the taxing process are or may be. The taxing
process or the manner in which taxes are levied in the economy may result in desirable or undesirable effects. The effects of the taxing process may be designed by taxing authorities to achieve desired objectives. The designing of the tax programs to achieve specific or general objectives is referred to as tax policy.

The effect of tax policies on the income of the taxpayer is threefold: Firstly, tax policy to determine who shall bear the tax load, thereby directly affecting the distribution of income and assets after taxes; secondly, tax policy to change the distribution of income before taxes, because tax measures not infrequently give a competitive advantage to some occupation, line of business or some business activity; and thirdly, to affect the amount of every individual's real income, through influences on national income and the price level. Taxes affect the short run and the long run stability and size of both national income and the price level.


The Bases for the Development of Tax Policy

The most numerous and most persistent issues of tax policy are those relating to the distribution of the tax load. The theoretical

7 Ibid., p. 19

basis of tax policy actually begins with an idea or an ideal that guides the distribution or apportionment of tax burden among taxpayers. Some
decision must be made as the basis upon which tax burdens are to be allocated among various taxpayers.

How tax burden should be apportioned among individuals has no doubt been the subject of discussion and controversy since the beginning of political organization. So long as poverty and insecurity compel the sovereign to employ every available fiscal device in order to maintain sovereignty, questions of justice are naturally subordinate. Once stable government and a measure of economic freedom appears, considerations of equity are forced to the front. More revenue devices are available than are required. To what extent shall each kind of levy be employed? But at the center of the problem, is the question of how tax burden should be allocated, of what is the most equitable system.\(^8\)

---


The fact that tax burden should be distributed "fairly" or "justly" was a requisite in traditional public finance.\(^9\) But what does "fairness" and "justice" imply? It is necessary to postulate the need for government performance of certain functions for the benefit of society. For this reason, contributions cannot be left on a voluntary basis, permitting each individual to contribute what is "right" or "fair."

If coercive power and compulsion are to be used to exact contributions, some positive basis of allocation should be determined. This approach, \(^10\)

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\(^9\) See Rolph and Break, *op. cit.*, pp. 8 ff. for a discussion of financial traditionalism.


in effect, sets forth a series of rules or guides for government conduct in taxation.
Shultz and Harris point out that "every doctrine of tax justice is based on an arbitrary assumption — taxes should be 'just.' Yet this is hardly a tested scientific principle. At best, it expresses a pious hope."


It is no simple problem to determine the relationship between justice and equity in tax apportionment. The ideas of protection, service, or exchange form a partial basis for expressing the relationship of the individual and the state whereby equity and justice may be attained.

12 Rolph and Break, op. cit., pp. 93 and 95; see also Shultz and Harris, op. cit., pp. 199-202.

This relationship is expressed by first defining the functions of the state and then devising a fiscal program of revenues to implement these activities.


Justice in Taxation Policy

The concept of justice cannot be defined without reference to the goal to be attained, a goal which is directed to some social or individual purpose. "Justice is an ideal, an end to be achieved. It is impossible to decide whether this or that particular tax, or what tax system, is
"just" until it has been determined, first what the ideal is and second whether the tax in question operated as an approach to this ideal.\footnote{11}{Ibid., p. 502.}

The ends of tax justice are satisfied when the economic conditions or effects are made relatively the same by taxation. For example, justice may require that every member of society, or every person who participates in attaining ends in a society, should contribute to the support of society to the extent of his participation in society.

Justice in taxation cannot be defined without some ethical position set forth by the person who defines justice. Justice is, in part, a type of index. It is a "base" or "norm" to which the taxing process is related. The comparison to the "norm," whatever the "norm" may represent, provides a given view of tax justice.

In our contemporary society, various economic goals have been set forth by economists. Tax justice may be achieved in the attainment of these goals by relating the participation of the individual in accomplishing the goals with the tax cost or tax loss while the goals are being implemented through government programs.

The following paragraphs illustrate such a view of achieving tax justice.

In testimony to the Joint Economic Committee in 1959, Neil H. Jacoby suggested the following significant tasks, as goals, that confront the United States in the 1960's.
1. Economic provision for national security
2. Increased efficiency and economic growth
3. Fostering economic growth throughout the free areas of the world
4. Strengthening the United States' position in foreign trade
5. Defending the purchasing power of the dollar
6. Invigorating competition
7. Adapting to rapid population increases
8. Increasing the geographic and occupational mobility of people
9. Improving education of all kinds at all levels

---


These tasks were identified as the crucial tasks of this decade. All of these tasks form guidelines for emphasis on increased activity in both private and public sectors of the economy. These tasks also point to the requirement of a fiscal system that fosters more saving and risk-taking investment, larger capital formation, and thus rapid and sustained growth of the United States' economy.

The United States needs a more rapid average annual rate of growth for the following reasons:

1. To supply millions of new families with homes and a complement of durable and nondurable goods and services.
2. To obliterate the remaining pockets of substandard living in our land.

3. To support massive scientific research and development efforts and a huge enlargement of educational activities.

4. To provide our industries with the most efficient equipment that will make it capable of meeting the intense competition from abroad.

5. To supply new capital goods that will take advantage of burgeoning body of scientific knowledge.

6. To enlarge the outflow of American investment abroad.

7. To reduce the danger of inflation.

8. To provide an example to the world of a dynamic economy based on open markets and private enterprise.  

______________________________________________________________________________


______________________________________________________________________________

In this illustration the two most important factors to be considered in appraising tax justice are the effects of taxation on the vigor and the growth of the economy and on fairness — the economics and the ethics of taxation.  

______________________________________________________________________________

17 Blough, op. cit., p. 353.
Equity in Taxation

Equity in taxation is that aspect of tax "fairness" that is concerned with similarities among taxpayers. Equity is achieved when persons in a similar taxing position are taxed the same. In tax administration the question of equity is whether everyone is being required to pay the amount of tax due under the law. The ideas of equity that influence tax policy are those that appeal to the public as sound. At the same time a concept of equity may not be carried to its conclusion or achievement because it may interfere with economic progress or goals of the economy.

18Blough, op. cit., p. 408.

The achievement of equity in taxation vis a vis the goals of the economy is predicated upon a selected type of discrimination. Equity may be discerned more readily with references to bases of inequality in taxation than with reference to taxing similarities. The taxing administrations determine the type and degree of discrimination. The discrimination thus provides a generic type of equity among the taxpayers of the total economy. For example, the inequity of a tax would have to be compared with the inequities of inflation. Thus concepts of equity refer to relative discrimination rather than absolute even-handed impartiality in determining tax distribution. The problem that remains is to determine how far this principle of discrimination should be carried and to what extent discrimination involves a conflict with the ideas of "fairness" and relative equity.

The Assignment of Economic Value to the Role of the State

Economic theories and principles have traditionally provided the framework for the study and evaluation of the principles of distributing the tax burden or economic value of the state among individual taxpayers. However, in the development of apportionment principles, the role of the state necessitating support has shaped the manner in which tax burdens are distributed. Tax apportionment theories may be based upon economic and political effects of taxation. The range of the effects of taxation is extremely broad. Yet the effects are measured against a multifarious standard referred to as the "public interest."

Theories of fiscal systems and thus state-individual tax relationships rest upon a concept of the state. Any discussion of fiscal systems is partly composed of economic and political elements. The political basis of taxation is simply a conception or theory of the state in which is found the justification and character of taxation. Such a theory includes not only the nature and role of the state, but also the nature and role of the individual. As a theory of the state implies taxation, so taxation implies an economic relation of the individual to the state. The economic bases of taxation are, in part, an interpretation of the political principles of the state. The state must ultimately determine the amount of economic values that are diverted from the private sector to the public sector.

Goals for the economy such as high levels of national income and increased growth provide the nature of the responsibility of the government agencies charged with the public interest. The goals determine
the manner in which the resources of the economy, controlled by the government, are to be channeled or directed. The means by which these goals are to be accomplished rest with the interpretation of the value of the government role in the private economy. But the assignment of economic value to the role of the state is a problem of practical significance.

Two fundamental criteria -- "benefits" and "ability" -- have been postulated as standards for this process of assignment. 20

Shultz and Harriss use six major standards for the assignment of economic value to taxation. 1. the benefit doctrine, 2. the privilege doctrine, 3. the state-partnership doctrine, 4. the objective ability doctrine, 5. the subjective sacrifice doctrine, and 6. the neutrality doctrine. The author of this research groups standards 1 through 3 under the benefit basis, and 4 and 5 under the ability basis. Item 6 is viewed as an application of one or more of the other five bases. Although the author questions the neutrality basis as a substantive concept, it does provide direction for evaluating "discriminatory" taxation. Shultz and Harriss, op. cit., pp. 192-198.

The Benefit and Ability Principles

The benefit doctrine of tax distribution is concise: Each individual should be taxed in relation to the cost or the value of service, protection or privilege he derives from government functions. Whenever government costs are incurred for the benefit of individuals, such costs should be borne by them. This principle points out the desirability of allocating taxes according to the benefits which individuals enjoy from government action.

The ability doctrine of tax apportionment is based upon the principle that government costs are incurred for general social purposes and are an obligation of society rather than particular individuals. This obligation is distributed among individuals composing the social unit in a manner that imposes the least hardship. The least hardship results when each individual contributes in "some" relation to his ability to pay taxes.\(^{22}\) Ability to pay refers to relative real sacrifice among individuals necessitated by tax payments. The objective standard of ability may be either property or income. Thus the individual who can give up property or income claims through taxation with the least sacrifice or dissatisfaction has the greatest ability to pay the next dollar in taxes.\(^{23}\)


Definite interpretation of these doctrines and principles is exceedingly difficult. "There is no unanimous acceptance of one factor to the exclusion of the other"\(^{24}\) and widely different premises may be drawn from each of the premises. Yet the doctrines of apportionment built from
and around these concepts deserve attention, "if only because they are so firmly intrenched in the literature and even in lay discussion."  


The Role of This Study

At the same time, there are no general rules that can serve as a rigid framework for the analysis of tax policy as modern society attempts to adjust their thinking to a relatively permanent requirement that approximately one-third of National Income is devoted to "public" rather than private needs.


During the last twenty-five years, economists have devoted themselves to problems in the theory and application of fiscal or budgetary policy with emphasis placed on the expenditure side of fiscal activity.  

The absence of a theory of the public economy becomes evident. The task of such a theory remains largely undone. Any approach to a complete treatment of the public economy requires an examination of the tax exaction process, as well as the processes by which the fiscal role of government has developed.

28See Roy Blough, op. cit., pp. 353-380, for a discussion on the effect of tax distribution on prosperity and growth.
The foundations upon which a modern fiscal theory can be built require a process of discovery and exploration. The first stage of the construction of a modern fiscal theory is one of achieving historical perspective. The particular area of emphasis of this research is the historical development of the state revenue-expenditure relationships reflected by the manner in which individuals should share in the support of the state. By tracing the development of the changes in revenue-expenditure relationships from the simpler conditions of the past, the purposes and functioning of the contemporary fiscal system can be better understood. Moreover, an analytical survey of economic history gives a perspective to social and economic development that sharpens the perception and encourages impartial judgment concerning present day fiscal goals.

**Hypothesis of the Study**

Research for this study is directed to test and evaluate the following tenants of fiscal theory.

The historical development or evolution of theories of tax apportionment reflect three distinct lines of emphasis with reference to equity and justice and the tax system.

1. The benefit principle of tax apportionment reflects emphasis on "neutral" equity and "strict" justice. In the obligation between individuals or groups and the state, both parties are on equal footing. Action of the government in this relationship is an attempt to preserve a minimal interference in individual or group interests. The effect of government action is to establish an economic and legal environment
whereby government is sharply limited in influencing "natural" relationships between individuals or groups.

"Strict" justice infers that the tax relationship is predicated upon the basis that what was owed to the state, by contract-like exchange or by conditions or property ownership, had to be returned in the strictest equality.

2. The ability principle based on sacrifice reflects an emphasis on "exaction" equity and "distributive" justice. In the relationship between individuals or groups and the government, the parties are on unequal footing. The government exercises the advantage over the individuals or groups. Action by the government in this relationship is an attempt to implement a purposeful interference in individual or group interest. The government role in this interference is one of arbitrator or "decision maker" for influencing a "desirable" economic and legal relationship among individuals and groups. Tax apportionment is passed down from the state in such a manner that people with greater capacity not only pay absolutely more, but also relatively more, in taxes.

"Distributive" justice refers to the obligations of a government toward its citizens. The distribution of "owed" benefits was ruled not by the principle of equal positions, but by broader principles of general or social well-being.

3. The conglomerate apportionment principles, which combine benefit and ability as well as distributional effects of expenditures, reflect emphasis on "redistributive" equity and "social" justice. In the obligation between individuals or groups and the government, the parties
are on unequal footing. The government exercises its advantage. How-
ever, certain groups or individuals occupy the advantage over other
groups or individuals because of their relationship with the government.
Action by the government in this relationship is an attempt to imple-
ment the advantage for certain members of the society vis-a-vis all mem-
bers of society.

The effect of this type of government action is to establish an
economic and legal environment whereby government is responsible for
the status of economic relationships between members of society, taken
as a whole or an aggregate.

"Social" justice infers that the tax relationship between individu-
als and government is predicated upon the basis that individuals have
obligations toward other individuals as members of society. The dis-
tribution of the benefits is ruled by the principle that government ex-
penditure decisions are more important than the exaction considerations
of individuals. The economic and social vitality of the society is
predicated upon government action which guides or influences individuals
or group action for the aggregate benefit of the society.

4. The emphasis has shifted from the individual to society as a
whole. Contemporary tax apportionment principles weigh the tax burden
alternatives in terms of social significance rather than personal sig-
nificance of the taxpayer.

Purposes of the Study

The purposes of this research are to point out

1. the changing views of economists on the role and
   responsibility of government;
2. the historical development of tax apportionment doctrines based on the ability and benefit principles;

3. the "schools" of economic thought which have integrated taxation and fiscal theory with general economic theory;

4. the historical development of the ideas and concepts which underlie any modern theory of tax apportionment;

5. the basis of tax apportionment most consistent with and applicable to the theoretical framework of modern economic analysis.

Scope and Limitations of the Research

It is assumed for the purposes of this research that tax apportionment doctrines rest on economic theory and the role of the state to be supported by taxation. The review of apportionment doctrines in this study, is developed first by making references to the role of the state, and secondly, exploring the theory and principles which provide the basis for the allocation of the tax burden. This review is undertaken with reference to particular economists and authors who provided contributions or who explored the gaps in the theses of others. English, French, American, German, Italian, Austrian and Scandinavian authors are included. The exposition of ideas begins with Adam Smith as the founder of the classical tradition. The historical review
encompasses the significant works from that period until 1961. Such an historical review need not be a comprehensive historical narrative, nor need to begin chronologically earlier than is required to trace the simpler forms of government organization that are closely related to the existing economic structure.

This research is limited to the apportioning of the tax burden of expenditures for the central government. The fiscal system represents the political unit in its direct impact upon the economy. Since "the economy" under consideration is viewed as "national" in scope, the political units of government are considered as a single unit in its operation upon the economy. The established political framework given in the analysis of each author will be considered as a given factor. The justification of the role that government plays is a function of public policy for each author and is regarded as a given factor in the analysis. The type of programs requiring tax support are evaluated within the context suggested by the authors cited in the research. No attempt has been made to investigate particular types of government expenditures or each source of revenue for the state. No attempt will be made to evaluate apportionment doctrines vis-à-vis a particular tax or rate structure, or to justify the selection of rate structures which specifically implement apportionment theses.

The research has been directed to pointing out some of the important ideas and practices in the development of apportionment doctrines. This method is designed to indicate not only the character of the problems involved, but to emphasize the fact that apportionment doctrines reflect certain economic and political as well as ethical ideas.
It is practically impossible to isolate economic from either political or ethical ideas. However, the emphasis of this research rests with an economic orientation. As such, political thought, per se, is outside the scope of the study. The author suggests that the reader may find the work of G. H. Sabine, *A History of Political Theory*[^29] or F. W. Coker, *Recent Political Thought*,[^30] particularly helpful in pointing out the political aspects in the development of economic thought.


No effort will be made to deduce new principles of taxation, nor bases of apportionment, nor to develop a theory on the basis of new principles. The object of the study is rather, upon the basis of various contributions, to ascertain the present principles applied to apportionment theories. Upon that basis, to discover by analysis and criticism of historical theories, the principle of apportionment consistent with the modern theory of the public economy.

**The Development of the Subject Matter**

The ideas and positions of the authors to be reviewed in this research were obtained from library sources and will be developed and presented in the following sequence.

Chapter Two contains a review of the role of the state in Classical and Neo-Classical economic thought from 1776-1900. Chapter Three
presented the principles of apportionment of the tax burden introduced by selected economists of the Classical School. The apportionment theories of the spokesmen of the Neo-Classical fiscal theorists are presented in Chapter Four. The Continental and Scandinavian contributions on apportionment, the pricing of government services, and the revenue expenditure determination are included in Chapter Five. The authors following in the modern fiscal tradition with the coincident emphasis on fiscal policy and aggregative analysis are the subject for discussion in Chapter Six. A summary of the contribution and material present to this point with emphasis on the political basis of economic principles is presented in Chapter Seven. The final substantive chapter, Chapter Eight, presents the contemporary view of the revenue-expenditure determination process. Some generalized statements as to the author's conclusions are offered in the final chapter, Chapter Nine.
CHAPTER TWO

A Survey of the Ideas and Theories of Classical and Neo-Classical Economists on the Role of the State in Economic Activity, 1776-1900

Introduction

"Public finance in our sense and especially modern taxation, first developed in the course of the fifteenth century in the Italian city-republics, Florence in particular, and in the German free towns (Reichsstädte)." However, tax collections, fiscal operations and expenditures by ruling groups have been a feature of economic life in all periods of recorded history. Taxes were collected and expended for public projects in Roman and Egyptian antiquity.


Payments were exacted from land holders and peasants for the support of local authorities throughout the Middle Ages.

Coming down to medieval society and medieval thought, we find new conceptions of the state and more definite ideas concerning taxation. The system by which individuals gave up their persons and property to lessor lords for protection, and these, in turn, their persons and property to higher nobility, and the higher nobility to royalty; the system of sub-feudation and indeed, the whole feudal system, inculcated the idea of the dependence of the individual upon higher political power, and so made protection a dominant idea of social and political structure of society.


The support of government activity through a system of revenue raising devices is certainly not unique with the city republics of Italy and the German free towns. It was the need for regular tax collections that was unique. In that era, administrations were established for levying taxes systematically and expending the revenues from them.


At the same time there was gradually developing, a theory of a "social compact or contract" as an explanation of the nature of the state.

No theory of the state has exerted a wider and deeper influence in the fields of politics, economics and finance, particularly in England, and the United States.

6 Weston, op. cit., p. 77.
The Theory of Social Contract

The theory of social contract has received its fullest development in the writings of Hobbes\(^7\) and Locke\(^8\) although the doctrine is older than the Leviathan. \(^9\) "Hobbes emphasized the protection of life, Locke the protection of property, and Rosseau the liberty that is conditioned by the protection of both. But the more important fact is, that with all alike the idea of a contract best expresses the nature of the state; and further, the state originated in the necessity of protection, or at least, has as its function the protection of the lives and property of its citizens."


The concept of contract plays no role in the theory of taxation of these contract theorists. Rather the basis of the state and taxation was included in their ideas of protection. Hobbes clearly stated that the basis of taxation is found in the protection that the citizen receives from the state. ‘Taxes are nothing else but the wages due to them who
hold the sword to defend private men in the exercise of their several trades and callings.\textsuperscript{11}


For Hobbes the purpose of the state is the protection of life of the individual that he may enjoy the peaceful pursuits of a living, and the individual should pay for the expense of this protection; the tax which is the price of the 'bought peace,' should therefore be based upon the benefits derived from this protection; and since the value of this benefit is determined by the amount of enjoyment, which is itself measured by the amount one enjoys in the way of consumption under the protection of the state, the tax should be based upon the consumption of the individual; and since all equally enjoy the benefits of protection, as thus measured by consumption, all should bear the burden of taxation.\textsuperscript{12}

\textsuperscript{12}Weston, op. cit., pp. 80-81.

Locke did not give great attention to the matter of taxation. However, Locke based taxation upon protection and suggested "government cannot be supported without great charge, and it is fit every one who enjoys a share of protection should pay out of his estate his proportion for maintenance of it." This statement suggests that the principle of taxation is based upon protection. Locke emphasized the moral obligation to pay the cost of protection since arbitrary taxes "invades the fundamental law of property and subverts the end of government.\textsuperscript{13}

\textsuperscript{13}Locke, op. cit., sec. 140.

\textsuperscript{14}\textit{Ibid.}
In the contract theory, the relation of the state to the individual is that of a protector and guarantor of liberty. The idea of the state as a protector of life and property has persisted since the study of economics began to be distinguished from philosophy, or theology, or physical science. "The point of view of the economists was determined by the conflict of interest uppermost at the time and by the attitude of the economists toward the conflicting interests."\(^{15}\) These differences among economists distinguish different "Schools" of economic thought.

Schools of Economic Thought

With the decline of feudalism and the rise of the merchant class into public power, economists representing "Mercantilist" interests pointed out how the monarch or legislature might best promote the national interest by promoting the interest of the merchants.\(^{16}\) The mercantile interests were promoted through protective tariffs, or bounties on exports, or monopolist charters for joint stock companies, or navigation laws, or the exploitation of colonies and their own agriculturalists.\(^{17}\)


\(^{17}\) John R. Commons, *op. cit.*, p. 110.
The mercantilists flourished in the seventeenth century culminating with John Locke and The British Revolution of 1689.

First protest against mercantilism was made by the French Physiocrats. The Physiocrats flourished for thirty years in France during the mid-eighteenth century.

Next came the Classical School of economists, whose leaders for seventy years from 1776, were Adam Smith, D. Ricardo, Thomas Malthus, and John Stuart Mill.

Smith represented the conflict between Mercantilism and Industrialism.... The various empirical policies known as Mercantilism were developed along with the rise of monarchies and markets against the opposition of Feudalism, and along with the accompanying experience that exchange-value as a means of livelihood for manufacturers and merchants depended upon control of supply or demand. A centralized government in England furnished this control both for foreign and colonial markets and for the local guilds of manufacturers and merchants in the domestic markets. This regulation was always justified on the basis of public welfare - a hypocritical justification according to Smith, because it always favored a privileged few whose private welfare was represented by them to be identical with the public welfare.

John Locke substituted parliament for the monarch in the exercise of this collective control, but Adam Smith substituted, in fact though not in philosophy, the judiciary for both monarch and parliament.

Each based his argument on a return to the natural law of divine benevolence instead of the arbitrary regulation of supply and demand by the king, for Locke, but by parliament and guilds for Smith. Smith therefore required a natural regulator of
supply and demand in place of collective regulation, and he found it, not in the common-law courts, but in the breast of every industrious and thrifty manufacturer and merchant.


Principles of taxation need not be derived from the specific functions or responsibilities of government, or from the historic origin of the state, but can be derived from the nature and end of the state. Functions of governments determine limits of taxation and the actual origin of the state influences the character of its system of taxation.

The economic basis of taxation of the classical economists rests upon their theory of the state as the protector of persons and property. It is an economic relation that is counterpart of the Contract theory of the state and is largely an outgrowth of it.


“It was the supreme achievement of Adam Smith and David Ricardo to bring order into economic inquiry.” The building of the classical system of public finance was so much the work of Smith that it seems wise to the author to concentrate on his work. The other writers to be considered in the following section, J. S. Mill, J. B. McCulloch and T. R. Malthus, are responsible for modification in the classical doctrine yet their agreements are so fundamental that their names must remain linked in the history of economic thought.

The purpose of Part I of this chapter is to point out the role of government activity as viewed by selected classical economists. The chapter material is organized to illustrate that theories of the state establish various responsibilities and functions of the state which must be supported by revenues, including taxation. The purpose of Part II of this chapter is to present some representative ideas and theories of neo-classical economists during the period 1870-1900, which indicate the changing responsibilities and functions of the government. Part II is developed so as to point out the works of the economists and their views of the role of government in economic activities. The views of Alfred Marshall, C. F. Bastable and J. S. Nicholson are presented in Part II.
PART I
The Role of the State in Classical Economic Thought

Adam Smith and The System of Natural Liberty

Smith who wrote the Wealth of Nations was also the author of the Theory of Moral Sentiments and it is difficult to understand the economic ideas of the one without some knowledge of the other.

Human conduct according to Smith was naturally actuated by six motives: self love, sympathy, the desire to be free, a sense of propriety, habit of labor, and a propensity to truck, barter and exchange one thing for another.

Given these springs of conduct, each man was naturally the best judge of his own interest and should be left free to pursue it his own way. If left to himself he would not only attain his own best advantage, but he would also further the common good. The result was achieved because Providence had made society into a system into which a natural order prevailed.

The consequence of this belief in natural order implies that government can be rarely more effective than when it is negative. Its intervention in human affairs is generally harmful. According to Roll's interpretation, "when Smith applies the natural order to economic matters..."
he becomes a strong opponent of all forms of state intervention with
the ordinary business of industry and commerce." 27

27 Ibid., p. 117.

Book V of the Wealth of Nations makes clear the role of the sover-
eign in eighteenth century Great Britain. The expense of defence, of
justice, and of erecting selected public works encompass the revenue re-
quirements of the central government. Smith stated that according to

28 Smith, Wealth of Nations, pp. 653, 669, 681 and 682.

a system of natural liberty, the sovereign has only three duties to at-
tend to:

First, the duty of protecting the society from
the violence and invasion of other independent
societies; secondly, the duty of protecting as
far as possible, every member of the society from
the injustices or oppressions of every other mem-
ber of it, or the duty of establishing an exact
administration of justice; and thirdly, the duty
of erecting and maintaining certain public works
and certain public institutions, which it can
never be for the interest of any individual, to
erect and maintain, because profit could never re-
pay the expense to any individual or small number
of individuals, though it may frequently do much
more than repay it to a great society. 29

29 Ibid., p. 651.

The manner in which the burden of expense of the sovereign was to
be distributed among the taxpayers was made specific by Smith. His
four canons of taxation of equity, convenience, certainty, and economy
in collection provide a basis whereby taxing causes a minimum interference
with the allocation of resources. In Smith's view any activity of

the sovereign other than those cited above is an extraordinary restraint

imposed upon the system. "Any restraint or even any extraordinary en-
couragement is in reality subversion of the great purpose which it pro-
motes. It retards, instead of accelerating, the progress of society
towards real wealth and greatness; and diminishes, instead of increasing,
the real value of the annual produce of its land and labor." 31

The government, Smith concludes, is unfitted by nature for economic
function, and therefore in these matters wisdom lies in the principle of
government nonintervention. Smith's conclusion follows from three facts.
First, governments exhibit spendthrift propensities; 32 second, the re-
moteness of government, precluding the minuteness of attention required;
and third, the inefficiency of the negligence and thriftlessness of its
agents. 33

On the first point Smith proclaims:

It is the highest impertinence and presumption, there-
fore, in kings and ministers, to pretend to watch over
the economy of private people, and to restrain their
expense, either by sumptuary laws or by prohibiting the
importation of foreign luxuries. They are themselves always, and without exception, the greatest spend-thrifts in the society. Let them look well after their own expense, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will.\textsuperscript{35}

\textsuperscript{35}Ibid., p. 329.

In enlarging on the second point attention is drawn to what Smith believes is the true function of government, as well as to its incapacity:

No incitement to the attention of the sovereign can ever counterbalance the smallest discouragement to that of the landlord. The attention of the sovereign can be, at best, but a very general and vague consideration of what is likely to contribute to the better cultivation of the greater part of his dominions. The attention of the landlord is a particular and minute consideration of what is likely to be the most advantageous application of every inch of ground upon his estate. The principal attention of the sovereign ought to be to encourage, by every means in his power, the attention both of the landlord and of the farmer; by allowing both to pursue their own interest in their own way, and according to their own judgment; by giving to both the most perfect security that they shall enjoy the full recompense of their own industry; and, by procuring to both the most extensive market for every part of their produce, in consequence of establishing the easiest and safest communications both by land and by water, through every part of his own dominions, as well as the most unbounded freedom of exportation to the dominions of all other princes.\textsuperscript{36}

\textsuperscript{36}Ibid., p. 785.

On the third fact, Smith says that the state's agents, who are paid out of public funds are not interested in administration. Consequently agents are prone toward oppressive and expensive management. In writing of princes, who like private persons, for the purposes of
mending fortunes, have become adventurers in the common branches of trade, the verdict recorded is that they scarcely ever succeed.  

37 Ibid., p. 771.

It is true that Smith preferred individual action in the vast majority of cases, but his was no blind preference. Private enterprises to be useful must be actuated by personal interest and competition must keep actions within the limits of justice. Nonintervention was set up as a general principle and not as an absolute rule.

Adam Smith attempted to define the natural limits of the state and government. "Political economy," wrote Smith, "has two distinct objects: first to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly to supply the State with a revenue sufficient for public services. It proposes to enrich both the people and the sovereign." 38 Smith gave primary consideration to the people, in whose ser-

38 Ibid., p. 397.

vice and for whose service the state existed. His position implied that interference by government in economic life would jeopardize the natural tendency for men in pursuit of their individual interests, to obtain want satisfaction from limited resources. Interference in the free mar-

political economy of Adam Smith was in the first place based on the principle of identity of interests, it admitted the partial necessity of having recourse to the converse principle. Conversely, all government intervention is justified by the principle of artificial identification of interests.\textsuperscript{40}


It is true that Smith advocated numerous government regulations. Jacob Viner's study revealed twenty-six exceptions to the "laissez faire" advocated by Smith to protect the public interest. These arguments are widely scattered throughout the Wealth of Nations. Smith's overall conclusion concerning the role of government suggests "a 'laissez faire' freedom from laws or agreements regulating trade, prices, wages, working conditions and output."\textsuperscript{41}


Far from enjoying an absence of government regulation, the entrepreneur of the early eighteenth century was plagued by the residues of an intensive and varied body of doctrine regulations which had been handed down from the age of the Tudors. These were suited to a handicraft economy, and were directed to the goals of a mercanti.istic system. They included restrictions upon the mobility of labor, the regulation of wages, and obstacles to the development of the large factories

by business men. The "laissez faire" literature of the time was an appeal to sweep aside the feudal and mercantilist incrustation and free an adolescent capitalist system to develop unhindered.\textsuperscript{43}


Taylor states that it must be clear to the careful readers of Smith "that his belief in 'laissez faire' and free competition was not a belief in the absolute right of individuals to make as much money as possible, regardless of the consequences, but on the contrary a belief that the public's right to good service at fair prices could be best protected by universalizing the right to pursuit of the best profits obtainable. Smith preferred to trust the individual's moral sense, plus his fear of competition, rather than a law which prescribed the quality of his product and his output."\textsuperscript{44}


John R. Commons supported a different view of Smith's idea of laissez-faire.

His idea of government is not completely laissez-faire, as was that afterwards set up by the anarchists. It is a government which actively holds every individual away from every other individual. Each individual, in the language of anthropology, is 'tabu' but each may voluntarily raise the 'tabu' for a short period of time and may voluntarily authorize the government to enforce his promises upon himself for the benefit of others. If this is done, then
every individual has "perfect liberty." This perfect liberty means that he is free to seek his self-interest in any way he pleases. He is free to choose what he will do with his own body, or with the objects of nature which he owns, or with the output of his labor, or with the output of other people's labor which he has received in exchange; and the state will lend its physical power to enforce his individual will. The innate "sense of propriety" was enough to prevent abuse of liberty, although that liberty had the aid of the state to enforce it.\footnote{John R. Commons, op. cit., p. 163.}

\footnote{The author of this research accepts the Common's interpretation since it implies that self-interest alone could not fulfill the Smithian idea of a laissez-faire government. Laissez-faire at Smith's time was a common law meaning of liberty and property. Liberty in this sense included all that is contained in the meaning of individual property. Liberty included exclusive holding of property, liberty to change such prices as an individual could and equality with other individuals before the law. Smith's meaning of liberty was not merely the absence of statutory compulsion imposed by custom, or trade practices, or business ethics. "All of these impose restrictions upon an individual through collective control of his liberty to do as he pleases." \footnote{Ibid., p. 165.}}

This Smithian idea of the role of the government was a starting place for development by his followers in The Classical Tradition.
Thomas R. Malthus on the Neutral Role of the State

So far as general theory is concerned, Malthus' work started with the Wealth of Nations and recoined the theoretical contents. 47

47J. A. Schumpeter, op. cit., p. 482.

Malthus was less insistent than Smith in relegating government to a strictly neutral role, when he indicated, "it is obviously impossible for a government strictly to let things take their natural course; and to recommend such a line of conduct, without limitations and exceptions; could not fail to bring disgrace upon general principles, as totally inapplicable to practice." 48


But it is to be recollected, in the first place, that there is a class of duties connected with (these) subjects, which it is universally acknowledged belongs to the sovereign; and though the line appears to be drawn with tolerable precision, when it is considered generally; yet when we come to particulars, doubts may arise, and certainly in many instances have arisen, as to the subjects to be included in this classification. To what extent education and the support of the poor should be public concerns. What share the government should take in the construction and maintenance of roads, canals, and public docks? What course it should adopt with regard to colonization and emigration, and in the support of forts and establishments of foreign countries? On all these questions and many others, there are differences of opinion; and on all these questions the sovereign and his ministers are called upon to decide.

Secondly, every actual government has to administer a body of laws relating to agriculture, manufactures,
and commerce, which was formed at a period comparatively unenlightened, and many of which, therefore, it must be very desirable to repeal. To remain inactive in such a state of things can only be justified by a conviction, founded on the best grounds, that in any specific change contemplated, taken in all its consequences, the balance of evil will preponderate; .......

Thirdly, there is one cause in every state which absolutely impels the government to action, and puts an end to the possibility of letting things alone. This is the necessity of taxation; and as taxes cannot, in the nature of things, be imposed without interfering with individual industry and wealth, it becomes a matter of the very highest importance to know how they may take place with the least possible prejudice to the prosperity of the state, and the happiness of the individuals.

It is obviously, therefore, impossible for a government to let things take their natural course; and to recommend such a line of conduct, without limitations and exceptions, could fail to bring disgrace upon general principles, as totally inapplicable to practice.\(^9\)

\(^9\)Ibid., pp. 14-16.

However Malthus asserts, as had Smith, "that a propensity to govern too much is a certain indication of ignorance and rashness."\(^5\)

\(^5\)Ibid., p. 16.

**John S. Mill on the Optional and Necessary Roles of the State**

An idea of a type of social compact appears in the writings of John S. Mill. Mill introduced a utilitarian theory of the state with an implicit role of protection for the individual. According to Mill,
mankind is of such a nature that every individual seeks the greatest possible amount of pleasure and the avoidance of the greatest possible amount of pain. The ideal of life being the "greatest happiness of the greatest number."  

This ideal is realized when every individual is given the fullest liberty to act according to his own impulses and beliefs, subject only to the same liberty of others. It is the maintenance of the conditions essential to this liberty that the utility of government consists in its usefulness to the goals of individuals. A type of utility that is grounded upon the permanent interests of man as a progressive being.

Mill held that the "sole end of which mankind are warranted individually or collectively, in interfering with the liberty of action of any of their number, is self-protection." With the functions of government directed to this end and restricted to this purpose, there is developed the highest individuality. Thus "every one who receives
the protection of society owes a return for the benefit, and the fact of living in society renders indispensible that each should be bound to observe a certain line of conduct towards the rest."

55\[Ibid., p. 552.\]

Among other things this "line of conduct" consists in each person bearing his share of labors and sacrifices incurred for defending the society from injury and molestation.

56\[Ibid., p. 552.\]

Yet Mill proceeded to broaden the Smithian conception of the role of the sovereign. For Mill, government had both "necessary" and optional responsibilities to assume in his re-emphasis of the classical doctrine. The necessary functions of government recognized by Mill are substantially the same as those suggested by Smith. However, the optional functions are more multifarious and are not capable of being circumscribed by very definite lines of demarcation.

There is a multitude of cases in which governments, with general approbation, assume powers and execute functions for which no reason can be assigned except the simple one, that they conduce to general convenience. We may take as an example the function of money (which is monopoly, too) of coining money. This is assumed for no more recondite purpose than that of saving to individuals the trouble, delay and expense of weighing and assaying. No one, however, even the most jealous of state interference, has objected to this as an improper exercise of the powers of government.

But enough has been said to show that the admitted functions of government embrace a much wider field than can easily be included within the ring fence of any restrictive definition, and that it is hardly
possible to find any ground of justification common to them all except the comprehensive one of general expediency, nor to limit the interference of government by any universal rule save the simple and vague one that it should never be admitted but when the case of expediency is strong.\(^57\)


The optional functions include management of the affairs of individuals who do not understand their own interest, and over those who cannot give practical effect to their desires unless a common rule is imposed upon all concerned and also individuals who are conducting literary or scientific undertakings which do not appeal to the interest of enough private individuals to secure support.\(^58\)

\(^{58}\) Ibid., pp. 956-974.

These functions in no way contradict the classical position that the scope of governmental activity should be limited as narrowly as possible. Mill was outspoken in stating his reasons why governments should not interfere in private economic activity. Basically government interference involves compulsion and tends "to starve the development of some portion of the bodily or mental faculties."\(^59\) Government activity involves expense which is met from compulsory contributions levied upon persons or property. Any increase in government activity leads to an increase in its power and influence. "The public collectively
is abundantly ready to impose not only its generally narrow views of
its interests but its abstract opinions, and even its tastes, as
laws binding upon individuals."

Mill's other objections to government interference reflect the
universality of the effectiveness of self-interest in the classical
framework.

But though a better organization of governments
would greatly diminish the force of the objection to
the mere multiplication of their duties, it would
still remain true that in all the more advanced com-

munities the great majority of things are worse
done by the intervention of government than the
individuals most interested in the matter would do
them, or cause them to be done, if left to them-
selves. The grounds of this truth are expressed
with tolerable exactness in the popular dictum,
that people understand their own business and their
own interests better, and care for them more, than
the government does or can be expected to do.61

Again emphasizing the role of the individual in his final point
against government interference, Mill states:

It is, therefore, of supreme importance that all
classes of the community, down to the lowest, should
have much to do for themselves; that as great a de-
mand should be made upon their intelligence and vir-
tue as it is in any respect equal to; that the gov-
ernment should not only leave as far as possible to
their own faculties the conduct of whatever concerns
them alone, but should suffer them, or rather en-
courage them, to manage as many as possible of their
joint concerns by voluntary cooperation: since this
discussion and management of collective interests is the great school of that public spirit, and the great source of that intelligence of public affairs, which are always regarded as the distinctive character of the public of free countries.\textsuperscript{62}

\textsuperscript{62}Ibid., p. 949.

For Mill as for Smith, and Malthus before him, public intervention should be restrained to the narrowest compass. Restraint on government should not be absolute, but in every instance of new regulations, the burden of making out a strong case should be thrown not on those who resist, but on those who recommend public action.\textsuperscript{63}

\textsuperscript{63}Steiner, op. cit., p. 58.

"Mill was a strong advocate of "laissez faire" on political and economic grounds. Yet he admitted that in every age there would be some activities which government should undertake because they were urgently needed and private individual would not or could not perform them."\textsuperscript{64}

\textsuperscript{64}Buckingham, op. cit., p. 55.

\textbf{J. B. McCulloch and a Joint Stock Theory of the State}

The classical tradition for the function of government is further substantiated in the writings of J. B. McCulloch.

It is sufficient to state that the experience of all ages and countries shows that good order and tranquillity at home, security from foreign invasion, and the speedy and impartial administration of justice, are indispensable to the vigorous exercise of
industry, the accumulation of wealth, and the well being of society; and that where they are wanting, the energies of the population are prostrated, industry paralyzed, and poverty and barbarism universally diffused. The duty of making adequate provision for securing the means by which so much good may be realized on the one hand, and so much evil averted on the other, is, therefore, imperative; an expenditure for such objects is most productive; it is essential, indeed to the existence of the body politic, and being productive of universal advantage, it should be defrayed by the joint contributions of society. Hence the fundamental principle that, in so far as practicable, all the subjects of a state should contribute to the sums required to maintain its fleets and armies, with the various functionaries and institutions, necessary for defence against hostile aggression, for the preservation of internal peace, the promotion of prosperity, and the protection of every citizen in undisturbed enjoyment of his property and rights.65


Again, in McCulloch, any objections to extensive functions of government are predicated upon the restraining influences imposed upon the private sector in determining allocation of resources.

Though taxation be necessary, it should always be kept within the narrowest limits. The best taxes, provided they produce the necessary supplies, may, Speaking generally, be said to be the lightest, or those of which the pressure is least felt. But how light, soever, all taxes necessarily at first encroach somewhat on the means of enjoyment or of the accumulation possessed by the parties by whom they are paid; and whatever be their amount, and however imposed, they must necessarily fall either on the revenue of the contributors or their capital stock. Perhaps, indeed, there is no tax the produce of which is not partly derived for both these sources. It is, however,
abundantly certain that all taxes, when judiciously imposed, and not carried to an oppressive height, occasion an increase of industry and economy, and but rarely encroach on capital. Under these conditions they operate as motives to restrain expense and as incentives to labour and ingenuity, frequently occasioning the production of more wealth than they abstract. But the power to make increased exertions, and to save from expense, though not easily defined, is not illimitable. And whenever this limit has been attained — that's whenever the burdens of taxation is not fully compensated by the increased production or increased saving — it must encroach on the means of future production, and the country will then begin to retrograde. Taxation when carried to this extent, is one of the severest scourges to which people can be subjected. By diminishing capital, or the funds destined to support productive industry, it lessens the national revenue, the only fund out of which taxes can be permanently paid; and lays the sure foundation of public poverty and disgrace, in the destruction of individual fortunes. 66

66 Ibid., pp. 6 and 7.

McCulloch believed that a joint stock theory of the state supported a minimum of government intervention in individual affairs. In this view the state functions as a protector of the individual and of property as it insures security. The state is part of a joint concern where each person's wealth and property make up the assets of the national stock. This joint stock theory of the state is consistent with the insurance theory of taxation which McCulloch recommended.

67 Ibid., p. 17. See page 70 Chapter Three.

Summary of the Classical View of the Role of Government

Viewed within the classical framework, the role of the state was a passive one. "The state should not undertake to dictate, direct or
influence what should be produced or how much, of what quality or
by what methods," is the manner in which J. M. Clark summarizes the
role of the state in classical thought. 68 State intervention tends
to result in large and enduring errors, whereas the errors of free
economic enterprise are likely to neutralize on another. For purposes
of practical issues of government intervention, the classical group of
economists argue as if the free economic enterprise would realize the
maximum benefits to society.

It was not that under "laissez faire" there would be realized an
identity of individual and community interests. Smith's statement that
the interest of those who derive a profit from commerce and industry are
opposed to the interests of society as a whole, distinguishes him. It
is precisely because of the inherent lack of coincidence, between the
politically most active and the economically most strategic class in an
economy which pivots on profits, that state intervention tends to accentu-
te the exploitation of the community. 69

68 J. M. Clark, Social Control of Business, Second Edition (New


Smith and his Classical successors persuasively showed that inter-
ference by government in economic life would jeopardize the natural
tendency for men to obtain the greatest satisfaction from limited re-
sources. Moreover government was then considered as a "consumptive"
rather than a "productive institution." In this classical view, public outlays in no way increased the industry of the country of the employment of labor.

The utilitarianism of Bentham greatly influenced Mill in his adherence to a "laissez faire" position for the state. The profundity of Bentham's role for the individual in seeking his self-interest is illustrated in this statement: "Men are the best judges of their own interest; and the interference of rulers in a commercial transaction is the interference of people inferior in knowledge of the facts, and whose interests are 'sinister' or inconsistent with those of the persons really concerned." A forceful characterization of economic liberalism was made by Mill; "'Laissez-Faire,' in short, should be made the general practice: every departure from it unless required by some great good is a certain evil." Smith believed that nature provided the key to harmonious world. It was self-interest, which, when directed by liberty and justice, would bring about the fullest reward of all freedom. Self-interest, freedom 

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72 Mill, op. cit., p. 950.
and sympathy when combined would assure mankind the greatest happiness.
The idealistic assumptions which rested upon his convictions appear unrealistic in that too much reliance is placed in the infallibility of man's judgment. Somewhere between unrestrained competition and completely regulated governmental activity is the area in which Smith believed the economy should operate.⁷³ "Smith spoke, in the infancy of the industrial revolution, for a freely balanced economy in which manufacturing was the most dynamic element, needing no leading strings,"⁷⁴

John Stuart Mill represented a transition from economic orthodoxy to broader conceptions of human values, of institutions, of what is feasible, and of what government can and should undertake to do. Mill sought to escape from the fatalism of economic laws independent of human institutions. "His charter of justified functions of government accepts private activity as the general rule."⁷⁵ Mill's suggestions for government action were modest, and his chief restrictions were that only highly important values justify the compulsory variety of governmental interference. But with Mill, as with Smith, the presumption in favor of laissez-faire did not apply to unrestrained competition.


⁷⁵Ibid., p. 53.
The doctrine of "laissez faire" was not long allowed to go unchallenged. Smith based his advocacy upon the supposed identification of public and private interests. This principle of identity of interests was challenged by Malthus. On the question of non-intervention, Mill admitted only the validity of one economic argument, namely the superiority of self-interest as an economic motive.  


Later challenges to the classical position on the role of the state will be discussed in Part II of this chapter.
PART II The Role of Government in Neo-Classical
Economic Thought, 1870-1900

Introduction

The Classical view of government was challenged in the period
between McCulloch's Treatise in 1815 and the next general treatment of
public finance by Bastable in 1892. The reformists temper of
utilitarian liberalism in the early nineteenth century was in sharp
contrast with the more conservative tone of the liberalism of the later
nineteenth century.

The brilliant success of English industry in the period 1850-
1873, "seemed at the time still to prove the value of individual ini-
tiative and enterprise." Yet the effect of the depression, 1873-

1886, was characterized by a change in this belief in laissez-faire.
of industry and economic conditions. During the depression there was a great extension of the activity of municipalities and not merely the State.

The belief in the efficacy of laissez-faire which prevailed for the first seventy years of the nineteenth century in Great Britain changed with the growth of state intervention and state control which occurred in the last thirty years.

This contrast of belief appears in the writings of British neo-classical economists during this thirty year period.

The Role of Government in Neo-Classical Economic Thought

G. F. Shirras pointed out that, "a theory of public expenditures was not necessary in the nineteenth century because the scope of the functions of government was restricted. Orthodox Victorian finance is the best example of this." Schumpeter suggested that for England,

"Gladstonian finance was the finance of 'nature order,' laissez-faire, and free trade. From the social and economic vision that this implies the most important thing was to remove fiscal obstructions to
private activity. Fay contends that every Liberal Chancellor of the Exchequer between 1853 and 1898, and nearly every Conservative

Chancellor of the Exchequer was the financial disciple of William Gladstone.

During the years of Gladstonian influence in conservative fiscal policy, economic thinkers were beginning to exhibit concern for the requirements for government intervention in economic activity. Near the end of the period of Gladstone's influence on fiscal conservatism, Alfred Marshall was the spokesman for British, neo-classical economic ideas.

**Alfred Marshall’s Recommendations for Government Action**

Marshall's pre-eminent concern with poverty is reflected in his particular recommendations for government action. For Marshall, it is the responsibility of the society at large to make the lowest grade of labor "scarce and therefore dear" through the instrumentality of the state aided by private groups endeavors, such as charitable societies.
Private groups functioning as "charitable middlemen" should serve as an antidote to socialists' pressure for increased bureaucracy in dispensing poor relief. A great fund of human values may be con-


served by the action of the state. The state should provide along with the aid of charities for the unemployable and indigent by means of poor relief. In addition, the state ought to take measures to make the lowest grades of labor dear.


With characteristic caution set in the context of an aversion to bureaucracy in relation to the individual, whether in his home or in the conduct of his business, Marshall observed in a letter to Mrs. Bosanquet, "Municipal Socialism has many dangers, economic and moral. I think municipalities should not speculate or employ direct labor nearly as much as they already do...." "Public authority cannot meddle with the inside of a man's house very much without risking injury to self-reliance and wholesome independence..." 89

89 Ibid., p. 445 (October 2, 1902).

Municipal housing seems to me scarcely ever right and generally wrong. Municipal free baths seem to me nearly always right. I should like an expenditure comparable with that for the South African War...
to be devoted to the removal of this sort of
degradation for a good many years to come ---
I should not dare to ask for many millions a
year. I hold such duty is righteous...........

90Ibid.

In a later letter to Mrs. Bosanquet the emphasis is on the limits
and the dangers of state intervention.

Action, to lessen the real evils of the poorer
classes without touching on that expenditure of
the rich which is necessary for their true well-
being.....is possible. But I think also that the
attempt to do it in a hurry would be dangerous;
for carelessly done, it might sap the springs of
freedom and energy. And in that danger I see the
most urgent of all calls on efforts of students
such as you and me.91

91Ibid., pp. 445-446 (October 28, 1903).

Marshall's concern with poverty is again amplified in a letter to
Percy Alden in which Marshall likened unemployment to a disease. "We
ought not to be afraid of very large expenditures of public and private
funds in removing and lessening the causes of the disease: on methods
of which you and our common friend (Lawrence) are high authorities."92

92Ibid., p. 447 (January 28, 1903).

Yet laissez faire, laissez aller is characterized in the follow-
ing manner. "Competition is a monster now grown of overwhelming
strength. But if he can be guided so as to work on our side then even
the removal of poverty will not be too great a task."93 The function

93Ibid., p. 361.
of government is to govern as little as possible. "When it governs, it fails, as an Army fails when it fights. But an Army to succeed must be active; and a government to succeed, must be ceaseless in learning and diffusing knowledge in stimulating and cooperating.

The government in a free country, is not an entity outside the nation but a considerable part of the nation; and it can discharge its duties to the nation only by so arranging and developing its work as to make government itself an education."  


Writers preceding Marshall and those who wrote after him made suggestions as to the role of the state consistent with the cautious intervention theme of the neo-classical orientation.

Henry Sidgwick and the Basis for Government Intervention

Henry Sidgwick, a predecessor of Marshall and a follower of Mill in the utilitarian tradition, openly asserted that the role of government may include interference in the private sector. "The prima facie ground, on which the interference of government with the distribution of produce that results from the individualistic organization of society, appears economically desirable, is the great and ever increasing inequalities in income to which this organization leads."  


Sidgwick approached the problem of the economic functions of the state in the following passage.

I have a certain alarm in respect of the movement of modern society towards socialism, i.e. the more and more extensive intervention of Government with a view to palliate the inequalities in the distribution of wealth. At the same time I regard this movement as on the whole desirable and beneficent—the expectation of it belongs to the cheerful side of my forecast of the future; if duly moderated it might, I conceive, be purely beneficent, and bring improvement in every stage. But—judging from past experience—one must expect that so vast a change will not be realized without violent shocks and oscillations, great blunders followed by great disasters and consequent reactions; that the march of progress perturbed by the selfish ambitions of leaders and the blind appetites of followers, will suffer many spasmodic deviations into paths which it will have painfully to retrace. Perhaps—as in the movements of the last century towards liberty—one country will have to suffer the pains of experiment for the benefit of the whole system of states; and if so, it is on various grounds that this country may be England.......... .

My recent fear and depression has been rather of a different kind: has related to the structure of government than the degree of its interference with property and contract. I have hitherto held unquestioningly the Liberal doctrine that in the modern industrial community government by elected and responsible representatives was and should remain the normal type. But no one yet has found out how to make this kind of government work, except on the system of alternating parties; and it is the force of resistance which this machine of party government presents to the influence of enlightened and rational opinion, at crises like this, which alarms. I find myself asking myself whether perhaps, after all, it is Caesarism which will win the competition for existence, and guide modern industrial society successfully towards its socialist goal. However, I do not yet think this; but it is a terrible problem what to do with party government. 97

C. F. Bastable on the Limitation of State Activity

C. F. Bastable, writing shortly after the publication of Marshall's Principles, referred to the limitation of state activities in the following manner. "The real ground for the limitation of state functions is not the existences of an abstract rule forbidding various classes of acts. The rule itself is dependent on the results of experience." 98


The Smithian concern for unproductive resource use is no longer apparent with Bastable since his primary interest rests with the difficulties in raising the funds for public outlays. However, "financial theory in its application to the modern state is at all events bound to recognize and indicate clearly the difficulties which the extension of state action is likely to produce." 99

99 Ibid., p. 56.

J. S. Nicholson on the Breakdown of Individualism

J. S. Nicholson, who wrote after Marshall and Bastable, also cited the influence of government as recognized in his time. "On the view taken in this treatise the production, distribution, and the exchange of wealth -- the three great departments of economic investigations -- depend upon a great variety of factors, and every one of these factors is
more or less subject to modification by the general and special influence of government.\(^{100}\) Nicholson pursued the rationalization of the


utilitarian justification of government activity with an ethical base

\(^{101}\) Albee, op. cit., pp. 411-414.

of Christian truths. \(^{102}\) Nicholson pointed out, "that the state at any rate ought to look to the maximum happiness of the whole society." \(^{103}\)

\(^{102}\) Nicholson, op. cit., p. 184.

\(^{103}\) Nicholson, op. cit., p. 185.

The role of government interference according to Nicholson is justified by the defects of individualism, which the unaided self-interest of individuals is unable to remedy. The methods of government actions are set forth by Nicholson \(^{104}\) and the essence of the method is summarized as follows:

\(^{104}\) Ibid., pp. 244-253.

The authoritative prohibition of any course of conduct so far involves a limitation of freedom and it may well happen that there will be no corresponding extension of freedom in other directions. On the principle of utility, the loss of freedom may be too readily held to be compensated by a gain of happiness in something else. But the loss of freedom tends to starve the development of character, and in the words of Mill, unless the conscience
of the individual goes freely with the legal restraint, it partakes either in great or in a small degree of the degradation of slavery.\(^{105}\)

\(^{105}\)Ibid., p. 252.

Summary of the Neo-Classical Position on the Role of the State

In the development of neo-classical economic theory after 1870, Nicholson and Sidgwick as well as Marshall applied Bentham's idea of calculations of amounts of "utility" for "happiness" directly to the problem of economic theory itself. There began a change in not only the philosophies but the practical objectives of the liberal ideals. "Victorian liberalism became largely a business class gospel: being oriented against the rising menace of socialism and the expanding activities of democratic government."\(^{106}\)

\(^{106}\)Taylor, Economic Liberalism, op. cit., p. 213.

As an outgrowth of applying a utilitarian orientation to an economic liberalism encompassing state action for the common "good," the state must look beyond the needs of the individual as such to the larger collective needs of society -- the welfare of the group. It must care for the common welfare and promote the national progress by doing for society the things which common interests require, but which cannot be done at all or efficiently by individuals' action single or through associations.

Schumpeter suggested that "retrenchment" was the victorious slogan of the day in the era of Gladstonian influence on public finance. "Retrenchment meaning (a) a reduction of the functions of the state to a minimum, (b) rationalization of the remaining functions of the state, which among other things implies a small military establishment, and (c) emphasis on the principle of the balanced budget.  

Yet all three principles of retrenchment were violated. The balanced budget was never intentionally violated, but the other principles lost their hold on political consciences. The progressive estate duty (1894) and the 'people's budget of 1909 aimed at other goals than revenue raising. Expenditures for social purposes toward the close of this period put an end to the "popularity" of low taxation on high incomes and of "retrenchment." The powers at work reshaping opinion after 1880 arose out of the unstable equilibrium of social forces created by the political compromises of mid-century. The most important were a disillusionment on the part of the middle-class critics with the kind of economy and society which prevailed and the growing strength of working class opinion in the State. "The combined effect of the two

109 Schumpeter, op. cit., pp. 768-770; also see Knowles, op. cit., p. 147.
was to establish new public goals, which were bound in the course of time to influence the way in which resources were used and income was distributed.

The liberalism of the later nineteenth century, while it still supported the classical position of free enterprise and limited government, took on a conservative tone. The conservative tone contrasts with the reformists' temper of the utilitarian liberalism of the early nineteenth century. Yet there remained in neo-classical thought the fairly clear vision of the good society and the good economy embodied in the classical-liberal programs where the state took action with caution.

The English attitude of the last third of the nineteenth century anticipated the conviction that standards of life can be improved through limited action of the state.

On the human problem which arose out of the excesses of industrial power, Marshall, Nicholson and Sidgwick expressed a cautious optimism with regard to the then current policies of reform. But this optimism was blended with a tough streak of caution, and with a steady insistence on the need to keep harnessed the strongest and not merely the highest forces of human nature. Marshall took a negative position on
nationalization and state regulation of business activity. "Much enthusiasm, but very little solid argument, has been prominent in pleas for nationalization." \textsuperscript{115} For Marshall, the socialists plans "take little or no account of the super-humanability required on the part of those persons in whom the chief function of the state are to be concentrated.... No doubt the state, like man himself is to be born anew in the new age; but no definite provision is made for his rebirth; and meanwhile the intimate dependence of progress on the right taking of risks, seems to be ignored." \textsuperscript{116}


\textsuperscript{116} Ibid., p. 651.

The neo-classical economists were, however, moving in the direction of a moderate interventionism. The view of the system of private enterprise was that it was basically sound, though with particular defects. These should be remedied by piecemeal methods which would not alter the fundamental character of the system. These economists found exceptions in laissez-faire, or necessary conditions unfulfilled. The public intervention which was approved can be characterized as trying to make the actual system work more nearly like the ideal model of free competition.

These ideas were antecedents of current ideas \textsuperscript{117} as to the role

\textsuperscript{117} See Chapters Seven and Eight in this research.
of the state in economic activity. The ideas of neo-classical econo-
mists and their classical predecessors as to the manner in which state
functions should be supported with individual tax contributions is the
subject matter of the following chapters, Three and Four.
CHAPTER THREE

Tax Apportionment Theories In
Classical Economic Thought,
1776 - 1850

Introduction

None of the classical economists discussed in Chapter Two disputed the desirability of some government activity. Some government functions had to be supported by taxing. It is true that the functions of the state, in the ideal regime, were narrowly defined and limited. The need for any taxing program which implied far reaching collective or public control of the economic system was denied. But the practical determination of what part of individual wealth should go to the satisfaction of individual wants and what part should be given to the government constituted the problem of distribution of the burden of taxation.

The purpose of this chapter is to present the principles introduced by classical economists for apportioning the cost of the support of the state among the individual taxpayers. Part I presents the benefit-ability approach of Adam Smith. Part II introduces the contributions of economists, who were not identified with the classical school, who modified or extended the benefit approach to apportionment. The ability to pay principle of tax apportionment as advanced by John S. Mill is presented in Part III of this chapter.
Part I

Smithian Benefit-Ability Principle of Apportioning the Tax Burden

Few passages in the literature of public finance are more celebrated than those in which Adam Smith introduces his canons of taxation. Smith set forth in his first canon that the "subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they enjoy under the protection of the state."¹


The expence of government to the individual of a great nation is like the expence of management to the joint tenants of a great estate, who are obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equity of inequality of taxation.²

²Ibid., p. 777.

In this first canon of taxation Smith provided a basis for distributing the tax burden based on ability as well as benefit.³

³Some one hundred years before the writings of Smith, Sir William Petty had suggested a similar benefit basis for taxation. "It is generally allowed by all that men should contribute to the public charge but according to the share and interest they have in public peace..... that every man ought to contribute according to what he taketh to himself or actually enjoyeth." William Petty, "A Treatise of Taxes and Contributions," 1677, The Economic Writings of Sir William Petty, C. H. Hall (Editor) (London: Cambridge University Press, 1899), p. 91.
Musgrave states that this first canon of taxation "raises some doubt whether Smith should be placed in the benefit camp, but other passages in the Wealth of Nations clarify his position."\(^4\)


Smith does provide more explicit verification that the cost of public expenditures should be allocated to "those who receive the immediate benefits" or by voluntary contributions of those who think they have occasion to use public services.\(^5\) The strict protective and contract theory of the state was tempered by Smith, even though he had specifically stated that persons should be taxed in proportion to that they enjoy under the protection of the state. Smith did not limit public works because they must be financed by a form of general revenue. "When the institutions or public works which are beneficial to the whole society, either cannot be maintained altogether by the contribution of such particular members of society as are most immediately benefited by them, the deficiency must in most cases be made up by the general contributions of the whole society.\(^6\)

\(^5\)Smith, Wealth of Nations, op. cit., p. 768.

\(^6\)Ibid., p. 768. Also see C. R. Fay, op. cit., pp. 39-43.

Smith's first canon of taxation introduced the ability element to supplement the benefit principle. It is assumed by Musgrave that,
"Smith was too realistic a thinker to overlook the difficulties of imputing to individuals the benefits that arise from general public services."  


"It should be noted, however, that Adam Smith introduced the word rather than the theory, the term 'ability' was used by him as a persuasive slogan without much content." 8 The conception of taxation as "expense of management to the joint tenancy of an estate" is given as an explanation of the meaning of "ability." "But it is only a confusion of ideas, that the principle of ability can be connected with the protective theory of the state." 9 The two ideas, benefit and ability, are totally distinct and mutually exclude each other. As Bastable said, "So far as the benefit or service principle is applied, it excludes the rule of taxation according to ability." 10


9 Weston, op. cit., p. 126.


Any contradiction in the benefit concepts cited above stems from a failure to discern the difference between a principle relating to a concept of justice in taxation and using such a principle as a guide
to practical tax policy. Smith certainly accepted the benefit principle of apportionment, but he made benefits equivalent to ability to support public expenditures. That is, for Smith, ability is determined by the benefits received; the benefits determining the ability, not the ability determining the benefit.

Modification of the Benefit Principle

Smith's concept of tax justice was never reinforced with criteria to determine the equality or inequality of taxation. Smith's successors carried on a lively debate as to what constituted equality and particularly which rate structure most nearly corresponds to the demands for justice. 11 "Ricardo quoted Smith's first maxim with approval without having discussed it." 12 Senior said quite explicitly, "that taxation rests on a particular kind of barter between the individual and the state in which the latter offers protection against payment which must be proportional to the protection." 13 Although most writers who accepted the benefit principle find a measure of the benefit in the assumption that their benefits are proportional to the amount of property enjoyed or

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12 Myrdal, op. cit., p. 164.

Senior's view was a different one. Senior viewed the benefits based on a theory of exchange.

11 West, op. cit., p. 128.

In all economic activities protection is required, and in the division of labor the function of protection is assigned to government. For the service that the government performs in procuring the protection, every economic activity owes an equivalent service in exchange. Or taxation like all private economic activity finds its basis and its principles in a theory of equivalent economic services. 15 Bastiat expresses this concept by declaring that "when a state renders a service equal to the tax there is an exchange, and that a good or a bad use is made of the tax, according as the service of the state is, or is not, equivalent to what the public gives in exchange." 16

15 Ibid., pp. 129-130.


Bastiat and Senior provide a principle of benefits that suggests individuals should contribute to the cost of the service of government in proportion to the gains of their exchanges.

Another, but different concept of the benefit doctrine is sanctioned by McCulloch. "Every individual should contribute to its support accord-
ing to his stake in the society, or to his means.\textsuperscript{17} The insurance theory of taxation is closely allied with the joint stock theory of the state. The state's function is to insure security of life and property. Hence, a tax rests on the same principles of the premium to an insurance company. E. Pershine Smith takes substantially the same point of view, "as government renders services to each and every one of its constituents, each and everyone ought to contribute to the expense of its maintenance in the ratio that he receives advantage it gives him as security of his person and property. So far as his property is concerned it is apparent that his contribution should be estimated as it would be by a private insurance company, by the amount at stake.\textsuperscript{18}

\textsuperscript{17}J. B. McCulloch, \textit{op. cit.}, p. 17.

\textsuperscript{18}E. Pershine Smith, \textit{Political Economy}, p. 264, quoted from Weston, \textit{op. cit.}, p. 132-133. (Original source not available in library facilities.)

During the nineteenth century the benefit approach came to be associated with a narrow insurance-premium interpretation of taxation. "Thereby the benefit theory tended to become an expression of bias toward public expenditures. Since taxes are properly a premium paid for protection, public services should be limited to those which serve protection. The essential basis of the benefit principle, that the citizen must choose and pay for whatever public services he wishes to obtain, was lost in the narrow confines of an insurance theory of taxation.\textsuperscript{19}

\textsuperscript{19}Musgrave, \textit{op. cit.}, p. 68.
PART II  Digression on the Classical Apportionment Principles

Concepts Introduced By Economists Not Identified With
The Classical School

There is a danger in attributing the source of ideas to particular individuals in any survey of the stream of economic thought. Attributing the concept of ability-benefit doctrine to Adam Smith is subject to such an inherent danger. Seligman gives substance to this concern in his historical review of the contributors to the literature of public finance. For example, Seligman cites Hugo Grotius as the originator of the benefit theory. As stated earlier in this chapter, Sir William Petty had also advanced a benefit theory. "It is generally allowed by all that all should contribute to the public charge but according to the share and interest they have in the Publick Place; that is according to their Estates and Riches."  

Physiocratic writers were also advocates of the theory of benefits and proportional taxation, although their practical proposal was a single land tax. According to Turgot, land alone produces "produit net," a net surplus above the expenses of production. Thus all taxes should be imposed in the first instance upon the landed proprietors.  

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20 H. Grotius, De jure belli ac pacis, Prolegomena, sections 5 to 10 inclusive; Seligman, op. cit., p. 159.


As only the proprietor of land can obtain a net product, they are the only class that has an interest in stable government. Indeed, a net product and a stable government mutually condition on another. "Without good government and tranquility there will be no net product, and with no net product, no government and no society."  

23 Francois Quesnay, Despotisme de la Chine (Paris: Guillaumin, 1767), Chapter 8, sec. 20.

The basis of the tax is the economic interest which the proprietors of land have in government, the principle of its distribution is the extent of the interest in the joint economic result -- the net product.  


Montesquieu stated, "The revenues of the state are a part of his property which each citizen gives in order to be sure of the other part, or in order to enjoy it in comfort."  


Mirabeau the Elder said that a tax is a payment made by the individual in return for the protection afforded by government since the expenses incurred by the state simply assure to the citizen an equivalent for what they give.  

In England, the most familiar instance of the rise of the benefit concept is that in the Elizabethan Poor Law, which provides for the taxation of every inhabitant of the parish according to the ability of the parish. Seligman suggests that the term ability here means property.

Sir James Steuart was the first important English writer to enunciate the principle of a tax on surplus over subsistence. This clear income base for taxation is the forerunner of the Ricardian tax base. "Seligman is quite right when he says that, 'the fullest discussion of the incidence of taxation is to be found in the works of Sir James Steuart.'" Although Steuart's conception of the role of liquidating the public debt was unique, the role that he prescribed for the state was mercantilistic. "His thesis that there is no natural order and that natural forces, if given free scope, are potent not only for the public good but also evil, makes him acutely aware of the necessity for a strong controlling authority."
I readily allow that every one who has been obliged to pay a tax, may have the desire to indemnify himself of the expence he has been put to, by augmenting his industry; but if on the other hand, taxes have put everyone to a considerable additional expence in proportion to his estate, it would be absurd to allege this diminution of his fortune, as the cause of a desire to augment his consumption.\(^{31}\)

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Thus the joint action of collecting taxes and spending them means a great increase in the circulation of wealth and as such a promotion of employment and industry. "Steuart's general conclusion about taxation is that when taxes are judiciously imposed, and actually levied without oppression, they enrich a nation."\(^{32}\) However the impact of Steuart's contributions in economic thought must be relegated to a lesser role than Smith.\(^{33}\)

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Ricardo, whose work in taxation was primarily devoted to the shifting and incidence of taxation, restated Steuart's emphasis on a subsistence exemption and Smith's proportional burden. "The power of paying taxes is in proportion to the net, and not proportional to the gross revenue. Proportional taxation means proportional taxation of clear income only."\(^{34}\)

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All of the authors in this section were advocates of the benefit doctrine, or the give and take theory. Some of the advocates sought to uphold the doctrine on grounds of protection by suggesting proportional rate structures. Seligman points out that Ricardo, Montesquieu, and Mirabeau fall into this group.\textsuperscript{35} N. Senior, who advocated a benefit theory, believed benefits should be implemented with such a proportional rate structure. Senior puts the give-and-take theory in this form, when he said, "We consider all that is received by the offices of government as given in exchange for services affording protection, more or less complete, against foreign or domestic violence or fraud. It is true that this exchange is conducted on peculiar principles...... No individual is permitted to refuse his share of the general contribution, though he should disclaim his share in the general protection. But the transaction, though often involuntary and still more often inequitable, is still an exchange and on the whole a beneficial exchange."\textsuperscript{36}


\textsuperscript{36}N. Senior, \textit{op. cit.}, p. 87.

Seligman also suggests that some of the benefit theorists advocated non-proportional rates structures.\textsuperscript{37} Sismondi is included

\textsuperscript{37}Seligman, \textit{op. cit.}, Chapter 3.
with these writers. Sismondi advocated the give-and-take theory and further maintained that the minimum of subsistence must be exempted.

"Taxation being the price paid by the citizen for his enjoyments, we must never demand a tax when there are no enjoyments." Sismondi suggested that the public expenses are destined to protect the rich against the poor, therefore it is just that the rich contribute not


only in proportion to their wealth but something in addition, in order to maintain this order which is so advantageous to them. Sismondi


was thus advocating something other than a theory of proportional taxation.

A review of the literature indicating that the benefit concept was interpreted as the basis for a variety of rate structures to implement practical tax justice is found in Seligman.

40Seligman, Progressive Taxation, op. cit., Chapters 1, 2, 3, p. 130 ff.

Summary and Evaluation of the Benefit Principle of Tax Apportionment

The economic basis of the benefit principle of apportionment rests upon the theory of the state as a protector of property and individual rights. The basic concept implied in this apportionment principle is
that the tax should be "proportioned" to the benefits derived from protection of property owned and enjoyed. A tax is regarded as an economic return for a "benefit received" from the government. The benefit is the basis for the individual to compensate the state for this protection in relation to the benefits each individual derives from such protection. This view of the principle was expressed by Adam Smith and Montesquieu.

The concept of protection was extended by Sismondi to encompass the protection of the individual. Smith's view is more tenable as a basis of tax apportionment, since the Sismondi view includes practically all that is contained in the idea of national well-being. Protection with such an extended conception loses any significance as a basis of taxation. The Sismondi approach requires the inclusion of protection of qualities such as honor, glory and religion. Apart from the impossibility of determining the value of these types of benefits, the economic relation between the state and individual cannot be expressed by the idea of compensation for benefits received.

Authors who supported the benefit principle advocated a variety of different bases for the determination of benefits.

A common standard for measuring benefits of government is found in income. With the Physiocrats only the income derived from the product net of land was regarded as a measure of benefits from or of government. But most advocates of the benefit theory have followed Smith in making benefits conditioned by the revenue enjoyed under the
protection of the state. Smith found the measure of benefits of government proportional to the amount of property owned and enjoyed.

From the economic point of view, income is an objective measure of benefits. Income would be a more definite benefits index than property as suggested by McCulloch or expenditure as supported by Petty.

Income does not indicate the value of the benefits received from government any more adequately than does either of the other objective standards. Each and all of these objective standards beg the whole question by assuming that benefits are limited to the enjoyments from property, or from income. Yet each of the authors implicitly admits that the benefits of government are far more extensive. No such objective equivalent of the benefits from government services is equivalent to all the benefits of government.

The general idea underlying the benefit theory is that political basis which assumes that a tax is a payment for a service rendered by the state to the individual. The basis of the tax is said to be a "service" or "benefit" received. The concept of service has been resolved into the service of protection, or the benefits derived in consequence of protection. The different forms that the basis has assumed are impossible to resolve into an objective standard, which would encompass the full "worth" of the services provided by the state.

The benefit principle of tax apportionment does however point out the requirement that the government received the amount due it for the "worth" that it provides. The obligation of the individual to contribute a payment for this "worth" is analogous to the contractual relationships of individuals or groups.
The fundamental difficulty of establishing an adequate objective index for the application of the benefit doctrine, was by-passed with the contribution of a new principle of tax apportionment. The new principle was introduced by John S. Mill in his suggestion that taxes should be levied in such a manner so as to provide for an equivalence of sacrifice for the taxpayers. This new principle is presented in the following section.
PART III  The Sacrifice Principle

of Tax Apportionment

Introduction

The preceding sections have noted that economists who accepted
the benefit principle have followed Adam Smith in making it equivalent
to ability. This view of ability provides a basis for distributive

\[1\]\textsuperscript{ supra, p. 78.}

justice in taxation. However, the concept of ability was freed from
its relation or alliance with the benefit as the manner of measuring
ability was translated into a new basis by later economists. The new
basis suggested in the following sections as ability-to-pay implies a
personal obligation of active participation in the support of the
state. The benefit and ability principles are thus regarded as two
entirely distinct conceptions, and not different names for the same
thing.

John Stuart Mill and the Origin of
Sacrifice Principles

The simple protection theory of the state was unacceptable to
Mill because the ends of the state go beyond those of protection.\[2\]

\[2\]See pp. 38-41 Chapter Two.

Therefore government must be regarded as a concern of all. that to
determine who are most interested in it is of no concern.\[3\]

Thus a new principle of taxation is needed. The new principle is based on the idea that all citizens should be treated equally under the tax laws. "For what reason ought equality be the rule in matters of taxation? For the reason that it ought to be so in all affairs of government." \(^4\)

\[^{4}\text{Ibid., p. 804.}\]

The objective concept of ability advanced by earlier economists was transformed into a subjective concept of equal sacrifice by Mill.

Mill was the first writer clearly to substitute subjective sacrifice for ability, as measured by revenue, as the basis of taxation. \(^5\)

\[^{5}\text{Weston, op. cit., p. 187.}\]

Mill's searching effort to determine equality in taxation makes up a major portion of Book V of his Principles. In this effort the sacrifice doctrine becomes a significant part of apportionment concern.

As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made clear to bear as nearly as possible with the same pressure upon all; which it must be observed in the mode by which least sacrifice is occasioned on the whole. If any one bears less than his fair share of the burden, some other persons must suffer more than share, and the alleviation to the one is not, on the average, so great a good to him as the increased pressure upon the other is evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each
person toward the expenses of government, so that he shall feel neither more nor less in convenience from his share of the payment than every other person's experience from his.

\[46\]

\[46\] Mill, Political Economy, op. cit., p. 804.

With Mill the basis of tax distribution is sacrifice. The goal of justice in taxation is to effect an equality of sacrifice, not giving up equal shares of the means of enjoyment, but giving up equal enjoyments. "The true principle of taxation I conceive to be, not that it shall be equal in proportion to means, but that it shall, as far as possible, demand an equal sacrifice from all, .... that is, a proportional sacrifice of enjoyments.

\[47\]

\[47\] Ibid., p. 802.

Mill's fundamental idea of justice is not in terms of objective ability, but in terms of subjective sacrifice. Mill rejected the benefit-ability of Smith\[48\] and viewed equality of sacrifice as a new principle of taxation. Weston suggests that "this view of the basis of justice is the natural result of the reflections of a philosophical mind on the obligations of the citizen of the state, and is no doubt influenced by a utilitarian ethics whose highest principle is the great sum of pleasure of others. It emphasizes the idea that the obligations of the individual calls for a sacrifice, a giving up, rather than an
active, positive effort." Myrdal states that Mill's view can be explained by the influence of French reformers and that the emphasis upon equality of individual sacrifice might have overshadowed the collectivist implications of the ability-to-pay approach.

Mill clings to the sacrifice concept and fails to find justification for the levy of various rates depending upon the source of the income. His basis of a just tax is entirely individualistic, the effect which the tax will have upon the community is entirely determined by the sacrifice which the collection of the tax forces upon the individual required to pay it. If the total of disutilities is greater when the taxes are levied in one manner than in another, the method of levy which results in the smallest total should be selected.

As individuals share equally in the benefits they should also share equally in the sacrifices necessary to obtain them. Mill's position solves the problem of absolute and relative equality, the absolute equality being the subjective, the relative equality of an objective character. For with respect to the protection of the government, there is only a relative equality in goods given up for the support of government. But with respect to the conditions in the free use of faculties,
there is an absolute equality of subjective interest. Thus there should be an absolute equality of subjective sacrifice for maintenance of these conditions. Such an equality is found in Mill's subjective equality of sacrifice as the norm for the distribution of tax burden.

Summary and Evaluation of the Sacrifice Tax Apportionment Principle

The first writer clearly to substitute subjective sacrifice for objective ability, as measured by revenue, was John S. Mill. With Mill the basic idea in the distribution of tax burden was sacrifice. The aim of justice in taxation is to effect an "equality of sacrifice." The aim is realized by each individual giving up equal enjoyments by way of tax payments. In a sense this process is Mill's explanation of the meaning of ability. For Mill the idea of sacrifice is not so much an interpretation of ability, as it is a new principle of taxation. For Mill the fundamental idea of justice is to be explained not in terms of benefits, but in terms of sacrifice.

This view is consistent with a utilitarian theory of the state, which acts to facilitate the achievement of the greatest sum of pleasure for each person consistent with the pleasure of other individuals. Sacrifice emphasizes the idea that the obligation of the individual calls for a sacrifice or a giving up of pleasure or satisfaction. Thus sacrifice is a negative concept. It expresses the basis of denial or a sacrifice of personal satisfactions for higher satisfactions that are common with others in the taxing community. The idea of equivalence of
sacrifice is an ideal conceivable only from the viewpoint of individuals as a whole in their relationships with one another. Equality of sacrifice is a particular view of tax justice that is inconceivable that the state should ever realize. Equality of sacrifice or relatively equal losses of enjoyments are conditioned by a variety of factors such as individual character, habits, et cetera. Economic indexes of the ability to sacrifice constitute only one basis for expressing the equivalence of sacrifice. Mill's theory of sacrifice does not add much insight to problems of establishing tax programs.

Even if equivalence of feeling is the ideal of justice in taxation, it is a purely abstract ideal. From the point of view of the government the equivalence of subjective feeling is relative to ability to satisfy private and public needs as determined by economic means. That is the important taxing consideration. The government has fulfilled its obligation to the taxpayer when it has apportioned the tax according to the ability of the taxpayer. This ability is determined by objective facts, that is, objective economic conditions of the taxpayer.

Mill's contribution to the theory of tax apportionment is an important and significant one. The concept of sacrifice provided the basis for a vast development in the theoretical aspects of tax apportionment in the last quarter of the nineteenth century.

The problems that were suggested by Mill concerning the subjective and objective indexes of tax paying ability have persisted in tax theory to the present day.
The impact of Mill's ideas on apportionment theories is developed more completely in the following chapter.

Until the middle of the nineteenth century, Mill and Smith provided the main streams of influence in the literature of public finance. The influence of Smith is undeniable. Therefore, the benefit principle, within a system of natural order, has remained a basis for taxing as a price for public services. Differences in the efforts of later authors to determine taxes on a benefits basis will be set forth in Chapter Five of this research.

Mill, in advocating equal sacrifice, failed to define the equality implied. With Mill's concept of sacrifice as a basis for development, there was confusion reflected by later authors in determining the rate schedule to implement the sacrifice principle. The attempts of later fiscal theorists to implement the sacrifice principle of tax apportionment through specific recommendations as to tax types and rate structure will be the primary topic discussed in the following chapter.
CHAPTER FOUR

Tax Apportionment Doctrines in Neo-Classical Economic Thought,
1875 - 1930

Introduction

J. S. Mill's "equality of sacrifice" was clearly the outstanding expression of a principle of tax apportionment in the nineteenth century. Equity of sacrifice was an expression of the basis for principles of taxation. It was not a new principle, but only a suggestion for determining a subjective form of sacrifice. The neo-classical economists who developed Mill's thesis used ability as a basis of taxation. Ability to pay involves the relation of one's economic wealth to his personal or collective wants, compared with the similar relation of every other member of the community. Differences in point of view or interpretation of ability were advanced as ability to pay provided the genus for apportioning the tax burden for neo-classical economists.

Economists in the last thirty years of the nineteenth century advocated the concept of "sacrifice" of income as a measure of ability. Schemes of apportionment based on ability led to three principles of sacrifice:

a) equal sacrifice
b) proportional sacrifice
c) minimum sacrifice
According to the principle of equal sacrifice, the direct money burden of taxation should be so distributed that the direct real burden of all taxpayers is equal; according to the principle of proportional sacrifice, so that the direct real burden on every taxpayer is proportionate to the economic welfare which he derives from his income; according to minimum sacrifice, so that the total direct real burden on the taxpayers as a whole is as small as possible.¹


These equality of sacrifice principles have been refined to include equal marginal, equal absolute and equal proportional sacrifice.

With Y = income, T = amount of tax paid, U(Y) = total utility obtained from income of Y:

\[
equal \text{ marginal sacrifice} = \frac{dU(Y-T)}{d(Y-T)}
\]

\[
equal \text{ absolute sacrifice} = U(Y) - U(Y-T)
\]

\[
equal \text{ proportional sacrifice} = \frac{U(Y) - U(Y-T)}{U(Y)}
\]

²Musgrave, op. cit., p. 96.

Even after the concepts of sacrifice were defined, there frequently remained confusion between the various concepts and the subsequent problem of determining the rate schedule required.³

The following sections will present the works of the contributors of sacrifice principles and point out problems in implementing the principles in a tax structure.

The purpose of this chapter is to present the evolution of the sacrifice principles as a basis of tax apportionment. Part I, the Equal Sacrifice Principle, analyzes the works of Henry Sidgwick, Alfred Marshall, C. F. Bastable and J. S. Nicholson. Part II, the Principle of Proportional Sacrifice, is developed with reference to the work of A. J. Cohen-Stuart. Part III of the chapter presents the Least or Minimum Sacrifice Principle as the contribution of F. Y. Edgeworth. A Summary and Evaluation of these sacrifice principles completes the section and is presented as Part IV. Part V of this chapter introduces the works of A. C. Pigou and Hugh Dalton, two twentieth century British economists. Both Pigou and Dalton developed theories of taxation which were based on the nineteenth century sacrifice theories.

PART I  Equal Sacrifice Principle of Tax Apportionment
Henry Sidgwick and the Restatement of Mill's Sacrifice Principle

Sidgwick, in 1883, contributed to the literature of the period a restatement of the equal sacrifice concept in his Principles of Political Economy. Sidgwick was particularly concerned with "justice" or equality in taxation. For Sidgwick "the obvious equitable principle -- assuming that the existing distribution of wealth is accepted as just or not unjust -- is that equal sacrifice should be imposed on all, except so far as it is thought desirable to make taxation a means
of redressing the inequalities of income that would exist apart from governmental interference." Faced with the dilemma of choosing a tax structure to implement this equality principle, he suggested a "progressively increasing tax on the luxurious expenditures of the rich." However, if once admitted, progression would be difficult to limit because of the impossibility of establishing any "definite quantitative comparison" between the money sacrifices of the rich and those of the poor. The resulting danger would drive capital away if progression were carried too far.

Sidgwick accepted sacrifice as containing the true principle of taxation and equal sacrifice expresses the fundamental idea which the principle involves.

Alfred Marshall and Taxation as a Problem of Constructive Ethics

Marshall added significance to the attempts to establish a "new" concept in the distribution of tax burden. "The notion that distribution should be governed by mere equity was long dominant, but now it is seen that the problem is one of constructive ethics; though, of course, on its technical side it calls for careful economic and political
thought." Marshall suggested the doctrine of least sacrifice as distinct from the equal absolute sacrifice and progressive tax rate structures.  

7 Memorials, op. cit., p. 347.
8 Musgrave, op. cit., p. 98.

the systems of graduated taxation, which are being foreshadowed in several countries, are in some measure based on the assumption that the addition of one per cent to a very large income adds less to the well being of its owner than the additional one per cent to smaller incomes, even after corrections for necessities have been made. It may be mentioned in passing that from the general law of utility that the utility to anyone of an additional one pound diminishes the number of pounds he already has, there follows two principles. The first is that gambling involves an economic loss, even when conducted on fair and even terms. .... a man, who having 600 pounds makes a fair even bet of 100 pounds, has now the expectation of happiness equal to half that derived from 700 pounds, and half that derived from 500 pounds; and this is less than the certain expectation of the happiness derived from 600 pounds, because the hypothesis of the difference between the happiness from 600 and 500 is greater than the difference between the happiness got from 700 and 600.  

Schumpeter points out that "Marshall began to approve of what was then considered high direct taxation -- including inheritance taxes -- but also espoused what was a mortal sin against the spirit of Gladstone finance, namely a policy that went beyond taxing for revenue and aimed
at taxing in order to change income distribution."\(^\text{10}\) In Marshall's view taxation involved problems of constructive ethics. If existing conditions or existing rights were not all that could be desired, the taxation scheme is under suspicion of being wrongly based, and even of aiding and abetting abuses. His analogy of government and the joint stock company, stated in his *After War Problems*,\(^\text{11}\) illustrates his orientation: "while a joint stock company is obligated to accept existing rights as final, the state is rather under an obligation to go beyond them, to inquire which of them are based on convention or accident rather than fundamental moral principle, and to use its powers for promoting such economic and social adjustments as will make for the well-being of the people at large."\(^\text{12}\)

\(^\text{10}\)Schumpeter, op. cit., p. 945.


\(^\text{12}\)Ibid., p. 317.

**C. F. Bastable - An Opponent of Progression**

Bastable confirms the position that sacrifice theories were predicated upon "the more accurate study of the variations in utility"\(^\text{13}\)

\(^\text{13}\)C. F. Bastable, op. cit., p. 307.

which forms the new mode of measuring the pressure of taxation. It
is final degree of marginal utility that becomes the measure of sacrifice.

The utility of a shilling is more to the possessor of an income of 100 pounds than it is to one of 1000 pounds, it does not follow that it is exactly ten times as great. The assumption that equal percentages of income are of equal utility is a rough 'first approximation,' admissible, perhaps, in the earlier stages of inquiry, but certain to give place to the more accurate results of later investigations.14


Bastable, supported the equal sacrifice concept and, as Mill had done many years before, identified this concept with proportional tax structures.15 Progressive rates would lead to a more extreme form of taxation "approximating, if not actually attaining, a state of social-

15Ibid., p. 323.

ism." In further criticizing progression he pointed out that the fiscal productiveness is slight while the economic effects are likely to be injurious.16 The proportional rate structure as the best standard of regulating taxes, stands as an intermediate method between the system of payment as recompense for state services, which is regressive, and the system of progression resting on the idea that sacrifice should be equalized.17

16Ibid., p. 323.

17Ibid., p. 323.
J. S. Nicholson on the Implementation of Sacrifice

Bastable's position on proportional and progressive rate structures was substantially the same as that of Nicholson. Nicholson rejected progressivity in the tax structure because, "the equalization of incomes by taxation is very like the social levelling of death."\(^{18}\)

\(^{18}\)Nicholson, op. cit., p. 284.

Problems of implementation were the keynote of Nicholson's discourse on tax apportionment. He criticized the equality of sacrifice on this implementation basis. "The imposition of equal sacrifices on all taxpayers must remain an ideal impossible of actual realization."\(^{19}\)

E. R. A. Seligman summarized this view of Nicholson as a practical problem in these terms. "Since sacrifice denotes something psychical, a tax takes away commodities which are tangible. Therefore it is impossible to ascertain the exact relation between them. The calculus of pain and pleasure cannot reduce the heterogeneous to the homogeneous."\(^{20}\)

\(^{19}\)Ibid., pp. 284-285.

\(^{20}\)Seligman, Progressive Taxation, op. cit., p. 143.

Summary of Views on the Equal Sacrifice Principle of Tax Apportionment

In the process of interpreting the equal sacrifice principle provided by Mill, there remained confusion between the initial problem of choosing between various concepts of equal sacrifice and the tax rate
required under a chosen concept. Sidgwick and Marshall favored a concept of equal absolute sacrifice, while Bastable and Nicholson supported a concept of equal sacrifice. Neither Bastable nor Nicholson were more explicit than Mill in the manner in which the sacrifice principles could be implemented on an equal basis. Their positions are clear only with regard to criticism of the usefulness of progressive tax rate structures to achieve the desired type of sacrifice. Both Nicholson and Bastable feared the levelling effects of progressive tax rate structures. Their fear of the use of such taxing devices points to the basis of their identification with proportional tax rate structures.

All of the economists, noted above, attempted to relate the concept of sacrifice introduced by Mill to a specific rate structure. Each author assumed that the marginal utility of money income declined with additional increments of income. Their discussions of taxation take the form of attempts to make more accurate the notion of the variations in utilities in terms of its money equivalence. The concept of progression was particularly repugnant to Bastable and Nicholson because the determination of taxation on the basis of variations in income utility disregarded the importance of the use of incomes in the role of capital. The economic effects of a progressive tax structure were detrimental to the factors that were responsible for economic success.

These writers may be characterized with the advocacy of laissez faire of the type supported by British conservatives at the end of the nineteenth century.
Marshall was more moderate in his opposition to the use of progressive tax rate structure. In his continuing concern with the human problems of an industrial society, Marshall accepted the use of taxation to change income distribution. However, Marshall viewed taxation as a problem of constructive ethics. This view suggests to the author of this research that Marshall's interest in tax theory was predicated in part upon the distribution effects of taxation as well as the exaction effects.

None of the authors discussed in the previous section attempted a sophisticated mathematical analysis in establishing an equivalence between utility and income. Yet each author was ultimately faced with the insurmountable problem of determining an objective standard for subjective sacrifice.

The mathematical approach to this dilemma was the work of Cohen-Stuart and Edgeworth. Their approaches to equal sacrifice determination are presented in the following sections, Part II and Part III.
PART II The Proportional Sacrifice Principle
of Tax Apportionment

A. J. Cohen-Stuart and the Total Utility
Approach to Equal Sacrifice

Accepting the principle of equity of sacrifice as the ideal of
justice in taxation, the mathematical economist Cohen-Stuart went
farther than any other economist in his attempt to give to the concept
of subjective sacrifice precise meaning. Starting with the position that
within every group of needs there is the same intensity throughout, to­
gether with the fact that the order of satisfaction of needs varies in­
versely with the means of satisfaction — income, only the larger in­
comes can satisfy the least intensive group of needs; so that the group
of needs affected by the tax is necessarily the most intensive of un­
satisfied needs, or the least intensive of satisfied needs. Thus mar­
ginal utility of incomes decreases as the income increases. Hence
every increment of tax corresponding to an increment of income has a
lesser marginal utility than the preceding increment. The sum of the
marginal utilities of different increments of income and of the tax
will represent respectively the total utility of the income and of the
tax. Dividing the total utility of the tax by the total utility of
the income, the resulting value is the relationship in per cent that
the total tax is of the total income upon which it is assessed. In
every case this percentage will be the percentage that any given tax
bears to the total utility of it corresponding income. 21

21A. J. Cohen-Stuart, Bydrage totde Theorie de Progressive Inkno­
sten belasting (Hague: Martinus Nijhoff, 1889), Chapter 5, quoted from
Weston, op. cit., pp. 197-199.
equality, all that is necessary is to find a tax rate that will yield a tax whose total utility divided by the total utility of the income paying the tax will be the same for every income. The tax and income reduced to units of utility must show the same relation to every taxpayer, since herein consists the equality of sacrifice.

Cohen-Stuart clearly stated the difference between equal and proportional sacrifice doctrines. Beginning with the definition of equality of sacrifice, there are four consequences of a tax: (a) the sacrifice of the money taken; (b) the sacrifice of enjoyments which this money might have procured; (c) the sacrifice of the proportion of this amount of enjoyment bears to the total enjoyments at the disposal of the taxpayer — which he calls, the sacrifice; (d) the moral effect produced or the pain. Equality of money sacrifice means that precisely the same sum be taken from every one; equality of sacrifice of enjoyments means that all shall be deprived of equal enjoyments; equality of sacrifice means that every one is to pay so much that the total enjoyment of each shall be diminished in relative proportion. That is, equality of sacrifice means proportional sacrifice of enjoyments. 22

22Seligman, Progressive Taxation, op. cit., pp. 278-279. See Ibid., pp. 281-284, for a reproduction of Cohen-Stuart's illustrative material on the diminishing utility of money income and Seligman's criticism.

Cohen-Stuart adopted the utility concept in assuming that the marginal utility of income varies in an inverse ratio to the total income. He also demonstrated that with various assumptions as to the declining
rate of utility, any tax rate structure whether proportional, progressive or regressive could bring about proportional sacrifice. A single tax rate structure is not simply deduced from the conception of the sacrifice of utility.\(^\text{23}\)


Summary of the Position of Cohen-Stuart on Equality of Sacrifice

Cohen-Stuart accepted the idea of equality of sacrifice as the ideal of justice in taxation. The contribution of Cohen-Stuart rests with the precise meaning which he gave to this ideal of tax justice. The development of his principle of sacrifice rests on the assumption that within every group of needs, there is the same intensity throughout, together with the fact that the order of satisfaction of needs varies inversely with the means of their satisfaction. In other words, only individuals with larger incomes can satisfy the least intensive needs.

In the taxing process, that group of needs affected by the tax is necessarily the most intensive of unsatisfied needs, or the least intensive of satisfied needs. This view of the taxing process is predicated on the fact that the marginal utility of incomes decreases as the income increases, since less intensive needs are satisfied by marginal income units. Therefore every increment of tax, corresponding to an increment of income, has a less marginal utility than the next preceding increment.

The matter of determining equality of sacrifice is apparently simple. Assuming a fixed gradation in the increase of the marginal utility
of every increment of income, a tax must provide a corresponding decrease in the marginal utility of every increment of income taxed away. Thus the sum of the marginal utilities of different increments of income and of the tax will represent, respectively, the total utility of income and of the tax. To produce equality of sacrifice, all that is necessary is to find a tax rate that will yield a tax whose total utility divided by the total utility of income paying the tax will be the same for every income. For, Cohen-Stuart, the tax should be such that the total utility of the tax for every individual will be the same percent of the total utility of his income as the total utility of the tax of every other individual is of the total utility of his income.
PART III Least or Minimum Sacrifice Principle of Tax Apportionment

F. Y. Edgeworth and the True Principle of Taxation

It was Edgeworth who stated the doctrine of the least aggregative sacrifice as the ultimate principle of taxation.  


T. N. Carver had written two years before that "minimum amount of repression or check to growth of wealth is secured by collecting the whole tax from those few incomes which have the lowest final utility."  


Carver examined the justice of the distribution of economic goods with a view to determining justice, and in so doing makes the first explicit statement of the minimum sacrifice principle. But it was Edgeworth who clearly enunciated the principle and developed the principle as a direct emanation of pure utilitarianism."  


27 Edgeworth, op. cit., p. 106.

For Edgeworth minimum sacrifice is the sovereign principle of taxation. "This principle may also be applied to justify differential
taxation on the ground of differences in other respects besides size of income: e.g. (a) permanence of income, (b) differences in the permanence of income, (c) differences in civil status, (d) number of children, age, and (e) other attributes."

Edgeworth's proposal to substitute the minimum for equal sacrifice was put forth primarily because the minimum sacrifice principle is the "only possible, only conceivable principle which can guide legislation on a great scale." The use of minimum, instead of equal, sacrifice enables us to pierce the sort of "metaphysical mist" surrounding the application of sacrifice principles. Minimum sacrifice assumes no exact relation between utility and means; it assumes only "what is universally admitted," that utility does not increase proportionally to means. Confusion had been caused by the conflict between forms of equal sacrifice, but the pure utilitarian has no difficulty in accepting minimum or equal sacrifice as equally inexact but equally useful approximations of the true principle of sacrifice; or rather that proportional sacrifice is more exact, being more in accordance with minimum sacrifice, equal is more useful, in this country at least, as being more familiar.

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29 Sir Henry Maine, Political Institutions, quoted from Edgeworth, Papers, II, p. 117.
30 Edgeworth, Papers, II, pp. 117 and 130.
31 Ibid., p. 117-118.
It follows in Edgeworth’s analysis that the sum of privation or sacrifice caused by taxation should be a minimum. Therefore if a certain amount of taxation is to be raised, "the prima facie best distribution is the whole amount should be paid by the wealthiest citizens. The incomes above a certain level should all be reduced to that level; the incomes below that level should be untaxed, the level being determined by the amount which it is required to raise." Edgeworth was quick to point out the dangers of this levelling principle. "There is the danger of driving the rich, or at least their riches from the country and checking accumulation; and there is the danger of awakening the predatory instinct in the poor, and precipitating revolution." However, in the consideration of equity in any political system, the test which should be applied "is the greatest happiness" principle.

Edgeworth thought that the rules of equity, when tempered with prudence, deduced from least sacrifice are not very different from the rules which are deduced from the principle of equal sacrifice and that as a working principle his proposals to substitute minimum sacrifice for equal sacrifice would not modify the practical direction afforded by the sacrifice principle. But Edgeworth did distinguish between equal and proportional
sacrifice under a genus which he called "like sacrifice." Equal sacrifice denotes the sacrifice of an absolutely equal amount of utility. Proportional sacrifice denotes an equal proportion of utility. Later in his essay Edgeworth used the terms interchangeably. Edgeworth employed the term 'equal' generically, covering proportional as well as equal in the proper sense. Edgeworth held that the minimum sacrifice concept was theoretically superior to the equal or proportional sacrifice theories because it required no knowledge of the utility curve other than that it sloped downward. Edgeworth thus claimed that only minimum sacrifice emphatically necessitates a progressive rate. One weakness of the equal sacrifice criterion and to some extent the proportional sacrifice criterion, is that not all declining utility curves result in progression; something more than the steepness of the curve must be known.

For Edgeworth a progressive rate structure would keep aggregative sacrifice of the economic community to a minimum because the least sacrifice would be incurred by each income earner thus allowing the greatest quantity of total satisfaction. The notion of equity in taxation finds its more correct expression in "like sacrifice" which constitutes the common
genus of which equal and proportional sacrifice are but species. "But like sacrifice must become an equi-marginal sacrifice which means an absolute equality of the marginal utilities sacrificed. These marginal sacrifices implemented by progressive rates should be at a minimum to be consistent with utilitarian ethics." Equi-marginal sacrifice finds expression in the principle of minimum sacrifice. Edgeworth did not claim that there is any real opposition between this view and the equal or proportional sacrifice views. On the contrary, he suggested that both the equal and proportional sacrifice are notions that show a confusion "in the minds of their advocates for equi-marginal sacrifice, itself leading to minimum sacrifice." Thus as far as Edgeworth's position Edgeworth, Papers II, op. cit., p. 116. stated, "the condition that the total net utility procured by taxation should be a maximum reduces to the condition that the total disutility should be a minimum. ...... it follows, in general, that the marginal disutility incurred by each taxpayer should be the same." F. Y. Edgeworth, "The Pure Theory of Public Finance," Economic Journal, Vol. VIII, (Dec., 1897), p. 553.

Summary of the Views of Edgeworth on Least Sacrifice

For Edgeworth, the sacrifice principle is accepted as containing
the true principle of taxation. Edgeworth maintained that neither "equal" nor "proportional" sacrifice correctly expresses the fundamental idea which the "true" principle involves. The notion of equity in taxation finds more correct expression in the term "like sacrifice," which is the common genus for both "equal" and "proportional sacrifice."

"Like sacrifice" is an "equi-marginal" sacrifice, which means an absolute equality of the marginal utilities sacrifice, through the payment of a tax. This "equi-marginal" sacrifice finds its expression in a minimum sacrifice, the principle to which the true basis of taxation is reduced. Edgeworth does not challenge or oppose the use of either "equal" or "proportional" sacrifice. He intimated that both these sacrifice notions are a confusion of equi-marginal sacrifice, which leads to minimum sacrifice.

In applying this principle to taxation, Edgeworth found that taxes should be so distributed that the maximum total net utility will be realized, or the minimum of total disutility. To continue Edgeworth's reasoning in this tax matter would mean that the marginal disutility incurred by each taxpayer would be the same. This reasoning based on Edgeworth's principle of sacrifice does not provide any definite rule for taxation. The basic difficulty in applying such a principle to taxation is assuming the exact relationship between utility and means.

It seems strange to the author of this research that such a pre-eminent mathematical economist as Edgeworth should advocate a theory based upon a principle that does not permit an exact mathematical expression.
The pursuit of tax "justice" was as profound a matter of interest among the neo-classicists as it had been with the earlier economists. The neo-classicists stated tax "justice" in sacrifice terms. Sacrifice of income brought about the loss of utility. The losses of utility determined by a given income distribution were rationalized with the standards of tax "justice." There was one pivotal assumption to all sacrifice doctrines, i.e., units of money can be translated into units of utility. It must also be assumed that the utility schedule has a downward slope. It was further assumed that this slope applied broadly to all recipients of income. The slope of the utility surface as postulated by various writers fostered confusion in attaining "justice" measured in sacrifice terms. This concept of tax justice, "along with ability or faculty is a more or less legitimate progeny of utility, and it has contributed about as much confusion, with respect to the ethics of public policy, as has utility with reference to the explanation of human behavior."\(^2\) The following pages of evaluation of the sacrifice principles support Simon's point. For example Nicholson\(^3\) and Bastable\(^4\)
reject the practical usefulness of utility surfaces and criticized the mathematical stringency of the subjective value system. According to Cohen-Stuart the rate of decrease of the utility is proportional to the increase of the income. Professor Edgeworth, on the other hand, maintained that the decrease of the former is at a more rapid rate than the increase in the latter. Schumpeter suggests that Edgeworth's attempts to correct "the widespread belief that decreasing utility, that

\[45\] Cohen-Stuart, op. cit., pp. 201-204.

\[46\] Edgeworth, Papers II, pp. 110-111 and 111n.

decreasing marginal utility of income is all that is needed to be assumed in order to make progressiveness of taxation follow from the postulate of equal sacrifice ...... is simply revived Benthamism .... or rather Benthamism in the armor of a better technique -- and implies only a quantitative conception of utility or satisfaction or welfare but also the further idea that the satisfactions of different people can be compared and in particular, summed up into the General Welfare a Society as a whole -- the idea of "interpersonal comparability of utility."  

\[47\] Schumpeter, op. cit., p. 1071.

Edgeworth attempted to avoid this issue with his minimum sacrifice principle which requires only that the surface has a negative slope.

\[48\] Edgeworth, Papers, II, op. cit., p. 117.

Edgeworth held that least sacrifice not equal or proportional sacrifice
produces the minimum disutility for the community as a whole. However, Cohen-Stuart suggested that "justice" in sacrifice terms can be achieved only by equalizing sacrifices that are proportional to the total utility of income. But since utility surfaces have varied shapes, Cohen-Stuart suggested that regressive, progressive or proportional rate structures may be required to make sacrifices proportional.

None of the sacrifice principles afford definite data for the determination of tax rates. No operative tax system nor tax structures can be constructed from the subjective value bases of utilities and satisfaction. Seligman strikes a blow at the equal sacrifice doctrine in these terms. "It is quite impossible to say whether the identical tax on people of identical income or property will produce the same relative pressure, i.e., occasion an equal sacrifice. Since sacrifice bears no relation to the amount of the commodity, it is just as conceivable that in individual cases a regressive tax may produce just as much, or as little, equality of sacrifice as a proportional or a progressive tax.
rate of taxation whether proportional or graduated. Theory itself cannot determine any definite scale of progression, whatever. "While it is highly probable that the buds of justice would be more subserved by some approximation to a progressive scale, considerations of expediency as well as uncertainty of the intercalations between various parts of the entire tax system should tend to render us cautious in advocating any general applications of progression."

Equal sacrifice applied to a declining utility curve does not necessarily result in progression. A regressive rate structure, in effect, may result. Assuming that the utility curve does not decline and that all dollars have an equal amount of utility, equal sacrifice would result in each taxpayer paying the same number of dollars regardless of his income. A person with twice as much income as another would pay an effective rate of tax one half that paid by the other. In order that each would pay the same rate, the man with twice the income must pay twice the number of dollars in tax. In order that equal sacrifice results in a proportionate tax the utility curve for money income must be such that for any given percentage increase in the amount of money there must be a like percentage decrease in the marginal utility of money.

The proportionate sacrifice standard would "clearly result in progression with any utility curve that would satisfy the requirements for progression under equal sacrifice; and obviously it would also do so for any money utility curve which declines at all."\(^56\) Cohen-Stuart

\(^{56}\)Blum and Kalven, \textit{op. cit.}, p. 43.

demonstrated this by pointing out that it is possible to construct utility curves which sloped in a manner that on some parts of the curve a regressive tax followed from the application of the proportionate sacrifice principle.\(^57\) The steeper the utility curve, the steeper will be the progression dictated by the proportionate sacrifice. One weakness of the proportionate sacrifice and also the equal sacrifice principles, is that not all declining utility surfaces result in progression; something more about the steepness of the curve must be known.\(^58\)


\(^{58}\)Blum and Kalven, \textit{op. cit.}, p. 52.

In contrast, the minimum sacrifice necessarily gives some progression if the money utility declines at all. But while it may be true that if money utility declines, minimum sacrifice does give some progression, it is no better guide than proportionate sacrifice in giving certainty to rates.

Seligman adds an interesting aspect of the use of progressive rate structure and tax "justice" in the following statement:
We see that while progression of some sort is demanded from the standpoint of ideal justice the practical difficulties in the way of its practical application are well-nigh insuperable. Progression is defensible only on the theory that taxes are so arranged as to strike every individual on his real income...... Under such conditions it is doubted whether greater individual "justice" will be attained by a system of progression, than by the simple rule of proportion; and it is questionable whether the ideal advantages would not be outweighed by its practical shortcomings.  

59 Seligman, Progressive Taxation, op. cit., p. 268n.

The usefulness of the sacrifice doctrines has continued to be evaluated until the present time. The evaluation in the form of criticism generally takes two approaches: (1) based on methodology and consistency of assumptions and, (2) based on the practical application of any such doctrine.

Blum and Kalven support type one criticism of the use of utility schedules.

To begin with, it is necessary in comparing the value of money of two men with different incomes to make explicit whether one of them is below the minimum subsistence level or whether both are above it. To make a case for progression over and above that which accompanies the exemption of subsistence income it must be shown that the value of money declines for incomes above the exemption level. It is not enough to argue that taking a dollar from a man with less than subsistence income entails more sacrifice than taking a dollar from a man with a very high income.  

60 Blum and Kalven, op. cit., p. 57.
Continuing the evaluation, Slade Kendrick criticized the ability to pay or faculty aspects of sacrifice in the determination of rate structures.

The marginal utility concept when applied to taxation must be extended from the specific commodities for which it is used in economic theory to the generalized commodity, money. For the purposes of graduated taxation, it will not do to say merely that the utility of food, clothing, or other goods declines as their supply increases. The tax is laid not on these things but on money income or inheritance. The utility of money itself, that which has command over all things of purchase and sale whether for near or distant uses, for consumption of investment, and which in consequence, has come to be the substance of power, and the symbol of success, must be held to decline with the increase in supply. The application of the marginal utility concept to a sacrifice theory of taxation requires also that the payment of money by the individual to the government shall be deemed sacrifice on his part. And if any of these sacrifice theories is to mean anything in practice, the sacrifice involved in the payment of taxes must be capable of quantitative expression. All these requirements are basic to the doctrines of sacrifice. 61


Gunnar Mydral takes up the criticism of the assumptions of the subjective value fiscal theorists in the following manner.

Whichever maxim, proportionality or progressivity, one accepts, it is clear that, in order to maintain the principle of ability as the basis, one must make calculations about the subjective value as income changes. These calculations involve interpersonal comparison. Thus individualist marginal utility must be broadened into speculations about
social value. Unfortunately there is no empirical material for such speculations.

But the following difficulty is even more serious: Suppose we had settled the question of the diminishing marginal utility of income, which is, quite impossible. The principle of ability would still not have been defined.


Blum and Kalven offer an explanation of the appeal of the utility and sacrifice doctrines in tax apportionment. "The ostensible scientific form of the sacrifice theory, which purports to deal with the way people actually react to money, frequently conceals a normative judgement either about the way that people ought to value their money or about the social value of typical expenditures at different levels of income." 63

63 Blum and Kalven, op. cit., p. 69.

The scientific form of the theory of sacrifice adds confusion rather than order to the interpretation of the theory. Definite interpretation of the different sacrifice doctrines is exceedingly difficult. The doctrines all relate to taxation on the basis particular to money income. Each doctrine involves the conception of a functional relationship between the amount of money income and its marginal utility. The area under an income-utility schedule is conceived to measure total utility. Thus sacrifice may be interpreted on the basis of the loss of total utility or losses of utility at the margin. In the chronological
development of apportionment theories of the nineteenth century, the elements of subjective judgment of income occurred with and are a product of the development of the mathematical treatment of value theory.

The next section of this chapter introduces the work of two British economists, Pigou and Dalton, who continued the work of interpreting the nature of the loss of utility in tax exaction. These authors make explicit their views on the utility of money income in relation to the sacrifice theory of tax apportionment.
PART V  Nineteenth Century Apportionment Doctrines
As A Basis for Twentieth Century Fiscal Theory

Introduction

The contributions on sacrifice doctrines set forth in the preceding sections can be attributed to authors writing in the nineteenth century. Throughout most of the nineteenth century, writers in the English tradition concentrated on the problem of defining ability to pay more exactly. As income came to be accepted as the index by which to measure ability to pay, the question became one of deciding whether taxation in accordance with ability to pay should require regressive, proportional, or progressive taxation. The development of marginal utility analysis in the last quarter of the nineteenth century brought a considerable refinement in the equal sacrifice doctrine. The equal absolute, equal proportional and equal marginal sacrifice concepts were distinguished. However this emphasis on exaction of taxes fell short of providing a full answer to the determination of budget policy. Nevertheless a transition to the expenditure side of the budget was provided by rewriting sacrifice in terms of equality of income. This formulation began in the works of A. C. Pigou and Hugh Dalton, two twentieth century British economists. 64


Hugh Dalton and the Requirement of Equity Among Taxpayers

In writing in the third decade of the twentieth century, Hugh Dal- ton was critical of the emphasis on equity in nineteenth century
apportionment principles. Since there was no clear definition of equity forthcoming from these principles, it "cannot be proved that the principles are in fact equitable, but only that certain people at certain times think them so. Equity, an elusive mistress, whom, perhaps, it is only worth the while of philosophers to pursue ardently and of politicians to watch warily."  

Dalton advised that, "when we look at the problem of the burden of taxation from the point of view, not of equity, but of economy we stand on surer ground .... any system of public finance should be conceived simply with a view to maximum social advantage in the long run."  

As to the older principles of apportionment based on sacrifice, Dalton pointed out the "necessity to assume some relation between money income and the economic welfare derived from it." Assuming that the relation between income and welfare is the same for all taxpayers and that the marginal utility of income diminishes fairly rapidly as income increases: 

the principle of equal sacrifice leads to progressive taxation, the principle of proportional sacrifice to still steeper progressive taxation, and the principle of minimum sacrifice, as already pointed out, to a relatively high level of exemption and very steeply progressive taxation of those not exempt. The principle of minimum sacrifice, indeed, gives
this result, so long as it is assumed that marginal utility diminishes at all with increasing income. Both equal sacrifice and proportional sacrifice, rigidly applied, involve making all members of the community however poor (provided that they have some economic welfare to sacrifice) contribute something.68

Thus each of the alternative interpretations of ability to pay leads to some degree of progression. "This practical conclusion is now generally accepted by modern opinion, which responds most readily to the suggestion that considerable the heaviest burden should be placed upon the broadest backs."69 Dalton holds with the ability to pay principle for the distribution of tax burden70 and is drawn "toward the doctrine of minimum sacrifice .... but this doctrine must be interpreted more broadly by economy than by equity."71

However, the best system of taxation interpreted from the economic point of view is that, "which had the best or the least bad economic effects."72
But one practical conclusion emerges ... there is no reason, on the grounds of economy, why all, or even the majority of, the members of a community, in which great inequality of incomes prevails, should contribute to taxation. No equitable doctrine, such as equal or proportional sacrifice, which presupposes some contribution, however small, from all those who have economic welfare to sacrifice, finds any strong support in consideration of economy.\(^\text{73}\)

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Dalton proposed that the role of public finance was derived from the considerations of maximum social advantage. There are no desirable limits to the increase or decrease in taxation except those measured by "social losses."\(^\text{74}\) The relative ability of people to pay taxes must be measured by the "relative effects of their payments, not only on distribution, but upon production and, upon the whole economic welfare of the community."\(^\text{75}\)

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Arthur C. Pigou and the Optimal Distribution of Tax Burden

Arthur C. Pigou added great insight and perspective to the study of apportionment principles. He confronted the problems of interpersonal comparisons of utility, elaborated on the principle of equi-marginal
sacrifice and viewed taxation from outside the framework of the earlier neo-classicists.

His study on interpersonal comparisons was carried on at length to set forth the support the least sacrifice principle. Pigou pointed out that to speak of aggregate sacrifice or satisfaction implies that the satisfactions are capable of being summed. "If they are not, neither least sacrifice nor equal sacrifice can possibly be used as principles of taxation." It has been argued that they cannot be summed because they are non-quantitative and that every mind is eternally separate from one another. So there is no way in which mental states of different people can be combined. "The first criticism is contrary to experience since we all know we are happier at one time than another and some events inflict greater sacrifice than others. Different satisfactions and sacrifice to the same person are quantitatively comparable." For Pigou, the second criticism is more persuasive.

Although direct measurement is unattainable and indirect measurement is unreliable, we cannot disprove that similar men will not be mentally affected by similar situations in the same way. We expect similar
situations to produce similar mental effects, and it is only when they do not that we think there is something to explain. Based on these statements, the concepts of aggregate sacrifice and distribution of sacrifice may be used. Thus arguing on the basis of interpersonal comparisons and known preferences, Pigou found no conceptual difficulty in determining the appropriate tax system. He held that there was no logical or intuitive choice between the equity principle of equal absolute or equal proportional sacrifice. Arguing on welfare grounds, he considered equal marginal sacrifice the only proper rule, not as a matter of equity, but because it met the welfare objectives of least sacrifice.

Pigou distinguished between the requirement for an equal sacrifice imposed on people in equal positions and the principle that an equal sacrifice should be imposed on all people. He concluded that equal proportional sacrifice indicates continued progression at the upper level of the income scale, even though a Robinson Crusoe stranded on an island of plenty might find that the marginal utility is constant.
But Pigou's suggestion that least sacrifice can be implemented by equi-marginal sacrifice is clear.

... the truth is that, when distributional aspects are alone in question, least aggregate sacrifice will not be promoted by a system inflicting equal sacrifice all round. This is very easily seen. For, if the abstraction of 1000 pounds from an income of 10,000 pounds inflicts the same sacrifice as the abstraction of 100 pounds from an income of 1,000 pounds, then the abstraction of 1,100 pounds from an income 10,000 pounds must inflict less aggregate sacrifice than the abstraction of 1,000 pounds from that income plus the abstraction of 100 pounds from the 1,000 pound income. In order to secure least aggregate sacrifice taxes should be so distributed that the marginal utility of money paid in taxation is equal to all the payers. If the utility of the last penny of A were less than that of the last paid by B, a reduction of sacrifice could be secured by transferring part of B's assessment to the shoulders of A. Thus the distribution of taxation required to conform to the principle of least sacrifice is that which makes the marginal -- not the total -- sacrifices borne by all the members of the community equal.\(^84\)

\(^{84}\) Pigou, Public Finance, op. cit., p. 57.

If we push farther towards the concrete, it appears that a system of equimarginal sacrifice fully carried out would involve lopping off the tops of all incomes above the minimum income and leaving everybody, after taxation, with equal incomes.....the logical procedure would be first to take for the government's needs the tops of the highest incomes, and then continue taxing middle grade incomes and giving bounties to the smallest incomes till a dead level of equality is attained.\(^85\)

\(^{85}\) Ibid., pp. 57-58.
The problems of distribution of taxes does not relate to particular isolated taxes. The principle of least sacrifice requires that the whole system of taxes be distributed in a certain way and failing optimum distribution, least sacrifice tells us that if one kind of distribution is inferior to the optimum, is nevertheless superior to another kind. 86

86 Ibid., p. 56.

In extending the scope of his analysis beyond the burden effects of taxation, Pigou and subsequently Dalton proposed that resources should be distributed among different public uses so as to equalize the marginal return of satisfaction for each type of outlay and public expenditures should be pushed to the point where the satisfaction obtained from the last dollar expended is equal to the satisfaction lost from the last dollar of tax taken. 87 But Pigou warns that regardless of the tax system and the role and extent of satisfaction, "People's well being depends on the whole system of law, including the laws of property, contract and bequest, and not merely upon the law about taxes. To hold that the law about taxes ought to affect different people's satisfaction equally, while allowing that the rest of the legal system may properly affect them unequally, seems not a little arbitrary. 88

87 Ibid., p. 25; Dalton, op. cit., Chapter 2.

88 Ibid., p. 44.
It was a matter of concurrent but non-English development that the total role of the state’s fiscal activity was incorporated in the theories of the role of government and tax apportionment. For example, the revenue and expenditure effects were incorporated in the fiscal theory of nineteenth century Italian and German economists. The contributions of the Continental economists who attempted to make the revenue and expenditure sides of government synchronous are to be presented and discussed in the following chapter.
CHAPTER FIVE

Principles of Apportionment of the Tax Burden
and the Role of the State
Among Continental Writers,
1890 - 1926

Introduction

British economists during the last quarter of the nineteenth century were concerned primarily with the burden effects of taxation in economic activity.

During this period certain German and Italian writers were concerned with the redistributive effects of tax policies. While the writers held different political and economic views, their unifying characteristic rests with their willingness to accept some positive action of state intervention. Where the concept of sozial-politik or "social welfare" had made inroads in economic and political thinking, economists were concerned with integrating the activity of government and revenue exaction into "new" fiscal theory.

The purposes of this chapter are to point out (1) the relevant contributions of German, Italian and Swedish economists to the development of "new" fiscal theory, (2) the de-emphasis of the burden effects of tax apportionment theories of selected Continental economists, (3) the adoption of the benefit and sacrifice apportionment theories
to a variety of different views of the role of the state, (4) the emphasis on incorporating political elements into the fiscal theories of selected Continental economists and (5) the emphasis of Continental writers on including both tax exaction and government expenditures elements in fiscal theory.

The chapter material is developed so as to point out the respective views on fiscal theory of selected Continental economists. Part I presents the views of three German writers, Wagner, Stein and Sax. The theories of deMarco and Mazzola, both Italian fiscal theorists, are presented in Part II. The work of two Swedish economists, Wicksell and Lindahl, are presented in Part III. Part IV presents a Conclusion and Evaluation of the contributions of these Continental fiscal theorists.
Von Adolf Wagner and the Productive Services of the State

Von Adolf Wagner, the dean of German public finance,¹ distinguished between pure fiscal theory and sozialpolitik.² The state is no longer satisfied with raising adequate revenues, but it is also charged with the responsibility to interfere with the rights of private property to bring about a more "equitable" distribution of wealth.³ The function of the government in production is to transform material goods (Sachguter) in the form of a tax into immaterial goods (öffentlichen Einrichtungen, Dienstleistungen). "Because it is indispensable to the entire economic life, and for all private activity of individuals, the services of the government, and therefore the government itself, must be regarded in an economic sense, as eminently productive."⁴ The government is a direct agent of production and therefore a tax is also productive. Wagner noted that when the state gives service for taxes, there is a kind of exchange (eine Art Tausch), but that the conditions


³Ibid., p. 159, 1st Ed.

⁴Ibid., p. 13, 1st Ed.
of the exchange are set by the state. "Thus the services of the state and taxes appear as correlates to each other." The principle of exchange is a general compensation and no separate accounting can be made with individuals as to the advantages they receive from the state.

Wagner's productive theory lies wholly outside of the principles of private economy. His conception of the functions of government and of a general compensation, without individual reckoning paved the way to his social-political conceptions, in which he found both the basis and the principles of taxation. The state is a *sine qua non* of production but not a directly active force in production; it is only a condition for production. Wagner did not assume this relation to be the only relation that determines principles of taxation and did not view taxation as a purely economic problem. This position is illustrated in

In the domain of public finance, expenditures should increase in order to enable the state to assume new functions... for the purpose of bringing about a different distribution of wealth.
It is the modern 'social problem' influencing both scientific and public affairs, which is here beginning to work this transformation in the science of finance.\(^9\)

\(^9\) Wagner, op. cit., 2nd Ed., p. 150.

The consequences of this view, so far as the concept of tax justice is implicated, require universality and equality in taxation.\(^10\) Wagner rejected the least sacrifice apportionment principle and suggested that everyone should pay some taxes distributed on the equal sacrifice basis as the norm of tax justice. The equal sacrifice theory shows more definitely how equality in taxation is to be accomplished, (wirtschaftliche Leistungsfähigkeit).\(^11\)


In determining the equality of sacrifice Wagner used an objective not subjective standard, i.e., the effect upon economic conditions rather than the effect upon subjective feelings.\(^12\) Wagner considered

\(^12\) Weston, op. cit., p. 190.

the source, size, character of income and also conditions of health, indebtedness so "that taxes will occasion equal efforts and sacrifices over against other needs."\(^13\)

\(^13\) Wagner, op. cit., 2nd Ed., p. 350-351.
Lorenz von Stein on the Re-Productive Activity of the State

These proposals of Wagner did not pervade European fiscal theory of the nineteenth century. However, his approach introduced the idea of collective or aggregative needs of the community or society.

Contrasting with Wagner's collective approach to tax justice is the individualistic orientation of Lorenz von Stein. Stein cites the point that:

The higher justification of taxation lies in the utilization of these contributions for the ends in the name of which they are levied, namely fulfillment of the individual through the whole and through the conscious activity of the whole. i.e., the administration of the state.14


Stein regarded government from the point of view of its indispensableness to the building up of capital (Kapitalbildungsprocess) and "all services and payments to the government are, economically speaking, nothing else than an integral part of the cost of production for every economic product."15 He regarded production from the standpoint of the individual and considered government as an indirect agent of production, and any taxes a "reproductive." Taxes were reproductive in the sense that they enable government, through administration, to maintain the conditions of capital building. "This reproductive of
the tax is, and will remain, the absolute condition of the power to pay taxes, therefore also the condition of taxes, and so of civic life itself."\textsuperscript{16} Taxes must be sufficient to enable the state to attain

\textsuperscript{16}Ibid., p. 359.

its highest efficiency in maintaining the conditions of production, of capital building, but never in excess of the value of services of the state in capital building.\textsuperscript{17}

\textsuperscript{17}Ibid., p. 359.

The economic principles that guide the state in matters of taxation, proposed by Stein, are that individual income should be so distributed between private expenses and taxes -- between the satisfaction of private and collective needs -- that both the highest efficiency of the state and the highest efficiency and development of the individual are attained.\textsuperscript{18}

\textsuperscript{18}"Oberstes Princip der Finanzwissenschaft ist die wirtschaftlich verhaltensmassige Deckung des Staatsbedarfs gegenuber einer nicht minder verhaltenissmassigen Deckung aller nicht-staatlichen Bedarfe." Quoted from Adams, \textit{op. cit.}, p. 28, from Stein's \textit{Grundsätze der Steuerpolitik}; also see Weston, \textit{op. cit.}, pp. 156-157.

Stein, as did Wagner, based his concept of justice in taxation on a sacrifice principle with ability to pay of income as the measure of sacrifice. There was no ability to pay taxes until the income had exceeded that required to supply necessities of life, since in the satisfaction of wants there is no "clear" income until the state of enjoyments
is reached.

The apportionment of the tax burden is considered by Stein as a part of public administration and not solely a part of the science of public finance. In his view, the various fields of tax theory cannot be properly stated without two categories:... the principles and the history of taxation, i.e. economic principle, financial principle, the principles of the public economy. Thus the general necessity for individual contributions of taxes must rest on the dual nature of the development of fiscal and political theory.

Emil Sax on Collective Wants

Although the theories of Adolf Wagner are based upon the conception of an economic relation between the individual and the state, his fiscal theories do not attempt to place taxation upon a purely economic basis, or to determine its principles by purely economic laws. Emil Sax took a contrasting position by insisting that the problems of taxation are to be solved simply and solely by the application of economic principles and economic laws.

Sax sanctioned the position that man is a creature of wants whose
satisfactions is the aim of his life. Wants are infinite in variety; some are satisfied by the individual directly, others by the collective action of individuals. Some of the collective wants are satisfied by voluntary associations within the state, others by society organized as a body politic or by the state itself. But however the satisfactions are achieved, the greatest possible satisfaction with the least effort is the governing principle.\(^{23}\) The least effort principle determines all collective action and what action will be collective, or in other words determines the functions of the state. State functions must extend to the satisfaction of all wants that cannot be satisfied by individual effort. Collective wants of whatever type are determined by the law of satisfactions common to all wants, a condition that follows from the nature of the individual and society. Collective wants like individual wants must be determined by the law of greatest utility and of least disutility. The same law must determine principles or doctrines of taxation.\(^{24}\)

\(^{23}\)Sax, op. cit., pp. 61-63.

\(^{24}\)Sax, op. cit., pp. 295-306.

"In his law of satisfaction of want, Sax thinks that he has found the key to the solution of the whole problem of the true principles of taxation, and indeed, in its simplicity, he finds a guarantee of its validity."\(^{25}\) For Sax, the simple law of value is the "light which, 

\(^{25}\)Weston, op. cit., p. 104."
like the electric flames of the sun, clears up, all at once, the
hitherto dark, confused province of taxation.  

26 Sax, op. cit., p. 444.

Sax made no effort to refute the ability and sacrifice theories
other than to suggest that in themselves they explain nothing.  
What Sax attempted to do was to supply the tertium comparationis that gives

27 Weston, op. cit., p. 194.

them meaning. The determination of ability and sacrifice rests in the
comparison of the intensities of marginal needs, before and after the
imposition of the tax; and "all needs have, without distinction of
ends to which they are referred, a tertium comparationis is sensation."  

28 Ibid., pp. 194-195.

In Sax' analysis, taxation according to ability to pay or sacrifice re-
volves about sensation and the system for tax payments should effect
equivalent sensations.  

29 Emil Sax, "Die Progressivsteuer," Zeitschrift für Volkswirth-
schaft, Socialpolitik und Verwaltung (Ester Band: I Heft, 1892), p. 90.
sulting from the imposition of the tax that ability and equality of
sacrifice find explanation. Thus, "equivalence of sensation," i.e. of
sacrifice, is only equality of sacrifice in a new dress.  

30 Weston, op. cit., p. 194; also see Grundlegung, p. 514.
taxation is that "every individual should value the goods taken from him as highly as every other individual values those goods taken from him." The marginal utility of goods, subjectively determined, and given up as a tax should produce an equivalent sacrifice.

In Sax's view, private sensations are felt by the individual and are measurable by him by contrasting and comparing needs. Collective needs on the contrary are conceived by individuals, but as belonging to the whole are indirectly controlled and satisfied by representative or elected agents. These collective needs do not pertain to the individual but to the common good and are only remotely capable of measurement by comparison if at all. Thus for Sax, collective wants are satisfied by the same rule which satisfies private wants through the voting process in a representative government. Although Sax admits that the individual has a very indirect and very inadequate control over public expenditures and that the public good may give way to the interest of a class, but, "this state of things cannot endure for in the course of time the wrongs will be righted, if needs be by revolution." Sax admitted some compulsion might be necessary to force some
individuals to support programs that may not be advantageous, but the satisfaction of collective and individual wants is essentially similar in nature.\footnote{Musgrave and Peacock, \textit{op. cit.}, p. 178.}

\footnote{Musgrave and Peacock, \textit{op. cit.}, p. 178.}

\textbf{Summary of the Ideas of German Fiscal Theorists}

The Germans cited above, as well as Goldscheid, attempted to include both revenue exaction and state expenditures in their tax apportionment doctrines.\footnote{Rudolf Goldscheid, \textit{Staatssozializme oder Staatskapitalisme} (Wien: Humbolt, 1917) and Musgrave and Peacock, \textit{op. cit.}, pp. 202-213.} Their effort was based on their willingness to permit the state to purposely redistribute income of individuals through taxation. Thus the state was accepted and incorporated into production and distribution concepts as a factor in the determination of an economy's wealth.

According to Sax, the method by which a society satisfies its collective wants, is by the same rule which society satisfies its private wants, that is through the agency of representative government by means of a vote. Although the individual has a very indirect and very inadequate control over public expenditures for collective needs, the prevalence and power of the individual or a class in a representative government ruler, as well as the ruled, enforces the sacrifice of self to promote the general happiness of society.
It is Sax's position that problems of taxation are to be solved simply by the application of economic principles and laws. His fundamental concept is that collective wants of people resolve themselves into individual wants in such a manner that they constitute a part of the totality of wants. Collective and private wants are precisely on the same plane. In taxation as in economics, it is a question of intensity of wants on the one side and of the marginal utility of goods on the other. The utility is determined by the greatest satisfaction with the least possible sacrifice. In brief, the laws of subjective value are the crux of the problems of taxation. The problems of taxation are solely economic problems and only by a strict adherence to economic laws is "justice" in taxation possible. The practical rule for tax apportionment that Sax deduces from his view is the same as previously expressed in the theory of equal sacrifice. At best the equivalence sacrifice view of Sax's differs from the equal sacrifice theory of Mill only in giving an ultimate measure of sacrifice. The ultimate measure of sacrifice is the marginal utility of goods which is determined by applying the utility theory of value to government expenditure and tax collections.

Wagner viewed the function of government in production as transferring material goods in the form of money taxes into government services. Wagner emphasized a "social view" of production and the government is considered a direct agent of production. Thus taxes become "productive."

For Stein, who regarded production more from the viewpoint of
the individual, government was considered as an indirect rather than a direct agent in production. A tax was "reproductive" in the sense that it enables the government to maintain conditions of capital expansion. But neither Stein nor Wagner made use of these production theories as a basis for taxation.

Wagner accepted the sacrifice theory of Mill in that the sacrifice theory shows how equality in taxation may be accomplished. Wagner found "taxation according to ability" the norm for tax justice.

Sax as did Wagner based his concept of tax justice on the sacrifice of the utility of income. This sacrifice provided the reasonable basis on which personal freedom for all individuals could be implemented through government tax policy.

Each of these German economists incorporated the older sacrifice theories of ability to sacrifice in their tax apportionment schemes. Each viewed the political form of government as a parliamentary democracy. Yet each viewed government activity as a productive or reproductive economic function.
PART II  Italian Fiscal Theorists

Introduction

Although there are no singular contributions by Italian economists writing in the last two decades of the nineteenth century, the thinking of Antonio de Viti de Marco is significant. Luigi Einaudi, however, is more emphatic in attributing to de Marco (and Mazzola) an attempt to save the science of public finance from the chaos that existed at the time of their writing.  

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Antonio de Viti de Marco

De Marco applied "historical reality" in his method of interpreting public finance. DeMarco viewed society as moving from the "monopolistic" state toward the democratic, "cooperative" state.

In a monopolistic state decisions on taxing rest in the hands of classes that have the power or jurisdiction to use government for their own benefit. The prices charged for public services in a tax rate are monopolistic prices. The prices of public services are said to be monopolistic because no economic like restrictions face the monopolistic price makers, nor is there any possibility of obtaining any substitute services or prices.  

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DeMarco, op. cit., pp. 36 ff.
In a contrasting cooperative state all classes have the political privilege of participating in the administration of the state. Even in the cooperative state, taxes are collected by compulsion, but only after the masses participate in tax legislation. The whole aggregate of tax payers benefit from state expenditures rather than a single taxing group. Thus a collective unit reacting to individual pressures decides the nature and the amount of the tax burden.

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\(^{39}\text{DeMarco, op. cit., p. 41.}\)

For deMarco the history of the nineteenth century reflected a change from the monopolistic state to the cooperative state. This change in political control must be reflected in any framework for establishing a tax structure for exacting support of the state.

In the cooperative state, the provision for general or tax financed public services was considered an exchange relationship, where the citizen's duty to pay taxes is matched by the duty of the state to provide public services.

The amount of taxes that the individual pays in a modern cooperative state corresponds to the cost of the general public services which the individual consumes.

\(^{40}\text{Ibid., pp. 61-69.}\)

A recognized exchange relationship exists between the consumer and the State producing any special public service and a similar exchange.
relationship exists between the State as the producer of general public services and the community of taxpayers.\footnote{Ibid., p. 112.}

But the tax price cannot be determined according to each person's actual consumption of public services. Such services are not divisible into units of sales. The individual consumption of such services is an unknown quantity, and the problem consists of solving for this unknown.\footnote{Musgrave, Public Finance, op. cit., p. 72.}

DeMarco accepts "the proposition that the consumption of general public services is proportional to the income of each citizen."\footnote{DeMarco, op. cit., p. 114.} Yet the demand for these public services differs with the esteem with which individuals demand the service. However, a person's income may be taken as an index of his demand for public services. Taxes may be looked upon as a subscription payment for the average consumption of public services over a period of time. Since almost all public services are instrumental in private production or consumption, de Marco considers it permissible to assume that the consumption of general public services is proportionate to the income of each taxpayer.\footnote{DeMarco, Il carattere teorico dell'economia finanziaria (Rome: 1888), Chapters 3 and 4.}
The manner in which the cost of public services is to be apportioned within the community is a three-fold problem. The distribution of burden is a technical, judicial and economic problem. For deMarco, the distribution of the direct and indirect taxes constitute the technical problem. The choice of rate structure comprises the judicial problem and shifting and incidence, diffusion and evasion made up the economic problem.

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The judicial problem is important in this study. In discussing this problem of taxation, deMarco sets forth his views on apportionment.

The proportional tax is a real tax; the progressive tax is a personal tax. These words are to be understood in the sense the proportional tax is levied on things, on goods, without taking account of the person who owns them; the Treasury directs its attention to the wealth affected and considers the proprietor, or his representative, merely as the intermediary through whom the payment is made.

The percentage of the total income of the community which is needed to cover the needs of the state is applied to the income of each individual and to the components of individual income.

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DeMarco preferred the personal tax over the real tax and pointed out that taxation should be progressive. The economic case for progression holds because the tax dollar is worth less to the rich man than to the poor, the former's marginal income utility being lower.
If charged the same tax price the rich man would reap an undeserved surplus. Hence the rule of the single price cannot be applied for public services and a progressive tax is required.\(^7\)

\[^7\text{Ibid., pp. 168-170.}\]

In the opinion of the author of this research, the idea of economic equivalence is the salient emphasis in deMarco's suggestion for a type of voluntary exchange relationship between the government and the taxpayer. The democratic process will insure the taxpayers that state expenditure will satisfy their needs. Economic and then political action will assure that tax payments will be put to good use.

Thus deMarco is in part responsible for an early statement of a voluntary exchange theory of public finance. In this politico-economic framework, his method of tax distribution provided a "just" theory of taxation.

With deMarco, the old benefit theory is reapplied to a modern setting of a cooperative state.\(^8\) This is a new orientation to the study of apportionment principles, since the subject matter includes a contemporary setting which recognizes both expenditure and tax exaction, explicitly in the scope of the analysis.\(^9\)

\[^8\text{Musgrave, Public Finance, op. cit., p. 69.}\]

\[^9\text{DeMarco, Principles, op. cit., p. 100.}\]
Ugo Mazzola and the Concept of Public Aims

Like deMarco, Ugo Mazzola was repelled by the "mixture of practical precepts, rambling discussions of philosophic and political themes, comments on legal texts, and loose applications of definitions and economic laws which made up the literature of Public Finance."  

Mazzola attempted to build a more precise logical structure for public finance. In organized society there exist individual aims which must be rationalized with other aims obtained only by collective cooperation. The other aims or "public" aims are conditional to the attainment of the aims of individuals. A voluntary association for political cooperation must be supplemented by some compulsion to attain all the desired aims of the community. This structure of society with its public aims sets Mazzola's analysis aside from the traditional approach to public finance.

Public aims must be differentiated from the individual aims and therefore an individualistic orientation to public finance cannot provide the theoretical or actual mechanism for satiating public aims.

With Mazzola, public finance then becomes a science which is autonomous
and therefore not merely an integral part of the study of economics.

The attainment of public aims through the role of the state becomes
the subject matter for his study. Mazzola, proceeded to apply formal
economic tools to the pricing of the activity of the state. 53 The

53 See Mazzola, The Formation of the Prices of Public Goods,
trans. by E. Henderson, printed in Musgrave and Peacock, op. cit.,
pp. 37-47.

"law of price formation for public goods" is a correlate to price for­
formation for private goods.

The question of price and price divergencies
with respect to the final utility of public goods
arises only with the advent of an exchange economy
and when political organization becomes a special
case of the division of labor. The acquisition of
public services then becomes an act of exchange,
but does not alter the fact of their being comple­
mentary to private satisfactions. 54

54 Ibid., p. 44.

It will be seen that this is not a law governing
the economic process and establishing a relation of
sequence between individual and collective needs, a
single case justified by stated reasons. We find
that resources are again simultaneously employed for
both private and public needs, and the law of the
formation of prices of public goods comes into its
own. 55

55 Ibid., p. 45.

Mazzola states that the burden of raising the required means to
pay for public goods must be so distributed that after the distribution
all the separate shares of resources collected have the same degree of
final utility, so that each member of the community pays for the consumption of public goods a price which corresponds exactly to the degree of final utility which the goods have for him. If public goods are sold at a single price, they will fail to maximize the satisfaction derived from outlays, since some customers will find that this price exceeds the marginal utility derived from the goods.  

"Yet they cannot be excluded from the benefits rendered by such services."  

This problem is solved if each consumer pays a price equal to the marginal utility that he personally derives from public service. Thus Mazzola apportions the burden of the cost of public goods, by applying marginal utility to expenditures of individual income.

With Mazzola as with DeMarco, the heart of the approach was the recognition that the tax and expenditure sides of the budget must be determined together, so that the satisfaction of social wants may be traced to the preference of individual members of society.

Summary of the Views of Italian Fiscal Theorists

Perhaps the most important characteristic of DeMarco's fiscal thought is the dualism found in his models of the cooperative and monopolistic state. DeMarco accepted the state as the subject for study rather than the individual. He developed a theory in terms of
two models of the state and the cooperative state is the standard for fiscal theory. His central idea is that in the cooperative state, the producers and the consumers of public services are identical. Therefore, it is erroneous to conceive of a tax as other than a form of price. The essence of his fiscal theory is the marginal equivalence between the two sides of the public account, i.e. tax and expenditures.

It is assumed by the author of this research that deMarco attempted to apply marginal productivity theory of distribution to fiscal analysis, i.e., resources will tend to be priced in accordance with their marginal productivity whether used privately or publicly. DeMarco's approach indicates that if specific public resources are really in the nature of productive inputs and do affect certain activity in a different manner, that allocation of resources will tend to be adversely affected unless public services are directly priced.

Mazzola also posited a basis to price both public and private services. Mazzola suggested that services should be priced so that all the separate shares of resources used had the same final degree of utility. The process of determining the marginal utility of public goods provided the mechanism for distributing the tax cost of public services.

Mazzola's view of the state was consistent with his utility approach, since the state rationalized individual aims through collective cooperation. A voluntary association of individuals in a political arrangement provided a source of compulsion for individuals to respond to collective interests.
Mazzola's contribution to fiscal theory reflects the heritage of utility which influenced the development of fiscal theory in England and Germany in the late nineteenth century. However, deMarco broke with the utilitarian tradition in an approach that was to provide the basis for later Italian fiscal theory.

The proposals of the German and Italian writers include the view that the state activities are responsible for direct and complementary benefits to society. This idea is a necessary condition to the body of theories that attempt to determine both revenue and expenditure simultaneously. The manner in which Sax, Mazzola and deMarco chose to view the political nature of the apportionment principles provided a base from which the Swedish writers, Wicksell and Lindahl, launched their "new principles" of public finance.

Knut Wicksell and the Reintroduction of the Benefit Theory

Knut Wicksell cited his "new concept" of tax justice in his work in 1896. Essentially Wicksell has no new principle of taxation, but merely a modernization of the old benefit theory. Wicksell indicated that the benefit doctrine was applicable by modernizing the role and nature of the government, due to the fact that the benefit theory had been predicated on an outmoded concept of government. In fact, Wicksell observed that the whole theory of public finance at the time of his writing rested on the outdated political philosophy of absolutism.

The theory (of public finance, W.L.K.) seems to have retained the assumptions of its infancy, in the seventeenth and eighteenth centuries, when absolute power ruled almost all Europe. It is true that the pure concept of absolute state power was diluted, somewhat timidly and ineffectively, with elements of the constitutional monarchy, dating from 1815 to 1830. But hardly anyone has gone further, not even in countries where no monarchy exists, either by virtue of constitution or de facto.

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59 Knut Wicksell, Finanztheoretische Untersuchungen und das Steuerwesen Schwedens (Jena: Germany, Gustav Fischer, 1896), ch. 1.

60 Musgrave, Public Finance, op. cit., p. 71.

61 Musgrave and Peacock, op. cit., p. 82.
Wicksell chose to emphasize the dynamic element of change in pointing the way toward desirable development of public institutions and the theory of public finance.

The science of public finance should always keep these political conditions clearly in mind. Instead of expecting from a doctrine of taxation that is based on the political philosophy of by-gone ages, it should instead endeavour to unlock the mysteries of progress and development. The movement that is afoot cannot be stopped, but it might be guided in a direction such that a desired goal is fully attained to the satisfaction of all.62

Wicksell's reference to a movement refers to the "steady progress toward parliamentary and democratic forms of public life."63 Wicksell held that the parliamentary or democratic form of government is a requisite for his viewpoint of the role of the state and the manner in which it is to be financed.64

With the substitution of a modern parliamentary government for the archaic political form, Wicksell proceeded to modernize the benefit doctrine in a contemporary setting and thus to update the theory of public finance.

Within this new political framework, a principle of voluntary
consent can be made operative for exacting taxes and supporting government services. Wicksell thus creates a type of economic and political basis for weighing benefits of government activity. "No public expenditure should ever be voted upon without simultaneous determination of the means of covering the cost." This is accomplished through voting in a political democracy, with minority and majority voices being reflected in proportional representation in parliament.

It will assuredly be one of the most important tasks of the future to attenuate and eventually to eliminate the conflict between social classes. It is not the business of the science of public finance and of tax legislation to do away with the egotism of social classes, but to assign it its proper place as a safeguard of legitimate particular interests.

Wicksell ventured further from the traditional economist's position in citing a political system which will legislate the desired role of government. The democratic procedure of decision making permits the individual taxpayer to weight the "benefit" from the role of the state. Since there is simultaneous voting on expenditures, the voter carries out his own quid pro quo, benefit-cost determination. This
procedure permits the evaluation of both the revenue and expenditure role of government.

68 _Ibid._, p. 120.

Apportionment Principles of Wicksell

In my view the benefit principle can and must be applied to all those activities of the state which involve the problem of a rational delimitation of separate state expenditures.

By contrast the benefit principle can definitely not be applied to expenditures which are based on something other than the interests of present citizens, for example, expenditures which result from obligations undertaken by the State at some earlier date.

69 _Ibid._, p. 82; Musgrave and Peacock, _op. cit._, p. 79.

Wicksell believed that no one could judge but the individual himself, the benefit of proposed and existing activity of the state. Therefore the individual should be permitted the opportunity to determine the nature and scope of public service as well as participate in determining the tax support program. Wicksell pointedly criticized the attempts to apply the one-sided tool of the sacrifice doctrine of apportionment.

.....the sacrifice or ability theory is equally hard to reconcile with established facts. But this did not much worry its defenders. They simply exclude those spheres from tax theory proper, as allegedly appertaining rather to the "private economy" operations of the state.

70 Musgrave and Peacock, _op. cit._, p. 74.
It (the sacrifice theory, W.L.H.) determines and indeed can determine only the distribution of taxes but has nothing whatever to say on the absolute amount of the total tax bill (and hence of the individual's tax bill).71

71Ibid., p. 75.

For Wicksell the sacrifice theories with their subjective value analysis were vague formulations and should be replaced by one theory that is more precise and meaningful. Such a theory must exclude the sacrifice principles.

No one can complain if he secures a benefit which he himself considers to be (greater or at least) as great as the price he has to pay. But when individuals or groups find or believe they find that for them the marginal utility of a given public service does not equal the marginal utility of the private goods they have to contribute, then these individuals or groups will, without fail, feel overburdened. It will be no consolation to them to be assured that the utility of public services as a whole far exceeds the total value of the individual sacrifices.72

72Ibid., p. 79.

On the subject of tax justice, Wicksell characterizes justice in taxation as an integral part of his concept of "approximate unanimity"73


with a proportional relationship between revenue and expenditures.74

Wicksell, however, did refer to a two-fold study necessitated by tax justice. On the one hand, the study of the tax instrument to establish a just state of income distribution was rationalized with distributing the cost of public services in a way which is consistent with the policies of income distribution on the other hand. The completion of the two-fold study was the work of another Swedish economist, Eric Lindahl.

Eric Lindahl on Tax Justice and the Pricing of Public Services

Wicksell made reference to the need for future work by value theorists to establish more precise and a meaningful formulation for pricing public services. It was Eric Lindahl who attempted to formulate and make complete the pricing of such services which was consistent with tax justice, while providing satisfaction of public wants which left the just state of distribution undisturbed.

Lindahl took the position that the purely economic concern in tax theory becomes paradoxical if attempts are made to contribute a greater and more general satisfaction of wants.

Justice in taxation is inextricably linked with justice in the distribution of property, and for Lindahl it is nonsense to speak of a
just portion of an unjust whole. Just taxation implies that in the presence of a just property structure taxes are distributed in accordance with this structure and that any unjust property structure needs prior adjustment. If taxation is to correspond to any particular property structure, it must by and large reflect the individual valuations conditioned by that structure. However, when purposes of taxation become known, individual valuations should be permitted to frame government action to accomplish these purposes. The process of determining personal valuations is more fundamental than "principles" of justice in taxation.

The principles of justice may be put to one side when it comes to determining the aims of taxation and of other branches of economic activity. The aim may very well be maximum satisfaction of wants for the whole community, the wants of any one individual to be measured by the same standard as those of all others. It is irrelevant to ask whether this solution is just or unjust. A system of taxation which primarily corresponds to this aim is 'economically correct'.

Thus taxation becomes "uneconomic" when it fails to take some account of the people's sense of justice. Lindahl posited the requirement

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that the existing distribution of wealth and property leave nothing to be desired and a type of political democracy exists where voters may cast ballots and dollars in a manner directing legislation and government expenditures.

Lindahl predicates the attainment of tax justice on the "desirable property order" and a benefit basis of tax exaction. The benefit basis of exaction may be interpreted either on objective or on subjective advantages.

If the majority thinks that the advantages of public service benefit everyone in equal measure, then the result of the benefit principle will be taxation in direct proportion to ability to pay. In some cases such an interpretation of the principle is necessary, in others (e.g., expenditures for the church) opinions may differ as to whether differences in benefits should or should not be reflected in the manner covering the cost of certain expenditures. 79

79Ibid., p. 139; also Musgrave and Peacock, op. cit., p. 229.

Lindahl includes ability to pay as a measure of benefits or equality, but in terms of equal pressure on ability rather than equal tax amounts. Both forms of apportionment must be looked at broadly as attempts to bring benefit to the total community. Thus the ability to pay principle is not rejected if it is included in broad benefits to individuals determined through the voting process. The question of the correct amount of taxation is automatically solved together with the question of distribution, which is not possible if the ability principle
is regarded as an independent norm of taxation. But Lindahl is emphatic in his choice of the benefit theory since a definite property

order must be the basis for individual valuations which are the basis of the tax system. Thus the benefit basis is in accordance with a definite distribution of property.

Lindahl assumes as did Wicksell that the role of the government was not bound by abstract theoretical formulations. The role of government is determined through voter action in a political democracy. The voter determines what services the state will provide. The services provided are either direct or complementary to the wants of voters. Most public expenditures are of some personal benefit to the taxpayer. Law and order protect his life and property and enable him to earn a living in orderly conditions. In some cases the benefits accrue only to one or the other group of the population. The benefits from public services are not exclusively of a personal nature. They consist also in the satisfaction of the individual's altruistic desire that other people should enjoy certain material or spiritual advantages. The individual's valuation of public services is then the money value of his interest in the increment of common weal to all. Therefore the price assessment by

voters in tax-cost terms varies with individual interest. But there is a market type of valuation of the price paid for public services. An equilibrium type of price coincides with voters' evaluation of the benefit of the service.\textsuperscript{83}

\textsuperscript{83}Lindahl, \textit{Die Gerechtigkeit der Besteuerung}, op. cit., p. 89.

As demands are made by individuals for extension of service, Lindahl assumes that wealthy individuals can afford to sustain the additional tax burden of the service. At the same time, the poorer group in the society insists that the government role be curtailed. The share of burden for the poorer group would be relatively greater for them. Thus the state service is expanded; the share paid by the wealthier group increase; the cost of service becomes more and more expensive to this group. At the same time the poorer group, responding to the benefit from the added services are more willing to contribute to the expansion of service. Thus an amount is determined as reflecting the willingness of all groups to contribute for the expansion of services. A type of voluntary exchange results in a price of government services determined in a "market" like environment.\textsuperscript{84} There will be one particular distribution of tax-


costs which differentiates the "price" of public services for the various parties in such a way that everybody's wishes regarding the amount of the
tax coincide. Taxation can be arranged according to the different parties differing valuation of public services. As in the private economy, marginal utility and price can be made to coincide. On that assumption Lindahl proposes that the parties are in a position to safeguard their interests in equal measure and they will choose that solution. 85 The parliamentary political system establishes the mechanism for implementing this "market-like" process.

Lindahl's analysis provides the basis for determining the total amount of public expenditures and taxes, that is, the allocation of public expenditures among goods and services providing for the satisfaction of various social wants and the allocation of total taxes among the various individuals. These decisions are mutually interdependent and must be determined jointly. Lindahl also concludes that the benefit principle appears as a tax principle of universal validity. The possibility of working out a rational tax system on the basis of this principle is the most important practical result of the application of the theory of value to the study of public finance. 86

85 Lindahl, Die Gerechtigkeit der Besteuerung, p. 168.
86 Ibid., p. 304; Musgrave, Public Finance, op. cit., p. 74.

Summary of the Ideas of Swedish Fiscal Theorists

For Wicksell and Lindahl the theory of taxation is part of the theory of "social value." Thus every system of taxation contains some
element of value determination which is relevant to the pricing of public services. The theory of payment for state services according to value does not involve a comparison of total quantities but of marginal quantities only. This idea of the margin was the contribution of Lindahl. Wicksell had made use of an analogy between tax and price formation, but it was Lindahl who developed the idea in his pricing of public services. Both Wicksell and Lindahl pointed up this general orientation in solving both the problem of distribution of tax burden and the problem of the scope of government activity.

With this orientation, taxation need not be regarded as an "interference" with price formation, but rather as an integral part of it. Thus a type of fiscal optimum is permitted by maximizing the total utility derived by all taxpayers from state activity.

But the pricing of public services must be accompanied by certain conditions. Wicksell required a smoothly functioning democracy where political parties have equal opportunity of realizing the rights which are due them under prevailing property laws. Lindahl posited the requirement for a "correct" distribution of income and property. Before fiscal problems could be attacked, a "just" system of ownership of property and a correct distribution of property was required.

In effect these conditions for applying value theory to public services is an attempt to isolate the economic aspect of the problem from any incumbering political setting. Thus Wicksell and Lindahl have made the most penetrating attempt to justify fiscal theory in a rational economic sense.
PAKT IV  Continental Fiscal Theorists:

Evaluation and Conclusions

Up to the end of the nineteenth century the benefit principle of Smith, with its implicit basis for linking expenditure and taxes, provided no basis to derive the demand for public goods or services from the preferences of the taxpaying community.

In the nineteenth century, the theory of value was rephrased in terms of subjective utility and attention was directed to the nature of public wants. Could not the same principles be applied to the wants of individuals that were satisfied by government services? This point was discussed at length in the literature of German, Italian and Scandinavian writers during the 1880's and 1890's. Wagner, Stein and Sax believed that such an application was possible.

With this process for determining public and private utilities, there occurred the recognition that the revenue and expenditure sides of the government budget are synchronous, and the determination of both is part of the same problem. The interdependence between the revenue and expenditure problem is the crux of the contribution of this era.

One of the results of the interdependence approach occurred when the benefit approach to apportionment was revitalized by Swedish economists who viewed benefit as superior to the ability to pay approach.

Beyond this, the primary contribution of the continental writers rested with the determination of the nature of wants provided through
the public budget. Mazzola noted the particular characteristic of the wants, that is their indivisibility.  

\[87\] Mazzola, op. cit., p. 70.

If a single price were set for public services, some users would find that the price exceeded the utility derived from the services. Therefore, every user is supposed to pay a price corresponding to marginal utility of the services. If satisfaction from the use of public goods and services is complementary to that of individual wants, Mazzola concluded that total satisfaction is maximized because the user equates marginal utility derived from private and public outlays.  

\[88\] Mazzola, op. cit., p. 157.

Wicksell's principle of "unanimity" in the determination of the budget reflects the extension of the same ideal -- that is equality of distribution occurs, if a political and economic equilibrium prevails, if established by maximizing satisfactions.  

\[89\] Wicksell, Finantheoretische Untersuchungen und das Steuerwesen Schweden's, op. cit., pp. 116-124.

At about the same time that Mazzola offered his views, Sax classified collective wants in a manner which distinguished the specific shares of benefit derived by the individual. The level of taxation which the individual is willing to support must be such so as to exclude private needs which are more important to the individual than the unsatisfied collective wants. Sax pointed out that the total tax burden
should be distributed so that each individual's share is subjectively determined by what the services are worth to him. By this system, the budget expenditures must be determined together with the distribution of individual taxes.

The social and private wants are not distinguished as being felt differently, but because equal amounts of public services must be consumed by all.  

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90 Musgrave and Peacock, op. cit., p. xii.

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These ideas of Sax and Mazzola contain the essentials of later modification of the benefit theories.

In the works of Sax, Mazzola and Wicksell, there was an awareness that the political process ought to be explicitly recognized to attain the balance between wants. A development of this recognition was the core of Wicksell's contribution.

Wicksell chose the benefit principle of apportionment because it fits into the modern idea of democratic or parliamentary society, as well as permitting an integration of fiscal and general value theory. Based upon this position, taxation would be "unjust" if individuals were compelled to pay for the cost of public activities which he does not consider to his benefit. Wicksell rejected the equilibrium rule of Sax since if left to his own choosing, the individual would pay nothing for the supply of public services. The utility that the user receives from the public services depends upon the contribution of others and not upon his own
contribution. So maximum satisfaction must be determined by voting in a democratic society. Wicksell then proceeded to consider the degree of voter majority that should be applied to different types of fiscal decisions. So, with Wicksell, methodological improvements were set forth, first by using taxation to establish a "just" state of distribution, and second, by distributing the cost of public services in a way which is "just" and consistent with the state of property distribution.

Proceeding from the assumption of an established "just" distribution of income and property Lindahl determined the price-tax of public goods and services in a fashion similar to price determination in a market. The equilibrium supply of public services and the allocation of cost are determined by the intersection of supply and demand for public services.

This solution may meet the requirements of both the ability to pay and the benefit principle. Different taxpayers contribute different amounts of money income based on his personal evaluation of the benefit of public services and the utility of his money income in achieving personal services.

This solution may be the ultimate answer to be derived from the earlier works of Sax and Mazzola. It is perhaps the ultimate consequence of the benefit principle, or of a system which determines public wants on the basis of individual preferences. Yet a level of government services requires some contribution from taxpayers regardless of personal evaluation of the services offered. The implication is therefore, that the problem of the distribution of burden of taxation is one of compulsion and politically based, or a problem of social choice. Another
consequence of Lindahl's condition of equal consumption or a proper distribution of property is that the market mechanism fails to reveal consumer preferences with regard to social wants. Here the need for a political mechanism rises to induce consumers to induce users to indicate their scale of preferences. Both problems are directed to the alliance of government decision making and fiscal policy. It is in the implementation of this alliance that the writing of American writers, primarily in the depression years, are significant to the modern theories of government fiscal activity. The contributions of twentieth century English and American fiscal theorists in implementing the alliance between government decision making and fiscal policy will be presented in the following chapter.
CHAPTER SIX

The Role of Government and Tax Apportionment Doctrines
in Contemporary Economic Thought

Introduction

By far the most important economist in the first half of the twentieth century was John Maynard Keynes.\(^1\) He was an outstanding figure in government financial planning in two wars and his famous book, The General Theory of Employment, Interest and Money, can be said to have exerted a greater influence on public policy than any other since Adam Smith's Wealth of Nations.\(^2\) The writings of Keynes coupled with the ineffectiveness of traditional economics in coping with the problems of the great depression of the 1930's helped in the development of new concepts supporting an active government role in economic activity.\(^3\)

The depression oriented General Theory\(^4\) formulated by Keynes found general acceptance for policy matters in ameliorating the under-employment


\(^3\) Ibid., p. 394.

of the factors of production. The Keynesian approach shifted the problem orientation from factor allocation to the aggregate investment and consumption function.\(^5\)

\(^5\) A. H. Hansen, Fiscal Policy and Business Cycles (New York: W. W. Norton and Co., 1941), Chapters I, IV, VI, IX, XI, and XX.

Like many important economists, Keynes was not completely original. Various sections of his analysis bear some resemblance to many earlier writers, but Keynes was the first to effectively integrate earlier analysis and his own ideas into a unified theory. Knut Wicksell was a pioneer in the integration of monetary theory and general equilibrium theory. Wicksell analyzed the economic system as a whole instead of the isolated phenomena that had been the chief concern of the leading economists of his day. He analyzed business cycles as well as "normal" price movements. Wicksell introduced an explanation of the interplay between aggregate incomes and aggregate consumption as well as a relationship of savings and investment in determining equilibrium prices.\(^6\)


Wicksell's analysis was concentrated on the process of price movements, in which credit plays a large role. Credit and savings have a time dimension. For this and for other reasons he came to study time using processes. The most famous is his "cumulative" process, which proved to an important "type model" of economic development, i.e., a "model sequence."\(^7\)

Other Swedish economists of the "Stockholm School" built on Micksell's ideas. Lindahl, Myrdal, Lundberg and Ohlin made contributions which incorporated monetary theory into price theory. A unique characteristic of this school is the distinction between future expectations and periods already past.  


The findings of the Swedish economists provided some of the ideas on interest rate, savings and investment, employment, aggregative economic models, and the interpretation of business decisions to invest, which appear in Keynes' theory of effective demand and output-level determination. Their findings do not detract from the magnitude of the General Theory contribution.

Keynes certainly had other anticipators.

It is true that the original concept of national dividend and its distribution was considered by Marshall and richly elaborated by Pigou, but Keynes' approach to the solution is drastically different from that of Pigou, who argued that no employment would be possible in an economic system with flexible wage rates.  

9 Newman, op. cit., p. 379.

Newman also cites Gesell, Malthus and Hobbes as anticipators of the Keynesian contributions.  

10 "Certainly Keynes had predecessors, ...."
but the magnitude of his integration of both received and original ideas into a system acceptable to academic and political circles alike cannot be overestimated."  

Throughout this chapter, the concepts in Keynes' *General Theory* will be referred to as formalized views of Keynes. There will be no attempt to trace the historical development of the ideas, nor any attempt to determine the original contributor of such ideas. The emphasis in the chapter development originates with the impact and acceptance of the *General Theory* as a basis for modern or contemporary economic thought. The aspects of this modern economic thought that are relevant to the development of this research pertain to the role of the government in implementing 'Keynesian type' fiscal policy.

The purposes of this chapter are to point out, (1) the role of the government and government policies as suggested in the general economic theory of J. M. Keynes, (2) the importance of government fiscal activity in stimulating the level of employment and national income, (3) the emphasis of contemporary economists on the expenditure role of the federal budget, (4) the views of contemporary economists on taxation as a fiscal policy device, and (5) the absence of any explicitly stated principle of tax apportionment which may be used as guide for tax policy.

The chapter material is developed to point out the Keynesian influence in contemporary economic thought on the role of the state (Part I). Part II of this chapter presents the role of tax policy in Keynesian
fiscal analysis. Section A of Part II presents the expenditure characteristics of tax policy and Section B points out revenue characteristics of modern tax policy.
PART I  Keynesian Influence and the Role of Government

The aggregative approach of Keynes by-passed the traditional basis for evaluating the effects of government expenditures on economic activity. "The traditional problems of shifts in the allocation of resources has been relegated to a secondary position; the standard of reference has been shifted from the incidence of individual losses and benefits to fluctuations in employment and national income." 12


Government activity and expenditure programs were incorporated in the level of national income. 13 Government outlays were relied on to take up any investment and consumption lags in a desirable level of national income. 14 In this context the laissez-faire role of the


central government became antithetical to the required responsibility of the state. 15


The "allocation responsibility" designed for fiscal economists by the neo-classical framework was supplemented with a policy-making
role, particularly during and after the great 1930 depression. Relative to pre-Keynesian concepts the government responsibility was

16. This does not imply that the Keynesian theses were explicitly implemented in the legislative programs in the United States in the 1930's. See S. Harris, Saving American Capitalism (New York: A. A. Knopf, 1950), pp. 67-70 and S. E. Harris, John Maynard Keynes (New York: C. Scribner's Sons, 1955), pp. 191-196. "New Deal" programs provided for expenditures that are not inconsistent with Keynesian policy recommendations and economists influenced congressional and executive decisions on such programs, particularly after 1937.

broadened and the support of government activity became an economic end in itself.

The government's role of maintaining our total purchasing power is of vital importance, because of the import of our present budgets on the economy as a whole. It is doubly important because the percentage of our total purchasing power which is supported by government expenditures can be varied within reasonable limits each year with our total needs.

As we examine what government must and can accomplish, we are faced with many deep seated inhibitions and prejudices. Americans over forty years of age came to manhood in an age when government's primary responsibilities were largely to keep down crime, to see to it that we had the nucleus of an army and navy, to keep up the roads, and levy a minimum of taxes. We were told that any expansion of government represented an encroachment upon individual liberties to be resisted to one's utmost, and that even the necessary minimum of government was to be condoned rather than admired.17

17. S. Harris, Saving American Capitalism, op. cit., pp. 21-22.

With this orientation, five fundamental roles of government are

See Chapter Two, pp. 9-10, this research.

role of government is to act as an umpire between the four major groups which make up our economy -- business, labor, the farmer, and all of us consumers." The third responsibility of government is a unique elaboration of the Smithian context of "profitless" undertaking by individuals. The government is to provide those services which cannot reasonably expect to be created by individuals on a profit or loss basis, such as huge investments in TVA and other waterways projects and slum clearance, parks, hospitals and recreation areas. "The fourth responsibility of the government under our private enterprise system must be to assure reasonable equality of opportunity to every citizen, regardless of race, color or creed." And finally, the "fifth responsibility of government is so to integrate our export and import program that the work of relief and rehabilitation throughout the world will be pushed steadily forward." In 1934, H. D. Simpson offered the following
The movement may be characterized by the following broad features: the employment of national credit on a large scale, as an agency of national recovery; an enormous development of a policy of subventions from the national government to state and local governments; a policy of vast private subsidies; the direct expenditure of other huge sums by state and federal governments for relief and for providing employment; the development of a vast bureaucratic machinery, with a large degree of discretionary control over federal expenditures.

Writing about the same time as Simpson, Harley Lutz characterized the expanding governmental activities with reference to the economic and social philosophies underlying the economic programs.

It may be stated in either of two ways. It may be regarded simply as a vast emergency undertaking, aimed at the rapid restoration of a level of price and a volume of economic activity at a new price level which will relieve debtors, taxpayers, and the unemployed. Or it may be viewed as the entering wedge for an extensive reorganization of our economic structure and our government policy, whereby there may be perpetrated a degree and character of government control over economic processes, that would be rather mildly characterized as being "paternalistic." I hasten to state that no one openly calls it 'federal paternalism.' A much more attractive expression, "The New Deal" has been coined, but the shift in terminology should deceive no one.

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Lutz continued his evaluation by pointing out that we have added a new government function, that of providing an indefinite number of cushions and shock absorbers to protect individuals and economic groups against losses and against the consequences of our own incompetence or error. Roy Blough added insight into these opinions when he said,

"Economists in recent years have been more concerned than formerly with the possibility and desirability of directing and controlling our economic system through changes in economic and legal institutions, primarily through government."

The role of government, its expenditures, and thus the study of public finance during the 1930's, and since, have a non-traditional orientation. Public finance as it offered constructive contributions to the problems of federal finance, was integrated with the heterogeneous elements that made up the "macro-policy tool kit." Public finance with other areas of economic specialization became part of aggregative analysis. "Government fiscal policy, its spending and taxing, its borrowing and repayment of loans, its issue of new money and its withdrawal of money, shall be undertaken with an eye only to the results of these actions on the economy and not to any established traditional
doctrine about what is sound and what is unsound." The crucial problems of this view of government finance become the direction and amount of federal outlays.


28 P. Lerner, "Can We Cure Depressions," The American Socialist, (April 1958), Vol. 5, No. 4, pp. 6-8. This brief article presents the Lerner view of "functional finance" where he argues that the government should not stop spending short of achieving and maintaining full employment.

The political framework within which the economic policy is implemented and the structure of government organization are significant in determining the type of fiscal activity and the effectiveness of such policy.

State action to insure inadequate investment, public and private, together with a tax policy designed to raise the consumption function -- these are the types of measures which seem promising (to bring increased employment, W.I.H.29


Keynes observed that the enlargement of the functions of the government would seem to a nineteenth century publicist or American financier to be a terrific encroachment on individualism; I defend it, ......... both as the only practical means of avoiding the destruction of existing economic forms in their entirety and as a condition of successful functioning of individual initiative.30

30 Keynes, General Theory, op. cit., p. 378.
Public investment was considered as the primary stimulus to the recovery from the depression and for perpetuating high levels of employment.

Although the public investment factors were to provide the initial impetus to recovery and expansion, Keynes recognized that government programs might affect "confidence unfavorably and so curtail private investment. An increase in public works might raise the cost of capital goods and so affect private investment unfavorably." These reservations did not negate the emphasis on the use of public outlays to spur private sector activity.

The final major effect of the depression was to speed transfers to the federal government of responsibility for many functions that had been previously performed by states, local communities, private charitable institutions, or the family. These new responsibilities were in addition to the new functions taken on by the federal government which competed with or supplemented the role of private business.

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33 Hansen, Ibid., p. 104; Harris, Ibid., pp. 151-153.

This role of the state, with its financial responsibility, provided the permissive factors in the development of policy which included government as vital in attaining private sector goals. The economic literature of the post-Keynesian period provided support for the government participation thesis. To give an example,

The general problem of government economic policy can be easily stated. It must be such that government economic policy will supplement or stimulate total private spending on consumption or investment by exactly the amounts that will maintain full employment. The level of investment can be stimulated most directly by outright government investment. Useful investment schemes like these must be undertaken by the sole agency which can afford to take the risk of slow or zero return, the government.35


"During the thirties the main emphasis was on government investments in public works as a major recovery policy."36


The intervention of the state was accepted as a premise in economic analysis for the commitment of policy of "maximum production, employment, and purchasing power."37


The federal government has become increasingly committed to a policy, which future administrations will find it difficult to reverse, or initiating active and direct measures to maintain the national
income at a high level and to encourage, if not to assure, employment to those able and willing to work. The permanence of this political purpose, and of the collateral emphasis upon the more equitable distribution of income, seems assured, since it appeals not only to the millions who wish to escape from the precariousness of their livelihoods, but to almost all persons of intelligence and goodwill who see no reason why poverty should periodically stalk the land when we have such magnificent resources of materials, equipment, technical knowledge and human enterprise. The existence of the political purpose has not yet brought forth any generally acceptable program of action. It has, however, presented a challenge to the intellectual ingenuity and the inventiveness of economists, and has stimulated and concentrated analysis which has ever been given to any problem of economic policy.  

The analyses concentrated on employment and more recently on growth have almost universally recommended fiscal and monetary policy of the central government to stabilize income, and employment, and "in so far as possible to expand them and non-fiscal policies to make the private economy function more effectively itself and respond more promptly to forces for expansion."  

Until the present day, the role of the government as a fiscal agent has been viewed as either implementing or retarding consumption and investment or the newer goals of price stability and growth.  


These national economic goals have been established as legislative and political goals as well as economic goals. Section 2 of the Employment Act of 1946, as amended, states that:

The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practical means consistent with its needs and obligations and other essential considerations of national policy, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions to promote maximum employment, production, and purchasing power.

The best developed plans aimed at the provision of maximum employment are programs presented by W. H. Beveridge and Hansen.

Although neither of the plans has been adopted in the United States, the plans proposed assign an important role to government expenditure activity. In Beveridge's opinion,

It must be the function of the state in the future to ensure adequate total outlay and by consequence to protect its citizens against unemployment, as definitely as it is now the function of the State to defend
the citizens against attack from abroad and against robbery and violence at home.  

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Both Hansen and Beveridge are aware that the provision of full employment is a function of private sector vigor as well as the government increases in the quantity of funds available for the purchase of goods and services.  

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\[46\] Lindholm, op. cit., p. 59.

Keynes in The General Theory, as does our Full Employment Act of 1946, made public sector programs a central part of the system. The state could take the long view and the state's estimates would be influenced by the social advantages.  

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\[47\] Keynes, General Theory, op. cit., p. 164.

...armed with a variety of economic weapons -- weapons which may be used in direct attacks on specific economic maladjustments. "Keynes' emphasis on fiscal policy, one of his greatest contributions, is a new weapon in the government's armory."  

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\[48\] Harris, Keynes, op. cit., p. 156.

"is like a blood transfusion: it strengthens the system against all kinds of shocks."

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\[49\] Ibid., p. 155.
Fiscal policy of which tax policy is a major element has been seized upon as an instrument for preventing or ameliorating depressions and booms.  


Summary and Evaluation of the Role of the State in Contemporary Economic Thought

Prior to the 1930's, economists accepted the conclusions of the economic writings of the great classical economists that labor would be continually full employed and that the techniques and the natural resources of a nation would be used in a most efficient manner. The depression of the 1930's showed that this adjustment did not take place automatically. The idea that government could and should influence the prices of goods and services, the amount of consumption, the degree of employment, and income distribution -- through its collection of taxes, spending and borrowing, and purchase and sale of commodities, has been developed in formal economic analysis since the depression period. The importance of government fiscal activity in accomplishing full employment was made explicit by J. M. Keynes in his pioneer work in this area.

There is extensive evidence of this Keynesian position in the social policies in Great Britain prior to 1936. Keynes was not the original contributor in this area, but, after his British economic experience of some twenty years, formalized the views in a general economic theory. See W.H.B. Court, op. cit., pp. 277-287; F.J.C. Hearnshaw, The Social and Political Ideas of the Victorian Age (London: G.G. Harrap and Company, Ltd., 1933), pp. 16-29; L.C.A. Knowles, op. cit., pp. 147-162.
In contrast to traditional economics with its concentration on allocation and productivity, Keynes switched the emphasis to the significance of employment. In matters of public policy, the Keynesian system is of crucial importance. The emphasis is upon government spending not thrift. From this emphasis followed virtually all proposals for policy. Keynes proposed state intervention to assure adequacy of demand. The measures were general, not specific. They did not seek to dictate individual economic decisions but only to affect the aggregates of consumption, investment, and thus employment. The role of government in modern economic thought, is assigned the responsibility for maintaining "adequate" levels of employment and national income. The laissez faire basis for limited government role has given way to a requirement of positive action as national economic exigencies occur. In the economic analysis growing out of the post depression period, government has been assigned the same full-fledged economic status as consumption and investment -- national income = consumption + investment + government.

\[53\] Harris, Keynes, op. cit., p. 59.

\[54\] Strayer, op. cit., p. 140.
The apportionment principle, to direct the burden of taxation for implementing policy does not appear in the General Theory.

Keynes did not discuss matters of public finance per se. He looked at public finance as one of the instruments of a policy designed to influence employment and income. By using the term "fiscal policy" rather than the conventional public finance Keynes apparently intended to indicate that he was concerned only with the one aspect of public finance.

He used the term fiscal policy when referring to the influence of taxation of savings and of government investment expenditures financed by loans from the public. He looked at fiscal policy as one form of "state action as a balancing factor." 55


Keynes' reference to taxes or tax burden appear but a few times in his General Theory. The role of taxation was explicitly mentioned as to the burden on the level of consumption and the expected efficiency of capital. 56 Keynes singled out death taxes 57 and taxes on unearned increments plus taxes failing heavily on savers 59 as particularly

56 Keynes, General Theory, op. cit., p. 309.
57 Ibid., p. 95.
58 Ibid., p. 264.
59 Ibid., p. 372.
responsive to the factors that influenced the volume of employment. Keynes did not advocate progressive taxation as one of the important measures in alleviating unemployment. 60 If the average propensity to consume can be raised through such measures as progressive taxation,

the magnitude of cyclical fluctuations may be reduced. Although Keynes made the suggestions in this connection, he emphasized that in a capitalistic economy, the propensity to consume cannot easily be raised enough to have a significant effect upon the volume of employment. 61 Keynes' main suggestion in this area is the use of progressive taxation to redistribute the social income from individuals with a low propensity to consume to those with a high propensity to consume and thus raise the community's average propensity to consume. 62 From this point of view, the author of this research assumes that progressive taxation reduces inequalities of income because it takes a relatively larger part of the incomes of the wealthy than it does of the poor, and thereby provides some relief from the inadequate demand for consumption. "There are limitations to the extent to which progressive taxes are used and can

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60 Dillard, Economics of J. M. Keynes, op. cit., p. 83.
61 Keynes, General Theory, op. cit., p. 22.
62 Dillard, Economics of Keynes, op. cit., p. 327.
be used to promote high levels of economic activity. The whole tax system must be progressive for effective results."

63

Ibid., p. 82.

Keynes was aware that taxes might be oppressive. At one time he would support a capital levy as a means of dealing with the incentive problem; that is to get the burden over quickly.64 In 1937, he con-

64 Harris, Keynes, op. cit., p. 154.

demned the excess profits tax because it was arbitrary, penalized the young firm and reduced the difference of return on enterprise versus usury. It was like taking the first name listed in the telephone book for special tax assessments. A program for taxes on unimproved land

65 Letter published in The Times (London), April 24, 1937.

invoked a letter in which he protested against this tax on the preservation of beauty. "These people are to be penalized by taxation until the bungalow-builder and the real estate broker can have their way."


Other than these reflections as to "justice" and expediency of taxation, Keynes wrote little on the subject of taxation as such. So it has been left with the heirs of the Keynesian system to elaborate the role of taxation that supported his general policies.
Post-Keynesian Tax Policy

As Roy Blough pointed out, "the possibility of using taxation deliberately in stimulating or guiding the economy was seldom considered" prior to Keynes.\(^7\) Commonly the traditional dictum was passed on that taxation should be used only for purposes of raising revenue for a minimal level of public services. Since the General Theory, tax policy has been specifically used as an instrument to influence the expansion of production and the reduction of unemployment.

Tax policy as a component of fiscal policy has been used since the depression years in attempts to attain stability and growth. For example, Gerhard Colm posited a progressive tax system that falls more heavily on the portion of income that is saved than on the portion that is spent and thereby counteracts the decline in the propensity to consume.\(^8\) L. R. Klein states that an alternate method of granting subsidies to business is to lower business taxes. "Economists have recently been arguing strongly in favor of reduced business taxes in order to stimulate investment."\(^9\) Hansen contributed to literature with references to the role of taxation in carrying out Keynesian-like policy suggestions. Hansen viewed the exaction of taxes as a device to raise
total income: either reducing taxes without reducing deficits, without reducing expenditures or without any change in the tax rates, or by increasing expenditures and taxes to raise sufficient revenues for government expenditure programs. The Hansen proposition rests on the assumption that the tax is imposed in such a way that the money taken in taxes would have been saved as idle balances.

According to Dillard, a government which desires to stimulate a higher level of employment may combine spending, borrowing with taxing in many types of fiscal policy. Keynes dealt primarily with only one method, the case in which the government expenditures are increased without an increase in tax rates. Another fiscal policy suggested by Dillard operates through an increase in government expenditures financed entirely out of taxation. Under this policy, taxation must be increased as much as government outlay and therefore the budget is always balanced. "While it is true that all forms of taxation are to an


71 Dillard, Economics of J. M. Keynes, op. cit., p. 122.


73 Dillard, Ibid., p. 124.
extent deflationary in that they restrict private consumption, tax money spent by the government is in itself expansionary. Although higher tax rates reduce private consumption, they also reduce private savings and thus reduce the dependence of the economic system on effective demand from private investment.\textsuperscript{74}

\textsuperscript{74}\textit{Ibid.}, p. 125.

In Lindholm's review of the role of taxes and tax policy in the Keynesian fiscal policy framework, taxes \textit{vis a vis} investment, consumption, employment and income are emphasized. "A tax policy to maintain purchasing power is the first requisite for stimulating private investment."\textsuperscript{75} This type of tax program, requires that excise taxes and other taxes that reduce the impact of purchasing power be reduced to a minimum and during periods of depression be removed entirely; and that highly progressive taxes on personal income, estates, gifts, and trusts be the principle source of all government revenues. The rates of the income taxes should vary, depending on whether the income is obtained from active productive effort or from property ownership, and higher rates applied to income from property. However, taxes on investment income must not be so great that the plant is not expanded despite the stimulation of adequate purchasing power, for purchasing power will be largely dissipated in higher prices unless new investment provides

additional quantities of goods.  

Lindholm requires that "taxation to maintain a high level of consumption must be progressive." He points out that if taxes were collected from people in the very low income brackets, these groups would have a reduced amount to spend on different goods and services required to meet the standards of their community. If the government obtained funds from taxes paid by individuals in the highest income brackets, the result would be quite different. The taxes would be largely a reduction in private savings. Reduced savings would tend to increase interest rates and would also tend to decrease private investment expenditures. But in a period of unemployment, the possibilities of making profits from expanding production are lessened. This causes investors to increase their cash balances. Therefore the levy of taxes on those in the upper income brackets is apt to increase the size of the expenditure stream in the current period, whereas that is not likely to be the case if taxes are levied on those in the lowest income brackets.

The preoccupation of fiscal theorist in the post-Keynesian period with taxation as a compensatory device for low output and unemployment
led to a re-evaluation of the role of savings or idle balances. In the period of the middle 1930's in the United States tax plans were suggested to increase the circulation of money. The levy of a tax on "hoarding would force funds into investments or in purchases." 

79 and 80
A. Dahlberg, When Capital Goes on Strike (New York: Harper and Brothers, 1938), Ch. 7 and 8.

The levy of such a tax would stimulate additional investment or induce consumer spending by the rich above their customary levels. A tax upon idle balances also stimulates investment by savers similarly to a rise in interest rates without the disadvantage of increased cost to borrowers.

The Continuing Requirement for Compensatory Tax Policy

Since the concern and preoccupation with the economy's output and capacity characteristics have become a continuing responsibility of economists, fiscal theorists view taxation policy in terms of national income goals. Tax policy in the post World War II period was designed to maintain the optimal level of wartime employment.


Review of the testimony and hearings before the Committee on Ways and Means in 1959\textsuperscript{83} points up this continuing effort of economists to survey tax policy in terms of impact on various sectors in attaining aggregative goals in the level of economic activity. The divergent economic and political orientation of the contributors in the sources cited above supports the consistent use of tax programs to implement policies for the maintenance of full employment and high levels of national income.

Alvin H. Hansen has added substance to this view in his recent essays.\textsuperscript{84} Hansen takes a position on the role of government expenditures similar to the German, Wagner, in pointing out the "productivity" of such outlays.\textsuperscript{85} These government activities are utility-creating and in part efficiency-creating, no less than the activities of private enterprise.\textsuperscript{86} Thus taxes are not merely ways of collecting revenue but are in reality unique methods of redistributing income and fostering expansion in aggregate investment.\textsuperscript{87} Hansen holds the view that if the


\textsuperscript{85} Ibid., p. 100-103.

\textsuperscript{86} Ibid., p. 102.

\textsuperscript{87} Ibid., pp. 104-105.
government fails to continue to use the progressive income tax in a manner to implement a "desirable" distribution of income and suppress the concomitant waste of an opulent society the required role of fiscal policy will not be fulfilled.


89 Hansen, Economic Issues, op. cit., p. 110.

It is significant that Hansen reviews the historical development of the fiscal thinking of great "schools" of economic thought. In effect the Hansen views expressed in this essay indicate a regression to the ideas introduced and developed by Italian, German, and Swedish economists some thirty to sixty years ago. Hansen, however, makes no at-

90 Ibid., pp. 100-106.

91 See Chapter Five this research.

tempt to establish a basis for tax apportionment but merely advocates the expedient use of progressive income tax rate structures. Hansen supports the Keynesian oriented position that long term government tax policy should be predicated on the sector response to taxes. The response is viewed in terms of aggregate goals of achieving full employment or acceptable rates of economic growth.

There are dangers in attributing a consensus on Keynesian ideas to all contemporary economists. There is evidence in current writing
that the Keynesian dominance of fiscal policy may have been dissipated.

However, the refutation of the specific older ideas has offered little

new to be used in the construction of a non-Keynesian based design for fiscal policy and government taxing processes. The frame of reference of the variety of specific views does not void the suggestion that economists currently survey tax policy in terms of the impact on various sectors in attaining aggregate goals in the level of economic activity.

The body of fiscal theory that prescribes policy with reference to expenditure characteristics has provided few if any guides to the theory of apportionment of the tax burden.

The pendulum of emphasis, however, has shifted from the pre-Keynesian burden of collection to the post-Keynesian expenditure effects of government fiscal activity. Expenditure activity is the necessary function of the government to assure fiscal action consistent with the goals of the Employment Act of 1946. Yet the body of economic theory does not emphasize the traditional concern of the burden of taxation.

from the viewpoint of individuals. The emphasis has been placed on the effect of taxation on aggregative measures of the level of employment and income.

Section B Revenue Considerations of Tax Policy

The Over-Savings Justification for Taxation

A modern justification of progressive tax rates may be developed from the Keynesian conception that the propensity to consume is relatively constant and that the portion of national income that is saved is too great or that a large portion of net savings is made by high income receivers. The portion is considered too great because savings tend to be greater than investment opportunities. This may force the economy into a depression period during which the productive capacities are only partially utilized. The solution to the problem of depression is then closely related to the savings of high income earners. These savings can be reduced by levying taxes on the income of the wealthy and thereby preventing them from involuntarily creating conditions from which depressions arise. The largely new idea introduced in the 1930's was that all savings were not needed or used for capital expansion. The "oversavings theory" provided a basis for


levying taxes upon certain individuals and certain segments of the economy. Lindholm suggests that this basis of levying taxes on the individual is a concept of tax justice. The "oversavings" justification for taxation has no relationship to the ease with which tax income is secured. The tax is levied because the payment of the funds to the government will increase the total utilities enjoyed by all individuals. The net gains in utilities arise because, if funds are used by government, the economy continues to operate at capacity; whereas, if the funds were used as savings or idle balances, the economy would soon be operating far below capacity.

The oversavings theory is an expression of state-individual relationship rather than an explicit principle or theory of tax apportionment. It is not a concept on which the taxing process can achieve individual justice in taxation. It is a basis for attaining aggregate tax justice, through a centralized agency which attempts to equalize utilities. The oversavings theory is consistent with and indeed an aspect of the fiscal theory of Wicksell, Wagner, and Sax. The justification for tax exaction is not a requirement for fiscal theory since compulsion is inherent in the state-individual relationship. The over-savings
justification of tax exaction suggests a rational economic approach, if the Keynesian interpretation of private consumption activity is assumed. The only basis of tax apportionment in this orientation is the concomitant equality of private utilities from private and public "consumption" expenditures. Sax and Hicksell had previously provided the idea and the description of the fiscal system to implement this justification.

The Tax Consciousness Theory

Another of the state-individual relationships introduced once again in the Keynesian era has been referred to as the tax consciousness theory. The tax consciousness theory holds that because every citizen benefits from government, every citizen should pay taxes and pay them in such a manner that he is aware that he is paying them. Taxes justified by this theory are apparently levied as much to reduce expenditures as to provide funds to cover the costs of existing expenditures. Citizens may vote for extravagant and unnecessary government expenditures unless they are forced to contribute directly to government support. Lindholm cites the tax consciousness theory as being closely related to the concept of paying for benefits. This basic idea is that an expansion in


99 Lindholm, Public Finance, op. cit., p. 272; see Chapter One, supra, pp. 1-8 and 12-15 for a review of the earlier thoughts on the subject of tax-consciousness and benefits.
public expenditures or of the public economy is a type of sumptuary-like activity and the tax device will prevent the expansion of the activity. Taxes based on this theory require everyone to pay taxes who enjoy the rights of citizenship or for that matter the right to live in a particular society. But of more significance is the point made by Lindholm, that the application of the tax consciousness theory can effectively retard the expansion of government activity of any type.


**Tax Justice, Politics and Equity**

*Treatment in Modern Tax Apportionment*

Professor Blough, writing in 1944, offered some bases on which tax programs could be evaluated. He listed the following considerations to be noted in tax programs, (1) the constitutionality, (2) revenue capacity, (3) characteristics of justice, (4) the economic effects, (5) problems of administration and compliance and (6) political considerations. On tax justice Blough explained that the current drive toward tax equity as part of tax justice may be more important than the concern for tax justice. "If a tax contributes to bring a distribution

it is an unjust tax. Social justice is a highly subjective concept." 103

Blough also introduces the political considerations as being newly significant in the adoption of tax programs. The machinery for determining tax policy in the Congress must be recognized and appraised as conflicting political interests influence the type of tax program that is finally passed. Taxation programs in part are shaped by purely political bargaining. "The economist can develop those aspects of his work which point to a harmony of interests and to the reduction of the area of conflict. .... He can adapt his proposals for using taxation to support economic policy to the realities of the process of tax making." 105

Blough has introduced the practical, contemporary aspects of tax legislation which are certainly removed from the stringent and dominating theoretical aspects of the traditional public finance. His treatment of tax justice is also broader than the traditional treatment, since tax equity is distinguished from tax justice. "There is first of all the tax justice which is achieved by like treatment of likes. ....
Tax equity consists in recognizing the inconsequential differences for what they really are and adjusting taxes so that they fall with equal weight on people with equal ability to pay taxes." For Blough, "equal treatment of equals" is necessary for tax equity; tax equity is part of the larger concept of tax justice; tax justice is achieved when taxation results in a "socially just distribution" of income. Thus these suggestions for guides to tax policy rely on the manipulation of the tax exaction process to obtain desirable social goals. The approach to "equal treatment of equals" has been almost wholly in reference to the tax side alone. The implication being that if tax burdens of similarly situated individuals were identical, the equity criterion would be met. The necessity for looking at the benefit side of the fiscal activity has been understressed by Blough and has been overlooked completely in the oversavings and tax consciousness approach.

The views of Blough suggest to the author that equity and justice in taxation are valid ethical goals for a taxing process. However these ethical goals are one aspect of various principles of apportionment of the tax burden. For example, Blough assumes that equal ability to pay is the tax apportionment principle applicable in achieving his ethical goals of the tax system.

Equal treatment of equals refers to administrative justice, which
implements some underlying economic goal of a "socially just distribution of income." Equal treatment of equals in the apportionment sense must appear as a function of administrative equality. The equal treatment concept is not an economic criterion because the authors reviewed above have failed to advance an objective economic standard of "that which" the equal treatment applies to, or "that which" constitutes economic equality. Generally, the implication is that equal treatment for equals means the same tax treatment, the same procedure by taxing authorities, applied to the same tax position or the same income position. The tax or income position may be "justly" modified by particular economic and social characteristics, e.g., deductions and exemptions. The equal treatment approach may also be interpreted from the point of view of other "desirable economic goals." Equal treatment for equals may be achieved by the same administrative treatment of taxpayers who have the same objective ability (consumption and savings) to impede or influence the "desirable level" of aggregate demand, investment outlays or some other factor responsible for economic growth.

The procedural or administrative equity in the taxing process persists as a contemporary position for evaluating tax "justice." Yet this position is only one aspect of the problem of apportioning the tax burden. Either the ability to pay principle based on subjective sacrifice or objective income standards, or the benefit principle may be logically advanced as the "correct" principle of tax apportionment.

The authors, Jensen and Strayer, discussed in the following pages have oriented their positions toward the administrative problems of
achieving tax justice by emphasizing "equal treatment for equals."
Neither of these authors has explicitly related this aspect of tax
justice to a principle of apportionment, although each author relies
on the processes of tax exaction to support his arguments for "tax
justice."

Jens P. Jensen admits that justice is not an ultimate principle
of tax apportionment at all. "Taxes must be just where possible; ....
But to set out merely to make taxes just is as inappropriate as to
set out to make the climate just." 108 Justice, however, according


109 Ibid., p. 207.

to Jensen is peculiarly applicable in that segment of public revenue
where the cost and benefit can be apportioned. For such cases involve
an exchange of equivalents. But in taxation this equivalence is
usually lacking. Jensen, making the point that concepts of justice at a
given time are subject to change, points out that it is necessary to go
back to the notion of injustice in order to give justice any meaning.
As an example of injustice, Jensen uses two taxpayers enduring unequal
sacrifice, when no inequality in their circumstances warrants such dif-
fences. 109 Jensen does provide some direction for guides to an

equitable total tax system, which are no less traditional than his view
of tax equity and justice. Jensen's suggestion that tax justice is not necessarily an ultimate principle of tax apportionment does not

Taxes should take from the members of the State the least useful moneys. Taxes should stimulate, if possible, or at least not unnecessarily restrict production. "The tax should promote or at least not retard, the optimum distribution of wealth. Taxes should be such and so laid that the difference between the reduction of the taxpayers income and the net receipts of the treasury is a minimum." Jensen, op. cit., p. 223.

lead him far from the nineteenth century approach to the tax system which was designed to achieve that tax justice. His concept of the equitable tax system is still couched in the tax or exaction side.

Paul T. Strayer in his recent book devotes a section to the problems of equity in the apportionment of tax burden. Strayer's approach, as do those cited above, emphasizes the "equal treatment for

equals" criterion with its characteristic exaction orientation. Discrimination in capital gains, income and other current taxes is his chief concern.

This exaction emphasis is reflected in the views of the fiscal theorist discussed in this section. The theorists to be reviewed


in the following section challenge this exaction emphasis and introduce
the requirement that the expenditure processes of government must be
considered in modern fiscal theory.

The Unification of the Expenditure and Exaction Processes

The Indifference Approach

An attempt has been made by Paul Samuelson to unify the contemporary expenditure requirements and the traditional exaction emphasis of tax systems. Samuelson implements the unifying process by means of indifference analysis. Families of indifference schedules permit a variety of choices between the level of taxes and the outlay of expenditures. A position on an indifference curve reflects a point of indifference to the exaction of taxes and the cost of supporting government expenditures. This indifference curve approach provides a


singular improvement in the method of analysis available to view the determination of the burden of taxation. Although a more precise tool of analysis has been used, the device itself prohibits empirical application. Samuelson's model has little practical value or usefulness since only selected expenditures may be considered at one time on an indifference map or evaluated vis a vis the tax. Samuelson's device is a more sophisticated statement of pricing of public services already suggested by Lindahl.

The Distributional Effects Approach of H. C. Simons

H. C. Simons was extremely critical of the subjective or hedonistic standards of indexes of tax equality. In fact, Simons objected to the entire idea of equity based on the distribution of tax burden, and pointed to Wagner's approach as more sensible and important than the contributions of the utility theorists. For Simons, Wagner's "candor and clarity on these points have exposed his position to many adverse comments; ....." Simons then admits that American writers who have criticized Wagner have in part, been influenced by his work. Simons' position on equity in taxation reflects some of the Wagner influence. The introduction of "distributional effects" in the consideration of methods to achieve equity would be an indication of German influence.

The Simons' view eschews the idea of equity in the distribution of taxation as such and seeks it instead in the distribution of income. 

117 Ibid., pp. 5-6, and 15.
118 Ibid., p. 15.
119 Ibid., p. 15.
120 Ibid., p. 16.
121 Ibid., p. 17.
must be predicated upon a preferred distribution of income after taxes.

The Theory of the Public Budget and Tax Equity

R. A. Musgrave in his *Theory of Public Finance* has directed his energies to the requirement that the tax exaction process must be evaluated by both the impact on factor allocation and the level of income and employment. The work is oriented toward the requirement that taxes must facilitate the goals of full employment and high levels of national income. Musgrave provides a general framework for an economic theory of the "public household" combining the functional finance of the stabilization type with other objectives of budget policy, including provision for the satisfaction of social wants and adjustments in the distribution of income. "Assuming, a full-employment economy, the task of budget policy is to contribute to an efficient allocation of resources and a 'proper distribution of income.'" This involves


the problem of determining what social wants are to be satisfied and who is to pay for them. Beyond this he begins the task of designing "efficient" tax and expenditure policies that avoid excessive burdens, and of designing a tax structure that complies with the basic requirements of horizontal equity. Musgrave's views on equity once again emphasize the popularity of the "equal treatment for equals"

\[127\] Ibid., pp. 123-161.

criterion for apportioning the tax burden.

An objective index of equality is needed to translate equity into a specific tax system.


Perhaps the most widely accepted principle of equity is that people in equal positions should be treated equally. This principle of equity, or horizontal equity, is fundamental to the ability-to-pay approach, which requires equal taxation of people with unequal ability. It has been suggested that the rule of horizontal equity is valid, even though little can be said about the matter of vertical equity, or about how the taxation of people in different positions should differ. The requirements of horizontal and vertical equity are but different sides of the same coin. If there is no specified reason for discriminating among unequals, how can there be a reason for avoiding discrimination among unequals. Without a scheme of vertical equity the requirement of horizontal equity at best becomes a safeguard that might be provided equally well by a requirement that taxes be distributed at random.\[129\]

\[129\] Musgrave, Public Finance, op. cit., p. 160.
With Musgrave the question of equity is a matter of social choice. However, his evaluation of tax types and their relation
ship to equity is predicated on aggregative not, individual, income standards, rather than subjective utility standards. The standards that must be met are the aggregative goals of high levels of employment. Thus each tax type is evaluated as to its effect on allocation, distribu-

tion, or in other terms as to its effect upon income and the choice of expenditures.

It is not surprising that a tax structure designed to provide the same treatment for the same tax base, with gross income as the index of equality, should point to the personal income tax as a single tax..... finance by income tax is acceptable only where it serves as an approximation to the proper solution -- a solution that involves equal treatment of people with equal levels of effective demand for public services.

Where objective indices can be found to implement taxation according to benefit, supplements to the income tax are in order.

Musgrave uses both the ability to pay approach and the benefit approach for the apportionment of the burden of taxes. He suggests objective rather than subjective indexes of equity, and relates equity to aggregative goals of the economy. With this approach, Musgrave has made.
progress into the requirements of a modern apportionment principle to include exaction as well as expenditure effects of tax policy. His recognition of the fact that public and private demand draw on the same total endowment of resources and share in the same output, thereby jointly determining relative products and factors joins private and public expenditures and receipts, to determine aggregate demand and thus the state of employment and the general level of prices. There is a clearly defined point of impact at which the public-revenue or expenditure-flow is inserted into the income stream but the eventual dis-

\[133\text{Ibid., p. 205.}\]

tribution of the cost and benefit to the taxpayer may differ greatly from the way in which the initial liabilities or outlays are placed.\[134\text{Ibid., p. 205.}\]

Considering the manifold possibilities, it is difficult to say whether, on balance, the government expenditures will reduce or increase the individuals' sacrifice or benefit, or what the implications of future development will be. "Looking at the expenditure side, there is reason to expect the future expansion will be aimed at the expansion of social wants proper....... Looking at the revenue side of the picture, increased reliance may come to be placed on taxes that do not involve a highly restrictive substitution effect on work effort....... There is no reason to assume that public services are an inferior good, or that the income elasticity of public goods or services is less than that of privately
purchased goods or services." 135 "Expenditures for defense, as usual, offer particular difficulties in interpretation. Thus it is evident that no simple generalization is permissible." 136

135 Ibid., p. 255.
136 Ibid., p. 254.

It is important to note in the Musgrave framework, that the aggregate goals of the economy can be achieved or implemented only if the values of the taxes are determined dependently with the value of the expenditures. The relative additions or subtractions of "social utility" 137 provided by the offering of public services to particular

137 A common denominator is necessary as a starting point in order that any one concept of an economic system may be regarded as better or worse than any other. The term used is not important.

individuals or groups in the economy will be dependent in part upon the relative tax loads imposed.

In effect Musgrave is suggesting that there are co-determinants of either justice in taxation or equity in taxation.

Summary and Evaluation of Tax Policy and Fiscal Policy

John M. Keynes did not discuss matters of public finance per se. Keynes' concern with public finance was devoted to one area, that of fiscal policy. Fiscal policy was one form of state action which could be used to balance inadequacies in the private sector. Hence, taxes as a part of fiscal policy were viewed by Keynes and his followers as devices
to influence the levels of consumption and investment and thus the
level of national income. The Keynesian analysis introduced method­
ology by which individual activity was aggregated into sectors of
economic performance.

The traditional, exaction emphasis of tax policy of older schools
of economics was by-passed in the new orientation. The possibility of
using taxation deliberately in stimulating or guiding the economy was
emphasized in Keynesian and post-Keynesian tax policy.

Tax policy during the post-World War II period and at present
points up the continuing effort of fiscal theorists to evaluate taxa­
tion in terms of the impact on the volume of employment, stability
of prices, and expanding production.

Tax rate structures have been justified on the oversavings em­
phasis of the Keynesian system. But no theoretical guides to the ap­
portionment of burden have been forthcoming out of this era.

Tax justice which was a fundamental ethical concern in tradi­
tional fiscal theories is of lesser importance today than the broader
concept of tax equity.

Tax equity reaches fruition if "equal treatment of equals" is
established by taxes, using objective standards of income-expenditure
patterns.

The public budget provides for a variety of public goods and
services, through stabilization and distribution programs. With the
budget as a determinant in the level of national income, taxation is
subject to evaluation as to effects on allocation and distribution but
also upon national income and the choice of expenditures.

Apportionment of the burden of taxation is one side of the taxation coin, since public revenue or expenditures influence the distribution of cost and benefit to the taxpayer. The objective standards of aggregative economic goals can become personally measured only if taxes are determined dependently with the expenditures. In effect expenditures and exactions are co-determinants of equity in taxation.

If the individual's economic status is dependent upon the tax imposed as well as the manner in which the government uses tax monies to influence employment and national income, the apportionment doctrine required needs to be a synchronous device. The rates of spending and taxing may be varied in order to compensate for unwanted fluctuations in investment and consumption spending. The expected private sector effects of taxation upon efficiency of investment and propensity to consume as well as the expected effects of government expenditures on investment and consumption establish a fundamentally new orientation for the process of apportioning tax burden.

Implicit in this orientation is an assumption that types of benefits accrue to the individual and groups of taxpayers. Also implied is a particular relationship between the individual and the state. The following chapter will review the theories of apportionment, discussed previously in this work, and their relationship to the current setting. The next chapter will also present various views that characterize the role of the state vis a vis the individual or groups of taxpayers.
CHAPTER SEVEN

The Relation of Government Expenditures and Theories of the State to Theories of Tax Apportionment

Introduction

The works of fiscal theorists presented in the preceding chapter pointed out the expenditure orientation of fiscal policy developed during the period of Keynes' influence on economic theory. In view of this contemporary emphasis on the importance of public expenditures for public wants, it is relevant to the development of this research to relate this expenditure orientation to the existing theories of the apportionment of tax burden.

In the opinion of the author of this research, the relation of expenditures and apportionment may be designated and evaluated with reference to the following assumptions. The determination of the amount and distribution of government expenditures requires a parallel determination of the nature of private and public wants. The determination of the apportionment of the tax burden to support such public and private wants requires a parallel consideration of the concepts or theories of the state that is to administer public expenditures.

The purposes of this chapter are (1) to present various bases for classifying government expenditures, (2) to set forth the manner in which the changing bases of classification of expenditures indicate the character of the changing responsibilities of government, (3) to point out two
opposing theories of the state upon which theories of government expenditure may be erected, (4) to point out the criteria which are relevant to the identification of theories of apportionment with particular theories of the state, (5) to determine which theories of apportionment may be identified with particular theories of the state.

The chapter material is developed so as to set forth the neoclassical and "Keynesian oriented" as well as statistical and budgetary classifications of expenditures. The various bases of classification of government expenditures are presented in Part I of this chapter. Part II presents the individualistic and organistic theories of the state. A discussion of the relationship of apportionment doctrines and particular theories of the state is presented in Part II. Part III of this chapter emphasizes the postulates of the benefit and voluntary exchange theories in reference to the individualistic theory of the state. The postulates of the sacrifice theories are evaluated with reference to the organistic theory of the state.

Historical Setting

Modern criticism of the "traditional" apportionment principles has been conducted mainly on the premise that the doctrines neglect the expenditure of tax revenue.¹ Di Viti de Marco² and Duncan Black³

² Di Viti de Marco, op. cit., pp. 390-399.
have been emphatic in suggesting that tax analysis must include the manner in which government expends its revenues. The effects of taxation require a study of government expenditures. Black is prepared to argue that tax analysis must look upon a tax as including government expenditures and transfer payments.\(^4\)

\(^4\)Black, \textit{op. cit.}, pp. 144-148.

H. C. Simons once noted that, "one must know what the state does in order to discuss intelligently how revenues should be obtained."\(^5\)


Slade Kendrick has proposed the view that government expenditures should be treated as inseparable from a tax. "... if it can be shown that the expenditure of the funds yielded by a tax, changes the supply-demand relationship of the object taxed, a consideration of such effects of this expenditure is relevant to the analysis of the incidence of this tax."\(^6\) Earl Rolph offered the following evaluation of the revenue-expenditure approach suggested above. "The valuable feature of the taking-account-of-the-proceeds approach is the emphasis on the view that public expenditures should not be ignored in tax analysis."\(^7\)


An opposition view was set forth by Edgeworth and Pigou. Edgeworth held that the effects of taxation should be attributed to the tax and expenditure effects attributed to expenditures. Pigou analyzed the effects of taxes and expenditures separately, even though in his analysis he assumed expenditures were constant.

P. A. Samuelson laments the fact that although, "economic theorists have done work of high quality in the field of taxation, public expenditures seem to have been relatively neglected." Samuelson suggests that "we ought periodically to survey the neglected areas of theory to make sure that they do deserve to be left in their underdeveloped and backward states."


A. C. Pigou, op. cit., pp. 30-34, and 40.


Samuelson, Ibid., p. 332.
PART I  The Classification of Government Expenditures

Neo-Classical Classifications

Government expenditures may be classified as to the function of expenditures as well as to the functions of government. Both of these bases of classification were used by neo-classical fiscal theorists, although functions of expenditures predominated as a classification base. "Expenditure is an empiric fact, while functions of the state are part and parcel of social philosophy ... it is serious error to assume that there is a perfect correlation between these functions and government expenditures."\(^{12}\) In one view,\(^{13}\) the function of the expenditures themselves is the satisfaction of human wants and desires, measured in terms of utility and benefit. H. C. Adams is criticized by Guest for using a classification based on functions of government.\(^{14}\) For Adams


\(^{13}\) Ibid., p. 42.

\(^{14}\) Guest, Ibid., p. 42.

the government outlays were for either protective, commercial or developmental purposes. The need for protective expenditures would decline as the private sector continues to indicate economic expansion. The commercial expenditures were minimized in Adams' theory of public expenditures.\(^{15}\)

C. F. Shirras was troubled with Adams' classification because it was
difficult to draw the line between the different functions and wished
a classification "more in harmony with the everyday expenditure of
countries." Shirras then offered a two-fold basis of classifica-


tion of expenditures. Government expenditures are either primary or
secondary types. The primary expenditures were those the government
was obligated to undertake, i.e. defense, law and order, civil adminis-
tration and payment of debts. Expenditures which were useful but not
necessary, such as social welfare, education, sanitation, public health
and charitable relief, were the secondary type. 17


In a 1913 work, Carl Plehn made explicit the emphasis on benefits
in his classification of expenditures. 18 The classification introduced

18 C. C. Plehn, Introduction to Public Finance (New York: Macmillan

by Plehn was based on the degree of benefits conferred by the state:

1. functions which confer such a specific benefit upon
the individual, and so clearly performed solely for the bene-
fit of the individual, that he would "naturally" be expected
to meet the cost;

2. common benefits upon all members of the state,
that cannot be parcelled out and each portion assigned to
respect members;

3. special benefits that are separately assigned,
but the assignment is waived, making the full charges
fall on total ability;

4. special benefits on individuals unable to assist
in bearing the charges which are a common benefit to
society.\(^{19}\)

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\(^{19}\)Ibid., pp. 30-34.

Plehn clearly recognized the benefit aspect of government expenditures measured in individualistic terms but did not touch on the kinds of benefits received.

Professor J. S. Nicholson based his classification of expenditures upon the relation of public revenues. He distinguished four classes of expenditure according to their effect on the return of revenue: (1) expenditure with no return on revenue; (2) expenditure with indirect return on revenue; (3) expenditures with partial direct return; and (4) with full return or profit.\(^{20}\) The first class of expenditures might occur

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for military expenditures or for care of indigents; support of public schools illustrate his second type; the third class might be illustrated in the partial payment for a school system supported by fees; the fourth class would correspond to Adams' classification of commercial activities
of government. From this classification, Nicholson noted that "contrary to the prevailing popular opinion, the principle business of the state is to perform functions that do not yield corresponding revenue."

Nicholson's classification subordinates the expenditure problem to the revenue question and defines it entirely in terms of public income.

Classification for Statistical and Budgetary Purposes

Other bases of classification made for statistical or budgetary purposes were framed with strictly practical ends in view. According to Guest, such a classification was described by H. L. Lutz. In the 1929 edition of his *Public Finance*, Lutz introduced an extremely broad basis for expenditure classification. His classification may be termed an open-ended type with no relationship to benefit or utility. Lutz preceded Lutz with an open-ended type of classification devoid of any relationship to benefit or utility. Oakey introduced a classification with five different standpoints in order to furnish the information needed for accounting control purposes: (1) Organization Units; (2) Purposes; (3) Character; (4) Object; and (5) Funds. See Francis Oakey, *Principles of Government Accounting and Reporting* (New York: D. Appleton, 1921), pp. 334-356.
uses the following groups of expenditures, (1) Ordinary Government Activities; (2) Commercial Enterprises; (3) Public Debt; (4) Trust and other Special Funds; and (5) Bookkeeping Transactions.

Contemporary Classification of Expenditures

In the contemporary literature of public finance there is little indication that expenditure classifications distinguish between the functions of expenditures and the functions of government.

For example, H. M. Groves classified expenditures as self-liquidating, reproductive, productive and non-productive.\(^26\) Groves' classification may be used to point out the processes whereby expenditures contribute to changes in the size or volume of national income. Another, perhaps clearer, example of the function of government shaping the classification of outlays is found in Musgrave. Musgrave points out that government functions may have or bring about allocative, distributive or stabilizing effects in the private sector and that the public budget is classified on the basis of these effects.\(^27\)

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The basic purpose of the allocation expenditures is to implement government choices among various alternative and private uses of an economy's resources. It is the basic task of the distribution expenditures
of the government to determine and secure a "proper state" of income distribution. Musgrave points out that "private effective demand" cannot be accepted in furnishing a guide to the efficient use of resources.\(^{28}\) The function of stabilization expenditures differs sharply from the other two mentioned above. The concern is not with

\[^{28}\text{Musgrave, Public Finance, op. cit., p. 17.}\]

the allocation of resources between public and private uses or between alternative private wants. The purpose of the stabilization expenditures is to maintain a high level of resource utilization and a stable value of money.\(^{29}\)

\[^{29}\text{Ibid., p. 22.}\]

Samuelson preceded Musgrave in viewing public expenditures as to their general redistributive effects upon aggregate economic activity. Although Samuelson does not attempt to classify particular expenditures, he sets forth a grouping of expenditures which characterized the role of the state \emph{vis a vis} its outlay effects. (1) Optimal transfer expenditures occur given a social welfare function, and given the absence of all "external" technological and tastes and given universal constant costs to scale, there would be needed only one type of public policy -- redistributive transfers. Under some ethical assumptions, these might be from poor to rich rather than rich to poor; but only by chance alone would zero redistributions maximize a special social welfare function that depends on real incomes.
2. Minimal collective expenditures include "deadweight-theoretically-avoidable" tax burdens in addition to unavoidable real burdens involved in having to use resources for public purposes. So long as "real burden" expenditure is small, the deadweight burden is negligible, no matter how taxation is used. Only as a minor concern, does it matter what tax structure is used to cover the needed program.

3. Sizable "real burden" public expenditures require the recognition of the possibility of public collective services. These expenditures may be large rather than small and in any case will be finite rather than zero or infinitesimal. This aspect of expenditure effect provides an opening wedge for an alternative type of social allocation than the "optimal transfer" aspect. If constant returns to scale do not exist and if every good's consumption is not purely individualistic, then there will occur strong "external" effects of public expenditures. The nature of the external effects provide the basis on which the government expenditures re-allocate real burdens of tax support or provide bases for policy where individuals may be made worse or better off by the exchange of resources by public finance.30


Neither Samuelson nor Musgrave suggest any relationship between expenditures and individual benefit of utility of such expenditures.

Another basis of viewing the financial operations of government in the post-Keynesian period has been suggested by Professor Rolph.
Government operations which involve the use of resources or the acquisition of products may be divided into the following classes:

1. Operations which promote government objectives directly.

2. Operations which promote government ends that can be achieved only by fulfillment of the desire of particular persons or private organizations.

3. Operations which effectuate money transfers by government to private groups and by private groups to government.

Operations designated to promote private ends by the technique of:

4. Full price rationing of a service or commodity of particular private persons or organizations.

5. Partial price rationing of a service or a commodity.

6. Self-rationing of government facilities subject to overuse (diminishing returns).

7. No rationing of any kind (use of facilities not subject to diminishing returns).\[31\]


Operations 1, 2, and 3 are government functions, and the costs of performing them constitute the cost of what Rolph calls "government ends."\[32\] Operations 6 and 7 are treated as involving costs of government because these activities cannot be assigned to private groups in any measurable fashion. Operations 4 and 5 are viewed as "government
enterprise" functions which may or may not entail a subsidy in kind by private groups. These costs are costs of government because they do not promote government ends.  


Rolph's classification of government operations is similar to the "cost" classification, or "government-cost payments" used by the Bureau of the Census. This "cost" classification indicates the payment made to cover the cost of the service of government. Distinction is made by the Bureau of the Census between cost payments and non-cost payments in the annual publications of the Bureau.  

\[34\] Cost payments are payments that involve cost to the public treasury. Non-cost payments include debt-payments, investments, trust fund payments, and subsidies and grants. Non-payment costs are costs not in the form of money payments, as in the use of natural resources.

As such the costs may be classified on other bases, such as those suggested by Adams or Groves or Lutz. The importance of Rolph's classification device rests with the fact that government operations may be viewed as an enterprise function whose services may or may not require a corresponding cost-payment from the recipient of the services or goods. The public function may be distinguished by activities of government that
serve its own ends and those which serve the ends of private individuals or organizations. This aspect of the government expenditure role will be discussed in a later section.

Summary

Since public expenditures have many and diverse characteristics, no single classification of expenditures will suffice. Writers on expenditures have differed among themselves to any master principle of classification. However, the proper basis of classification for a particular purpose is the one that will best disclose what is desired to know. Expenditures may be classified according to characteristics of cost as was used by Kolph or by benefit from public service as incorporated by Flehn in his writing. J. S. Nicholson used a classification based on the fact that some public services yield a return to the Treasury for the money spent. This classification reflects the productivity of government expenditure.

The purpose of the review of such classification schemes is to point out that among neo-classical writers the government demand for factors was part of the total factor demand and in effect influenced factor allocation. The character of government expenditures did not imply that there were no effects of such expenditures on the economy. However, the direct effect on factor allocation as a whole upon the whole economy received little attention, in the various bases of classifying expenditure.

The post Neo-Classical classification of expenditures, by contrast, include categories of government expenditures which point to the effect
of the role of expenditures in attaining sector goals. This emphasis on the expenditure role of the government *per se* to purposefully implement policy for sector goals was illustrated by Musgrave's allocative, distributive and stabilization classes. Samuelson contributed to this emphasis by establishing a frame of reference for expenditure functions of the government.

Bases of classification have been suggested that do not emphasize the distinction noted above, but serve statistical and budgetary purposes. This type of classification was suggested by Lutz and incorporated into Rolph's classification scheme.

Inherent in the neo-classical suggestions of the classification of expenditures was the idea that government pursues expenditure goals that benefit or add "utility" to the position of the individual in the community. While the classification by Rolph implies that "government

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35 Guest, loc. cit., Vol. XX, p. 43.

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must be viewed as having ends of its own which cannot be broken down into the ends of individuals."36 Musgrave and Samuelson concur on the implication that government designs policy for the aggregate of individuals in the economy and undertakes expenditure programs to implement the policy ends. The two opposing positions illustrate the characteristic

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36 Rolph, op. cit., p. 37.
that public expenditure and thus certain aspects of apportionment may be erected on either of two political foundations, which represent two separate theories of the state.\textsuperscript{37}

\textsuperscript{37}Myrdal, \textit{op. cit.}, p. 158.
PART II  Theories of the State

A framework for expanding government revenues as well as apportioning the burden of the revenue may be erected on either of two opposing theories of the state.

The Organistic Theory of the State

In the first theory of the state, or what has been called the "organistic" or "organismic" theory, the state, including all individuals within it, is viewed as a single organic entity. The state is considered as a single decision-making unit acting for society as a whole. The state seeks to maximize some common denominator or a quantifiable magnitude of collective goals. This maximizing process will include the manipulation of many factors which are outside the scope of fiscal theory. "Many of the variables are non-economic; and even among those which may be classified as economic in nature, a relatively small proportion can be included in fiscal theory." The variables to be determined in the fiscal process are the expenditure variables and the tax variables. The allocation of the tax variables which will maximize collective goals, will be different for each distribution of total


The distribution of expenditure which will maximize collective goals will be a function of the tax variables. The relative additions to the collective position provided by offering public services to particular groups will be dependent upon the relative tax loads imposed.

For each distribution of public expenditures the necessary condition for the optimum allocation of the tax load is reached when a dollar tax upon each economic entity deducts an equivalent amount from the aggregate social utility. The economic entities for such tax comparisons may or may not be individuals in this analysis.

The theoretical steps in the maximizing of collective goals offer little or no direct guidance to fiscal authorities. This approach has been utilized in the theory of budgeting, where it can provide a frame of reference for the functional interdependence of the whole fiscal system.

Individualistic Theory of the State

In the individualistic theory of the state, the individual replaces
the state as the basic structural unit. The state has its origin in, and depends for its construction upon, the desires of individuals to fulfill a certain portion of their wants collectively. "The state has no ends other than those of its individual members and is not a separate decision making unit. State decisions are, in the final analysis, the collective decisions of individuals.\(^4\)

\(^4\) Buchanan, Fiscal Theory, op. cit., p. 12.

The income of the state represents payment made in exchange for services provided. Therefore, the state would not seek to make profit from any services offered. In this theory of the state, there is no implication that the services are sold to the individual taxpayer. In effect, the public service losses to government must be balanced by profits accruing from the provision of others. The range of public services are determined by the collective willingness to purchase them. "Ideally, the fiscal process represents a quid pro quo transaction between the government and all individuals collectively considered."\(^5\)

\(^5\) Ibid., p. 12.

The individualistic approach does not include the specifications of the fiscal system to be adopted by the collective individuals. The ends of the fiscal system may be determined by political decisions. This individualistic approach does enable the theorist to indicate the alternative distributions of tax burden and public expenditures. Given the collective goals of the individuals, the fiscal theorist may suggest tax and expenditure allocation which will aid in implementing collective goals.
Summary and Evaluation of Theories of The State

The organismic theory of the state gives a more complete normative pattern for the fiscal authority than does the individualistic theory. Since the government is the basic entity, the fiscal theory reduces to a statement of an applied maximization problem. Major obstacles rest in attempts to translate theoretical ideas into action.

In the organismic approach, the government need not represent the collective will of individuals and can be considered the originator of action in the abstract sense. The fiscal system exists as one channel through which certain government goals may be attained.

Public Wants and Politics and Theories of The State

Both the individualistic and organismic approaches to the theory of the state require parallel consideration of the determination of the expenditure allocation and the apportionment of burden. "Any theory of
the revenue-expenditure process remains incomplete unless the theory of the state concerns itself with the determination of how preferences are revealed. ¹⁹


Since government services are not priced for sale as in a market environment, some political decision making process is required. "This may not be a problem in economics as it is usually conceived, but it is an inherent part of the theory of the public economy." ⁵⁰ There is a two-fold problem indicated. On the one hand it is necessary to show how public wants are generated and on the other hand how individual preferences can be established if they cannot be revealed in the market.

Both Samuelson and Musgrave support the position that public wants are an inherent part of the preference patterns of individuals. In their views public wants do not differ from private wants. The individual demand curves for services supplied in the satisfaction of public wants may be derived from the indifference pattern of individual preferences -- as demand schedules for services supplied in the satis-

⁵⁰ Ibid., p. 116.

faction of private wants are derived. ⁵¹ In the satisfaction of private


wants, if an individual wants a product he must bid with a price to reveal his want and preference. This process may not hold for social or public
wants, since some consumers will be able to obtain the services whether they contribute or not. Since an exclusion from the public wants cannot be applied, there is no reason why consumers should reveal true preferences. The problem is to find a way by which consumers may be induced to reveal preferences so that the public services may be planned accordingly.

PART III The Apportionment Theories and The State

The Individualistic Theory and Benefits

In the individualistic view of the state, the extent and range of public services are set by the collective willingness of individuals to purchase them. Services will be provided as long as the "marginal aggregate" benefits are greater than marginal costs. Ideally, the fiscal process represents a quid pro quo transaction between the government and all individuals collectively considered.\(^{53}\) J. M. Buchanan contends that "each individual is subjected to some fiscal pressure; his economic resources are reduced by the amount of the tax he bears."\(^{54}\) Therefore, his real income may be increased by the benefits that he receives from public services. Distribution of the total tax burden among taxpayers is combined with the distribution of benefits from government services to complete the framework. In this sense the benefit principle must be applicable to this theory of the state. However, in the benefit theories of the seventeenth and eighteenth centuries, any imputation of specific benefits to individuals has "been almost completely glossed over.......

Overwhelming attention has been devoted to the allocation of the tax burden."\(^{55}\) The omission of the benefits received can be attributed

\(^{53}\) Buchanan, Fiscal Theory, op. cit., p. 12.

\(^{54}\) Buchanan, op. cit., p. 13.

\(^{55}\) Ibid., p. 13.
to the foundations of the benefit theory.

Gunnar Myrdal contributes insight into the foundations of the benefit theories of apportionment in his incisive review of the theory of public finance and the political influences on economic theory. Myrdal observes that the discussion of apportionment is carried on at two levels simultaneously. First, there is the discussion of principles in which "norms" for budgetary policy are established. "The norm is postulated to begin with. It is ... that taxation ought to be 'just,' that expenditures must be "economical," that individuals ought to be treated as 'equals,' etc." These norms are value judgments of various types rather than objective or empirical criteria.

Second, there was discussion as to what practical policies or what practical application was to be effected on the basis of the principles that were established as the "norm."

The principles are important because they give the resulting policy interpretations the characteristic of objectivity. The interpretation of the principles or "norm" borders on political theory, since the actions of the state and government authorities are concerned.

Classical Benefits Principles of Apportionment

The practical bases of taxation of the classical economists rest
upon their theory of the state as the protector of the individual and
property. Their principle of taxation is that the tax should be "pro-
portional" to the benefits derived from the protection. The
economic aspect of taxation is simply the economic side of the political

58 Weston, op. cit., p. 125.

doctrine. According to this view, a tax is considered as the expense of
protection, while the value of the protection is measured by the amount
of property protected. This is expressed by Adam Smith, whose canons
have become classics on principles of taxation. Smith noted that sub-
jects should contribute to the support of the government in proportion
to the revenue which they enjoy under the protection of the state. Smith
also noted that taxes should be certain, convenient, and economical.


The Smithian benefit theory was contributed in an era of particu-
larly significant economic and social change. Smith wrote in an era when
the monarchial support of business activity was nearly discredited.


The activity of the state was curtailed and expenditures were limited.
It was the political and economic philosophy of laissez faire or eco-

nomic liberalism that delimited the scope of the government activity.
The public outlays were in the form of joint costs to meet the collective
Thus the classical benefits doctrine neglected the expenditure aspects of political economy and emphasized the consideration of the principles in the treatment of the revenue aspects of taxation. This revenue emphasis based on the principles of justice, equity, convenience, etc., left the revenue-expenditure process outside the body of economic theory. The general idea underlying this theory is that political basis which assumes that a tax is a payment for a service rendered by the government to the individual. The basis of the tax is assumed to be a "service" or the "benefit from a service." The tax payment should be made in accordance with the "service" or "benefit" received. The "service" is ultimately resolved into the service of protection. The different forms that the basis has assumed may be stated in either the cost of the service or the value of the service.

In the benefits theory advanced by classical economists the principles level dominated the discussion. Expenditure considerations were obviated because the role of the state was restricted to providing a minimal level of services which could be assumed to have a quid pro quo
relationship to the private outlays. The benefit basis of apportionment offers no answer to the problem of either the determination of expenditures or determination of public wants. 65


The Voluntary Exchange Theory of Tax Apportionment

Although the traditional benefit doctrine contained an elemental basis of an exchange interpretation of the revenue-expenditure process, an explanation of "the process as a problem of value and price was not attempted until the reformulation of value theory in terms of the marginal subjective utility suggested an analogous interpretation of the theory of the public economy." 66 The traditional benefit theory and


the voluntary exchange theory differ as to the revenue-expenditure processes. The benefit idea was replaced by an analysis of the determination of absolute and relative tax shares on the basis of individual evaluation. This was previously postulated as a principle and was arrived at in the voluntary exchange doctrine as a condition of equilibrium resulting in the actual determination of the revenue-expenditure process. 67

DeMarco, an early advocate of a voluntary exchange thesis, postulated that the public economy will undertake to supply only those goods and services which it is superior to the private enterprise in production. For DeMarco, how the economy will procure want satisfaction from these goods is of secondary importance. The process through which such decisions are arrived at was his primary concern.

There are several aspects of this process noted by DeMarco as well as Wicksell and Lindahl. In determining the relative distribution of tax shares between various taxpayers, a choice must be made between the satisfaction of alternative wants by private individuals. Another choice must be made between the satisfaction of alternative public wants to determine the application of revenue from the first choice. One additional choice must be made between the alternate satisfaction of wants decided upon by the government and the wants of the individual. The third decision cannot be made without some knowledge of the relative distributions of tax shares and the expenditure allocation corresponding to different revenue and expenditure totals.

To explain these decisions, a process analogous to the private economy is made, namely, the allocation of the total cost of two joint
products to the supply prices of the two products. The allocation is made, not according to cost imputation, but according to the demand for the two products. A buyer of one product is willing to contribute a small portion of the total cost of producing both products. If one taxpayer desires a given level of public services he is similarly confronted with other taxpayers' unwillingness to contribute more than a certain percentage of the cost of these services. Under an assumption of equal bargaining power, a final agreement between taxpayers is reached at a volume of services at which the sum of the percentage shares, which both are willing to contribute, equals all or the total cost of supplying the services. While an equilibrium may be established at any level of services, if marginal utility and price are equated for both parties, the aggregate utility derived from the purchase of public services is maximized.

The total volume of taxation and the distribution of relative tax shares is determined by this market like device. This process does not explain the choice between alternative expenditure choices. This difficulty is solved by assuming that the decisions concerning allocation of public expenditure items and the distribution of cost to taxpayers are rendered simultaneously. The willingness of all taxpayers to contribute a given share depends on the prospective application of their contributions.

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71 Lindahl, op. cit., pp. 80-89.

72 Ibid., p. 85; Wicksell, op. cit., p. 77-80.
It is assumed by the author of this research, that the Lindahl, Wicksell position may be interpreted in the following manner. Whether or not each taxpayer is willing to accept a certain project depends upon his comparative evaluation of the marginal benefit to be derived from the satisfaction of wants resulting from the prospective public expenditure and the marginal benefit to be derived from his private outlay or in the form of possible tax contribution.

The voluntary exchange doctrine is composed of the two-fold aspect of principles as "norms" and problems as practical application.  

73 See p. 236 this chapter.

The principles as norms 74 are contained in the assumptions from which a competitive solution of the pricing process will result. The conclusion that the nature of the pricing process may not be competitive affects the merits of the theory as a solution to the problem cited above. According to Wicksell, the term "justice in taxation" may, as a matter of logic, be applied only on the assumption that a "just" distribution of income exists. 75 Accepting this condition, Lindahl divides

74 See p. 236 this chapter.

75 Wicksell, op. cit., p. 143.

the requirements for "justice in taxation" into the socio-political problems of establishing a just distribution of income and the fiscal
problem of not disturbing this income in the revenue expenditure
process. The competitive solution provides a "just" state of tax-

Lindahl, Gerechtigkeit, op. cit., p. 9.

ation. The correspondence between price and marginal utility for taxpayers indicates that they benefit "equally" in accordance with the given distribution of income. If however, imperfect competitive conditions exist or incomes are not distributed "justly," the relative position of different taxpayers will have been changed, implying that the prevailing distribution of relative tax shares fails to conform with the standards of tax justice. If the competitively determined equilibrium position is assumed to be "just," it follows that the underlying income distribution must be "just" and vice versa. This is circular reasoning.


Once the "just" state of the revenue-expenditure process is viewed in terms other than competitive-exchange-equilibrium, there is no difficulty in assuming "justice in taxation" to be consistent with any state of distribution, just or otherwise.

Lindahl summed his view on the principle of tax justice vis a vis the practical aspects in this manner: "Every system of taxation con-
tains an element of it (tax justice, W.L.H.) and these fiscal prin-
ciples are, therefore, unlike the socio-political principles, always rele-
vant and independent of the ethical evaluation of the distribution of property. Even if distribution is unjust, the relation between taxation
and a just distribution is not without significance. The solution of this problem is most important -- and the most difficult -- task of the practical theory of public finance. 78


In Lindahl's analysis the socio-political principles are outside the scope of his analysis and he discussed primarily the purely fiscal problem, which presupposes a given distribution of income. The fiscal problems are explained in terms of "certain factors" in the manner of marginal utility theory. His fiscal theory is a version of the older benefit doctrine. The idea of using marginal utility in this connection is his unique contribution. The refinement of the benefit principle, if valid, has the advantage of solving both the problem of distribution of tax burden and the scope and type of public activity. However, the underlying ideas of the principles applied are the same as that of liberal doctrines of the classicists. Taxation is not regarded as an interference with price formation under free competition, but as an integral part of it. Accordingly, the fiscal optimum is defined as that position in which the money values of the total utility derived by all citizens from state activity is maximized. 79


Although the voluntary exchange thesis of Lindahl and Wicksell bypassed and omitted, respectively, the socio-political problems of fiscal policy, this theory is applicable only when a given type of political
system exists. Lindahl, following Wicksell, arrives at the demand for
democratic government, a limited veto for minorities, specialization
of the budget through linking taxation to particular items of public
expenditure, and political representation. Another assumption is

80 Lindahl, op. cit., p. 87.

the equal distribution of political power. This means that all politi­
cal parties have an equal opportunity of realizing the rights which are
due to them under the prevailing property laws when fiscal legislation
is enacted. There must be no excess power of certain classes in the
determination of the budget. This assumption turns out to be a particu­
lar assumption rather than a premise of the theory.

81 Ibid., p. 88 ff.

82 Myrdal, op. cit., p. 182; see Lindahl, op. cit., p. 97 ff.

Aside from the fact that the very idea of voluntary exchange is
subject to criticism as being unrealistic, the assumptions regarding
the political process and conditions of bargaining power are the prime
targets for criticism of this theory.

83 Indirectly the element of compulsion affects the behavior of in­
dividuals in the formulation of collective decisions. In attempting to
minimize their own contributions, political groups are concerned with
the task of forcing a maximum contribution upon others rather than with
accepting the latter's voluntary offers. See Musgrave, loc. cit.,

Differences in bargaining power refer to the effectiveness of
two parties in their respective attempts to conduct the bargaining process so as to arrive at the most advantageous equilibrium position, without impairing the voluntary nature of the other parties' final decision. The most significant interpretation of the term points to

the degree to which a party is able to account for his own bidding on price, directly and through the reaction of the other party. If compulsion and unequal bargaining power are introduced into the analysis even as an element of market imperfection, the practical usefulness of the thesis breaks down. The theory as explained is invalid for use in a market or political environment that exhibits imperfection.  

See Lindahl, op. cit., pp. 92-95, for his suggestion for expanding the competitive assumptions.

dence from political reality -- witness the pressure group mechanism of modern parliamentary government -- testifies overwhelmingly for the assumption of unequal bargaining power."  

The voluntary exchange theory does solve the problem of determining simultaneously exactions and expenditures and may be logically valid. Disregarding the unrealistic nature of the assumptions, it fails to provide practical significance because it is incompatible with the institutional and social framework in which the modern public economy operates.

Ibid., p. 220.
The theoretical considerations are significant only insofar as they provide a scale of reference for analyzing the deviations of the actual conduct of the revenue expenditure process from the standards set by the theoretical models.

Musgrave's Supplement to the Theory of Voluntary Exchange

Musgrave in later work supplemented the unrealistic aspects of the voluntary exchange theory, namely the aspect of unequal bargaining power in the voting process.

Musgrave is concerned with finding a technique by which individuals can be induced to reveal their true preferences on budget policy. "Since these problems cannot be solved by the mechanism of the market, we must turn to a process of political decision making." Musgrave postulates that we know there exists a set of demand schedules for the satisfaction of public wants based upon the preference systems and incomes of various individuals. The means to accomplish the revelation of these demand schedules is the voting process, which will be followed by enforcement of tax policy and budget policy. The voting process offers a means through which rational individuals are forced to reveal their preferences, but it is also a device for establishing a government budget which will not satisfy everyone.

Since the same public services are available to all, and since all are subject to the same tax
formula, contributions will not be allocated according to the true evaluation of each and every member of the group. Yet the use of such a formula and the inherent compulsion are the only means by which voters can be induced to reveal their preferences. The trick, then, is to find the type of voting process that gives us the best approximation to a result based on the true evaluations.90

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In evaluating several voting systems, Musgrave includes the general case under majority rule where only two alternatives are decided upon. This will always yield a solution or at the worst, a draw. He also includes a situation with more than two alternatives where voting must be taken between pairs of alternatives. The outcome of this process is also determinate.91

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91 Musgrave, Public Finance, op. cit., p. 118.

Additional situations include: (1) A single service (one type of public service) where taxes with a fixed share are given and the size of the budget is to be determined in the voting process; (2) single service budget where taxes with variable and continuous shares are given and the budget is to be determined; (3) single service budget where the taxes with variable and reversing shares are given with the size of the budget to be determined; (4) single service budget where the size and the tax with fixed shares are to be determined; and (5) a multiple service budget where the size and fixed taxes are given and the composition of the budget is to be determined.92

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92 Ibid., pp. 121-125.
Musgrave contends that if the majority rule does not provide an efficient solution, the result of the majority voting is "optimal" in the sense that it is the solution agreed upon by more people than any other. The majority solution gives the greatest aggregate utility when the same positive weight or utility is attached to each person who agrees and no negative weights or disutilities are attached to persons who don't agree. This process of evaluating majority rule is fairly crude when compared to other systems where attention is given to the intensity of satisfaction or dissatisfaction of individual voters. Wicksell's system which is concerned with rights of minorities is one type more sensitive to the individual voter. Wicksell suggests that proposals for increasing expenditures by various amounts ought to be combined with different proposals for new taxes to finance these expenditures. If some combination obtains the required majority, whether three-fourths, nine-tenths or five-sixths, it should be enacted. The same procedure is to be used for adjusting the tax structure or for substituting one tax for another tax. These processes and the
different majorities are required to protect the interests of individuals who might otherwise have no influence through voting on a simple majority basis. Musgrave also concludes that the Wicksellian approach has the advantage of protecting minorities and serving as a stabilizing factor, but encourages a policy of inaction and interferes with the interests of the majority. 98

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98 Musgrave, Public Finance, op. cit., p. 128.

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Musgrave also reviews the plurality rule approach and the point voting scheme to complete his classification of the voting systems, as well as introducing the problems of strategy and collusion that would hamper the operation of the voting process. 99

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In his review of the voting process alternatives, Musgrave draws conclusions as to whether the systems are determinate or indeterminate based on their closeness to a utility "frontier," 100 and the principles that underlie the choice among various points on the "frontier." Musgrave's concern with the highly abstract concepts of the utility functions are beyond the scope of this work and are included primarily to characterize the manner in which rationales for various voting systems are established. Inherent in this approach is the reliance upon the use of "interpersonal comparisons" to establish the rationales.

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Musgrave's approach, as well as others that characterize the budget as a "welfare" plan, have the advantage over the traditional benefit and voluntary-exchange approach of introducing the expenditure side of the budget and suggesting the planning aspect of such expenditures.

Although the voting process does provide a basis by which social preference in the form of public wants may be revealed, the fact that compulsion is introduced and the point stressed that the same supply of public services must be consumed by all requires the conclusion that there is no single "optimal" solution for the amount supplied and the distribution of costs shares.

The supplemental aspect of the voluntary-payments benefit approach suggested by Musgrave furnishes no particular operational solution to the problem of establishing the revenue-expenditure process of current fiscal systems. However, this modification of the benefits approach underscores the quid pro quo orientation that is consistent with the individualistic theory of the state. There appears the individualistic principle of interest through which the extent and range of public services are determined by the collective willingness to pursue them. Services will be extended in the fiscal process to represent an exchange transaction
between individuals collectively and the government.

101 Buchanan, op. cit., p. 12 and Myrdal, op. cit., pp. 161 and 163. The voting mechanism does not in itself assure that a quid pro quo relationship will exist between the state and the individual. To begin with, there is the basic choice between an ordering of social preferences that is authoritarian to meet the personal preferences of a ruler, benevolent or otherwise; and the ordering that is democratic, to reflect the preferences of the constituent members of the group. Given our particular value judgment, the normative theory of the budget planning must be democratic. Musgrave, Public Finance, op. cit., pp. 117-118; see E. V. Bohm-Bawerk for the manner in which the subjective valuation of present and future goods is transferred to objective exchange value. Bohm-Bawerk’s subjective utility basis of value for individual wants is analogous to the Musgrave process of determining the aggregative value of public services. E. V. Bohm-Bawerk, The Positive Theory of Capital (New York: G. Stechert Company, reprinted 1923) translated by Wm. Smart, pp. 278-280.

The Organismic Theory of the State and the Sacrifice Theory of Apportionment

According to the organismic theory, the state is considered as a single decision making unit acting for the society as a whole to maximize some conceptually quantifiable magnitude. In this theory it is the function of the "fiscal brain" or "computer" to establish and select the tax variables which will maximize "social" utility. The al-

102 Buchanan, Fiscal Theory, op. cit., p. 9.

103 Ibid., p. 10.

location of the tax load which will maximize social utility, or minimize deductions from utility, will be dependent upon the relative tax loads
imposed. The principle of taxation which is appropriate in this theoretical framework is that of the Edgeworth-Pigou variety.

The relative criteria of comparisons are reductions from social welfare or utility; the least aggregative sacrifice approach is the correct one. The principle of equi-marginal sacrifice, or better subtraction, if values are given for the expenditure variables, provides an acceptable rule for the apportionment of total tax burden. For each allocation of public expenditure the satisfaction of this principle will define an apportionment which will minimize the subtraction from social utility.

Myrdal supports the Buchanan position on the relationship of sacrifice and the organismic theory of the state. Myrdal indicates that in the principle of levying taxes on the ability to pay, what counts is the ability to contribute towards the common costs of promoting collective interest. "This principle is best suited for an organic theory of the state."

Again following the lines of reference set forth in the preceding sections, the ability to pay doctrine is introduced for the specific purpose of evaluating whether this concept permits revenue-expenditure determination vis à vis its consistency with the theory of the stated requiring support. As stated previously, the problem is to find a way by which individuals may be induced to reveal preferences so that a budget may be planned accordingly.
Musgrave offers a very terse evaluation of the ability to pay approach in these terms. "It gives no clear-cut principle of tax distribution and fails altogether to answer to problems of expenditure determination." In evaluating the ability doctrine Myrdal concludes that the "scope of public activity and hence the amount of total revenue required are left indeterminate. Interest or benefit is a better criterion just because it says something about both expenditure and revenue." 

Underlying "the ability doctrine of taxation is the principle that government costs are incurred for general social purposes and are an obligation of society rather than particular individuals. This obligation must be distributed among the individuals composing the social unit in a manner which imposes the least hardship." As J. S. Mill wrote,

"Government must be regarded as so eminently a concern of all, that to determine who are most interested in it is of no real importance...... The practice of setting definite values on things essentially indefinite, and making them the ground of practical conclusions, is peculiarly fertile in false views of social questions."
Although the term ability is vague, it was J. S. Mill who propounded the subjective sacrifice doctrine, a refinement upon the objective ability doctrine of tax distribution. By saying that

ability is measured by, or even identical with the subjective sacrifice of paying a tax, it was possible to transfer a collective orientation into a more individualistic interpretation.

But how, according to Mill, is the share of support for the collective state to be determined. It must, he says, be based upon some "equitable principle" and such a principle he finds in the idea of "equity." Equality is regarded as the basic principle of government, whose chief function it is to maintain equal liberty in the enjoyment of pleasures, and equal conditions in the avoidance of pain.

From the viewpoint of Mill, "equality of sacrifice" is the highest expression (or the norm) of the theoretical idea of the obligation resting on the taxpayer. In this statement Mill presents an axiomatic principle of justice in taxation. The ends of justice are satisfied when the objective economic conditions, or the objective effects, are made
relatively the same by the tax. Or, when the tax is adjusted to the ability to support the state relatively to the ability to meet the wants of the individual. 116 This ideal of sacrifice, or equivalence of sacrifice, is an ideal conceivable by individuals and is not an ideal which is any part of the duty of the state to fulfill. "Determination of ability to sacrifice is not simply the ability of income to pay taxes relative to its ability to satisfy personal wants, but it is a matter of the relative ability of different incomes under different conditions and circumstances." 117

However, another principle or norm underlying this view of different circumstances of income is the principle that the "existing distribution of income and property should be disturbed as little as possible," 118 and "that the existing distribution of income is correct." 119 With this assumption, in order to cite the type and amount of taxation to maintain the principle of ability of sacrifice, calculations must be made about how the subjective value of income changes when incomes are higher or lower for different individuals. This can be accomplished only by

116 Ibid., p. 208.
117 Ibid., p. 209.
118 Myrdal, op. cit., p. 170.
119 Ibid., p. 174.
knowing the shape of the marginal utility of income curve. "From
the principle that utility should be maximized the simple rule is

120 Weston, op. cit., p. 104.

deduced that large incomes should be cut down to a certain level and
incomes below this level should not be taxed at all. The rule follows
directly from the diminishing marginal utility of income."121 The
image of such a curve is convenient in that it can be used to call at-
tention to both the aggregate amount of utility of a given total of
money or to its marginal utility.

121 Myrdal, Ibid., p. 174.

While the possible range of declining utility curves is enormous,
the methods of deriving such a curve are few. "The most common approach
has been to examine the matter introspectively and attempt to embody the
conclusions in a mathematical formula."123 It was in the interpretation

123 Ibid., p. 16; also see Pigou, op. cit., p. 91; E. D. Fagan,

of the slope of the utility curve that different authors substantiated
different rate structure for taxation. Or the justification for differ-
ent rate structures can be supported by varying the definition of equality.

124 R.T. Lapman, "Recent Thoughts on Egalitarianism," Quarterly Jour-
nal of Economics, Vol. LXXI, No. 2 (May 1957), pp. 234-266; Blum and Kal-
ven, op. cit., pp. 70-80; H.C. Simons, Income Taxation, op. cit., pp. 18-
19; Myrdal, op. cit., p. 174.
If it were possible to determine the shape of the utility schedule and possible to settle the questions on the characteristics of diminishing marginal utility, the principle of ability must be defined as well as the meaning of equal sacrifice. The only common factor seems to be that the word equality is taken as a symbol for some arithmetic relation.  

The sacrifice or ability theory, regardless of how implemented in a tax structure, applies only to the exaction of taxes. The sacrifice theories can be applicable in the fiscal activity of the government only in raising revenue. Musgrave uses the following characteristic of the ability doctrines to explain its popularity among English writers, "preference patterns under the benefit approach include public as well as private wants. Hence there can be no a priori judgment regarding the usefulness of the two." The ability to pay approach avoids this problem of judging the usefulness of government expenditures, "as it bypasses the expenditure problem altogether."

Musgrave, op. cit., p. 92.

This "equity approach" to taxation was limited to a "just" distribution of the given cost of public services, and is an allocation device per se for the distribution
of the burden. There remains the fundamental problem of determining the preference pattern of individuals for the given public services. The principle of marginal utility provides no concrete standard by which expenditure programs can be determined. The principle of sacrifice provides no operational means of allocating tax shares.

In the sacrifice or ability approach the abstract and ethical principles or "norms" dominate the doctrine. The operational rationale of the approach is of minor importance in the theory. The principles seek to establish optimum conditions. The necessary condition for this optimum in taxation is analogous to the conditions for optimum state-individual relationships in the organismic theory of the state. The optimum is reached when a dollar of expenditure yields the same return, in addition to social utility, in each allocation of total public expenditures among alternate uses which will maximize social "welfare."  

128 Buchanan, op. cit., p. 11.

This allocation is independently determinate only for fixed values of all the tax variables. For each given distribution of expenditures the optimum allocation of taxes is reached when a dollar's tax upon each tax paying entity deducts an equivalent amount from aggregate utility.  

129 Ibid.

The theoretical steps in the maximizing the total utility of the state or community of individuals offer little or no direct guidance to governmental fiscal authorities.
Summary of Part II and Part III

It was pointed out in the preceding section that aspects of public finance may be built upon two theories of the state, the individualistic and the organismic theories.

These theories of the state can be characterized with reference to apportionment doctrines or rather typified by the manner in which taxes are apportioned among individuals. In the individualistic theory the total tax burden among taxpayers is combined with the distribution of benefits from government services. In this sense the benefit principle must be applicable to this theory of the state. In the traditional benefit theories, any imputation of specific benefits to individuals has been omitted with overwhelming attention devoted to the allocation of the tax burden. The revenue emphasis was based upon political concepts which assume that a tax is a payment for a service rendered by the government to the individual. The basis of the tax is assumed to be a service or a benefit from a service. The service is ultimately resolved into the service of protection, or the benefits derived in the consequence of protection. The revenue emphasis based on principles of justice, equity and convenience left the revenue-expenditure process outside the body of economic theory.

In the voluntary exchange theory, the benefit idea was replaced by an analysis of the determination of absolute and relative shares based on individual evaluation. This had been previously postulated as a principle in the benefit doctrines, but was arrived at in the voluntary
exchange doctrine as a condition of equilibrium resulting in the determination of the revenue-expenditure process.

In determining the relative distribution of tax shares among various taxpayers, choices must be made between the satisfaction of alternate wants of individuals, to determine the application of revenue to satisfy the wants of individuals and between alternate satisfaction of wants decided upon by the government and individuals.

The last choice cannot be made without some knowledge of the relative distribution of tax shares and the expenditure allocation corresponding to different revenue and expenditure totals.

These decisions were made in the voluntary exchange theories, by a market like process reflecting demand for services. If marginal utility and the price are equated, the aggregate utility derived from the purchase of public services is maximized for each individual. The choice between alternate expenditures is made by assuming that allocation expenditures and distribution of costs are made simultaneously, through the willingness of all taxpayers to contribute a given share depending upon the application of their contribution.

This voluntary exchange theory is operative in a framework which requires "just distribution of income," competitive conditions, equal distribution of income," competitive conditions, equal distribution of political bargaining power and non-compulsory payments for government operation.

The voluntary exchange theory does solve the problem of determining exaction and expenditures. The assumptions, however, are unrealistic
and the theory fails to provide practical significance because it is incompatible with the institutional and social framework in which modern public economy operates.

The organismic theory of the state requires a fiscal "center" to establish and select tax variables that will maximize social "utility." The allocation of the tax load which will maximize deductions from utility will be dependent upon the relative tax load imposed. The principle of taxation appropriate in this theory of the state is the ability to pay or sacrifice type.

The ability to pay approach to apportionment gives no clear-cut principle of tax distribution and fails to answer the problem of expenditure determination. The scope of public activity and hence the amount of total revenue are left indeterminate. Underlying the ability to pay doctrine is the principle that government costs are incurred for the general social purpose and are an obligation of society rather than particular individuals.

Although the term ability is vague, it is measured by or identified with the subjective sacrifice of paying a tax. The share of support of the state is based upon the principle of equity or equality of sacrifice. The calculations of the tax share are based upon how the subjective value of income changes with different incomes and different definitions of equality.

The possible range of declining utility functions, which reflect the subjective value of income, is enormous. Regardless of how implemented
in the tax structure, the ability to pay approach applies only to the
exaction of taxes. There remains the problem of determining the
preference pattern of individuals for public services. The opera-
tional rationale of this approach is of minor importance. This prin-
ciple seeks to establish optimum conditions of state-individual re-
lationships in the organic theory of the state. But the theoretical
steps in maximizing the total utility of the state or community of
individuals offer no direct guidance to government fiscal authorities.

Although expenditures of the government cannot be classified
specifically as to the theory of the state, expenditures may be classi-
fied to indicate the changing nature of responsibilities assigned to
government. However, theories of the state may be typified by the
manner in which taxes are apportioned or assigned to individuals. The
apportionment principles as formulated, include or exclude the problem
of expenditure determination and assignment. The benefit and ability
to pay theories do not include expenditure considerations. The volun-
tary exchange meets this particular problem. The voluntary exchange
theory incorporates the revenue-expenditure approach with the individual-
istic theory of the state.

The voluntary exchange theory as such contains a compatible frame-
work for evaluating expenditure requirements of the state. In the in-
dividualistic theory, the total amount of public expenditure and its al-
location among uses have been assumed to be fixed outside the pale of
fiscal theory.
The importance of the expenditure-revenue processes of government activity will be reviewed in the following chapter. It will be the task of the next chapter to ascertain whether or not modern aggregative economic analysis provides a method of evaluating the concurrent effects of taxation and expenditures. The following chapter will also evaluate the contributions in modern fiscal theory in relation to the requirement that any theory of tax apportionment should include reference to both the expenditure and exaction effects of taxation.
CHAPTER EIGHT

Taxation, Government Expenditures and Contemporary Economic Analysis

Introduction

Duncan Black and Antonio di Viti de Marco were referred to in the previous chapter in terms of their views that suggest a coordination of the tax-expenditure process of government fiscal activity. DeMarco noted that tax incidence emphasized the spending aspects of government finance. Money raised by taxes must be spent by governments in a different way than it would have been spent if left in the hands of individuals. This emphasis on the spending features of government finance and the rearrangements in private demand for products which have both private and public uses is a distinguishing characteristic of deMarco's point of view.\(^1\)


Black noted taxation as having two aspects, tax collections and the resultant expenditure of the tax moneys by government. In Black's view, the effects of taxation include a study of what is called government expenditures and particularly transfer payments.\(^2\)

Professor Earl Rolph in commenting on the deMarco-Black orientation interprets their position to embrace the following propositions.

1. Government expenditures in any time period depend on the tax revenue of that period,

2. the effects of these expenditures should be taken into account and in the analysis of the effects of taxes, and

3. shifting of taxes will depend at least in part on the specific pattern of government demands for goods and services.

Proposition (1) is a functional one......
If a government obtains cash from another means, it cannot be true that all expenditures are financed from tax receipts.... It is factually wrong to treat government expenditures as rigorously dependent on tax yields. 3


Propositions (2) and (3) may be admitted however. Government expenditures do occur, and a theory of taxation should not be based on the assumption that they do not exist. Nor need a theory of shifting require such an assumption.... It appears more appropriate for purposes of analysis to treat government expenditures as determined by the political and administrative decisions rather than as functions of particular tax yields. 4

4. Ibid., p. 11.

Rolph also points out that if the tax-expenditure processes are to be viewed simultaneously, a method of analysis must accompany the point of view. 5 But DeMarco and Black as well as J. M. Buchanan refer to

the position that fiscal analysis has proceeded as if all taxes were net subtractions from income, never to be returned.

Buchanan contends that, "J. B. Say's dictum that 'the value paid by the taxpayer is given without equivalent or return' has been accepted, although lip service has been paid to its inherent fallacy." Such a limitation leaves the body of theory incomplete and inadequate.

The determination of whether or not modern fiscal theory is inadequate and incomplete as Buchanan points out is the fundamental purpose of this chapter. More specifically the purposes of this chapter are: (1) to determine the methods by which aggregative analysis may be used to indicate any redistributive effects of government expenditures; (2) to set forth the scope and method of analysis used to evaluate both the tax and expenditure effects of fiscal policy; (3) to introduce the contributions of fiscal theorists who have abandoned the traditional "micro-analysis" basis of evaluating fiscal theory; (4) and to point out the limitations of apportionment theories that incorporate both the tax exaction and expenditure effects of government fiscal activity.
The chapter material is developed so as to point out the work of J. M. Buchanan and E. R. Rolph in developing an aggregative framework for tax analysis. In the author's survey of the literature of public finance, Buchanan and Rolph contributed the only analysis of the apportionment theories of taxation which make use of aggregative methods. Part I of this chapter presents the aggregative analysis of the tax-expenditure process of J. M. Buchanan. Buchanan's classification of fiscal systems and his position on the neutrality of government expenditures are presented in Part I. Rolph's theory of fiscal economics as a method of evaluating government and private expenditures, functions of income and taxation are included in Part II. A Summary and Evaluation of the Buchanan and Rolph contribution completes the development of the chapter.
PART I Aggregative Analysis of the Tax-Expenditure Process

Buchanan's Classification of Fiscal Systems

J. M. Buchanan makes his position clear in noting that the "final economic position of the individual, after his relationship with the 'fisc,' can be expressed in the form of a balance between two sides of the fiscal account." 9

If we accept the quid pro quo premise the balance will always be zero. This balance can be called the "fiscal residuum." If an individual's tax burden exceeds the total value of benefits received from government services, he will have a positive residuum. He will pay a net tax. If the value of the share of public benefits which he enjoys exceeds the value of the contributions which he makes to government, the residuum will be negative. The individual will receive a net benefit. Only by a comparison of the residua of individuals can the total effects of a fiscal system be analyzed and evaluated. 10

Buchanan's view of the expenditure process raises a fundamental question as to how the valuation of the residua may be measured. He uses what he terms the "most realistic hypothesis," that of equal per head sharing. 11

For another example of the application of the same principle, see J. R. and U. K. Hicks, Standards of Local Expenditures (London: Cambridge University Press, 1943), p. 3; Buchanan, op. cit., p. 17.

9 Ibid., p. 17.

10 Ibid., p. 17.

11 For another example of the application of the same principle, see J. R. and U. K. Hicks, Standards of Local Expenditures (London: Cambridge University Press, 1943), p. 3; Buchanan, op. cit., p. 17.
Using the concept of "residuums" as a criterion, Buchanan establishes a general classification of fiscal systems. These fiscal systems recognize that the burden of taxation may not be considered without at the same time considering the benefits from the expenditures made out of such taxation. The fiscal systems are divided into three groups characterized by the two-fold distribution effects.

The first fiscal system includes tax-expenditure processes which tend to increase the inequality in the distribution of real income among individuals and may be classified as "aggravative."  

The "aggravative" system would be reflected if individuals with low income showed positive "residuums," while the individuals with high income showed negative "residuums." Buchanan characterizes some systems of sixteenth and seventeenth centuries which collected revenues from elements of the population for the support of royalty, as this first type of fiscal system.

The second type of fiscal systems are those which would tend to return to all individuals the equivalent of the tax contribution and have no net effect on the prevailing distribution of real income. This type of fiscal system is classified as a "status quo" system. This type is

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12 Buchanan, op. cit., p. 17.
13 Ibid., p. 18.
typified by the fiscal systems of the nineteenth century, when a large share of revenue was collected on property and a major portion was expended in the provision of protection.

Finally, Buchanan's third system is a type that is characteristic of the modern state. In this third type of fiscal system called "equalitarian" or "redistributive," a large share of the revenue is derived from the proceeds of progressive income taxes, and a major portion of the expenditures in peacetime is devoted to the provision of welfare services.

For Buchanan, regardless of the fiscal system, there occurs a quid pro quo relationship between the government and individuals taken together. "This is represented by a balancing of the net taxes paid by certain individuals against the net benefits received by others in the first and third classifications. Only in the second classification does the collective equalization of benefits and taxes imply that the individual receives in benefits the approximate equivalent of contributions made."

This basis of classification leads Buchanan to suggest that it may be wise to abandon the use of tax rate structures to characterize the redistributive effects of taxation. Such terms are useful in describing
the nature of the tax system, "but they do not describe the fiscal system, as would appear to be in the case of ordinary usage." For example, progressive taxation may be justified because it can be em-
ployed in such a manner to bring about a more equal distribution among individuals. Standing alone, the statement that progressive taxation does redistribute real income is not true. This redistributive effect can be supported only by applying particular assumptions about the manner in which the government releases the revenue into the income stream. "If individual shares in the common benefit from the public expenditures are all equal or approximately so, then progressive taxation will lead to a more equal distribution." The same type of reasoning is applied to proportional rate structures for justification of a redistributive effect. Without a consideration of the individual benefits, all that can be stated is that progressive tax rates will probably bring about a more equal distribution of income than proportional or regressive rate structures. Certainly, if a significant tax increase or change in the structure is proposed, the ultimate manner in which the proceeds are expended should be used as a basis to determine the nature of any tax change.

The Role of the "Fiscal Scientist"

Buchanan recognizes that the objectives of fiscal systems are
determined by political decisions. The individuals in the community choose the desirable fiscal system or assign the responsibility to the taxing authorities. The "fiscal scientist" can provide policy guides to action in several ways: if the desired degree of redistribution is known, the alternative pairs of tax-burden and public-expenditure allocations which will yield this result can be indicated; if the desired degree of redistribution and the existing public expenditure pattern is known, it is possible to set up the tax system, assuming that attainment is possible; and given the redistribution and the apportionment of the tax load, the expenditure pattern can be established.  

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Although Professor Buchanan suggests that the most productive empirical work can be carried on in estimating the amount of redistribution carried out by the fiscal system, he offers no practical suggestions to the process of imputing individual shares of benefits to individuals. "The traditional difficulty encountered in the attempt to impute specific shares of the benefits from public services to individuals, even upon the recognition of the communal nature of the aggregate benefit, should not be deterrent." "It will not be, once it is fully comprehended that the benefit side cannot be left out and any sort of generalized theoretical framework set up. It must be recognized that the omission yields results
equivalent to those produced by adopting even more arbitrary assumptions than the heroic ones admittedly required concerning the incidence of expenditures." 22

22 Ibid.

It should be noted in the Buchanan thesis that the fiscal authority has been assigned responsibilities of designing alternative fiscal systems on the basis of the desired redistributive effect in the community. He does not concern himself, as does Musgrave, with the determination by the voters as to the public expenditure allocation, tax shares, or the total revenue-expenditure process. The implication is that it makes little difference as to how the revenue-expenditure responsibility is assigned so long as the total results in "residuum" terms supply the desired fiscal system.

Buchanan is concerned with making the reader aware that his classification of fiscal systems suggests a particular orientation of the revenue-expenditure problem. He is not concerned with the structure or method for implementing such a view. 23 In fact, the Buchanan view may or may not be relevant to the body of economic analysis available for evaluating this revenue-expenditure process.

23 See Tibor Barna, Redistribution of Income through Public Finance in 1937 (London: Oxford University Press, 1945) for a type of method for studying the Buchanan redistributive effects.

An Aggregate View of Neutrality

In Buchanan's "status quo" system, the fiscal activity of the state
returns to all individuals the equivalent of their contributions of
taxes and thus there is no net change in the real income of the indi-
viduals in the community. Buchanan defines real income in terms of
"market" values and ignores subjectively defined concepts.24

By pointing out that the fiscal system characterized by zero
residuums would not redistribute real income, he is using real income
in an objectively measurable sense. This "status quo" fiscal system
recalls the principle of distribution of taxation that Dalton referred
to as "leave them as you find them" where income inequalities should be
neither increased nor diminished by taxation.25 This principle can
only be applied when it has been decided how inequalities of incomes
should be measured.26 Aside from the definite problem of measurement

suggested by Dalton, this attainment of the "status quo" raises prob-
lems of neutrality, or the attainment of neutrality in the revenue-
expenditure process. As Musgrave observes, revenue-expenditure activity
of the government may affect the level of expenditure in the private
sector. Effects of budget policy upon the profitability of investment
may be favorable or unfavorable. But, unless proper provision is made
for the satisfaction of basic public wants, "efficient" operations in
the private sector are impossible. At the same time the revenue-expenditure
process must avoid capricious interference with the satisfaction of private wants. The ease with which government interference can be avoided depends on the structure of the expenditures and may become increasingly difficult as the level of the budget rises relative to total income.

Musgrave is emphatic in stating that changes in levels of gross national product or national income are no precise indication of the effects of the revenue-expenditure policy upon economic "welfare" at this point. A review of the manner in which budgets influence national income may be a meaningful approach to the neutrality concept.

The Neutrality of Government Expenditures

It is assumed by the author of this research that government expenditures, whether or not the budget is balanced, cannot be considered as "neutral" in effects on national income. Support of the author's opinion may be found in the works of John F. Due, E. R. Rolph, and


Musgrave, Public Finance, op. cit., p. 54.

G. F. Break\textsuperscript{30} as well as A. H. Hansen\textsuperscript{31} and others.\textsuperscript{32}


\textsuperscript{32}Barry N. Siegel, \textit{Aggregative Economics and Public Policy} (Homewood, Ill.: R. D. Irwin, Inc., 1960), pp. 110-117. See J. M. Buchanan, \textit{Public Finances} (Homewood, Ill.: R. D. Irwin, Inc., 1960), pp. 70-86, for a particularly lucid description of the economic effects of balanced budgets resulting from a variety of analytical methods and different assumptions. Buchanan concludes in this work that at best, multiplier analysis yields the less heroic theorem that budgetary changes upward are expansionary and changes downward are contractionary.

The balanced budget theorem\textsuperscript{33} which may be used as a basis of proving neutrality in government expenditure effects is based upon extremely rigid and unrealistic assumptions.\textsuperscript{34} The application of modern aggregative analysis which introduces modification of the completely static analysis of Keynes,\textsuperscript{35} reinforces the conclusion that government expenditures

\textsuperscript{33}The increase of government expenditures would, if all other factors are held constant, increase private incomes by the increase in government expenditures. But the increase in government expenditures is to be accompanied by an equal increase in tax yields. Thus the after tax incomes are not increased at all by an increase in government expenditures. Since consumption is determined by after tax income, consumption remains unchanged. Thus the increase in government expenditures is the only change in total expenditures.

\textsuperscript{34}Rolph and Break, \textit{op. cit.}, pp. 471-474; Buchanan, \textit{Public Finances}, \textit{op. cit.}, pp. 74-77.

must have some effects upon the level of national income.  

36 See Siegel, op. cit., pp. 110-116 for a review of the effect of the government tax and expenditure multipliers. In Siegel's analysis the net negative effect of the increase in taxes upon spending and national income is less than the positive effect of the expenditure increase, and national income will rise in the face of an equal increase in taxing and spending, p. 116.

The neutrality of a government budget is tenable if the fiscal action "represents nothing more than a transfer of purchasing power from one group to another within the same economy, and if the spending habits of the two groups are approximately the same, the effects seem to cancel out."37 The conclusion assumes that incentives to invest and to work are not modified by the change in government expenditures. These assumptions may have some short-run approximations in reality, but the author of this research assumes that budget and expenditure neutrality seem less correct for changes in government purchases of goods and services.

If balanced budgets, government spending, and taxation preclude neutrality in government fiscal activity, Buchanan's "status quo" fiscal system has little or no relevance to the modern views of the tax-expenditure process. The aggregative view of Buchanan's second type of fiscal system suggests the difficulty of achieving a "non-redistributive" fiscal system. If traditional incidence theory is employed, where tax and expenditure changes are expressed in terms of changes in supply and demand
schedules of individual firms, the author's position is not refuted.


If factor allocation rather than income aggregates are noted in the evaluation of the "status quo" system, other indications of the effect of tax-expenditure neutrality are discernible. The following section introduces several individualistic approaches to fiscal neutrality.

**Individualistic View of Tax Neutrality**

An individualistic approach to the condition of neutrality may be expressed with reference to either factors of production or the person as consumer and investor. In one view, a tax is neutral when it does not remove or impair any instrument of, or incentive to, essential or useful production and when it does not remove or impair any essential or useful element of consumption. Taxes should not interfere with the market system and "should be imposed so as to place the least burden upon whoever is taxed." However, taxes do affect the individual in the manner in which he disposes of or receives his income, even though the tax policy is designed with "neutrality" as a guide.

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38 Musgrave, Public Finance, op. cit., p. 111.
The effects of a tax which arise from the presence of a positive rate of tax upon a base subject to greater or less control by the taxpayer are called announcement effects. These effects follow from the change in the costs of alternative behavior patterns, a change induced by the tax formula itself. The same class of effects applies to government payments to the individual since they present the potential recipient with a formula which he may be able to influence with his own actions.

The "announcement" aspect of a tax may be said to "cause" a different pattern of behavior to the extent that it makes some action more expensive and may lead to different choices than would be made. Ideally, to discover the announcement effects of a tax, it is necessary to know what a person's behavior would be if he were not confronted with the choice set by the tax, as compared with his behavior when confronted with that choice.

If, however, a tax is based upon a subject which directly reduces his income or in effect confronts the taxpayer with the alternative of spending fewer dollars, the effect of the tax is viewed as the income effect of the tax. The tax liability is a reduction in net income for the
person taxed. If income is the base of a tax, an individual can influence his liability by influencing the amount of his income.

The classification of effects of taxes given, there remains no simple way of rating taxes according to their effects on neutrality. Only the head tax can be given a categorical reference (the income effect). For other taxes, only generalized statements may be made.

e.g. taxes on goods and services with a low rate of substitution tend to be superior to those with a high rate of substitution. This vagueness is unfortunate. What may be recognized, however, disregarding the effects vis-a-vis particular taxes, is that individuals react to changes in tax structures and to tax types. A person viewed as an income recipient finds his stock of cash balances (stock) reduced by making tax collections, i.e. payments to government and his income (flow) reduced by tax liability. This individual is placed in a position where he can buy less, given prices for the goods and services required. The reaction to the price change may be reflected in changed consumption patterns or in a changed work-leisure pattern. Both Rolph and Musgrave view the possibility of a zero announcement and income effect type tax as illusionary,
either from the standpoint of the actual determination of effects or from the standpoint that such tax types do not exist.\textsuperscript{47}


The importance of the two concepts of the effects of a tax as stated by Rolph is that any differences that a tax may make can be traced to these two concepts.\textsuperscript{48}

\textsuperscript{48}Rolph, op. cit., p. 16.

The individualistic approach to the neutrality of fiscal systems supports the authors' position that the burden of proof for Buchanan's "status quo" fiscal system rests upon a consideration of the tax rate structure and tax types vis-à-vis individual income utility and costs of the firm.\textsuperscript{49}

\textsuperscript{49}See p. 273, supra, and Buchanan, Fiscal Theory, op. cit., p. 19.

The distributive characteristics of Buchanan's other fiscal systems are accepted by Rolph and Musgrave.\textsuperscript{50} However, there is no agreement among these authors as to the revenue-expenditure process that gives rise to the distributive characteristics. As pointed out in the previous chapter, Musgrave directed his attention to "modernizing" the method of analysis inherent in the voluntary exchange approach to
revenue-expenditure determination. Rolph's attacks on Buchanan's methodology is presented in Part II of this chapter, following the summary of Buchanan's position. Rolph's rejection of the Buchanan fiscal systems view of the tax-expenditure relationship will be presented in Part II of this chapter.

**Summary and Evaluation of Buchanan's Fiscal System Analysis**

In Buchanan's analysis the final economic position of the individual can be expressed in the form of a balance between two sides of the fiscal account. If an individual's tax burden exceeds or is less than the total value of benefits received from the government, a fiscal residuum occurs. This residuum concept provides a basis of individual per head sharing of the total effects of a fiscal system.

The fiscal systems are classified with the recognition that the burden of taxation may not be considered without at the same time considering the benefits from the expenditures made from such taxation. Fiscal systems may tend to increase the inequality in the distribution of real income. Buchanan designates these systems as "aggravative." The "status quo" system tends to return to all individuals the equivalent of the tax contribution and there is no net change in the distribution of income. The third type of fiscal system, which is characteristic of the modern state, is the "equalitarian" or "redistributive" system. The major portion of expenditures support welfare services and funds are raised from progressive income taxes.

In all of these fiscal systems, a quid pro quo relationship between
the government and the individual is represented by a balancing of the
net taxes paid by individuals against the net benefits received.

Buchanan's classification of fiscal systems suggest a particu-
lar orientation of the revenue-expenditure determination. The classi-
fication scheme does not include the actual processes of revenue-
expenditure determination. Buchanan assigns "a fiscal authority" the
responsibility for policy guides, (a) once the desired degree of re-
distribution is known, (b) or after public expenditure patterns are
known, (c) or when the apportionment of the tax burden is given. The
processes where individual choices of public and private wants, and tax
loads are determined are neglected in the analysis. The assigned role
for the fiscal theorist in suggesting alternatives is consistent with
the individualistic theory of the state.

What Buchanan does include is an aggregative orientation to the
budgeting process. Although he insists that the fiscal system must be
classified on the basis of individual residuums, the benefits and burden
equalization is stated in collective terms -- "balancing the net taxes
paid by certain individuals against the benefits received by others."

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51 Buchanan, Fiscal Theory, op. cit., p. 19.

Benefits and burden of governmental budgeting activity are classified as
to whether the total process results in collective "aggravation" or col-
lective "redistribution" effects. Although the classification scheme
and the role assigned to the "fiscal authority" imply autocratic action
by the state, the general policies to be implemented are initiated by individuals.  

52 "The fiscal system exists as a channel through which collective goals may be accomplished."  

53 Buchanan voices a plea that the traditional dictum, "tax without equivalent or return" leaves the body of fiscal theory incomplete and inadequate.  

54 The paramount need is that the interdependence of the two sides of the fiscal process be clearly understood.  

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PART II  The Rolph Theory of Fiscal Economics

The Revenue-Expenditure Process

For Professor Rolph, the Buchanan theory that taxes and expenditures are inseparable may be interpreted as holding that the expenditures of the government are functions of tax yields. This proposition is unrealistic because taxes are not the only source of government revenues

\[56\text{Rolph, op. cit., p. 84.}\]

and "there is no good reason for assuming taxation must be the only method of financing government when it is not."\[57\] A relationship may be established between tax revenues and expenditures in terms of the government's propensity to spend. In the United States, with the

\[57\text{Ibid., p. 10.}\]
\[58\text{Ibid., p. 10.}\]

recognized behavior of Congress in enacting appropriations and the behavior of the executive branch in making expenditure, "may not be properly described by a theory that government expenditures depend upon revenues."\[59\] Rolph suggests that a more reasonable view of the process

\[59\text{Ibid., p. 10.}\]

is one which establishes an expenditure pattern and a tax pattern, "letting the chips fall where they may, leaving the Treasury the job of finding sufficient revenues to meet the resulting commitments."\[60\] Rolph

\[60\text{Ibid., p. 10.}\]
concludes that it is factually incorrect to treat government expenditures as rigorously dependent on tax yields.

However, government expenditures do exist and a theory of taxation cannot be based on the assumption that expenditures do not occur. But total government expenditures may increase and decrease in no precise relation of tax revenue to particular projects. This view implies that budgets may be in balance or that deficits occur.\textsuperscript{61}

\textsuperscript{61}\textit{Ibid.}, p. 13.

**Taxes and Subsidies as Transfer Payments**

With the orientation stated above, Rolph views taxes as a transfer payment from private groups to the government with two functions. (a) Taxes reduce money incomes of private groups for any given level of national income and (b) taxes rearrange the pattern of distribution among households and individuals.\textsuperscript{62} "The first function carries with it the implication that taxes are deflationary devices with respect to private demands for products and old assets."\textsuperscript{63} In the second function, the rearrangement of income is relevant to questions of equity since limitations of taxing and subsidy devices influence the ability of government to redistribute income.\textsuperscript{64}

\textsuperscript{62}\textit{Ibid.}, p. 54.

\textsuperscript{63}\textit{Ibid.}, p. 54.

\textsuperscript{64}\textit{Ibid.}, p. 54.
Rolph considers taxes and transfer payments together as components of the national income in the social accounts. "Taxes should be viewed as transfers because they are a clear and definite case where income is obtained which is not in payment for services rendered." A tax is a transfer because the nature of taxes, namely that they give rise to revenue to government and are not paid as a condition of obtaining particular services. Likewise, "subsidies should be viewed as transfer payments because by definition they refer to payments by government for which the government receives no product service or asset." Rolph bases this accounting technique on the requirement to portray taxes as a real sacrifice. This sacrifice is implied if it can be shown that individual-government transfers reduce the amounts which people obtain as takers of transfers. This approach provides Rolph with the necessary monetary framework for his fiscal analysis. This accounting procedure is not used in any of the current national-income estimates. C. S. Shoup, "Development of National Income Data," Survey of Contemporary Economics (Homewood: Irwin Co., 1948), Ch. 8.

Ibid., p. 66.

Ibid., p. 67.

Ibid., p. 67.

Ibid., p. 81.
A theory of money is required to explain how various governmental financial measures affect private expenditures.

Of the four types of governmental financial activities -- purchases, sales, negative transfer payments, and positive transfer payments -- only part of one, namely, government purchases directly impinges upon the demand for current output. Taxes, subsidies, and debt operations are relevant to the rate of expenditures for goods and services only through indirect effects on private decisions. If there were no such influences, a government might confine its financial activity to expenditures alone and eliminate thereby the political difficulties associated with enactment and enforcement of a tax system. But taxes are needed to offset the inflationary effects of government expenditures...... Taxes are also necessary to offset inflationary private monetary expenditures arising from government doles, subsidies, and interest payments. As far as I am aware, no school of thought is prepared to deny these propositions.  

Rolph cites a number of monetary theories presently used to explain how government and central bank techniques affect the level of aggregate expenditures and current output. He rejects the Keynesian approach and adopts a variant of the quantitative approach which may be termed the "asset" approach.

"The capital value of a person's asset is taken to be the dominant objective determinant of his expenditures for consumption and investment." In choosing among different assets including cash that an individual wishes to hold, demand for the new real assets is determined...
and to some extent the demand for other individuals. The asset approach contains the important negative implication that current income is not the objective determinant of current expenditures. It is because of this negative implication that Rolph repudiates the Keynesian emphasis that expenditure determination is based on the principle of income. "... Contemporary events cannot be mutually causal."\(^{72}\)

\(^{72}\)Ibid., p. 84; Keynes, General Theory, op. cit., pp. 100 ff.

Theory of Expenditures

Government Expenditures

For a closed system, (Rolph purposely neglects international repercussions) the aggregates to be explained in this theory of expenditures are the government money expenditures for current output, consumption expenditures, and the value of current private capital formation, computed net of depreciation, obsolescence, and inventory disappearance.

Government expenditures require no special economic explanation since they are fixed by the political complexion of the society and the government, and by the needs that individuals believe the government should meet.\(^{73}\) The aggregates to be explained are the private rather than the government expenditures.

\(^{73}\)Rolph, op. cit., p. 84.

Private Expenditures

The maximum amount that an individual can spend is the actual market
value of his real assets and the amount of cash retained from previous earnings. The same position is stated by Rolph in his theory of consumption expenditures, "the amount of a person's consumption expenditures depends upon the value of his asset holding, including cash. The greater his asset holding, the more he spends on consumption, but the smaller is the proportion of these expenditures to his asset holding."  

Therefore, Rolph argues, the prices and quantities of consumption and investment goods depend upon (a) the quantity of money, (b) upon the banking and fiscal policies and finally (c) upon the desires of individuals for cash and investment and consumption items.

For the economy as a whole, the amount a person spends for new physical things depends upon the money value of his wealth minus the value of the claims of other people against his wealth. The particular combination of possessions and claims a person "inherited" from the past may or may not be the combination that the consumer prefers. One holder of assets, in view of the prices of the things he owns, may be discontented with some of them. If other asset holders have similar attitudes, the price of such items must fall until enough asset holders are willing to hold all the existing assets of that class of wealth. Prices of assets are too high in general if people prefer to hold more money. The attempt to hold more money cannot actually succeed if all asset holders hold more money. However, the amount spent in any period depends upon the valuation placed upon old wealth and subjectively upon
the estimates of possible gains or advantages of holding new wealth. This approach makes net worth or asset holding and not income an objective determinant. Unlike the Keynesian position, current income is treated as irrelevant in determining current expenditures. In this point of view, current income does not impose any limit upon how such a person does spend during the same period. Income can only influence consumer and business conduct only in anticipation of future asset positions.\footnote{Rolph and Break, \textit{op. cit.}, pp. 486-491.}

Thus, the prices of old assets are a determinate rather than a determinant as are all current prices. Thus the more some people prefer assets, the more other individuals can spend for consumption.\footnote{\textit{Ibid.}, p. 98.}

This view relates the flow, expenditures on output, to stocks, the conditions of past income. However, to this point nothing has been contributed concerning the function of income.

\textbf{Functions of Income}

A main function of income is to offer people positive incentive for management of resources.\footnote{\textit{Ibid.}, p. 98.} From this point of view, ideal allocation of resources occurs when each homogeneous type of resources is distributed in such a way that the marginal gain is equal in every actual method of
use. This ideal can be met only if money gain is the relevant consideration of resource owners.\textsuperscript{78} Another function of income arises from the net gain in money income over a period of time. "The net gain of a

\textsuperscript{78}Ibid., p. 99.

person from the use of resources owned by him is the increase in the value of his assets when the value of the consumption services taken is not reduced in computing net gain."\textsuperscript{79} The total of all incomes in a society, is equal to and determined by expenditures upon current output.

\textsuperscript{79}Ibid., p. 99.

If the expenditures are known, aggregate incomes are then determined. In each period of time, individuals spend cash which they own at the opening of that period and during each period of time individuals obtain cash from sales to other individuals.\textsuperscript{80} "Literally, a person does not

\textsuperscript{80}Ibid., p. 101.

spend income, cannot spend income, and never will spend income."\textsuperscript{81} The basis of denial that a person's expenditures depend upon the size of his income, simultaneously determined, is Rolph's contention that asset holdings determine expenditures.\textsuperscript{82} Rolph makes the point and argues that

income receivers require a period of time to adjust spending habits to obtain a relation between income and consumption. "Strict logical consistency, within the Keynesian framework, requires that the period in question be of infinite length." In this view the basic difficulty with the Keynesian consumption function approach rests with the requirement that income be created in the present period which primes the system, so that people can decide how much to consume and how much to save. The promise implied in the consumption function approach, with the coincident multiplier, is that two contemporaneous events are causally dependent upon one another. None of the interpretations of the propensity to consume succeeds in overcoming the basic difficulty that expenditures cannot depend upon the income to which they give rise because such a theory involves the impossible condition that contemporaneous events can cause one another.

Rolph, op. cit., p. 113.

Saving and Taxation

Rolph presses his position of income-expenditure simultaneity in his discussion of saving decisions. In the Keynesian concept of saving,
saving means the difference between the individual's income and the money value of consumption expenditures in the same period. For the aggregate or the total economy, the difference between aggregate income and consumption equals saving. In the position stated by Rolph, the concept of consumption is amended when account is taken of government activity.  

When taxes are transfer payments, as tax yields increase, government income is increased by that amount and private income is decreased by that amount. Therefore, a government decision to increase taxes corresponds to a decision to reduce private money incomes. On the basis of this supposition Rolph concludes correctly that "the amount of saving for the entire community including government is independent of the tax yield." The following additional propositions emerge from the requirement for aggregate equality for Saving and Investment:

2. Saving for the entire community including government is independent of the kind of tax devices (or subsidies) employed:

3. Private saving is always decreased one dollar by an increase in taxes of one dollar, and private saving is always increased one dollar by a subsidy of one dollar.
The amount of private saving is independent of the kinds of taxes or subsidies employed if net government revenue is held constant.  

Income-Expenditure and Taxation

Based on the validity of the monetary theory developed, Rolph's conclusions are presented below.

1. Income in the present does not affect expenditures in the present. Taxes viewed as present government revenue or income, are therefore of no significance either to present private expenditures or to present government expenditures. Expenditures can be analyzed without having to be concerned with mutual causation between those expenditures and the income resulting from them.

2. The function of taxation in revenue terms is to reduce private money incomes and to increase government money incomes. Taxes are monetary devices since taxes reduce cash holdings and yield revenue.

3. Taxes should not be viewed as equivalent to government expenditures. Taxes transfer the spending power of private groups and may act as an anti-inflationary
device. Taxes redistribute income, if taxes are tied to a base that requires or induces individuals to alter choice patterns, because of their relation to the tax base. Taxes can be devised to induce people to be more or less efficient.  

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**Summary and Evaluation of Rolph's Fiscal Economics**

Earl Rolph readily recognizes the need for interdependence of expenditure-revenue determination. In his work, Rolph, as did Buchanan, neglected the explanation of the processes for determining public and private wants and the manner in which individuals select or reject tax systems. Rolph relegated this aspect to the political process when Congress and the executive branch determine expenditures and the Treasury is responsible for finding revenues to meet government commitments.  

"Since these are the facts, a theory of taxation should conform to the facts and taxes should be analyzed against a background of whatever government policies happen to be."  

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Rolph interprets the Buchanan position to embrace the propositions that government expenditures in any period are dependent upon the tax revenues of that period, and the effects of the tax should be taken into
account in the analysis of the effects of taxes. The first proposition is rejected both on factual and theoretical grounds. The second proposition is refuted on methodological and other analytical grounds.

Taxes are not the only source of government revenues, therefore deficits and surplus may arise regardless of tax revenues.96 Expenditures are not wholly dependent on tax yields.97 The theoretical basis of the refutation is developed within the framework of modern aggregative economic analysis.

Taxes are transfer payments from private groups to the government with the function of reducing money income and rearranging the pattern of income distribution. In Klopfe's view, taxes are related to the level of private and public expenditures. Private expenditures depend upon the present value of an individual's asset holdings, including cash.98

Public expenditures are fixed by the political complexion of society and the needs that individuals believe the government should meet.99 Private expenditures are thus a function of private income. But it is cash not income that is spent.100 A person does not, cannot and will not spend
Since income earners require time or a period of time to receive money income and adjust spending habits. Rolph rejects the Keynesian position that consumption rests with the requirement that income be created in the present period and people decide to consume or save that income in the same period. This Keynesian position involves the impossible condition that contemporaneous events can cause one another. In Rolph's view, present consumption and saving are a function of present asset holdings which stem from past income not present income.

Rolph uses an aggregative expression for the equality of saving and investment in his approach to the taxes-saving relationship. Considering taxes as transfer payments, the greater the yield of taxes, the greater is the income to the government and the smaller the private income. Taxing of private income offsets a comparable revenue to the government. Thus "saving for the entire community including government is independent of the tax yield." Saving is independent of the tax devices used. The amount of saving is independent of taxes or subsidies employed if net government revenue is held constant.

Based on the validity of his monetary theory: (a) income in the
present does not affect expenditures in the present; (b) taxes are of no significance either to present private consumption or to present government expenditures; (c) government expenditures can be analyzed without concern with the mutual causation between expenditures and revenue; (d) taxes should not be viewed as equivalent to government expenditures; (e) taxes are used for a variety of non-fiscal purposes.

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With the use of macro-or aggregative analysis, Rolph contends that the Buchanan position is untenable. The analysis provided by Rolph, suggests that the revenue-expenditure process cannot, analytically, and may not, practically, be evaluated simultaneously. The point of disagreement is the time lag or the time period for income-asset-consumption choices to be made. But Rolph does recognize the problem as monetary. Taxes and expenditures are treated in sector terms rather than in individual terms of impact through shifting and incidence. Rolph's method of analysis presents taxes as money elements which directly affect the level of national income.

The validity and use of this monetary basis for fiscal theory rests with the reality of his assumptions and their interpretation.

The expenditure-revenue determination is completed, with Rolph's analysis, with the implication that the quid-pro quo balancing of the Buchanan type does not occur in the contemporary fiscal environment. But the quid pro quo balancing may occur for aggregates over "time." However, there is the basis to weigh this balancing in aggregative
rather than individualistic terms. This position is largely devoid of the traditional requirement for equity as an inherent principle in the quid pro quo, revenue-expenditure process.
PART III Summary and Evaluation of the Rolph and Buchanan Contribution

In the contemporary setting of fiscal theory, both the revenue and the expenditure sides of government budgeting must be viewed in order to develop an adequate theory assigning responsibility to taxpayers.  

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This importance of the revenue-expenditure coordination has been emphasized in the works of only a few modern fiscal theorists. In the few sources of information offered by modern fiscal theorists on the process of simultaneously analyzing taxation and expenditures, Buchanan and Rolph have made particular contributions. Both Buchanan and Rolph have proceeded beyond the traditional studies in public finance, which separate the financing of resources used by government and the choice of resources to be devoted to public purposes. Neither author has provided a method of analysis which can deal directly with this two-fold problem. The most important collective decision making process, which requires choosing the proportion between public and private wants, has again been relegated to future work. Rolph requires the Treasury to choose the alternative sources of taxes. Buchanan assigns the same responsibility to a "fiscal authority."

Neither author has provided a method of analysis by which the two-fold collective decisions can be examined with any degree of exactness. Neither work has sufficiently integrated existing theoretical analysis in such a manner to term them realistic. The failure to construct or reconstruct a method of analysis thus leaves fiscal analysis
without a method to weigh the real costs of taxes and the real benefits or disadvantages of expenditures as public services.

Regardless of the criticisms of Rolph and Buchanan, both theorists have been responsible for at least recognizing the nature of a contemporary fiscal problem.

Rolph uses an asset approach in an attempt to explain the changes in private expenditures on goods and services and to illustrate how various government fiscal policies affect private expenditures. In the view of the author of this research, if the asset approach is carried to its logical conclusion it implies that government expenditures have either no effect or a positive effect on national income. For example, the wealth position of private groups neither increases nor decreases as taxes and expenditures are changed by equal amounts since taxes are transfer payments. The savings position of private groups is not influenced by the change in tax collections. In fact, taxation has a persistent beneficial connotation. If taxes were not collected, private expenditures would grow too rapidly. Therefore in the Rolph analysis, taxation is dictated by "public" requirements to meet government and service government debt and surpluses. 107

107 See Rolph and Break, op. cit., pp. 486-489 for a summary of the asset and Keynesian approach to the determination of private expenditures. Rolph and Break point out the manner in which different government policies as to deficit financing, budget surpluses and balanced budgets influence the size of private expenditures. The summation drawn by Rolph and Break as to the logical conclusions of the asset approach are substantially similar to those introduced in the preceding paragraph.

Other aspects of Rolph's analysis are summarized in the following paragraphs.
Rolph deserves credit for having focused attention on a possible methodological treatment of apportionment in a modern theory of the public economy. Rolph has analyzed the effects of taxes independently of changes in the level of government expenditures and/or other taxes. Both the level of government expenditures and the structure of other taxes are explained away with a ceterius paribus assumption.

But Rolph does include tax and expenditure aspects in his analysis. For Rolph, a tax is a money transfer payment to the government from the taxpayer. The real burden from government fiscal activity arises from the expenditure not the revenue side of the fiscal account. In Rolph's analysis, the real burden is an aggregate determined by the share of total economic resources over which the government has economic jurisdiction. In Rolph's method the government expenditures are held constant and thus any aggregative real burden does not change as a result or because of tax changes.

The background of his approach is consistent with the modern emphasis upon taxes as deflationary devices and the fact that federal budget is no longer committed to a "balanced" or "equilibrium" norm.

Rolph considers taxes as a monetary phenomenon in transfer terms. This represents a radical departure from the traditional view of taxes in fiscal theory. Since taxes may be applied for stabilization purposes with no connection with the level of expenditure, the monetary role of taxes has merit. Modern dis-equilibrium analysis would challenge Rolph's position. Relative positions of individuals before and after taxes may
be identical, but the proper comparison is before not after taxes. It is with the tax and without the tax where the comparison should be made. If the imposition of a tax succeeds in stabilizing economic activity, which otherwise would have occurred, the initial position is a dis-equilibrium one. In this case the effects of the tax must be compared with the effects of the instability which would have taken place in the absence of the tax. Static analysis must always compare alternate positions at the same instant of time, not successive positions over time.

Again in this case, it is Rolph's instantaneous time period analysis that guides his emphasis. Rolph's analytical framework assumes a fully competitive, closed economy in which resources are fully mobile in the long run. The simple two-commodity, no-savings model is used. Explicit assumptions concerning the policies which are to be carried out by the monetary authority are somewhat absent from Rolph's analysis. He fully recognizes the extreme importance of monetary theory. His monetary analysis is conducted almost entirely in terms of process.

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109 Ibid., p. 114.
111 Buchanan, Fiscal Theory, op. cit., p. 128.
112 Ibid.
Nowhere does he specifically point out the monetary framework within which the analysis is conducted. The failure to make explicit the type of monetary framework has weakened the efficacy of much of the aggregative analysis.


Rolph's contribution, in addition to method, rests with his inroad into incidence theory in a monetary framework. His work requires more consideration. It may well provide a significant guide to the treatment of taxation in the aggregate economy models.


In the author's review of the current literature of fiscal theory, no work is available which extends beyond Rolph's analysis. Therefore, the author of this research concludes that it is methodologically impossible to evaluate, simultaneously, the tax and expenditure effects of government fiscal activity. The Rolph position is accepted, since there appears no method of compromise between Buchanan's classification of fiscal systems and the tools of modern aggregative analysis. In the author's opinion the following statement by Buchanan is important in characterizing the tax-expenditure approach to fiscal theory. "The point to be emphasized is that the failure of the existing set of fiscal
institutions to encourage decision makers to consider tax burdens and public service benefits simultaneously tends to make the process of fiscal choice less rational than it could be otherwise." 115

115 Buchanan, The Public Finances, op. cit., p. 182.

The purpose of this work was to develop an historical survey of the principles of the apportionment of tax burden. In the opinion of the author, Rolph and Buchanan have made the most recent relevant contributions to this survey. The following, and final chapter of this research will characterize the historical development of apportionment principles and present conclusions as to the significance of such principles in the development of modern fiscal theory.
CHAPTER NINE

Summary and Conclusions

PART I Characteristics and Significance of Theories of Tax Apportionment

Introduction

The principles of taxation, that is, the appropriate criteria to be employed in the development of the tax structure, have received attention from the earliest days of public finance.¹ Writers on public finance have attempted to establish criteria by which the revenue and expenditure policies of the government should be evaluated; and some have attempted to explain the principles by which revenue and expenditure policies are in fact determined.² The theories by which the cost of government should be apportioned among taxpayers since Adam Smith's writing can be classified into two broad categories: benefit theories and ability theories.


Theories of Tax Apportionment

The Benefit Theories

The benefit theories postulate *quid pro quo* tax payments "in proportion to the revenue which they respectively enjoy under the protection of the state." The benefit approach to tax burden apportionment was widely accepted among political theorists of the seventeenth century. Taxation as a price for services rendered seemed a natural complement to the contract theory of the state. This complementarity persisted through the early years of the nineteenth century, when it gave way to the greatest happiness principle of utilitarianism. The Smithian notion of levying taxes on the basis of services received by the state applied to a fundamentally laissez-faire environment.

The general idea underlying the benefit theory is that a tax is a payment for services rendered by the state to the individual. The service is ultimately resolvable into either the cost of service or into the value of service. The cost basis leads to difficulties, since the total tax must equal total cost of government but cost cannot be individualized. The value of service is an equally impossible basis because this "value" is practically an unknown quantity. Between the known and unknown no relationship can be established. Accordingly, the benefit theory of tax apportionment has suffered from its inherent limitations and has always been of quite limited usefulness in modern political systems.

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The Benefit Theory as a Basis for the Voluntary-Exchange Theory

During the nineteenth century, the benefit theory came to be associated "increasingly with a narrow insurance-premium interpretation of taxation...." This decay of the benefit theory was halted


toward the end of the nineteenth century. The benefit theory was revitalized by Wicksell (1896) and Lindahl (1919) in a modern framework. In its renaissance, the benefit theory was closely related to the traditional benefit theory but with one important difference. While the classical writers had postulated taxation according to benefit as a standard of tax justice, Wicksell and Lindahl interpreted the benefit theory as a condition of equilibrium. Taxation according to benefits received was to be formulated by determining tax shares according to subjective valuation of public services. The construction of a normative model of the public economy in terms of voluntary exchange established the first operational theory of the public economy.

Benefits were replaced by analysis of the determination of absolute and relative tax shares, on the basis of individual evaluation. Taxes were considered more or less voluntary payments made by the individual in exchange for services supplied by the government in accordance with personal evaluation of the services. Previously postulated as an ethical standard, taxation according to benefits was now arrived at as a condition of equilibrium resulting in the actual determination of the expenditure-revenue process.
The voluntary-exchange approach pointed to the fact that public services involve the withdrawal of resources from private use. Unless the tax and expenditure sides of the budget are considered jointly, there is no way of telling whether the benefits received derived from public services are worth the losses that are the result as other wants become unsatisfied. At the heart of this approach was the recognition that the tax and expenditure sides of public activity must be determined simultaneously by voter approval in an election. Satisfaction of public wants of the citizen must be traced to the preferences of the individual members of the group. The essential point of this approach is that the tax must be set as a price which is designed to maximize the satisfaction that the consumer derives from his payments for public and private services. The "market-like" equilibrating force by which this adjustment is secured is the political mechanism by which the agency of government is forced to represent the wishes of the voters.

The competitive solution is established in the voluntary exchange approach, providing a "just" state of taxation. The correspondence between price and marginal utility prevailing for both parties indicates that they benefit "equally" in accordance with the prevailing "just" state of income distribution. While a "just" state of income distribution and a competitive market structure are given factors, the construction of a theoretical model of the public economy based on voluntary exchange is defective. The model is derived from these given factors as standards of justice rather than from a realistic interpretation of the actual expenditure-revenue process.
The modernizing of the benefit approach incorporated a socio-political element into the analysis. The enunciation of the socio-political factors in the determination of tax needs recognized the role and function of government in redistributing resources and income. Non-economic political and social factors had been previously incorporated in contributions of fiscal theorists (Wagner and DeMarco) who presented public finance as an historical and institutional study. Both Lindahl and Wicksell were vitally influenced by the social responsibilities and the parliamentary political form of the state and incorporated these factors in their reformation of the benefit theory.

The Ability Theories of Tax Apportionment

The ability theories of tax apportionment attempt to establish the tax contribution according to a subjective or objective determination of the sacrifice that a taxpayer is "able" to make in the payment of taxes. Ability theories of apportionment make "ability" the expression of the idea of positive, active participation in the expenses of the state, corresponding to the positive active participation in the ends of the state. The full implication of this approach to apportionment is the obligation upon each member of the state to contribute something according to his ability. However vague the term ability may be, it is clearly a reference to the fact that tax obligations rest upon every citizen of a state.

A tax according to ability is a universal proposition implying that the ability is relative to persons and implies a personal obligation.
In brief, "ability" as a basis of taxation, involves the relation of one's economic income and/or wealth or other index to his personal and collective needs as compared with the similar relation of every other member of the state. The objective measure of ability -- the ability to sacrifice utility of money income -- expresses a denial, a sacrifice of personal satisfaction for higher satisfactions that are the common end of the state.

The implementation of all sacrifice concepts is dependent upon the determination of the income-utility curve for individuals. The methodological innovations of marginal utility analysis provided the modus operandi for the refinement of J. S. Mill's basic equal sacrifice principle. "The more accurate study of the variations of utility, which forms the common starting point of the researches of Jevons, Menger, and Walras, has among its other effects given a new mode of measuring the pressures of taxation."  


The equal, equal proportional, and equal marginal sacrifice concepts introduced during the nineteenth century were predicated upon a declining marginal income-utility schedule. These sacrifice theories have been effectively criticized by Kendrick, Blum and Kalven, and Myrdal on rigid theoretical premises of interpersonal comparisons and utility-income schedule determination. The ability theories based on sacrifice are viewed as being impossible to implement.
The ability theories of the nineteenth century reflect a broadened governmental responsibility brought forward by industrialization with the shift in political power to the newly franchised working class. The justification of progressive tax rate structures in the sacrifice principle is concomitant with this shift in political strength. The term that is used to express the basis of one dominant version of distributive justice in taxation is ability or ability to pay. Sacrifice or ability is a refinement of justice which is impossible for the state to realize. The ends of tax justice are served only when objective economic conditions or the objective effects, are made relatively the same by taxation.

Theories of Tax Burden Apportionment and Contemporary Economic Analysis

The historical development and modification of the benefit and ability apportionment theories has resulted in part from the changing nature of government outlays and the introduction of new theoretical postulates in economic theory. Classical fiscal theory was concerned primarily with the distribution of tax burdens among individuals and factors of production. Contemporary fiscal theory is concerned with "functional" and compensatory finance to obtain full employment and a high volume of economic activity. Only in the last decade has there occurred renewed interest in the classical question of when and where resources should be used for public rather than private purposes and who should pay the cost of public services.
The traditional problems of shifts in the allocation of resources as a result of taxation has been de-emphasized in contemporary fiscal analysis. The standard of reference has been shifted from incidence of individual losses and benefits to aggregates or sectors of economic activity.

While theories of public finance reflecting benefits, ability and voluntary exchange may be logically valid, notwithstanding the unrealistic nature of the assumptions, they fail to provide a standard of tax apportionment. The theoretical models constructed prove incompatible with the institutions and social framework in which the modern economy operates. Based on contemporary fiscal theory, the unrealistic assumptions of these theories are of little practical significance and carry the implication that the theories failed to supply an explanation of the government's revenue-expenditure process.

Although the assumptions are unrealistic, the approach to fiscal theory suggested in the voluntary exchange approach has been the basis for a body of writing in recent years. The recognition that budget determination is a political process and not a market process is an explicitly stated given factor in the voluntary exchange approach. This given factor has been incorporated in the contemporary fiscal theory of Buchanan and Musgrave. For Musgrave, the voting process and political elements have been recognized as a necessary concern in the determination of a modern decision-making approach to fiscal theory. The public or private use of resources as well as the tax-benefit relationships for any one individual depends upon the decisions of the responsible organs
of government and not upon a market process. There are political tasks that are only indirectly related to such individual needs as are expressed in a market place.

In the author's opinion, the most important conclusion drawn from the position, stated in the paragraph above, is that the decision of choosing the proportion between public and private uses of resources is de-emphasized in contemporary economic analysis. If this collective decision process is considered relative to our democratic society, it is essential to place major emphasis of this centralized fiscal decision making process.

Major emphasis has been placed on this decision making process by Buchanan. In his analysis, the individuals' economic position must be viewed in the form of a balance between the two sides of the fiscal account. The tax burden is a relationship expressed between the tax payment and the value received from government services. This approach points out that it is impossible to speak of the burden of taxation without considering at the same time, the benefits from expenditures made out of taxation. Regardless of the kind of fiscal system, there should exist a quid pro quo relationship between government and all individuals taken together. Quid pro quo is represented by a balancing of the net taxes paid by certain individuals against the net benefits received or a collective equalizing of benefits and taxes.

In the formation of a methodology to enable the results of government policies to be evaluated, there is no consensus among modern fiscal theorists. The Keynesian and the asset (Rolph's) approach applied with
ceteris paribus assumptions applied to public expenditures and other
taxes, permits the analysis of the effects of a tax without considering
revenue. Or impounding taxes in a ceteris paribus assumption permits
the analysis of expenditure effects without the full consequences of the
effects of expenditures. But neither of these methods of analysis permits
the consideration of both tax and expenditure effects simultaneously.
In fact, the two methods provide the basis for rejecting the evaluation
of concurrent tax-expenditure effects within the framework of contem­
porary economic analysis. This conclusion is substantiated if Rolph's
definition of taxes is assumed. Taxes are transfer payments from the in­
dividual to the government. If taxes are viewed as a monetary phenomenon,
taxes do not impose a real burden upon the income distribution.

Since a tax may be used to implement policy rather than for revenue
purposes, a tax may be analyzed in a purely monetary type of analysis.
This point of view represents a radical departure from orthodoxy in
fiscal theory.

One realistic implication of the modern revenue-expenditure approach
to fiscal theory, and thus apportionment, is that governments may purpose­
fully redistribute income through taxation. Whether viewed from the
framework of Buchanan's "equalitarian" fiscal system or within the frame­
work of a monetary approach, the redistribution is analyzed in aggrega­
tive terms. The background of both approaches is to be found in the
post-Keynesian emphasis on taxes as tools of deflationary and growth
policy. A significant point in this background is that the individual
is de-emphasized in favor of broader considerations of total economic effects. The pre-occupation of the older fiscal theorists with the impact of tax collections no longer is coincident with the state-individual relationship in a modern economy.

Any quid pro quo relationship consistent with modern aggregative analysis is one in which tax collections as a collective are balanced against an expenditure collective. In the author's opinion, this quid pro quo view represents a converse benefits approach, or a redistributive benefits approach. Converse benefits occur as the tax revenues become expenditures in the government transfer of purchasing power. The expenditures are a contemporary criterion in determining the volume of national income and the level of employment. In the aggregative sense, the expenditures determine the benefit of the government services and goods rather than the benefits determining the tax yields. Thus the contemporary approach to fiscal theory must view apportionment of the tax burden as a phenomena influencing money flows or stocks through some methodological device that can indicate aggregative changes by the objective measures of "economy" performance.
Theories of tax apportionment provide several "principles" indicating how the tax burden could be distributed among individuals and groups. Two of these "principles," the benefit and ability principles, have been presented in the body of this research. The "principles" of tax apportionment leave much to be desired in providing criteria upon which fiscal decisions may be made. In the historical development of apportionment principles, little attention has been paid to the question of how much the tax load should be. As a result, the amount and distribution of public expenditures have been determined outside the scope of economic analysis, or as a subdiscipline of economics. This exclusion of expenditure "principles" has limited the usefulness of traditional fiscal theory. Nevertheless, the existing "principles" of apportionment have been important in shaping public attitudes on taxation.

The analytical expression of apportionment principles can be applied to indicate the results of alternative fiscal proposals. The subjective or ethical nature of the "principles" of tax burden distribution is at the base of the problem of relating these concepts to tax policy. The author concludes that at the present time there are no rules or guides that can serve as a rigid framework for the analysis of tax policy. Even greater difficulty is encountered in the formulation of the model or "just" tax system for the long run. Tax policy for short or long run purposes cannot be analyzed without criteria for criticism and evaluation.
If the treatment of the issues of tax policy bypass the difficult issues of relating ability, benefits and equity to specific guides to tax policy, the existing fiscal process cannot be understood. Analytical methods in the form of "scientific" criteria are doomed to failure in tax policy. But given a precise statement of criteria for fiscal processes, "scientific method" may be adopted to develop complete theories of public finance.
PART III. The Problem Orientation of Fiscal Theorists

The purpose of this part of this chapter is to direct attention to particular characteristics of the contributions cited in this research. To expedite the purpose of this section, the writers introduced in this research are grouped into two categories: Anglo-Saxon and Continental writers. The Anglo-Saxon group includes authors whose works were first published in the English language during the period from 1840 to the present. The Continental writers include authors whose works appeared first in some language other than English in the period from 1860 to 1940. This is substantially the same grouping that J. M. Buchanan uses in his Fiscal Theory and Public Economy. There appears a significant enough difference in method, substantive content and influence to classify these authors into the two groups. The following comments point out these differences.

Anglo-Saxon fiscal theory has analyzed the effects of particular fiscal measures, usually tax measures, upon the private economy. The analysis has been conceived in a partial equilibrium framework, although recently the Keynesian influence has aided in shifting this emphasis. The usefulness of the Anglo-Saxon thought depends upon, and is limited by this characteristic feature. Fiscal theory has been an adjunct of economic theory, and as such has been useful for many purposes.

The merit of the Italian and Scandinavian writers is that they placed fiscal theory in a broad framework in which interdependence between analyzing and explaining the results of government action has been
recognized. However, problem solving has been relatively neglected.

There is little discussion of the effects of particular taxes or expenditures in Continental works.

The English language tradition in fiscal theory has almost completely neglected the problem of collective choice, which is a major problem in the theory of public finance. Collective choice has been introduced only in welfare economics, and these attempts have not been related to fiscal theory. The Continental emphasis upon the public sector as the basis for analysis, de-emphasizing the private sector, has drawn attention to the matter of collective choice. Collective choice is a subject requiring analysis from the aggregate as well as the taxpayer-recipient point of view. In this area, the Swedish economists and Musgrave provide the guides for theoretical analysis. The majority of English and American authors have provided little or no guidance if the matter is recognized at all.

The fiscal theorist of the English and American tradition have devoted their energies to the content of equal, proportional, and other sacrifice theories vis-a-vis particular tax structures.

The Continental writers were critics of the sacrifice theories of apportionment and other normative theories and principles, which were the content of the contributions of the Anglo-Saxon writers. No important Continental writer, Cohen-Stuart excluded, has advanced the ideas of Edgeworth, Sidgwick or Nicholson in their fiscal theories.

The Continental contribution, particularly the Italian, has been in the criticism of the proposition that the best tax system is achieved when
sacrifices are minimized. Although DiViti de Marco's theory was couched in normative terms by applying the marginal productivity theory of distribution to fiscal theory, he goes beyond the problems of tax paying in his recognition of the role of the state.

Because of many factors, Continental fiscal theory is strongest where Anglo-Saxon theory is weakest and vice versa. The Continental writers de-emphasized problem solving in their fiscal analysis. The English speaking writers, who devoted their efforts to problem solving, overlooked the point that problems are conditioned by their methodological framework.

English tradition fiscal theorists are usually individualistic in emphasizing that it is the individual or the private economy which is the subject of their analysis. The individual and the private economy have been treated within a framework of partial equilibrium analysis. Only within the past few years has there been an attempt to treat the effect of the public economy in a general equilibrium frame of reference by the American writers such as Musgrave and Buchanan. Recently developed Anglo-Saxon models include the active role of the state and the more important feature of linking together taxation and exaction emphasis. This scope and method of fiscal theory may be a valuable adjunct to the modern theory of public economy.

Comparison of the orientation of the Anglo-Saxon and Continental theorists emphasizes the fact that the approaches to the theory of public finance are based upon various sets of values and institutions to which the theory is to be adapted. The implication of this conclusion
denotes that debates over theories of public finance and particularly
tax policy will range over the entire area of economics and politics.
Any conclusions will reflect value judgments about the nature of
economics and politics as much as about the "ultimate truth" of
fiscal theory.
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