The Pure Theory of Government Finance

A Suggested Approach

I

A framework for the pure theory of government finance may be erected on either of two political foundations, which represent, in turn, two separate and opposing theories of the state. Since neither construction is entirely appropriate when applied to all the problems faced in the fiscal area, the proper methodological procedure seems to be the setting-up of alternate theories.

In the first, or what may be called the "organismic," theory, the state, including all individuals within it, is conceived as a single organic entity. In the second, the state is represented as the sum of its individual members acting in a collective capacity. The individual and the state are fundamentally opposing forces in the latter concept, while in the organic view the state, or general interest, subsumes all individual interests. The theory of government finance based upon the second concept of the state may be called the "individualistic" one.

These two approaches have not been clearly separated or distinguished in the literature of government finance. Some variant of the organismic theory normally has been applied to the public expenditure side, while the individualistic theory has been predominantly employed in considering the distribution of the tax load. Fiscal marginalism has been extended to define the

From *Journal of Political Economy* 57 (December 1949): 496–505.

optimum allocation of public expenditures among alternative uses, that is, in the pure theory of budgeting. The allocation of total tax burden among alternative sources, has, on the other hand, traditionally been discussed in terms of the relative tax pressures imposed upon individuals.[1] Such asymmetry, while perhaps appropriate in practical application, does not appear formally complete. It seems desirable to develop the two theories independently at the outset.

II

In the organismic theory the state is considered as a single decision-making unit acting for society as a whole. Presumably, it seeks to maximize some conceptually quantifiable magnitude. A major difficulty is apparent in the determination of what is to be maximized. What is the common denominator to which the alternative goals of the collective entity may be reduced for comparative purposes, analogous to the equally vague, but less elusive, "satisfaction" or "utility" for the individual? A common denominator is necessary as a starting point in order that any one "configuration of the economic system" may be regarded as better or worse than any other, or indifferent.[2] This general end of society may be called "general welfare" or "social utility"; the name is not important.

"Social utility" is a function of many variables. The maximizing process will include the manipulation of many factors which lie outside the scope of fiscal theory. The structure of the whole social organization is itself a property subject to change. Many of the variables are noneconomic; and, even among those which can be classified as economic in nature, a relatively small proportion can be embraced in fiscal theory. The nonfiscal variables, therefore, must be accepted as parameters for the smaller system, and "social utility" must be maximized, subject to the constraints imposed. The variables to be determined in the fiscal process fall into two groups—the expenditure variables and the tax variables. The amounts of public expenditure allocated to each use comprise the expenditure variables. The amounts of tax load imposed upon each economic entity or tax source (individuals, business units, estates, etc.) comprise the tax variables. There are as many variables in the fiscal system as there are expenditure outlets and tax sources. Any allocation of the total tax load represents a solution for the whole set of tax variables. Any distribution of public expenditure among competing uses indicates a fixing of values for all the expenditure variables. Included in the setting of these values is the determination of total tax load and total public expenditures.

1. There have been, of course, certain elements of each approach present in most competent works. The individual benefits from public expenditures have never been entirely overlooked, nor have the social effects of taxation been completely neglected. The work of Hugh Dalton is representative of a complete organismic approach, with certain qualifications (*Principles of Public Finance,* 9th rev. ed. [London: George Routledge & Sons, 1936]). The theory presented by the Italian school best represents the individualistic approach (cf. Antonio de Viti de Marco, *First Principles of Public Finance,* trans. E. P. Marget [London: Jonathan Cape, 1936]).

2. P. A. Samuelson, *Foundations of Economic Analysis* (Cambridge: Harvard University Press, 1947), 221.

It is the function of the "fiscal brain" to select the values of these many variables which will maximize social utility. The maximizing process consists of a simultaneous determination of all the variables on both sides. The necessary condition for a maximum is produced when the partial derivatives vanish or when a dollar's tax load upon each economic entity deducts from social utility an amount equivalent to that added by a dollar's expenditure in each line.

It is important to note that the optimum values for the tax variables cannot be determined independently except for given values for the expenditure variables. The allocation of the tax load which will maximize social utility or, in this case, minimize deductions from utility will be different for each separate distribution of total expenditure. Similarly, the distribution of expenditure which will maximize welfare will be a function of the tax variables. The relative additions to social utility provided by the offering of public services to particular groups will be dependent in part 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 relevant criteria of comparison are reductions from social welfare or utility; the "least-aggregate-sacrifice" approach is the correct one. The principle of equimarginal "sacrifice" or, better, "subtraction," if values are given for the expenditure variables, provides an acceptable rule for the apportionment of the 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. It should be emphasized, however, that subtraction can be used only with reference to a social, not an individual, concept of utility.[3] For each given distribution of public expenditures the necessary condition for the optimum allocation of the tax load is reached when a dollar's tax upon each economic entity deducts an equivalent amount from aggregate social utility. The economic entities for such tax comparisons may or may not be individuals in this analysis.

Symmetrically, given values for the tax variables, an allocation of total public expenditure among alternative uses can be found which will maximize social welfare. This is also given by the application of the economic principle, or here the principle of "equimarginal addition." The necessary condition for the optimum is reached when a dollar of expenditure yields the same return, in addition to social utility, in each line. This allocation is independently determinate only for fixed values of all the tax variables. For each change in the apportionment of the tax load, a new optimum allocation of expenditure must be found.

Little more can be included in the framework of the organismic theory. Vague and general terms, such as "social utility" and "social welfare," are of little use in the discussion of policy problems. The theoretical steps in the maximizing of social utility offer little or no direct guidance to governmental fiscal authorities. As was mentioned earlier, this approach has been utilized largely in the theory of budgeting. Here it can provide a primary frame of reference, within which issues may be discussed, policies formulated, and decisions reached. Even in this limited usage, however, the functional interdependence of the whole fiscal system must not be overlooked.

III

The focus is completely shifted in the individualistic theory. The individual replaces the state as the basic structural unit. The state has its origin in, and

3. In this sense the principle of equimarginal sacrifice implies nothing about the ultimate equalization of incomes as a result of its application. This implication arises only when individuals are considered as the basic fiscal entities and when some assumption is made about the identities of individuals as pleasure machines.

depends for its continuance upon, the desires of individuals to fulfil 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.

The income of the state represents payment made by individuals out of their economic resources in exchange for services provided. In the provision of these services the state is, in most cases, in a perfectly monopolistic position. However, it does not seek to maximize net revenue. Services are offered at cost. The supply curve of public services is an average-cost curve, not a marginal-cost curve. This applies, of course, only to the aggregate of all public services considered in the abstract as some sort of homogeneous magnitude. In no way does it imply that each particular service is "sold" to individuals at the average cost of provision. In the social-service state many services are offered free; others at marginal-cost prices. In very few cases (the particular services provided in return for fees being the major exception) is there much connection between payments made to government by individuals and the special benefits enjoyed. But, when the aggregate of all public services is considered, the attempt is made to cover total cost. In effect, if public services are categorized, the "losses" to the government resulting from the provision of some services must be balanced by "profits" accruing from the provision of others.

The extent and range of public services are determined by the collective willingness of individuals to purchase them. Services will be extended as long as the aggregate benefits are held to exceed the costs.[4] For the total of all public services, aggregate benefits should approximately equal total costs in terms of sacrificed alternatives. Ideally, the fiscal process represents a *quid pro quo* transaction between the government and all individuals collectively considered.[5] The benefit principle must be applicable in this sense.

Each individual is subjected to some fiscal pressure; his economic resources are reduced by the amount of tax that he bears. His real income is increased by the benefits that he receives from government services. The al-

4. Cf. Edward D. Allen and O. H. Brownlee, *Economics of Public Finance* (New York: Prentice-Hall Book Co., 1947), 19.

5. The "pure" theory should be formulated on the assumption of stability in the economic system and thus balance between the two sides of the fiscal account. "Functional" finance precepts can be fitted into the framework at a second theoretical level.

location of total tax load among individuals must be combined with the distribution of benefits from publicly provided services in any complete theoretical framework. However, in this approach the imputation of specific benefits to individuals has been almost entirely glossed over in the orthodox literature. Overwhelming attention has been devoted to the allocation of the tax burden.

The practical omission of the benefit side can be attributed in part to the erroneous foundations of the benefit theory of taxation. In the legitimate rejection of the benefit principle as the universal norm for the distribution of the tax burden, too much was thrown out. This principle, widely accepted in the seventeenth and eighteenth centuries[6] and reintroduced in a more sophisticated form in the 1880's,[7] is based upon the premise that there should exist a *quid pro quo* fiscal relationship between the individual and government. The principle has been overthrown for two basic reasons. First, there appears no precise manner of imputing shares of the aggregate common benefit from public services to specific individuals. A significant portion of public funds is expended for the "general welfare," not to benefit particular persons or groups. Second, it is recognized that the underlying *quid pro quo* ideal is not at all acceptable in the modern state.[8]

But these two basic objections to the benefit principle are of fundamentally different natures. The first is a technical or an administrative difficulty, which prevents the principle from having direct applicability to policy. The second rests upon a rejection of the ethical premise that there should be an individual *quid pro quo*. If we accept the *quid pro quo* ideal, the benefit principle is correct in the abstract; and the problem of individual imputation of benefits is a technical, not a theoretical, problem. De Viti de Marco recognized this and therefore accepted as a working hypothesis the return of benefits roughly in proportion to incomes. Thus, adopting the ethical standard of the benefit principle, he justified a system of proportional taxation. In such a theoretical framework the apportionment of the tax load is directly dependent upon the benefit hypothesis formulated. If benefits were assumed to accrue equally per head, de Viti de Marco would have held a system of poll taxation to be appropriate.[9]

The rejection of the benefit theory of taxation should rest not upon the difficulty of individual isolation of specific benefits but upon the unacceptability of the ethical ideal of the individual *quid pro quo*. Once this commutative fiscal relationship of the individual with government is thrown out as the norm, is there any value to be gained from attempts at surmounting the technical problem of individual-benefit imputation? In orthodox fiscal theory the implied answer to this question has been "No," with the result that benefit considerations have been seriously neglected. The whole expenditure side of the fiscal account has been given little attention. In the individualistic approach, both the total amount of public expenditure and its allocation among uses have been assumed to be fixed outside the pale of fiscal theory.

Fiscal analysis has proceeded as if all taxes were net subtractions from social income, never to be returned. J. B. Say's dictum that "the value paid to government by the taxpayer is given without equivalent or return"[10] has been implicitly accepted, although lip service has been paid to its inherent fallacy. It is evident that such a limitation leaves the body of theory incomplete and inadequate. If benefits from public services accrue to individuals as a group (and this is impossible to deny), it follows that specific benefits are received by particular individuals, regardless of the technical difficulty of dividing the common benefit among them. Aggregate benefits must be in the nature of a quantitative magnitude and thus subject to conceptual divisibility. Benefits simply cannot be forgotten. Wicksell very clearly pointed out that the procedure of leaving out the benefit side amounts to concluding that each individual actually gets no benefit whatsoever from the government services provided him.[11] And, since the addition of any number of zeroes yields a zero

6. For an excellent short history of the early benefit theories see Erik Lindahl, *Die Gerechtigkeit der Besteuerung* (Lund: Gleerupska Universitets-Bokhandeln, 1919), 118 ff.

7. In the works of Pantaleoni, Sax, and de Viti de Marco.

8. Wagner clearly pointed out that, once the government began to provide social services, the benefit theory became completely inapplicable (Adolph Wagner, *Finanzwissenschaft* [Leipzig: C. F. Winter, 1890], 2:431–42).

9. Thus Graham says: "Since the value of most governmental services to the individual members of a community cannot be accurately assessed, nor can one take or leave them as he will, it could with some reason be contended that the ideal principle of allocation of the burden of taxation is neither progression nor proportionality but uniformity, that is, that all members of the community should pay the same amount" (Frank D. Graham, *Social Goals and Economic Institutions* [Princeton: Princeton University Press, 1942], 234).

10. *A Treatise on Political Economy,* trans. C. R. Prinsep (Philadelphia: J. B. Lippincott & Co., 1855), 413.

11. Knut Wicksell, *Finanztheoretische Untersuchungen* (Jena: Gustav Fischer, 1896), 82.

result, the aggregate benefit must also be zero if such an omissive assumption is made.[12] On this basis no public expenditure is theoretically justified. Furthermore, if no individuals in the social unit receive any benefit, it is apparent that no funds will be granted for the support of government. No tax bills could ever be passed by an elected representative assembly.

Only if individual shares of the aggregate benefit from public services are held to be roughly equal can the concentration of analysis on the allocation of tax burden alone be theoretically justified. It seems likely that this is the assumption made by some writers.[13] If phrases such as "chargeable against the whole community"[14] and "throughout the population"[15] can be interpreted as containing the implication that the benefits from most public services are shared equally among all citizens, then the approach has been internally consistent. If individual shares in the common benefit are considered equivalent, the real problems in fiscal theory are limited to the tax side, since equals would cancel equals when benefits are included in comparing the fiscal positions of individuals.

This necessary condition for the practical omission of benefit considerations should be clearly stated and its applicability empirically tested in so far as is possible. The dependence of the validity of the orthodox approach upon this rather narrow assumption was recognized by Kaizl and by de Viti de Marco.[16] But a general theoretical framework should not be so limited, even if this condition is made explicit.

12. Ibid.: "Ist jener Nutzen für die einzelnen Mitglieder der Gesamtheit gleich Null, so wird auch der Gesamtnutzen nicht von Null verschieden sein können."

13. For example, compare the following statements by J. S. Mill and Bastable:

"If a person or class of persons receives so small a share of the benefit as makes it necessary to raise the question, there is something else than taxation which is amiss, and the thing to be done is to remedy the defect, instead of recognizing it and making it a ground for demanding less taxes" (J. S. Mill, *Principles of Political Economy* [Boston: C. Little & James Brown, 1848], 2:354).

"But from the difficulty of discrimination it seems better to adhere to the general rule of distributing taxation without direct reference to the results of expenditure on different classes. Injustices of this kind ought to be corrected not by the redistribution of taxation but by alterations of outlay" (C. F. Bastable, *Public Finance,* 2d ed. [London: Macmillan & Co., 1895], 312).

14. Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938), 31.

15. Allen and Brownlee, *Economics,* 192.

16. ". . . das fundamentale Corollar der heutigen Auffassung der Steuergerechtigkeit

The difficult problem of individual-benefit imputation must be squarely faced. It is impossible to speak of the "burden of taxation" without considering, at the same time, the benefits from expenditure made out of such taxation.[17] Even the setting-up of untested explicit hypotheses concerning benefit accrual is preferable to omission altogether.[18] The most realistic hypothesis might well be that of equal per head sharing,[19] but alternative ones should be considered and tested if possible.

The final economic position of the individual after his relationship with the "fisc" can be expressed in the form of a balance between the two sides of the fiscal account. (If we accept the *quid pro quo* premise, this balance will always be zero.) This balance can be called the "fiscal residuum."[20] If an individual's tax burden exceeds the 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 residuums of individuals can the total effects of a fiscal system be analyzed and evaluated. Tax-burden comparisons alone are likely to yield quite different and perhaps misleading conclusions.[21]

. . . dass nicht nur die Last der Steuer gerecht vertheilt werde, sondern dass auch die Vortheile und Emolumente der öffentlichen Institutionen gleich vertheilt werden, dass sie Allen gleich zugänglich seien" (Kaizl, *Finanzwissenschaft,* 2:200, cited by Lindahl, *Die Gerechtigkeit,* 133).

"Thus one may abstract from the service of providing public security, if one assumes, and if the assumption corresponds to the facts, that the amount of security provided is equal for all productive enterprises that exchange their products. Thus, it is as if one were to cancel a common term in two terms of an equation" (de Viti de Marco, *First Principles,* 52).

17. Tibor Barna, *Redistribution of Income through Public Finance in 1937* (London: Oxford University Press, 1945), 3.

18. Ibid.

19. The use of this hypothesis has been found to yield important results in some areas. I have applied this to the theory of intergovernmental fiscal adjustment in a federal state and have been able to work out a determinate system of transfers without reference to particular tax burdens or particular service standards.

For another example of application to a similar problem see J. R. and U. K. Hicks, *Standards of Local Expenditure* (London: Cambridge University Press, 1943), 3.

20. The concept of a fiscal balance or residuum was utilized by Wicksell in a different sense (*Finanztheoretische,* 81).

21. The comparative study of the burdens of state and local taxes in New York and

This approach enables a general classification of fiscal systems to be made, comprising three major groups. First, those systems which tend to increase the inequality in the distribution of real income among individuals can be classified as "aggravative."[22] This type of system would be indicated if low-income individuals showed positive residuums, i.e., taxes in excess of benefits, while the high-income receivers showed negative residuums. Some systems of the sixteenth and seventeenth centuries which collected revenues from large elements of the population in the main for the support of the royal household and the nobility would perhaps be characteristic.

Second, those fiscal systems which tend to return to all individuals approximately the equivalent of their contributions and thus to have no net effect on the prevailing distribution of real income can be classified as "status quo" systems. This type would be indicated if a calculation of the fiscal residuums for individuals in all income brackets yielded roughly zero results. This type is perhaps best represented in the fiscal systems of the early nineteenth century, when a large share of revenue was collected from levies on property and a major portion was expended in the provision of protection, internal and external.

Third, those fiscal systems which tend to redress the prevailing distribution of real income toward more equality can be classified as "equalitarian" or "redistributive." If people in the low-income groups receive more in benefits than they pay in taxes and the upper-income groups contribute more than they receive in benefits, this type of system is indicated. This is, of course, the type which is characteristic of the modern state. A large share of revenue is derived from the proceeds of progressive income taxes, and a ma-

---

Illinois for 1936, published by the Twentieth Century Fund in *Studies in Current Tax Problems* (New York, 1937), can be used as an example. On the basis of tax-load comparisons alone, the tax load was found to be heavier in New York than in Illinois on eight out of the ten hypothetical families studied (p. 34).

By making the assumption of benefit accrual equally per head, and including New York and Illinois state and local expenditures in addition to the computed tax-load figures, it was found that the results were significantly changed. Where only two New York families out of ten were found to be in advantageous positions when tax burdens alone were considered, seven New York families became favored in fiscal treatment when the benefit side was included.

22. The use of the word "aggravative" here, of course, indicates the egalitarian "bias" of the writer.

jor portion of expenditures in peacetime is devoted to the provision of social services.

As was stated earlier, regardless of the kind of fiscal system, there should exist the *quid pro quo* relationship between government and all 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 type of system does the collective equalization of benefits and taxes imply that each individual receives in benefits the approximate equivalent of contribution made.

This simple classification represents nothing new.[23] It seems essential, however, that it be employed as the primary frame of reference within which more specific problems may be placed. One should bear in mind that the classification refers to fiscal systems, not to tax systems. Tax systems have been traditionally classified as regressive, proportional, and progressive, based upon the ratio of tax burden to income at different income levels. These terms are useful in describing the nature of a tax system, but they do not describe the fiscal system, as would appear to be the case in ordinary usage.

Progressive taxation has been justified because it leads to a more equal distribution of income among individuals. Standing alone, the statement that progressive taxation does redistribute real income is not true. It can be true only on the basis of certain assumptions about the other half of the fiscal system. If individual shares in the common benefit from public expenditures are all equal or approximately so, then progressive taxation will lead to a more equal distribution. But so will proportional taxation on the same basis.[24] Without considering the imputation of individual benefits, all that may be stated categorically is that progressive taxation will produce a more equal distribution of income than would proportional or regressive taxation. One cannot say that it will produce a redistribution; it may or may not.[25]

23. Cf. W. J. Shultz and C. L. Harriss, *American Public Finance*, 5th ed. (New York: Prentice-Hall Book Co., 1949), 104.

24. The statement that progressive taxation will redistribute incomes but that proportional taxation will not implies that benefits are returned to individuals in proportion to incomes and wealth.

25. The emphasis upon the redistribution effects of the tax side alone is indicated in

If a major share of governmental expenditures were allocated to provide protection to the property rights of the wealthy classes, then even a progressive tax system might not prevent the fiscal system from increasing real income inequality. On the other hand, if benefits were wholly in the nature of social services, poor relief, unemployment compensation, etc., then a *regressive* tax system might well be a part of a *redistributive* fiscal system.[26] Conversely, public expenditures made for the benefit of low-income groups may be financed by taxes on those same or even lower-income groups.[27] Certainly, if a significant tax increase or change in the structure of the tax system of any kind is proposed, the ultimate manner in which the proceeds are to be expended should, in part, determine the nature of the change. The same amount of redistribution may be as well accomplished by the levy of a sales tax to provide expanded social services as by an increase in the higher-bracket income-tax rates to finance additional defense expenditure. Since redistribution is only one goal of responsible social policy in the modern state, fiscal policy should reflect such possible alternatives.

The ratio of tax burden to income at various income levels should be separated from any underlying ideas concerning final distributive effects. Owing to the connotation which has caused them to be so sharply categorized with such distributive implications, perhaps it would be better if the terms "regression," "proportion," and "progression" were discarded.

The theoretical framework in the individualistic approach does not include the specification of a single fiscal system to be adopted by the society.

the following quotation for the *Annual Economic Report* submitted to the President by the Council of Economic Advisers in January, 1949: "The federal personal income tax has reduced somewhat the concentration of income. In 1947, for example, the lowest three-fifths of families received 29 per cent of total money income before tax compared to 31 per cent after tax, while the share of the upper one-fifth was reduced by taxes from 48 to 46" (reprinted in *United States News and World Report*, January 14, 1949, 72).

See also R. A. Musgrave and Tun Thin, "Income Tax Progression, 1929–48," *Journal of Political Economy* 56 (1948): 498–514.

26. In 1947 a state-wide general sales tax was imposed in Tennessee, with most of the proceeds earmarked for expenditure in the provision of educational services. It can plausibly be argued that the collection of the tax and the expenditure of the proceeds taken together are redistributive.

27. The British case seems applicable here. Should not the "redistributive" effects of the food subsidies be carefully scrutinized, considering the enormous levies on tobacco and liquor?

The ends to be served by the fiscal system are determined by political decisions. The framework does, however, enable the fiscal specialist to indicate the alternate distributions of tax burdens and public expenditures which will yield the desired results. If, for example, the society desires a fiscal system which will not affect the prevailing distribution of real incomes, any number of fiscal structures, tax-burden and expenditure allocations, can be formulated which will approximate it. Further, if this status quo ideal, plus an allocation of public expenditures, is given, the single most appropriate tax structure can be outlined.

A similar approach is suggested for other than status quo norms. The redress of the prevailing income distribution toward greater equality has been accepted as one of the fundamental purposes of the fiscal system in the modern state. The fiscal scientist can provide policy-makers with practical guides to action in several ways. If the desired degree of redistribution is known, the alternate pairs of tax-burden and public-expenditure allocations which will yield this result can be indicated. If this, plus the existing public-expenditure pattern, is known, it is possible to set up the tax system, assuming in this case that attainment is possible under the given conditions. On the other side, given the degree of redistribution and the apportionment of the tax load, the expenditure pattern can be established.

Society, however, does not normally make concrete decisions concerning the amount of redistribution desired. Rather, it determines an allocation of expenditures among uses and a distribution of the tax load which will, when combined, cause the fiscal system to be redistributive. The role of the fiscal scientist qua scientist in this situation is clear. With these properties he can determine roughly the amount of redistribution of real incomes actually accomplished through the fiscal process.[28] He is then able to indicate alternative tax and expenditure allocations which would yield approximately equivalent redistribution results, some of which might result in significantly different effects upon the economy. It is perhaps in the area of estimating the amount of redistribution carried out by the fiscal system that the most productive empirical work in the whole field of government finance can now be carried on. The traditional difficulty encountered in the attempt to impute specific shares of the benefits from public services to individuals, even upon

28. This is the approach taken in the path-breaking work of Barna (*Redistribution*).

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 based upon even more arbitrary assumptions than the heroic ones admittedly required concerning the incidence of public expenditures. With the expansion of government activity toward the provision of social services, and services to particular economic or social groups, the problem should present less of a dilemma. For example, the individual benefits from farm price supports can be more readily estimated than those from defense expenditures.

IV

In both the organismic and the individualistic approaches to fiscal theory, the paramount need is that the interdependence of the two sides of the fiscal process be clearly understood. Both approaches require parallel consideration to be given to the determination of the expenditure allocation and the apportionment of tax burden. In neither theory can either side be analyzed in isolation.

The organismic framework gives a much more complete normative behavior pattern for the fiscal authority. Since the government is the basic entity, the fiscal theory reduces to a statement of an applied maximization problem. The major obstacles lie in the attempts at translation of the theoretical guides to action into a realistic approach to practical policy. It becomes extremely arduous, if not impossible, to fill in the theoretical framework with empirical content.

In the individualistic approach the government represents only the collective will of individuals and cannot be considered the originator of action in an abstract sense. The fisc cannot be assumed to maximize anything. The fiscal system exists as one channel through which certain collective desires may be accomplished. The content of theory becomes the setting-up of a structural framework to enable the results of policies to be evaluated.

Taxation in Fiscal Exchange

Methodologically, the fiscal exchange paradigm is superior to its alternatives. This is demonstrated by the use of a simplified example. Difficulties arise when political processes force departures from basic exchange. Traditional equity norms can be viewed as constitutional protections against undue fiscal exploitation. In a broader perspective, the exchange paradigm remains applicable at the constitutional level. There are major philosophical advantages in remaining within the constitutional-contractarian framework.

1. Introduction

In his paper, "Reflections on Tax Reform," delivered as the C. Harry Kahn Memorial Lecture at Rutgers in 1972, Professor R. A. Musgrave acknowledged that the weakest part of the Simons tradition in tax reform policy discussion is its neglect of the expenditure-benefit side of the fiscal account. To assign a predominant role to equity criteria in assessing alternative tax instruments independently amounts to an implicit assumption that taxation represents a net withdrawal of resources from the social economy, a setting which Luigi Einaudi labeled as that of the "imposta grandine," literally the "tax as hailstorm." Much the same criticism can be levied against the independent analysis of alternative taxes in terms of their comparative efficiency properties, whether in the older excess-burden form or in the modern and more sophisticated optimal taxation framework.

From *Journal of Public Economics* 6 (1976): 17–29. Copyright 1976. Reprinted with permission from Elsevier Science.

I am indebted to my colleagues Gordon Tullock and Richard Wagner for helpful comments.