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UGO MAZZOLA AND THE ITALIAN DOCTRINE OF PUBLIC FINANCE

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UGO MAZZOLA AND THE ITALIAN DOCTRINE
OF PUBLIC FINANCE

by

ORHAN KAYAALP

A dissertation submitted to the Graduate
Faculty in Economics in partial fulfill-
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A b s t r a c t

UGO MAZZOLA AND THE ITALIAN DOCTRINE
OF PUBLIC FINANCE

by
Orhan Kayaalp

Advisor: Professor Charlotte Muller

This dissertation has three objectives. The first is to indicate the important place of Ugo Mazzola in the history of public finance. His 1890 book *I dati scientifici della finanza pubblica* marks the birth of the independent science of Public Finance which has attracted the best economists to its realm in Italy. The second aim is to introduce the English-language student of public finance to the Italian fiscal doctrine with which (s)he is still relatively unfamiliar despite considerable efforts of James Buchanan. In this connection, the contributions of two other Italian economists, Maffeo Pantaleoni and Antonio de Viti de Marco, must be pointed out since these three men shaped the "*scienza*" della finanza pubblica together although it was Mazzola who gave Public Finance its theoretical character by completing the analysis of the fiscal process started off by Pantaleoni and elaborated by de Viti de Marco. The third and last objective of this dissertation is to show that, although concentrating in the last two decades of the 19th century, the Italian fiscal doctrine based on the concept of public goods appears to be far more adequate than its Anglo-Saxon counterpart in tackling complicated fiscal problems of the State. What is recommended is an integrated approach whereby fiscal analysis is made within a public choice paradigm.

A c k n o w l e d g e m e n t

I am truly grateful to Professor Herbert Geyer who introduced me to the Italian tradition, and to Professor Harold Hochman who encouraged me to write my dissertation on this subject. Their guiding influence was instrumental in the conception and development of this product, and their sustained interest in this project gave me the necessary confidence that this work was of any value. My thanks extend especially to Professor Charlotte Muller, however, who in the course of four years of precious collaboration, helped this dissertation to mature to the present state. She worked closely with me on each page of the dissertation, from the first draft to the last, each time giving me invaluable insight, so very patiently and graciously.

UGO MAZZOLA AND THE ITALIAN DOCTRINE
OF PUBLIC FINANCE

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UGO MAZZOLA AND THE ITALIAN DOCTRINE
OF PUBLIC FINANCE

CHAPTER 1

THE ITALIAN CONTRIBUTION TO THE THEORY
OF PUBLIC FINANCE

The point of departure of this dissertation is the premise that the typical English-language student of public finance is generally unfamiliar with the Italian fiscal doctrine. Although another previously unknown body of fiscal doctrine, the Scandinavian school, has finally won an important part in the public finance curriculum, the Italian theory is still largely outside of it. The main reason for this omission is purely linguistic: Lindahl and Wicksell wrote in German, and later Johannsen in English, and their articles appeared in various continental and Anglo-Saxon journals whereas the Italian authors limited their audience to the readers of their elaborate textbooks and the local *Giornale degli economisti*. In spite of Buchanan's and Musgrave's efforts to introduce the Italians to American public finance circles, their success was not comparable to that which they enjoyed when they gave us Wicksell and Lindahl. One of the reasons that Wicksell and Lindahl have found such a warm reception was that they were, in some measure, seeking an "equitable" solution to taxation: this quest agreed wholly with the Anglo-Saxon tradition which considered public economy as generally unproductive, and taxation as a sacrifice that citizens must endure. The Italian tradition contained peculiar

features in this regard. Public expenditure was held to be productive, and taxes to be voluntary payments that the consumer would make for the enjoyment of public goods, or the private producer would make for the production-facilitating services offered by the State.

A few years ago, a cursory reading for a term paper assignment on Ugo Mazzola, an important 19th century Italian economist, indicated the scantiness of publications in English on the Italian work in public finance. One publication was Musgrave's *Theory of Public Finance* (1958) which, within the context of the "benefit" approach to taxation, introduced three Italian authors, Pantaleoni, de Viti de Marco and Mazzola, along with Wicksell and Sax, as the fountainheads of the "pure" theory of public finance. Musgrave's interest in the Italian fiscal doctrine *per se*, however, was a secondary one. His main objective was to trace back his multiple-branch theory of budgetary control to the two cardinal principles of fiscal process, "benefit" and "ability-to-pay." That ability-to-pay should be the foundation of a "proper" system of taxation was already entrenched in Anglo-Saxon fiscal theory. Musgrave wanted to explicate the other principle. With this in mind, Musgrave studied in detail the transformation of the benefit approach in the last two decades of the 19th century from a dictum of "justice" into a condition of efficiency.

Another available publication was Musgrave and Peacock's *Classics in the Theory of Public Finance* (1958). The excellent Introduction of this book was again based on the discussion of the two principles of taxation. No

conscious effort had been made to create a sense of the Italian doctrine, but the reader naturally gained an insight into the Italian fiscal tradition after studying the excerpts from the works of Pantaleoni, Mazzola, Barone and Montemartini contained in the book.

Buchanan's contribution was more substantial in this regard in that he addressed himself directly to the task of presenting to the English-language economist the essence of the classical Italian public finance theory. His well known essay^(*) offers a summary of the Italian fiscal doctrine, complete with a survey of institutional setting, a discussion of principal characteristics and specific contributions, and a comparison of the Italian and Anglo-Saxon traditions. Buchanan's interest in the Italian fiscal doctrine culminated in his 1968 book, *The Demand and Supply of Public Goods*⁽⁺⁾, the first English-language book in "pure" public finance, wherein taxes, viewed by Buchanan as a price for public services reflecting taxpayer demand, brought about an equilibrium between the supply and demand of public goods via a political process. The Italian influence is unmistakable both in construct and in spirit, and Buchanan consciously imparts this flavor to the reader through the exploits of

(*) See J. M. Buchanan, "*La scienza delle finanze: The Italian Tradition in Fiscal Theory*," Fiscal Theory and Political Economy: Selected Essays, Chapel Hill, North Carolina: University of North Carolina Press, 1960, pp. 22-74

(+) See J. M. Buchanan, The Demand and Supply of Public Goods, Chicago: Rand McNally & Co., 1968.

Tizio and Caio, two Italians on a desert island, one offering a public good (repelling mosquitoes) to the other.

Despite Musgrave's and Buchanan's efforts, the existing English-language literature is still inadequate in many respects. Musgrave deals with the Italian fiscal theorists only tangentially, in relation to the benefit approach to taxation and public expenditure. Buchanan, who wants to familiarize the reader with the classical Italian fiscal theory, uses too broad an outline in his essay to cover adequately a sixty-year period between 1880 and 1940, and does not sufficiently emphasize the earlier part, which was most important, although as an overview his achievement is admirable.

This dissertation focuses on a relatively short time period that covers the last two decades of the 19th century and devotes attention to three Italian economists, Pantaleoni, de Viti de Marco and Mazzola, in order of increasing importance. The period extending from 1880 to 1900 requires special emphasis. Those were the most fruitful years in the development of Italian fiscal doctrine. The premises of public finance formed during this period had a lasting effect on modern continental fiscal theory. Buchanan's attention is not specially focused on this period, although he concentrates on the works of Pantaleoni and de Viti de Marco, which came out in 1883 and 1888 respectively. Buchanan's focus on these two economists is much warranted since their ideas indeed influenced most Italian writers who followed. Pantaleoni and de Viti, undoubtedly the two most important economists in Italy in 1880-90, turned their

attention to public finance from time to time, and truly advanced the Italian fiscal theory. To their rank, however, must be added Ugo Mazzola, who studied fiscal phenomena exclusively and was instrumental, more than Pantaleoni and de Viti, in rendering Public Finance an autonomous science, distinct from Political Economy in Italy.

The omission of Mazzola in Buchanan's essay is quite surprising in that it was Mazzola, not de Viti or Pantaleoni, who defined public wants and public goods, and showed explicitly how an equilibrium between the supply and demand of public goods could be achieved within a political process with the help of voluntary tax payments. In view of the theme of his 1968 book, *The Demand and Supply of Public Goods*, which reflects so closely Mazzola's fiscal paradigm, Buchanan's omission of this important author becomes truly inexplicable.

Objectives of the Dissertation. The main goal of this dissertation is to expound the importance of Mazzola's contribution to the theory of public finance. But this could not be achieved without dwelling somewhat upon the background and basic characteristics of the classical Italian doctrine. Therefore, the secondary aim is to present some important features of the Italian fiscal framework, especially those that we owe to Pantaleoni and de Viti de Marco. These two men set the stage for Mazzola's illustrious performance. Mazzola's, de Viti's and Pantaleoni's contributions are intertwined. They were familiar with each other's work. They all started off as young professors at University of Camerino,

a small provincial university known for its adherence to economic liberalism. They then moved to a larger provincial university, University of Pavia, where Mazzola remained for the rest of his short life whereas Pantaleoni and de Viti moved to University of Rome, the most prestigious university in Italy. They were colleagues in most intimate terms, writing introductions to each other's manuscripts, and rotating the general editorship of the foremost Italian economic journal, the *Giornale degli economisti*, among them. They contributed lengthy articles to the *Giornale* from time to time, but Mazzola maintained a regular column, *Le cronache*, where he reported on current economic issues.

These three men felt a sense of dissatisfaction as they surveyed that sorry mixture of practical precepts, rambling discussions of philosophic and political themes, comments on legal texts, and loose applications of economic laws, which made up the literature of Public Finance in Italy.¹ As in England, Public Finance had up to the 1880's been regarded in Italy as an appendix to political economy dealing with the problems of taxation. All finance ministers, Scialoja, Sella, Magliani, Ferrara, had been professors of economics trying to find solutions to fiscal problems haunting Italy during the years of Unification, by applying that sorry mixture. Public Finance had been nevertheless studied apart from the mother discipline of Political Economy in Italy, but "...merely for the practical reason

1

L. Einaudi's Introduction to A. de Viti de Marco's English translation of *I primi principii dell'economia finanziaria*, Roma: 1888. Translated as *First Principles of Public Finance*, London: Jonathan Cape, 1934, p. 22.

of division of scientific labour that was made necessary by the fact that professional economists found it impossible to include along with general economic phenomena the very numerous and important phenomena which [were] associated with the life of the State."²

Pantaleoni, de Viti and Mazzola were quite aware that they were destined to shape the Italian fiscal doctrine. The product of their endeavor was a surprisingly modern, holistic, pure theory of Public Finance. The efforts of these three men in ^{the} 1880's resulted in the establishment of the *scienza* of Public Finance, with a specific aim of studying financial phenomena with all their possible manifestations and consequences (economic, political and legal), in the face of specific assumptions and by following proper deductive logic. As will be shown in the following chapter, our fiscal theorists were very careful in defining the propositions and assumptions of their theories, being fully aware that "...the phenomena of Public Finance are variable. Thus, the Public Finance of the Middle Ages is not the Public Finance of modern times; the Public Finance of states based upon slavery and absolutism differs from that of free and parliamentary states. The resulting treatment is a complex one, which passes from the abstract to the concrete."³ The dissertation will sort out the various contributions of

²L. Einaudi's Introduction to de Viti's *First Principles*.... cited in previous page, p. 23.

³De Viti's own Introduction to the English Edition of his *First Principles*..., p. 15.

Pantaleoni, de Viti and Mazzola in the forming of the new Science of Fiscal Economics and will demonstrate the leadership of Mazzola, the youngest member in the group, in this regard.

Relevance of the Dissertation. The dissertation is relevant to modern policy issues in that, in addition to pointing out the important place of Mazzola within the Italian fiscal doctrine, thus closing a gap in the history of economics, it introduces the English-language student of Public Finance to a framework which is strongest precisely in those areas where the Anglo-Saxon theory is weakest.⁴ While the converse also holds true, reconciling the two is not impossible, as proven by Lindahl to a certain extent. To do this, the student must be familiar with both frameworks. Many modern issues of public policy require this synthesis. For example, as in many other public policy fields, in health economics willingness-to-pay has been suggested as a new measure of utility of health services.⁵ The standard gamble and other techniques were used as means of ascertaining how much money a patient would be willing to pay to get rid of a disease. The making of resource allocation decisions in health care becomes more responsive to subjective preferences

⁴Buchanan's essay mentioned, p. 38.

⁵ See, for example, J. Steven Landefeld and Eugene P. Seskin, "The Economic Value of Life: Linking Theory to Practice," American Journal of Public Health, June 1982, Vol. 72, No. 6, pp. 555 - 566.

of consumers. Willingness-to-pay as a medium of allocation of private or public funds was totally familiar to Fantaleoni, de Viti and Mazzola. By contrast, coeval Anglo-Saxon fiscal theorists (Edgeworth, Sidgwick, later Marshall and Pigou), influenced by their doctrine of "ability-to-pay," reached conclusions which were quite opposite from those of their Italian counterparts.

The integration of these approaches is possible.^(*) Actually, both the Italian and the Anglo-Saxon fiscal doctrines had the same origin: Bentham's utilitarianism. Bentham took it for granted that utility was a measurable magnitude and that a "felicific calculus" was possible. He indicated certain variables (nearness in time, certainty, etc.) which would determine utility. However, Bentham was aware of the difficulties in the actual measurement of someone else's utility, and therefore settled for each individual deciding the utility only for himself. The State should maximize the sum of the utilities of the n individuals of the society. Bentham's prize pupil, J. S. Mill, correctly realized that the proper method to use in the felicific calculus was to be found in the benefit approach, rather than in ability-to-pay, since Bentham's criterion was based on individual preferences, and was thus consistent with the benefit approach, whereas ability-to-pay depended on commensurability of different individuals' utilities, or on the form of the social welfare function. To J. S. Mill, the benefit principle allowed this construct since it viewed the relation of taxpayer and State in *quid pro quo* terms.⁶

(*) As it is possible to gain a deeper insight to utility theory by integrating the two conflicting schools of welfare economics, the marginalist (Marshall-Pigou) and the ordinalist (Robbins-Hicks). For an excellent discussion of this issue see R. Cooter and P. Rappoport, "Were the Ordinalists Wrong About Welfare Economists?," Journal of Economic Literature, Vol. XXII (June 1984), pp. 507-530.

⁶R. A. Musgrave, Theory of Public Finance, New York: McGraw-Hill, 1959, p. 62.

But J. S. Mill still concluded that "ability-to-pay" was preferable to "benefit" since the latter would yield only qualitative results, probably useful for criminal justice, but not for economic decision making of the State. Edgeworth sealed the doom of the benefit approach when, using marginal analysis, he applied the sum-of-utilities criterion (minimizing aggregate sacrifice) to the determination of tax revenues, thus rendering "ability-to-pay" a trademark of the Anglo-Saxon fiscal doctrine.

While there were numerous problems in applying utility to *public* goods (e. g., externalities), the application of Bentham's hedonistic psychology to private choice did not yield problematic results. Bentham's utilitarianism became the starting point of modern economics, as the possibility of framing utility in marginal terms was grasped simultaneously by Jevons in England, Walras in Switzerland and Menger in Austria, between 1871 and 1874. Italian economists fully absorbed the utility view of value of private goods. The notion of utility had place in the writings of Bernardo Davanzati (1529-1606) and Ferdinando Galiani (1728-1787). That the value of commodities was derived from their utility, and not from scarcity or cost of production, was expounded in Ferrara's articles in 1850's, and about the same time, Briganti defined economics as "mechanics of pleasure, or hedonism."

What was problematic in public economy, however, was the fact that when the appropriate corollary to the principle of benefit, that is, the principle that the perceived benefit would be translated into effective demand and thus influence the allocation of economic resources, was applied to fiscal decisions, inadequate results were obtained. The British fiscal theorists found a wholesale solution to this problem by embracing the ability-to-pay view in which

State was no longer subject to the rules of the market process. This principle, suggested by no less than Smith himself and buttressed by Edgeworth, allowed for the treatment of the individuals' contributions to the financing of public goods as a separate issue, independent from the issue of the supply of public goods. The role of the individual in the determination of the offering and pricing of the public good was totally neglected. The individual was reduced to a mere "taxpayer," and the salient issue that emerged was "how much tax should the individual pay to a coercive State."⁷ In short, what prompted the English economists to favor the ability-to-pay approach was not its inherent superiority to the benefit approach, but the latter's inability to yield cardinal measurement of utility of public goods.

Italians were more reluctant to dispose of the benefit principle, which had its roots in Italy in the writings of St. Thomas of Aquinas (*Summa theologiae*, 1273) and later Tommaso Campanella (*La città del sole*, 1602), who expounded the principle as a dictum of justice. The State must be ruled by pure reason to advance the rational creature of God, man, to worldly and heavenly beatitude. This view was later applied to public finance by Francesco Ferrara, the teacher of all three Italian economists under consideration, as a principle of justice in the determination of the quantity and price of public goods; however, Ferrara's discussion was mingled with political and philosophical arguments that blurred the issue. The point is that the works of benefit-view authors, Italian or foreign, were

⁷ This point is made by Musgrave and Peacock in R. A. Musgrave and A. T. Peacock, Classics in the Theory of Public Finance, New York: St. Martin's Press, 1967, pp. ix-x.

known to Pantaleoni, de Viti and Mazzola. They read other benefit-view philosophers such as Grotius, Rousseau and Locke since all three were fluent in foreign languages.

Mazzola read Sax's *Grundlegung der theoretischen Staatswirthschaft* and Wieser's *Der natürliche Wert* in German; Pantaleoni, whose mother was English and who graduated from

University of Potsdam (Berlin) in classical studies before getting his law doctorate from University of Rome, was a polyglot, conversant with English, German and French economic literature. De Viti, a marquis, was trained in both English and French. These men found a very ingenious way to revive the benefit approach. They interpreted the benefit principle not as a condition of justice, as proposed by the authors mentioned, but as a condition of efficiency in the supply and demand of public goods. However, they were careful not to make the mistake that their English counterparts made when they extended this principle to public economics: although the relation between the citizen and the State is one of exchange, and the voluntary payment is the basis of valuation, the rules of valuation of public goods are different from those of private goods. While the tax is a price for the public goods enjoyed (or to be enjoyed in the future), the equilibrium of supply and demand of public goods is achieved by a political process in which the State acts in response to the "average" voter demand.^(*) The equilibrium, according to Italian fiscal theorists, is within reach, since the State is given sound, unambiguous rules to use in the determination of the output and price of the public

^(*)The modern version of this view is presented by H. Bowen, "The Interpretation of Voting in the Allocation of Economic Resources," OJE, 1943.

good in question. This issue will be elaborated in Chapter 2, Economic Activity and the State.

As suggested in the example referred to earlier where willingness-to-pay was proposed as a measure of demand for health services, the Anglo-Saxon economist familiar with the Italian tradition will be more careful in developing partial equilibrium models. The political paradigm must be taken into consideration. Things simply do not happen in a vacuum. To quote de Viti, we should "...treat Public Finance as a theoretical science, assigning to it the task of explaining [fiscal] phenomena as they appear in their historical setting. Hence it is necessary, on the one hand, to go back to the causes of these phenomena, and, on the other hand, to trace their effects."⁸ The economist is expected to give due attention to certain *ceteris* that are clearly *non paribus*. These might include personal differences in perceptions, cognitive processes, and values, as well as group decision processes such as bargaining, coalitions and prevailing organizational constraints.

The Plan of the Dissertation. Pantaleoni, de Viti and Mazzola cleared up many misconceptions that beleaguered the Italian public finance thought until 1880's. The dissertation groups these contributions under three headings.

In Chapter 2 are included the contributions of our authors in delineating the characteristics of the political

⁸De Viti's Introduction to his Principles, p. 15.

process that would bring about the equilibrium between the demand and supply of public goods. The leading role in this chapter belongs to de Viti. His conception of the State as a responsive entity is truly revolutionary, Mazzola's interest in this area is a secondary one: having accepted de Viti's political paradigm, he turns his attention to its corollary, that is, to formulating a proper decision rule for a State which is responsive to public demand, and aware of complications of group decision making processes. Mazzola asserted that the decision rule lay in economics, and not in sociology, politics, philosophy, law or religion.

Chapter 3 deals mainly with Mazzola's contribution in transforming the hodgepodge of Italian financial politics into a "science" of Public Finance. Mazzola's *I dati scientifici della finanza pubblica* (1890) marks the date of the birth of this new "pure" social science, which has been more respected in Italy than Political Economy. Italian Public Finance gained a theoretical character which Political Economy lacked for a long time. It was precisely the determination to remain theoretical that gave Mazzola's work a practical value: in this way, those who govern, guided by the aims of benefiting themselves, on the one hand (by securing their own continuation in office), and benefiting the whole nation, on the other, would rationally determine what alternative actions were available both in taxation and in spending, and what would be the consequences of each.

This chapter presents the characteristics of the "scienza" di economia finanziaria, or the "pure" Italian

theory of public finance, which surpasses the coeval British doctrine in many respects. The discussion of the Italian doctrine will be presented in relation to the British, although references will be made to the Austrian and Scandinavian schools; especially when Mazzola's contributions are examined in detail. The final chapter deals with modern implications of the Italian tradition of public finance. The Italian doctrine is not seen as a replacement for the Anglo-Saxon doctrine, which enriched the current discipline of public finance in many areas such as shifting, incidence, and various effects of various types of taxes - announcement, income, and distributional. What is suggested is a synthesis of these two seemingly incompatible approaches.

The main lines of the independent English fiscal doctrine relied heavily on taxation theory and fiscal policies as means of securing economic stability. A close examination of fiscal institutions and tools was made, however, only with reference to the tax side. Public expenditure was traditionally treated descriptively, with the support of scattered theoretical insights gleaned from Adam Smith or from the welfare economics of Pigou.⁹ Only in the past twenty years has the English public finance literature taken a turn toward a prescriptive theory of public expenditure, following contributions of influential authors such as Samuelson, Musgrave and Buchanan, whose theories were based on the discovery of "public goods" as a positive element. By and large, however, the Italian concept of public good has not yet fully penetrated the Anglo-Saxon fiscal doctrine, "...and it remained, for the most of the English-speaking economic world, yet another mystery in the Pandora's box

⁹J. G. Head, *Public Goods and Public Welfare*, Durham, North Carolina: Duke University Press, 1974, p. 68.

of Continental esoterica."¹⁰ This dissertation will have achieved its objective if it has conveyed the considerable importance of what it is in the box, and has related to the English-speaking economist the applicability of that stuff to concepts of modern fiscal theories more familiar to him/her.

¹⁰Ibid., p. 165.

CHAPTER 2

ECONOMIC ACTIVITY AND THE STATE

That the Italians were the true founders of the "pure" theory of Public Finance is unquestionable. As will be seen in this and the following chapter, the optimum condition analysis of public goods, which had its origin in Pantaleoni (1883) and de Viti (1888), and was elaborated by Mazzola (1890), was deeply admired, first by Continental authors such as Wicksell and Lindahl, and later by Samuelson, Musgrave, Buchanan and Peacock. The Italians, truly proud of this tradition, also claim that they were the fountainheads of Political Economy. To this end, they relish pointing out the many works of 17th and 18th century Italian economists who expounded original thoughts on the doctrine of value, money, population and international trade. The claims of the Italians to primacy in economic science were defended strongly by Ferrara in 1850s in the introductions that he wrote for the *Biblioteca dell' Economista*^(*), and later by Pantaleoni, in numerous articles that he published in the *Giornale*. It was asserted also by economists of other Continental countries that Galiani (1728-1787) was an opponent of interest rate restrictions in particular and the mercantilist system in general, that Verri (1728-1797) had pleaded for the abolition of trade restrictions, and that Ortes (1713-1790) was a

(*) Ferrara's instructive introductions to the 1st and 2nd series of the *Biblioteca dell' Economista*, Torino, 1850-70, were published separately in *Esame storico-critico di economisti e dottrine economiche*, Torino, 1889-1892.

precursor of Malthus.¹ The admirers of the Italian economists went so far as to suggest that Smith's book which appeared in 1776 had been indebted to Verri for his knowledge of the defects of protectionism, and to suggest even that Smith only completed the work of Serra (1550?-1610?).² To assess these claims is beyond the scope of this dissertation. Whether or not Smith read Verri or Serra will never be known. However, in order to make the point that economic science has always been an Italian vocation, two examples from the history of economic doctrines are worth mentioning:³

"First it was Italian writers -namely Ludovico Muratori, Ferdinando Paoletti, [Antonio] Genovesi, and others- who had pleaded for "the greatest happiness of the greatest number" many years before the publication of Bentham's well known books. Second, it is established beyond doubt that [Giammaria] Ortes in his *Riflessioni sulla popolazione* (1790) had already pointed out the disproportion between the increase of population and that of subsistence -even stating and discussing the geometrical growth of population- twenty or twenty-five years before Malthus. In England M'Culloch afterward went so far as to declare in his Literature of Political Economy that what was right in the doctrine of Malthus had been already stated [by yet another] Italian economist Giovanni Botero in his book, *Della ragione di Stato* (1589). The works of Botero, furthermore, had been

¹O. Weinberger, "The Importance of Francesco Ferrara in the History of Economic Thought," Journal of Political Economy, Vol. 48, 1940, pp. 91-92.

²O. Weinberger in op. cit., referring to A. von Schwarzkopf, *Beitrag zur Studien in Italien im 17. und 18. Jahrhundert*, Strassburg, 1872. [Serra was an adamant critic of mercantilism, especially of the application of restrictions to economic processes by the rulers of the Kingdom of Naples. This sent him to jail around 1602, with Campanella, where he died. His works were revived by Galiani in 1750s, and later by Ferrara.]

³O. Weinberger, op. cit., pp. 92-93.

translated into English; and it is strange that Malthus did not mention him, although he cited Machiavelli and was accustomed to read Italian texts."

By and large, however, the influence of the Italians on the English economists had been minimal: the influence was, in fact, in the other direction. A glance at the author indexes of Pantaleoni, de Viti and Mazzola reveals their familiarity not only with Jevons, Edgeworth and Marshall, but with lesser figures of the English political economy literature.

That the direction of the influence was a one-way street going north-to-south, although beneficial for the Italian political economist, prevented the English economist interested in Public Finance from incorporating the many original thoughts which would have enriched modern fiscal theory. As mentioned in Chapter 1, the Italians readily accepted Jevons's theory of marginal utility and the subjective value approach. In the works of Pantaleoni, de Viti and Mazzola, Jevons was always given due recognition, along with Walras and Menger. The Italian academic community of economics was ready to perceive the importance of the marginal revolution coming from the north. In fact, starting with Ferrara in the 1850s, it was clearly established in Italy that the basis of economic choice, private or public, must be individual valuation. The physiocratic concept of scarcity (*rareté*) and the British classical concept of cost of production had already been refuted as the proper bases of value. It was always the individual who made economic decisions, by considering the benefits expected and the costs

of alternative courses of action before he^(*) made a purchase decision (private goods), or for our purposes, before he committed public funds for any given social project.

Thus, the extension of marginal analysis to the public economy came very naturally to the Italian fiscal theorists under consideration. This line of reasoning led the three fiscal theorists under consideration to two general premises that were truly original -and, as it happened, completely at odds with the British fiscal doctrine. First, the spending aspect of government finance was given equal footing with the taxation aspect. Taxation was thought of in terms of both the tax itself and the government expenditures financed by that tax.⁴ In other words, a tax was never discussed in or by itself, but only in relation to how the tax money, called "tax-price" by de Viti throughout his essay *Il carattere teorico dell'economia finanziaria* (1888), and his book *I primi principii dell'economia finanziaria* (1928), could be used to provide public goods. The second premise had to do with the identity of the person who made the choice in the public economy. As in the English tradition, the burden of the costs and the satisfaction from the benefits of the public goods were felt by the private individual. But the person who decided on what type of tax to levy, how much to levy, and how to allocate the tax revenue to various public goods was not the same individual.^(#) The latter was a State official charged by the public with the specific duty of levying taxes necessary for the supply of public goods, which, in turn, would enhance the public's

⁴E. R. Rolph, The Theory of Fiscal Economics, Berkeley, California: University of California Press, 1956, p. 7.

^(*)The third person masculine pronoun will be used throughout the dissertation for brevity.

^(#)This issue will be elaborated in pp. 30-32 under the title The Ruling Class.

satisfaction of wants, public or private. Since a tax was interpreted as the necessary price of the public goods to be produced, as a producer of these goods, the State would have a tax claim for either the consumption of the positive utility that its services provided to the "consumer" of these goods, or the use of production-facilitating goods that the State would grant to the producers of private goods.

According to de Viti, because of the productive nature of the State fiscal activity, the citizens would welcome public goods offered in consumable form: street lights, police services, public education, etc. He carefully distinguishes the two dimensions of consumable benefits of such public goods. Taking public education as an example, de Viti asserts that only a portion of the benefit stemming from public education, the "general" benefit, is strictly indivisible, and thus to be financed with general taxes. The "particular", that is vocational, benefit of education should be subject to fees (tuition). Musgrave's famed multiple theory of the public household was influenced by de Viti's dichotomy via Wicksell and Lindahl. In fact, the central contribution of Musgrave's multiple theory is to be found in the twin concepts of "social wants" and "merit wants" which dominate his discussion of the Allocation Branch.⁵ Similarly, following Baumol's pioneering work of 1952^(*), it has been shown that the Italian public good concept can readily be generalized into the Anglo-Saxon concept of nonappropriability (or externality) to become an important element especially for

⁵J. G. Head, Public Goods and Public Welfare, Durham, North Carolina: Duke University Press, 1974, p. 214.

(*) W. J. Baumol, Welfare Economics and the Theory of the State, London, 1952.

for studying the misallocation of resources, economic instability, and suboptimal rates of economic growth.⁶

Tax, Public Expenditure and the State. The two characteristics of the Italian doctrine, namely, the intertwining of both sides of the budget and the inclusion of the State as a productive force in the economic life, were clearly presented in de Viti's definition of a tax as "...a share of the income which the State appropriates in order to produce for itself the means necessary for the production of general public services."⁷ This definition also prepares the way for de Viti's two dichotomies that would follow. The first dichotomy is between the "general" and "particular" uses of public goods mentioned above. According to de Viti, not all public goods are indivisible or non-excludable. In fact, the same public good might contain simultaneously a divisible and an indivisible benefit for the user. De Viti flatly rejects the organic view, which is based on indivisibility of social benefits. The organic view assumes a communal economy (*Gemeinwirtschaft*) in which the State decides singlehandedly as to what portion of private goods (income) must be transformed into public goods. The State must assume this task because the individual citizen cannot perceive the nature of "social" wants; he perceives, however, his incompetence in making collective decisions, and leaves fiscal decisions to the public authorities. The impossibility of individual valuation of public goods in the organic view emanates from the assumption that the State is a social organization with goals that are different in kind from goals that individuals pursue in the private economy. This premise

⁶Head's work cited, p. 214

⁷De Viti's First Principles of Public Finance cited, p. 111.

is diametrically opposite to that of the Italian authors, who see the State as an organization, created by individuals, the goals of which extend or complement their personal wants; consequently, the goals of the State are a composite of personal goals. Whether some of these wants are divisible or not is not crucial.

The second dichotomy that de Viti makes is between the fee and the tax.^(*) The fee procures for the State the funds necessary to maintain the provision of public goods for which expenditures have already been made. In de Viti's view, the marginal cost of making these goods available in perpetuity is usually small, and the fee will provide the necessary revenue for this. But to rely exclusively on fees will not enable the State to amass public funds for new public goods. In contrast to the fees, the tax supplies the State in advance with the means necessary for the production of additional or different public goods. Both, however, have in common the broader function of covering and distributing among the citizen-consumers the cost of production of public goods -and this is precisely the function of price in the private economy.⁷

De Viti then offers a decision rule as to when to use a fee-price and when to use a tax-price. The decision maker will determine two factors: is the public good a new one; and, is the social benefit indivisible. If the answer to both questions is "yes," then the fiscal tool to use is some form of tax. De Viti realizes that although the first question can be answered rather easily, the second question is quite problematic. Using examples from the administration

(*) De Viti also considers public debt as an additional source of financing of public goods. Although he departs from diametrically opposite premises, he concludes like Ricardo that public debt does not impose any burden in the future to the taxpayer or his successors.

⁷ De Viti's op. cit., p. 111.

of justice and public instruction, de Viti indicates that certain members of the community (users) benefit much more than some other members who do not consume these goods at all. A citizen goes to court to enforce payment of the rent that he is entitled to. Similarly, a citizen sends his children to public school. But not everyone uses those services. De Viti calls the public goods that some members of the community consume as if they were private goods "divisible," "special," or "particular" public goods. He does not conclude, however, that, because of the similarity between special public goods and private goods, the cost of administration of justice and public instruction must be financed exclusively by fee-prices. Although the public good in question may assume, depending on circumstances, the character of a special public good, the State may still want to finance it with a tax-price for other purposes (distribution, for example).

It would appear, according to de Viti, that the revenue for the maintenance of a highway would be derived from imposing a fee-price (toll). After all, the users can be clearly identified, and the public service is an existing one. However, the State might decide to impose a tax instead: the *quid pro quo* relationship between the producer-State and the consumer-citizens would not be altered. The adoption of a tax-price rather than a fee-price does not necessarily mean that the benefit stemming from the public good (highway) is indivisible. In fact, the State may decide to cover the cost in part by fees and in part by taxes: in all instances the exchange relationship takes place, wherein the State gives something of value to the citizens. The difference is only in the way that the burden of public levies is distributed among the various members of the community.

After carefully distinguishing the Italian or benefit view from the German or organic view of public goods, the former allowing divisibility while the latter does not, de Viti distinguishes his theory from those of the British authors. To Sidgwick, for example, the reasons that the financing of a lighthouse must be covered by taxes rather than private fees were: (1) the minimality of the marginal cost of maintenance, with which de Viti would concur; and, (2) the impossibility of excluding those shipowners who do not want to subscribe to this service. What Sidgwick was saying in effect was that if there were a way of either excluding the non-users of the public good, or dividing the total utility generated among the users, then a private price would be in order. In other words, the reason that we had taxes rather than prices, was the impossibility of distributing the cost of public goods according to the benefits enjoyed by different individuals. In contrast, according to de Viti, the services of the lighthouse would be considered a public good regardless of the way that its cost was financed. The relationship of economic exchange between the State and the consumer was still present, and to each productive service of the State corresponded a tax claim. Although he did not deal with this particular example of Sidgwick in detail, de Viti warns the reader:⁸

"...against the common error to the effect that individual valuations of the utility of general public services are impossible because the share of utility which each individual citizen derives from the military defense of national territory, or the administration of justice, or public

⁸De Viti's First Principles...., cited, footnote in p. 118.

security, or the maintenance of highways, is unknown and unknowable. This -it is said- has no counterpart in private economics!

As a matter of fact, however, in order to demolish the series of economic errors contained in these propositions, it is well to take a concrete example precisely from private economics. When Jones buys a ticket for a theatrical performance, could it be said that the share of utility which he derives from the performance is known or knowable? Yet no one can doubt that there does exist an economic exchange-relationship between the price of the ticket and the enjoyment that the buyer hopes to derive from its use."

Thus, says de Viti, public services of this sort are the typical case, where, as in the situation in the private economy just described, it is not necessary to match to the tax that the citizen pays the share of the public good that he actually consumes. It is enough simply that the individual compare the tax to be paid with his subjective evaluation of the benefit to him of the public good in question: "the only necessary condition is that the evaluation must be made by the same person, as taxpayer and as user of the public goods."⁹ If the individual does not think the public good is worth as much as the tax claim, yet the public expenditure is approved by the majority of the citizens, he falls into a minority, whose members cannot be excluded from enjoying the benefits of the public good under consideration, despite their recalcitrance. The next section deals with this problem.

The State and the Allocation and Distribution of Public Goods. Before attempting to clarify the issues governing the allocation of public goods and the distribution

⁹De Viti's First Principles..... cited, p. 122

of the burden of taxation, de Viti asserts one more time that public goods are not always productive. The organic view, he says, circumvents the complicated notion of personal evaluation by conveniently assuming that there would be no social loss in transforming private goods into public goods. A close look at the Italian Parliament of the 1880s showed de Viti the enormous ineptitude of the politicians in trying to accommodate the conflicting goals of the various interest groups. Using examples from tax proposals, that involve "general" public goods to be offered some time in the future, de Viti makes the point that, even on the abstract hypothesis of a State in which all taxpayers would participate in the preparation of the budget, some citizens would find a given good of no interest to them, or overpriced for the benefit they expect. (This is what de Viti refers to as "unproductiveness.") In offering general services, which are indivisible, the State is, to be sure, guided in its choice of a given type of production by the anticipated demand of the majority, but it subsequently adapts the supply to the total consumption of both the majority and the minority.¹⁰ In other words, to judge the economic utility of public expenditures, it would be necessary to deduct from the degree of productiveness felt by the majority the degree of unproductiveness felt by the minority:¹¹

"On the other hand, it would be erroneous to measure the harm done to the recalcitrant minority by the whole amount of tax which this minority is obliged to pay; for the minority

¹⁰De Viti's First Principles... cited, pp. 123-124.

¹¹Ibid., p. 124.

becomes a *de facto* consumer of the service produced and therefore it is probable that the minority, or some part of it, would have consented to the production of the public service if a smaller tax had been suggested. The damage suffered by the minority is measured, therefore, by the difference between the tax which it pays and that lesser tax which it would have been willing to pay. From this conclusion results a difference between Private Economics and Public Finance which has noteworthy consequences: namely, that *demand* and *consumption* coincide in Private Economics, whereas they do not coincide in Public Finance. Public goods are consumed by those who did not demand them, as well as by those who did."

The above argument refers to the determination of the "total" utility of the proposed public good and the "total" amount of taxes necessary for the production of the given public good. De Viti calls this process the determination of the "value to the community." Simultaneously, however, the individuals who are called upon to give their judgment in advance concerning the advisability of the public expenditure under consideration will make a comparison between the marginal utility of the general public good and the marginal disutility of the tax that they each will be required to pay out of their individual budgets. This process is what de Viti calls the determination of the "value to the individual." From the standpoint of this theoretical setup, it follows logically that the problem of value to the individual -that is, the problem of the distribution of the tax burden- is settled at the very moment that a decision is made with respect to the problem of "value to the community." that is, the problem of the productivity of the public expenditure.¹²

¹² De Viti's First Principles..., cited, p. 126.

De Viti's conclusion follows his hypothesis that all citizens participated in the determination of the value to the community. But, because value to the community cannot be considered in the absence of value to the individual, a conflict will arise among the prospective taxpayers who are in the process of deciding the extent of the public outlay in terms of how to minimize the tax share of different individuals. This is a very serious problem and requires close scrutiny -so much so that the problem of distributing the tax burden becomes an independent problem of the productivity of public expenditure:¹³

"Still more obviously does it become an independent problem when account is taken of the facts (1) that not all taxpayers participate in the calculation with respect to the value to the community of a given expenditure; (2) that not all exercise the same relative influence in the making of this calculation; (3) that not all give their assent; and, (4) that over a period of time, during which the first decision is subjected to periodic revision, the same individuals are not involved.... It is the task of a positive system of taxation and of the improvements made in such a system to make the two results coincide."

From this point on de Viti starts a threefold investigation of the problem of distribution of tax burden, that he examines under the headings of "technical," "juridical," and "economic" distribution, concluding that, although a knowledge of the technical aspects of taxation, such as direct vs. indirect taxation, and a familiarity with juridical issues, such as the exemption of minimum income, are required, the solution of the problem

¹³ De Viti's First Principles.... cited, p. 127.

is mainly an economic one.^(*) However, technical and juridical action may neutralize, reinforce, or modify the economic effects sought. But before going into this discussion, the political framework must be explored further. In the sections that follow, de Viti's, Pantaleoni's and Mazzola's views of the State will be examined, along with the views of other Italian economic and political thinkers, such as Pareto and Mosca, that are critical of the paradigm that our three authors use for analytic purposes.

The Ruling Class. The most common criticism directed to the Italian theory of public finance concerns its peculiarity that, while it is based on individual valuation of public goods, it allows a ruling class to make fiscal decisions. In other words, the criticism goes, the Italians see no problem in assuming that the benefit from public goods and the burden of accompanying taxation are felt by the individual while in reality decisions concerning the allocation of public funds and the distribution of the tax burden are left to politicians. This criticism was raised not only by economists outside of Italy, such as Wicksell and Wieser, but also by Italians opposing de Viti's views, such as Barone, Ricca-Salerno and Pareto. Before attempting to elaborate on this issue, it should be emphasized that de Viti, Pantaleoni and Mazzola always studied Public Finance within its historical setting. As was mentioned before,^(**) our fiscal

(*) This consists of, first, eliciting the preferences of the individuals concerning the public good in question, then equalizing the marginal cost (tax-price) with the marginal benefit of the good in the eye of the consumer citizen.

(**) See p. 7.

theorists always make sure that this orientation is well understood. De Viti treats "...Public Finance as a theoretical science, assigning to it, [first of all], the task of *explaining* the phenomena of Public Finance as they appear in their historical setting. Hence it is necessary on the one hand, to go back to the causes of these phenomena, and, on the other hand, to trace their effects."¹⁴ Mazzola also states:¹⁵

"The conflict among various political doctrines in terms of what must be the functions of the State is quite unimportant in the study of Public Finance. For our purposes, the economic functions of the State are those that are in effect in any given time and space. The a prioristic view, that is, what economic functions the State must undertake, is much less valuable for the Public Finance student than the a posteriori approach which examines the efficiency of such functions. The list of public services offered by the State is variable, in the face of changing conditions in the society....The State, like any other organism, is subject to the law of evolution."

In order to understand fully why de Viti opted for a ruling class in his analysis, the Italian political setting prior to 1888, which marks the date of the publication of de Viti's *Il carattere teorico dell'economia finanziaria*, should be considered briefly.

¹⁴De Viti's First Principles... cited, p. 15. Author's italics.

¹⁵U. Mazzola, *I dati scientifici della finanza pubblica*, Roma: E. Loescher & Cia., 1890. My translation

The Political Setting. When Cavour died in June 1861, three months after the declaration of the unified Kingdom of Italy, he left behind neither a viable parliamentary system of politics nor a responsible and able cadre who could deal with the pressing problems of the new State. The years that followed his death were years of political and economic chaos. This raised the question among intellectuals as to whether Unification was due entirely to Cavour's personal skills, and gave rise to the concern that, unless a viable political and economic model was constructed, the country would again be divided. In the thirty-year period that followed Cavour's death, the country tried a vast range of political and economic prescriptions under the leadership of a series of Prime Ministers, who, among other things, could never balance the catastrophically unbalanced budget. To the radicals^(*), who perpetuated Cavour's ingeniously contrived majority for fifteen years, the proof of success was deemed to be the ability to balance the budget. This finally became a reality in 1876 under Minghetti's premiership, but this result was achieved by keeping taxes intolerably high and inequitable, and by selling ecclesiastical lands. Ironically, it was that year that the radical economic and social policy ended with the election of Depretis, who promised a liberal economic and social system.

In his ten years as Prime Minister, Depretis took important political and social measures such

(*) In contrast with the English connotation, in Italian political parlance, the term *radicale* refers to conservative philosophy. Etymologically, *radice* means the roots, or the origin, and *radicale* is someone who appreciates and wants to retain the roots.

as quadrupling the electorate by reducing the age and taxpayer qualifications, improving public health by opening public health centers, and making public education compulsory. In the economic field, Depretis's record was equally impressive. The liberalization policy that he followed, included the abolition of "forced" currency, a relic of the political struggle before 1861, the revocation of the grist tax, and the leasing of the State railways to private companies. These liberal acts were constantly challenged by the radicals, and these were not the only two parliamentary groups in conflict. Additionally, federalists were struggling with centralists, clericals with anticlericals, Monarchists with republicans and nationalists with collaborationists who thought that Italy's survival depended on good relations with former enemies, namely, Austria and France. To add color to this active scenario, Italian Marxists and anarchists were quite vociferous. While discussions were going on inside and outside the Parliament -which was evenly distributed between two coalitions, one Depretis's liberal-leftist and the other Minghetti's radical-rightist- as to the ethical nature of the future Italian State, Pantaleoni, de Viti and Mazzola were adhering more and more to their apolitical views of the State, in the hope of bringing some order to this political chaos from the realm of financial economics.

Pantaleoni and the State. Pantaleoni's interest in Public Finance was secondary to his interest in Political Economy. His economics textbook *Principi di economia pura*,

(1889), that precedes Pareto's *Cours* by seven years, truly rivals Marshall's *Principles* in both scope and analysis. Pantaleoni was careful to call his specialty "Economic Science," and not "Political Economy," and his *Principi di economia pura* has a refreshing mathematical exposition that was lacking in coeval Continental economics literature. When he turned his attention to Public Finance, Pantaleoni naturally retained his mastery of the concept of utility, augmented by his grasp of marginality that he derived from the triumvirate of Jevons, Walras and Menger.

According to Pantaleoni, it is quite possible to place the State within a framework of individual hedonism. The State's ends are reconcilable with individual "egoism" because the individual is not an egoist whose every act tends exclusively to maximize his pleasure and happiness, but he is a "'tribal' egoist" who is so constituted as to identify his own maximum happiness with that of his species.¹⁶ Pantaleoni's concept of tribal egoism reflects closely H. Spencer's hypothesis that the individual would not act injuriously to two relevant organisms, his own and that of the society to which he belongs, since otherwise his own existence would be harmed. In other words, since the individual seeks a hedonistically efficient outcome, and wants to make this outcome a permanent one, the outcome must be in harmony with his own survival. Pantaleoni was quite familiar with Spencer's Social Statics (1851), where this view was expounded, and he applied this hypothesis remarkably well to his "pure" theory of Public Finance.

¹⁶M. Pantaleoni, *Pure Economics*, New York: Kelly & Millman, 1957, p. 22. Translated from his *Principi di economia pura*, Milano: Fratelli Treves, 1931, by T. Boston Bruce.

The State, according to Pantaleoni, is a fixture of social life not for supernatural reasons, nor for the sole reason of preparing the ground for the *homo oeconomicus* to promote his individual hedonism. Assuming a surplus, not a situation of tradeoff between social and personal wants, Pantaleoni views the former as extensions of individual wants. Within this framework, Pantaleoni's *homo oeconomicus*; who is actuated by tribal egoism, makes sure that his own selfishness is satisfied, but he also contributes voluntarily to social ends. This frame of reference, formalized later by Mazzola, leads the student of economics toward more realistic premises than the classical framework. In the latter the State is viewed as a necessary evil that is tolerated because it promotes freedom by preventing internal and external predation and because it provides certain services shunned by private entrepreneurs because of their unprofitable nature. The switch of paradigm in no way deters economic analysis. On the contrary:¹⁷

"...economic problems may be worked out just as easily and correctly by taking as our rule the hypothesis of a *homo oeconomicus* actuated by tribal egoism, who with regard to each act will compare the expected increase of tribal happiness...with the apprehended diminution of his individual happiness...[as by starting with] the hypothesis of a *homo oeconomicus* actuated by individual egoism. It must be observed ...that the wider hypothesis of a *homo oeconomicus* actuated by tribal egoism...is the simpler and truer one, and that by its means the scope of ordinary economic problems is extended to comprise those also which are usually classified separately as forming part of a special class of problems of State economics."

Pantaleoni envisages a society where both the State and the individual have, in the first place, present interests. In other words, both parties are benefited by certain present *de facto* situations, and they act in conformity with this first series of interests. In the second place, both are

¹⁷M. Pantaleoni, *op. cit.*, p. 22.

interested in the future, and consequently act in accordance with a second series of interests, bringing it into harmony with the first, according to very complex heuristic processes that take place within a political order.¹⁸ The economist should concentrate on how well the State achieves the allocation of public goods in response to present public demand, and how correctly it calculates the consequences of these actions in the future. To do this, the State must safeguard all prospective and present interests, giving them the weight that is necessary to ensure its own preservation for an indefinite period.¹⁹ Pantaleoni does not elaborate any further on the implications of the position that he is taking. He proceeds right away to apply marginal calculus to public expenditures, treating public expenditures as outlays of the private consumer; however, the decision maker in question is an "average" member of the Parliament endeavoring to equalize the marginal yields from different outlays. In one stroke, Pantaleoni merges the two sides of the fiscal account, public revenue and public expenditure, with the Walrasian system, and establishes, as early as 1883, the two cardinal principles of the Italian fiscal doctrine yet to come: (1) that the two sides of the budget must be determined jointly; and, (2) that the satisfaction of social wants must be traced to the preferences of the individual

¹⁸ Pantaleoni, op. cit., p. 23.

¹⁹ *Ibid.*, p. 23

members of the group.⁽²⁰⁾ However, the equalization of the marginal yields of the relevant public expenditures does not come about automatically by *tâtonnement* as in the Walrasian system. Although the basis for the calculus of the benefit of the public goods in question is individual preferences, the actual process of valuation does not take place in the voluntary market mechanism: as has always been the case throughout history, the actual budget is prepared by government agencies. Both Mazzola and de Viti accepted the inclusion of a governing elite to lead the public economy to equilibrium. The following two sections deal with this issue in more detail.

Mazzola and the Ruling Class. Concurring with Pantaleoni that the equilibrium of the public economy is not a result of a purely voluntary market process even in the territory of "special" public goods whose utility can be traced to individual preferences, Mazzola holds that a governmental cadre is necessary to render the equilibrium possible. Public decision makers are elected officials. Acting as a *homo oeconomicus* to whom is entrusted the specific task of achieving equilibrium in the public economy, the agent must act with knowledge and skill, and with responsibility and sentience.* The agent must first identify and quantify the subjective preferences of the citizens, and then act to satisfy these preferences to reach an equilibrium. The agent knows that, unless this is not achieved, his tenure will be terminated. The equilibrium is achieved

(20) R. A. Musgrave, Theory of Public Finance, New York: McGraw-Hill, 1959, p. 70.

*"Sentience" refers to responsiveness of the State to the needs of the public.

simultaneously in two realms, the economic and the political. Mazzola accepts the political framework of Pantaleoni without hesitation; however, the decision rule that he prescribes is not the same one proposed by Pantaleoni. In Mazzola's view, after eliciting the preferences of the citizens, the agent equates not just the marginal yields of various public expenditure projects, but marginal yields of public and private goods. This point will be elaborated in Chapter 3. The most extensive analysis of the ruling class, however, was made by de Viti de Marco.

De Viti and His Dual Hypothesis on the Form of State.

What needs to be seen at this juncture is the contribution of de Viti in introducing the dual theory of the State, since this explains, in both tyrannical and democratic versions, that there is a sentient ruling class.

De Viti builds the basic premises of his theory on the historical development of the State from a feudalistic to a democratic form. Nowhere in this history does one see a State which was entirely oppressive, in the sense that the preferences of the citizens in the public economy were totally unheeded, or conversely, a State which was totally democratic. Regardless of how oppressive or democratic the State might be, however, one thing remained the same: the satisfaction from public goods and the burden of their financing were felt by the citizens, but the decisions concerning what amount of tax to levy and how to allocate the revenue among various public projects always rested with the State. The State was always sentient of the social wants of the citizens, but did not always try to

accommodate these wants when they clashed with the ruling class's own objectives. De Viti points out that the historical development had led the State closer to the democratic mold, although there was yet some distance to cover before the totally democratic society would be attained. Tracing the historical development of England from the 13th century on, de Viti concludes that the right of the taxpayers to approve the total public revenue and to distribute it among various public expenditures is the most important economic element in the modern State, and that this process must be made an integral element in the modern theory of Public Finance.

In order to give the student of Public Finance a box of tools to interpret the confusing financial decisions that take place in the field, de Viti forms two models of the State, one totally oppressive and the other totally democratic, in the hope that the student can draw inferences from these two constructs and apply them to the particular type of State under consideration. What de Viti had in mind was to rescue Public Finance from the chaos that it was in both in the Parliament and in the academe. The two limiting hypotheses constructed by de Viti de Marco, although highly abstract, were deemed to be useful in the practice of Public Finance in that these hypotheses, by means of successive deductions, approximations and comparisons, would lead to fiscal phenomena that are more concrete and nearer to reality.⁽²²⁾

(22) Einaudi in op. cited, p. 25.

What de Viti was doing amounted to, first, to envisage the State as a producer of (public) goods, and second, to trace the behavior of this producer in two opposite (public) market structures, the monopolistic and the perfectly competitive. He was hoping that some day a theorist would come up with another model of State more realistically positioned in the spectrum limited by his two schema. He was looking forward, in other words, to someone who would render Public Finance the service that Chamberlin and Robinson performed in the field of price theory some fifty years later, when they added yet another set of tools to the workshop of economists to increase their ability to analyze and predict the behavior of the firm that was monopolistically competitive. Unfortunately this did not come true, in the field of Public Finance, neither from Italy nor from abroad, either because de Viti's dual theory did not reach the audience outside of Italy, or because even if it did, it was dismissed as being too abstract. In Italy too de Viti met resistance, especially from those who believed that fiscal decisions were political decisions, and that therefore a political, not economic equilibrium must be sought. These authors were the followers of Pareto and Mosca, and included important figures such as Barone, Fasiani and Puviani. De Viti's theory, however, was hailed by Fasiani and Einaudi, unfortunately to be silenced later by the advent of vehemently Fascistic writings of Masci and Ricca-Salerno. De Viti also witnessed his closest colleague, Pantaleoni, leaning further and further to the Fascist camp until his death in 1924. By and large, however, the Fascist ideology which rekindled the "organic" concept of the public economy from the writings

of earlier German authors such as Schaeffle, Ritschl and Wagner, made the scene only after the 1930s in the State-supported publications of lesser Italian economists; but by then, the de Vitian paradigm had already established itself as the typical Italian fiscal doctrine.

More on the de Vitian Duality. On the one end of the political spectrum de Viti has his "monopolistic" State, structured as an absolute monarchy or oligarchy, in which a ruling class makes decisions singlehandedly with respect to both the taxation and expenditure sides of the fiscal account. The ruling class resembles the monopolist because it determines the tax-price that it charges the citizens in such a way that, after the citizens "buy" the public good in question, the ruling class earns an "excess" profit for itself. The State is in a more favorable position than the monopolist in the private economy since the State can not only set the tax-price as high as it wished but can actually force citizens to consume the public good under consideration. Additionally, the State may use its administrative and legal faculties to proscribe use of substitute (public) goods as well as to regulate any "future" producers of the (public) goods other than the State. Owing to these favorable conditions, the monopolist State can assure its own existence for a long time.

Obviously, however, the monopolist State would not survive indefinitely. A glance at the political histories

of many nations which started off as monarchies or oligarchies would reveal the fact that over the centuries larger and larger proportions of citizens have participated in State affairs, and this has been achieved after considerable struggle. It is possible, therefore, to envisage the other extreme of the spectrum where this struggle for participation has culminated in a final stage in which all citizens are invited to express their judgment concerning the appropriateness of a public project to be offered in the future. In this scenario -one that Wicksell would envy since it preceded his own *mise-en-scène* by almost four decades- the suppliers and consumers of public goods are one and the same. It is impossible to have in this model an "excess" profit that the ruling class would divert to itself. The cost of production is a "net" cost, including, to be sure, a portion that the citizens would pay for the efforts of their elected economic agents who are expected to operate within the limits of the mandate given to them by the voters. The agents have proper authority to achieve the organizational task entrusted to them, but their responsibilities are also clearly delineated by the electorate. De Viti notes that, whereas in the private economy the task of achieving organizational goals is delegated to a manager who is the mere agent of the stockholders of the firm, in the public economy the public administrators have under their disposal a power that private managers lack: the power of compulsion. The public administrators resort to this measure, however, only under extreme circumstances in which the individual citizen fails to honor the decision in which he participated previously. As Peter Drucker

will have said some seventy years later,^(*) if the individual has participated in the determination of the organization's goals -that will eventually affect him as a member of that organization- and if these goals are clear and measurable, both the individual and the organization will benefit from this arrangement. On the one hand the individual, having realized what the organization would require of him as a member, will show more commitment in the accomplishment of those goals: the participation process is instrumental in informing the individual of the overall requirements of the organization. On the other hand, because of the active participation process that is involved, the administrator will apprehend the nature of the goals of the individual members, and will be in a position to adjust organizational goals to reconcile them with the members' goals. This will result in more and more successful operation, resulting in simultaneous realization of organizational and personal wants.

In sum, the Italian fiscal doctrine delegates the task of taking necessary measures to promote maximum satisfaction to the citizenry to a cadre, call it civil servants, Finance Ministers, or what have you. However, economic resources are scarce and public wants are unlimited. Consequently, it would be impossible for the cadre to satisfy all the citizens. But an economic solution is still possible: taxes are regarded by the citizens as a subscription fee for the average consumption of public goods over a period of time, analogous to a "season's

(*) P. Drucker, The Practice of Management, New York: Harper & Row, 1954.

ticket."²³ Since almost all public services are either instrumental in private production or necessary for private consumption, as mentioned above, de Viti considers it permissible to assume that the consumption of general public services is proportionate to the income of each citizen. This point will be elaborated in Chapter 3. For the purposes of this chapter, regardless of what decision rule is adopted, "an element of arbitrariness still remains [in de Viti's model], but it is assumed to be small, provided that taxpayers have the right to, and in fact do, approve tax legislation."²⁴

The Italian Criticism of de Viti's Theory of the State. That the de Vitian extrema^(*) do not present themselves in reality is an idle objection. De Viti was fully cognizant of this. He knew that he was expounding abstract models, and he would have been truly ecstatic if someone had conceived yet another theoretical structure of the State that allowed further economic insight. While neither purely monopolistic nor purely competitive markets are a reality, price theory has nevertheless thriven within these two limiting hypotheses. Another function of these extremely abstract limiting cases has been the normative implication that they conveyed, namely, the notion that the purely competitive market is something to aspire to. Similarly, de Viti's dual model achieves both functions

²³ Musgrave's Theory of Public Finance cited, p. 73.

²⁴ Ibid., p. 73.

(*) One dealing with the monopolistic and the other with the cooperative State.

in that, on the one hand it prepares a suitable background for the development of more detailed models, and, on the other, it sets the values that the Public Finance specialist should cherish, "...for what other ideal can seem better in the eyes of the student of Public Finance than that of a State dedicated to the service of the general interest, in the present and in the future, of the whole nation?"²⁵

The task of the student of Public Finance, according to de Viti, is to observe fiscal phenomena with utmost impartiality, free of passions, sentiments and prejudices, which vary from place to place and moment to moment.⁽²⁶⁾ De Viti thinks that his theory of fiscal process, although definitely abstract, is much more valuable in this regard than other perspectives being offered in Italy and elsewhere in the name of Public Finance. Apart from the scholar of Public Finance, the politician too would benefit from de Viti's vision of the State, since:⁽²⁷⁾

"the statesman who, when he reads, looks, not for minute rules of daily life, but for a guide which, like a beacon, will direct him in the choice of the road which he seeks, and which he will later traverse in very different ways according to the changing phases of history, will always be grateful to de Viti for having offered two guiding lights. One of these he will certainly wish to avoid; for no one wishes to govern peoples for one's own sake or for that of the group to which one belongs. The other beacon flashes a hope of arrival in a port which will represent a gain for all, the attainment of that goal which is best suited to the whole nation."

²⁵Einaudi's Introduction cited, pp. 26-27.

²⁶Ibid., p. 25.

²⁷Ibid., p. 27

Although Pantaleoni's, Mazzola's, and more importantly, de Viti's contributions to Public Finance were appreciated greatly in Italy to the point of reverence, their view nevertheless met fierce criticism from certain academic circles. The criticism was especially directed to the assumption that the ruling cadre would promote the welfare of the citizenry, since in actuality, the politicians in the Parliament were making fiscal decisions to enrich either their own welfare or the welfare of the groups that supported them. According to this criticism, fiscal decisions were made quite differently from those decisions made in the private economy, therefore, there was no need to straitjacket financial phenomena within the framework of the "pure" theory of Financial Economics. Fiscal decisions were political decisions pure and simple, and they required political sophistication rather than economic-financial sophistication. This criticism gained support not only from certain Italian economists under the influence of Austrian economists, like Ricca-Salerno, who was influenced by Wieser, but also from the most renowned Italian political economist of the day, Vilfredo Pareto.

According to Pareto, it was a characteristic of human beings, taken collectively, to create a desired distribution of income and wealth that reflected the inequality of ability inherently in existence among them. In his *Trattato di Sociologia generale* (1916), Pareto sees in the human nature a nucleus which is constant and

a part which is variable. The fixed part consists of instincts, appetites and selfishness; the variable part consists of either logical reasoning, or reasoning that is supported by logic (rationalization.) Pareto calls the former *il residuo*, and the latter *la derivazione*, and the former usually prevails over the latter. This happens in the following manner. The *residuo* contains the basic philosophy that gives rise to man's long term and short term actions. Some people want to extend their *residui*, that is, their values, over the other members of the society: to do this they employ various media. Arts and letters, religion, the judicial system, and finally the political and economic system are all the results of the labors of a given class of people directed to establishing a framework wherein their *residui* would prevail. The *derivazioni* are nothing but the logical explanations that the dominant classes (priests, politicians, artists) give to accommodate their *residui*. However, when a given set of values becomes increasingly inadequate in dealing with the problems of the day, another enterprising class will harp on the inadequacy of the existing *derivazione* and try to institute its own. Politics is a struggle where the various logical reasons (*derivazioni*) are publicly exalted, while these rationalizations are used only to establish selfish rules. The inherent inequalities among the members of the society are constantly exploited by certain groups opposing the present ruling group. The present ruling class, however, is fully cognizant of this dialectic. To prevent

a takeover, the ruling class would apply the laws of "sociology" (which includes political science) to entrench its rule. According to Pareto, sociology has acquired a mathematical character that now enables its user to make the right inferences. In his own words, sociology is now enriched by the inclusion of the "Galilean method," and he credits himself for this achievement.

Pareto's thoughts were seized at once by the political scientist Mosca, the philosopher Masci and the economist Ricca-Salerno. In his book *Elementi di scienza politica*, Mosca was expounding as early as 1896 the view that societies are always ruled by minorities. The talk of "majority rule" is a joke. Minority rule is the norm and one type of minority constantly overthrows another type of minority. This struggle for power is not based on a historical dynamic à la Marx: the minorities involved in the struggle may be military, clerical, hereditary, or based on "aristocracy of wealth or merit."

The main theme in Mosca and Pareto, in short, is that men adept at chicanery and cunning overthrow those who are not crafty enough to keep their position. Eventually, the new group in turn is overthrown by men using chicanery and cunning.²⁸ Therefore, if the ruling class wants to rule indefinitely, it must search "sociology" to discover

²⁸E. Whittaker, Schools and Streams of Economic Thought, Chicago: Rand McNally & Co., 1960, p. 305.

proper decision rules. Sociology as understood by these authors, approaches the German concept of *Staatswirtschaft*, where the economic, social, political, legal and ethical aspects of the public economy are given equal attention and where the valuation of public goods is done by the ruling class, not necessarily under the principle of economic efficiency, but under any principles deemed important by the State, although achieving economic efficiency at the same time is still desirable.

In spite of criticism from such eminent figures of the Italian academe, the doctrine developed by Pantaleoni, de Viti and Mazzola survived it without real damage. Their theory was not directly incompatible with Mosca's and Pareto's view of the historical development of the ruling class. That the ruling class came to power by conniving, while significant for political sociology, is not so relevant in economic analysis. The point is that, once in power, the ruling class will want to extend its tenure indefinitely; and to do so, it will constantly compare the utility and the cost of its actions. The belief that the State offers productive services does not necessarily mean that all public spending is productive. Our three men understood that unproductive uses of public goods were quite common. They further understood, however, that this unproductivity was due to the inclusion of political, or in Pareto's language, sociological considerations in the public economy. The Italian fiscal theory was firmly based on the premise that unless a proper economic decision rule is adopted by the ruling class, the various political groups would press the State "...to carry out class policies which are anti-economic from the

standpoint of the community."²⁹ The classes which are politically inferior or weak would pay for public services which they would not demand of their own accord. The unproductiveness of public expenditures would therefore produce crises of economic exhaustion and political reaction, which in the long run would re-establish equilibrium.³⁰ In other words, reliance on short term socio-political factors would actually hasten the fall of the governing class because economic discontent would remove political support.

Having survived this challenge, the Italian tradition had yet to survive one more criticism. Even when it was assumed that the ruling class would adopt economic decision making in dealing with fiscal phenomena, the issue of compulsion still needed clarification. Pantaleoni did not recognize compulsion in his model wherein the individual citizen would go along with the majority even though his preferences were not exactly in line with the majority's preferences. In other words, he would change his mind and conform with the majority decision. De Viti, however, recognized the presence of coercion, which he euphemistically called it "... a certain degree of compulsion." Because the governing body would try to accommodate the wants of the citizenry, first by eliciting everyone's preferences and later by concentrating on the "average" voter preference, some citizens would be compelled to go along with the majority decisions. But the reactions of these people could not be ignored. In fact, the ultimate success of the governing body would be measured

²⁹ De Viti's Principles... cited, p. 117.

³⁰ Ibid., p. 117

(*)This issue was treated, not any more elaborately than de Viti, 55 years later by H. R. Bowen, "The Interpretation of Voting in the Allocation of Economic Resources," Quarterly Journal of Economics, Nov. 1943, pp. 27-48.

in terms of how it minimized this dissatisfaction. Despite all the efforts of the ruling class, a degree of dissatisfaction is expected to remain; however, the equilibrium is still a "just" one since all the participants of the political process knew in advance that if they did not conform with the majority's decision they would be compelled to cooperate. In other words, according to de Viti, "a certain degree of compulsion" would not violate the principle of justice.

One group of Italian economists, mainly Barone and Cosciani, although sharing de Viti's views, believed that de Viti understated the role of coercion. Regardless of what the "master" called it, coercion was a part of the de Vitian paradigm. Despite of this, however, de Viti's structure was still valid. According to Barone and Cosciani, people obviously do not freely and voluntarily contribute to the financing of public goods. If they really did, there would be no need for the State. Given that unanimity will not usually be the case, coercion is unavoidable, and the State will administer it when necessary. The citizens are fully aware of this. According to Barone, the prefixing of the distribution of the tax burden by the public, which is implicit in the work of de Viti, is essentially equivalent to choosing a social welfare function: once this is chosen and action is taken in accordance with it, no pretense of voluntary choice needs to be maintained.³¹ Barone proposes that de Viti's structure be viewed as a "normative" model, truly in line with modern welfare economics, which had started to take shape in the late 1930's.

Similarly Cosciani states that:³²

"...the study of finance consists in the examination of

³¹ Buchanan's essay cited, p. 68

³² Ibid., p. 68

the reasons for and the effects of the substitution of coercive choices for individual choices. Two sets of individual behavior are involved: first, that of the ruling class in making the decisions, and secondly, that of the taxpaying group in responding to the alternatives put before them. Anglo-Saxon fiscal theory has, of course, almost exclusively been concentrated on the second of these two sets of behavior. In a very real sense, therefore, our theoretical structure is more in keeping with the ruling class tradition than with the voluntary tradition. The merit of the ruling class conception appears to be its usefulness in forcing the separate consideration of these two aspects of fiscal action."

Again, giving de Viti's theory a normative nature, Cosciani concludes that coercion must be introduced. The individual will be expected to comply with the mandate that the majority bestowed upon the ruling class in promoting general welfare.

The second group of economists tried to show ways to minimize even further the coercion which was obviously present in de Viti. Puviani, and later Pasiani, allowed the ruling class to have recourse to certain measures that create a "fiscal illusion" to modify the perceptions of any given group of citizens in line with the majority's wishes rather than resorting to coercion. Writing in 1897 in *Teoria della illusione nelle entrate pubbliche*, Puviani stresses that the ruling class might create illusions to lead various categories of citizens to think that either the tax burden are lighter or the benefits expected from the proposed public goods are greater than

what they actually are. (*) Fasiani, true to his de Vitian roots, studies fiscal illusions in two limiting cases, the monopolistic and the cooperative political frameworks, and derives certain prescriptions for the administrator. The important contribution of this line of thought is that although the ruling class influences voter behavior via fiscal illusions, the voter, who is still a *homo oeconomicus*, never behaves irrationally. The individual who behaves in the presence of an illusion will act consistently; given the same choice situation on two separate occasions he will tend to make the same decision, provided that "learning from experience" does not dispel the illusion and provided that his utility function does not shift in the interim.³³ Consequently, the ruling class can make predictions about the effects of the various tools at its disposal to create illusion among the voters, and use them effectively in lieu of coercive measures.

Mazzola's view on coercion has not been mentioned in this chapter. His position is unique in the Italian literature in that he flatly rejects the notion of coercion. He claims that coercion would be totally unnecessary in his model, which achieves both economic efficiency and justice. Nevertheless, Mazzola was criticized by Wicksell as being too complacent about this. These discussions will be presented in the following chapter, which concentrates on Mazzola's contributions to the Italian fiscal doctrine. As for

(*) See Buchanan's Public Finance in Democratic Process, Chapel Hill, North Carolina: The University of North Carolina Press, 1967, pp. 126-143.

³³Ibid., p. 127.

the fiscal illusion, the manipulation of the electorate through any kind of illusion, but especially fiscal, is open to challenge, both on ethical grounds, and on purely economic grounds such as those of the modern theory of "rational expectations." However, misleading the voter is not exactly an Italian specialty. Politicians loyal to Marshallian-Pigovian concepts of public finance too harp on the "intended" benefits of public expenditure projects, in the hope of altering the perceptions of the average voter. The Italian efforts are more honorable in this regard in that the faculty of fiscal illusion is entrusted to a managing class which is assumed to act in objective good faith as a true *paterfamilias*.

CHAPTER 3

UGO MAZZOLA AND THE INDEPENDENT "SCIENCE" OF PUBLIC FINANCE

With his Scientific Elements of Public Finance¹, Mazzola declares the independence of the "science" of Public Finance in Italy in 1890. Parenthetically, in Mazzola's usage, as well as in the Italian academic parlance, *scienza* does not necessarily mean "positive" science. Although Public Finance is occasionally referred to as *scienza positiva* in Italy, the emphasis is not on empirical work, but on impartiality and deductive reasoning. By *scienza* Italian generally denote a systematic body of knowledge built upon sound hypotheses and logical inferences where, as opposed to *arte*, the observer does not apply his own values. In this context, law too is considered a science, albeit of a particularly normative nature. Under this weak concept of science, nevertheless, according to Pantaleoni, de Viti de Marco and Mazzola, Political Economy of the 1880's was still an art. Actually, this view was shared by most Anglo-Saxon economists of the same period, who did not yet grasp the contribution

¹U. Mazzola, *I dati scientifici della finanza pubblica*, Roma: Ermanno Loescher & Cia., 1890.

of Jevons, their compatriot. With Jevons Political Economy gained a scientific character in the Italian sense in that Jevons treated:²

"...[Political] Economy as a Calculus of Pleasure and Pain...The Theory of [Political] Economy thus presents a close analogy to the science of Statical Mechanics, and the Laws of Exchange are found to resemble the Laws of Equilibrium of a lever...The nature of Wealth and Value is explained by the consideration of [marginal] pleasure and pain, just as the theory of Statics is made to rest upon the equality of indefinitely small amounts of energy."

Despite Jevon's 1871 work, the typical English economist of the 1880's, who was still imbued with the British classical theory of value which was based on cost rather than utility, did not view Political Economy as a science. In fact, even Sidgwick, a staunch utilitarian who grasped Jevons's contribution, believed that Political Economy was still an art, especially when applied to public economy. The "personal" calculus of utility would make private economy decisions determinate, but when the State entered the economic field, the policy-making aspect of Political Economy based on ideal values would take over. This view was totally absorbed by Pigou, who, following Jevons and Sidgwick, integrated the classical tradition with utilitarian psychology. In the hands of Sidgwick, and later of Pigou, the "art" or policy-oriented aspect of Political Economy became even

²E. Whittaker, Schools and Streams of Economic Thought, Chicago: Rand Mc Nally and Co., 1960, p. 266, quoting from Jevons's Theory of Political Economy, London, 1871.

more pronounced to such an extent that Public Finance was regarded as little more than utilitarian ethics applied to certain economic problems.³

As was mentioned in Chapter 1, the Italians were more at home with the notion of utility handed down to them by Aquinas, and perpetuated by Davanzati, Galiani, and finally Ferrara. The concept that the value of commodities was derived from their utility, and not from scarcity or cost of production, was established in Italy much before the the decade of utility that held sway in Europe in the 1880s. Nevertheless, Political Economy did not qualify as a science in Italy, in spite of the theory of individual valuation that was introduced in Italy by domestic authors and later formalized by Jevons. To Pantaleoni, Mazzola and de Viti, to put Public Finance under the auspices of Political Economy would be a disservice: this would reduce it to Financial Policy, imbued with value judgments, just like Political Economy.

In any case, science or not, Political Economy was not an appropriate tool for analyzing fiscal phenomena. As was seen above, the Italians were aware of the Walrasian (1874) and later Paretian (1896) constructions which drew Political Economy closer to

³Whittaker's book cited, p. 311.

being a "science" in the Italian sense. However, Pareto himself was clearly stating that his structure would hold only in the private market. In the public goods market, an exogenous social utility function would be called for. This function would be determined by the State after a series of economic, social and political considerations. The Italians did not have any objections to the utilitarian calculus as long as it pertained to private goods: Political Economy used an appropriate method in this regard. But to transpose the economic methodology, in the manner of the Political Economy of the day, to State fiscal activity would be totally incorrect. There is a basic difference between private wants and social wants. This dichotomy was already hinted at by Pantaleoni, and treated somewhat by de Viti. It was Mazzola, however, who elaborated on this.

What Pantaleoni had done was to apply the Walrasian system to the foundation of the theory of Public Finance, holding that a conscious valuation of the benefits of public expenditures could be achieved by the *homo oeconomicus* who was motivated not by individual, but by tribal egoism. Mazzola's contribution was more direct. The aims of the individual are of primary interest to him. To attain these, however, the individual accomplishes other (social) aims, which represent the *necessary condition* for the accomplishment of the prime aims. But social aims cannot be

obtained otherwise than by *collective cooperation*:⁴

'Man does not set as his ultimate or direct aim such things as national defense or general security. He wants to accomplish his material aims of life, or his spiritual aims in the field of moral or intellectual improvement. He cannot arrive at these ends, however, unless he is able to live in such a way that he feels secure against his foreign and internal enemies and is prepared to cooperate with other men for the achievement of aims denied to men who live in a state of isolation. Therefore the 'public' aims are distinguished as being 'conditional' to the attainment of the ultimate aims of man and as being attainable only through political cooperation. The voluntary association of private individuals would not serve the purpose; what is needed is rather a political cooperation...''

One of the two goals that Mazzola wanted to achieve was to put in order the many vague notions peculiar to Public Finance: the nature of social wants, public goods, free riding, the pricing of public goods, etc. His second goal was more ambitious. Having defined the basic elements of the fiscal process, and having shown that the *modus operandi* of fiscal economics was quite different from that of Political Economy, Mazzola wanted to show that Public Finance was an independent social science, with a subject matter -public ends, public needs, and public goods - quite dissimilar to that of general economics.⁵ He succeeded splendidly on both fronts. As for his second goal, Public Finance is still taught in Italy today as a separate branch

⁴Einaudi's Introduction to de Viti de Marco's Principles.... cited, p. 23, referring to Mazzola.

⁵Ibid., p. 23

of scholarship, where the discipline has the illustrious name of the "'*scienza' delle finanze,"* while economics is still referred to as "*economia 'politica.'*" The "science" of finance not only has attracted many of the better scholars, but has probably been even more widely respected in Italy than general economic theory - so much so that the best Italian economists have felt themselves compelled to do some work in the field.⁶ With the single exception of Pareto, who was not without major influence although he was not a direct contributor, all of the outstanding Italian economists have devoted some time to finance theory.⁷

As for the first goal, although it did not find fertile ground in the Anglo-Saxon world, Mazzola's *I dati scientifici delle finanza pubblica*, which is still not translated into English *in toto*, clarified many nebulous notions peculiar to a developing science to the extent of influencing many prominent Austrian and Scandinavian economists. Wicksell's and Lindahl's important works in public goods theory are said to have departed from Mazzola's premises with the intention of reconciling his views with those of Sax and Wieser, who were in search of an "equitable" solution in the pricing of public goods.⁸ This issue will be elaborated later in the chapter.

⁶Buchanan's essay mentioned, p. 27.

⁷Ibid., pp. 26-27.

⁸Musgrave makes this point, especially in R. A. Musgrave and A.T. Peacock, Classics in the Theory of Public Finance, New York: St. Martin's Press, 1967, p. xiv.

Towards a "Pure" Theory of Public Finance. As mentioned in the preceeding chapter, the Italians were not the only ones who separated Public Finance from economics. The Italian tradition has always been appreciated in German-speaking academic circles, which includes the Austrian and Scandinavian academe, where the concept of *Staatwirthschaft* was in effect. However, whether the Italian-German approach of separating Public Finance from economics is an appropriate one is open to controversy.^(*) As for the Italian approach, according to Buchanan, *la "scienza" delle finanze*, despite the scientific, positivistic and objective connotations that it carries, is still hopelessly removed from actual policy issues, and unfortunately it still:⁹

"...resembles philosophy more than it does Marshallian economics. The goal of Italian fiscal theorists has been that of providing generalized or philosophical explanations of the fiscal process. Research has been concerned with the "nature of things" rather than with finding operational propositions in the modern scientific sense. Italian scholars have been interested, by and large, in constructing complete, integrated systems and the criterion for success has been logical consistency rather than usefulness for making predictions, actual or conceptual."

This orientation is certainly evident in Mazzola's book. In fact, in its Preface -which I have

(*) See pp. 22-26 of the dissertation and Exhibit 2 for a comparison between the German organic view and the Italian benefit view.

⁹Buchanan's essay cited. pp. 37-38.

translated and present in Exhibit 1- Mazzola wants to make sure that this is clearly understood. In full agreement with de Viti, Mazzola believed that the strength of his theory was in its being abstract and integrated. This strength has finally been recognized by just a few English-language scholars. In general, however, the Italian approach to Public Finance would still appear sterile to the uninitiated Anglo-Saxon fiscal economist. Nevertheless, the philosophical emphasis of the Italian tradition actually:¹⁰

"...has a great deal of value for the Anglo-Saxon scholar who has been trained in the Ricardian-Marshallian tradition and who has been substantially influenced, albeit unconsciously in some cases, by pragmatic-institutionalist ideas."

The Anglo-Saxon scholars are by no means expected to abandon their valuable policy-oriented approach. In any case, the Italian systematic approach does not preclude the problem-solving orientation. Quite to the contrary, Mazzola was truly convinced that partial equilibrium models were needed to tackle the everyday fiscal problems which were so blatant in the life of the Italian State. But, according to him, the time for arriving at partial equilibrium conclusions had not yet come. After warning the student not to get lost in the

¹⁰Buchanan's essay cited, p. 38.

jungle of fiscal problems, and after enriching him with his "pure" theory of Public Finance, Mazzola ends his work by stating that he strongly wished to:¹¹

"...find practical solutions to urgent fiscal problems. I also wish pure scientific research to have a major part in exposing the true nature [of fiscal phenomena.]"

Political Economy by itself did not have enough clout to accomplish this. It was clear that an economic solution was required: but this was to be found neither in economic science nor in sociology, political science or philosophy, where some authors believed it would be. However, the pure economic principles of the fiscal process must first be understood before applying any rules to the public economy. Mazzola agreed with Pareto in some measure: there was indeed a ruling class at work. But the members of that class have not come to power necessarily by chicanery: in most cases the citizens put them there. The ruling class is desperately in need of proper methods for allocating public funds among various public goods so that the group can remain in power for a long time. According to Mazzola, the most satisfactory solution for everyone could be brought about only through "coordinated" research, that is, empirical research based

¹¹Mazzola, op. cit., p. ix. Also see Exhibit 1, pp. iii-iv. My translation.

on pure theory which would tackle a fiscal problem as it actually manifests itself within the prevailing socio-economic framework.

Mazzola starts off by introducing the State as a producer of public goods. As such, the State charges a price for the consumption of the positive utility that its services would provide. In this connection, the Physiocratic and Classical distinction of "productive" and "unproductive" labor that still lingered in the economic literature was confusing the analysis unnecessarily. That there was no difference between "material" and "immaterial" goods as long as they satisfied human needs was Mazzola's firm belief. Mazzola's critique of two Austrian authors, Sax and Wieser, is worth mentioning here. These two economists agreed with Jevons's concept of individual valuation. However, Sax had not yet purified himself of the murky Physiocratic/Classical view of value; and Wieser, who was closer to the Italian doctrine than Sax, thought that economic reasoning would not contribute to achievement of a "just" distribution, whereas ethical reasoning would .

Mazzola's Critique of Sax. Sax contends that the State does not provide public "goods" but provides public "services." The tax is the price of these services, and must be equal to their "subjective" value

to the user. In the private economy too services are valued and prices are determined in this fashion. In other words, the basic fact is that, as opposed to "material" goods, services -private or public- do not possess an exchange value of their own, and their subjective values emanate from the intensity of the need of the individual.¹² Mazzola is completely at odds with this explanation and is further disturbed by the fact that such an explanation finds an adherent in Italy in the person of Ricca-Salerno, a fiscal theorist of the highest stature.

As he indicates in the Preface, Mazzola's main reason for publishing *I dati...* is precisely to stop diffusion of this misleading influence in Italy by Ricca-Salerno. Also, he wants to show that to consider public goods as immaterial goods, or services, would imply that Political Economy is the appropriate discipline to use in the determination of the prices of these goods. To this end, Mazzola assigns a whole appendix in *I dati...* wherein he attacks this Physiocratic/Classical dichotomy with remarkable clarity:¹³

"A want -public or private- is a painful sensation which can be satisfied only through an action from

¹²See E. Sax, *Grundlegung der theoretischen Staatswirtschaft*, Wien, 1887, pp. 191-196. The 1924 version of this book is free from this confusion. The new version, which was written in Italy where Sax found a haven after his dismissal in 1893 from the German University of Prague, is quite in line with the Italian tradition. Sax lived in Italy continuously from 1893 to 1927, when he died in Fiume.

¹³Mazzola's *I dati...*, p. 221. My translation.

the exterior world. The parts of the exterior world apt to satisfy wants are called "goods;" consequently, these cannot be other than "material" goods. Services are to be considered either as labor, hence as all labor, a human action to change matter into beneficial use, or as a product, hence as all products, modified matter.

Therefore, services are goods like all other goods and their valuation is not any different from the valuation of other goods. In fact, if it comes to that, Jevons's explanation is far superior to Sax's, in that Jevons defines commodity as "...that object, substance, action or service that can bring pleasure or eliminate pain."¹⁴ Mazzola rejects Jevons's structure, however, when it is applied to the public economy, as will be seen later.

Mazzola's Critique of Wieser. Mazzola is critical of Wieser on different grounds from Sax's.¹⁵ Wieser actually paves the way for Mazzola to refute Sax's theory of public goods. He observes that if Sax's theory were indeed a law affecting both the private and the public economy, everyone would be expected to pay a price commensurate with the intensity of the need one felt. This would mean that wealth would cease to offer any ascendancy, and poverty would cease to be a hindrance to the satisfaction of a given want; Wieser notes, however, that only in the public economy sphere is this phenomenon observed, whereas in the private economy

¹⁵Mazzola refers to Wieser's *Der natürlische Werth*, Wien, 1889.

there is gross inequality in the distribution of satisfactions.

Wieser is appalled by the spectacle of a society which is governed by two sets of rules, those of the private economy as explained by the laws of Political Economy, and those of the public economy. Wieser is not sure what discipline is to be used to discover the rules that are in effect in the public economy. He does not elaborate on the issue of the coexistence of such two diverse forms of economic organization. He says, however, that the explanation probably lies in philosophy, sociology and law rather than economics. To this, as though to reject the Anglo-Saxon accusation that the *scienza finanziaria* is philosophical, Mazzola replies:¹⁶

"[T]he analysis of this matter does not lie outside the limits of the theory of value. We do not need historical or philosophical study; we simply need to know why the prices of certain goods are formed in one way and the prices of certain other goods in another way. This is a question of economics pure and simple, and not of philosophy or jurisprudence."

It should be recalled that, before Mazzola, de Viti focussed on the want-satisfying properties of public goods. Like a private good, a public good provides an "actual" satisfaction for the individual who "consumes" it; that is, he does not consider the "intended" efficiency of

¹⁵Mazzola's *I dati*., p.165. My translation.

of a public good to satisfy a social want. The individual does not care what utility is attributed to that particular public good by the State or by other members of the society: it is the satisfaction that he would get from the "consumption" of it that the individual uses for valuation. In other words, the Italian theory of public goods can be considered a "demand side" theory. Although the supply side of the fiscal account is considered to an appropriate extent, the ruling class is thought to supply those public goods in which the citizens have shown an interest. The propelling force in the pricing of public goods is the indivisibility of their "consumption", that is, the jointness of their demand. (*) Until the appearance of Downs's book in 1957, the field of Public Finance lacked a theory of public-goods supply whereby the the government, viewed as a collectivity of utility (voting) maximizers, determine the extent of public outlay.¹⁶

Mazzola's point of departure was the premise that the individual does not live by private goods alone. The individual's total satisfaction depends on a combination of private and public goods: the two categories are

(*) While they elaborated jointness of "demand", the Italians did not concentrate their attention in jointness of supply. The latter was treated later by Buchanan in "Joint Supply, Externality and Optimality," *Economica*, 1966, and later on by Musgrave in The Theory of Public Finance. Musgrave employs the term "joint consumption" in the Italian sense, but he switches to the term "non-rivalry in consumption" more recently, for example, in his "Provision for Social Goods," in J. Margolis and H. Guitton eds., Public Economics, London, 1969. The crux of the matter of both the supply and the consumption of public goods offered jointly is the fact that, once made available to one individual, the same good can be made available to other individuals at no extra (marginal) cost.

¹⁶ Buchanan makes this remark in his "Public Finance and Public Choice," National Tax Journal, Vol. XXVIII, No. 4, Dec. 1975, p. 388. He refers to A. Downs, An Economic Theory of Democracy, New York: Harper, 1957.

"complementary," and the two kinds of goods are consumed simultaneously. De Viti's introduction of a producer-State in 1888 had extended theoretical economics to fiscal activity. The extension consisted of accepting the State as the subject for study in lieu of the individual and studying the behavior of the State in fulfilling its tasks, not that of determining the ends of State activity in the Anglo-Saxon sense.¹⁷ The decision rule consisted of the comparison of the marginal cost and the marginal benefit of the public expenditure in question by the ruling class. Earlier still, Pantaleoni had made clear in 1883 that, since the State was considered as a producer of consumable goods, or a facilitating factor in the production of private goods, the State should equalize the marginal yields from equivalent units as perceived by the average legislator.¹⁸ What was needed to be done was to synthesize the theories of de Viti and Pantaleoni in such a way that those members of the ruling class who represented the State and acted as *homines oeconomici* were given a decision rule that tied social wants to the preferences of the individual. Mazzola addressed himself squarely to this issue.

Mazzola and His "Pure" Theory of Public Finance.

In order to remain in power indefinitely, the ruling class

¹⁷ Buchanan's essay cited. p. 31. Emphasis mine.

¹⁸ *Ibid.*, p. 31.

must act in "objective" good faith to accommodate the needs of the citizens who gave it their mandate.^(*) When the ruling class achieves economic equilibrium in the public goods territory, political harmony is also achieved. In other words, an economically efficient equilibrium in the public sector is also a "just" equilibrium. This dual equilibrium will be challenged by various interest groups, however. The ruling class will keep track of the changes in the preferences of the individuals or coalitions:¹⁹

"Equilibrium is disturbed if the budget plan reflects the view of particular interest groups, in which case adjustment is called for. Thus, we meet the idea that a political equilibrium prevails if an economic equilibrium of maximum satisfaction is established. This same thought -an extension, as it were, of the invisible hand into the political sphere- reappears in many subsequent writings, [after Mazzola], including Edgeworth's doctrine of equality in distribution as agreed upon by "reasonable" men and Wicksell's principle of..."unanimity" in the determination of the budget plan."

The decision rule expounded by Mazzola stems from the twin principles of "indivisibility" and "complementarity" of public goods. Mazzola uses the principle of indivisibility as a general concept that also covers non-excludability and non-rivalry of public goods. Public goods contribute to private satisfactions, but the individual quantities of consumption of such goods cannot be determined, and their

(*) According to Italian jurisprudence, "objective" good faith is what the law expects from a man of average intelligence and average honesty acting to accommodate his and his family's needs. This is the reflection of the Roman law concept of *paterfamilias*.

¹⁹Musgrave and Peacock's Classics... cited, p. xiii.

exact share in the satisfaction of each individual is not known:²⁰

"This individuality of consumption constitutes a technical reason preventing the establishment of a single market price. In the case of a market price for any good, anyone who cannot pay the price must abstain from consumption. But if public goods had a price exceeding their final utility for some classes of consumers, these latter's inability to pay the price would not debar them from using the goods [non-excludability]: to debar them, it would be necessary to withdraw the goods altogether even from the use of those who can pay the price, otherwise those who do not pay would still enjoy the public goods [free-rider issue]. Hence the price is fixed for each consumer in accordance with the maximum he can pay as determined by the degree of final utility the goods have for him. The indivisibility of public services also explains why, whenever the consumption of some public goods can be ascertained from case to case and whenever such consumption has certain determinate and identifiable individual characteristics [merit wants], the public economy resorts to a device very similar to prices in the private economy, namely fees."

Mazzola did not develop fully the elements of free-riding, merit wants and coercion in his theory. This gap was filled later by Wicksell and Lindahl, who synthesized the works of Mazzola and Sax. According to Mazzola, the search for a "just" solution was not warranted since, if the fiscal decision maker behaved as expected, he would obtain an efficient and an equitable equilibrium in public economy simultaneously. In Mazzola's words, the prices of

²⁰ Musgrave and Peacock, op. cit., p. 43.

public goods are determined as follows:²¹

"In any economy, the tendency towards maximizing utility causes available resources to be so distributed among various uses that the degrees of final utility of all the goods allocated are, after the distribution, equal. The formation of the prices of public goods comes about in such wise that in any economic unit the degrees of final utility of public goods are, after the distribution, equal. This price formation is different from that of the market and rests on the complementary nature of the utility of public goods and on the objective conditions of their consumption."

As a result of this complementary character of public wants, the individual is satisfied fully only when he has equated the marginal utility that he derives from his outlay, public and private.²² Each individual, in turn, is required by the State to pay a price corresponding to the marginal utility he receives from the public good being offered. Clearly, since public goods are "consumed" equally by all, unlike in the private economy, in the public economy a "unique" price -akin to the market price- cannot be determined. In other words, the individuals will be expected to contribute in varying amounts to the financing of public goods under consideration, reflecting the varying marginal utilities that are derived. The prices of public goods will be determined by the State through a political process wherein the managing class will take into consideration the "total" satisfaction of the citizens, total in the sense dictated

²¹Musgrave and Peacock's Classics...., p. 46.

²²Ibid., p. xiii

by the complementary character of public goods. Like de Viti, Mazzola explains fiscal activity by the behavior of this managing class, but he denies explicitly the German organic view of "über-individualism."²³ Although it is the governing elite, not the individual, that is acting in the public economy, the elite possesses the ability to elicit the preferences of the electorate and acts in good faith to achieve economic equilibrium in the realm of public goods. In doing so, the governing elite, of course, also achieves its ultimate aim, which is to remain in power indefinitely.

Mazzola's "Principle" and Social Justice. Mazzola is quite aware that, its logical consistency notwithstanding, his "price" theory of public goods does not reflect the real life situation: but he is not thwarted by it. Using the same argument as Buchanan did eighty years later (referring to his 1967 book), Mazzola notes that he is building a pure-theoretical structure wherein, as a first step, abstraction has been made from time and space, in order to reveal "constant properties" of fiscal economics. He asserts further that, now that the objective conditions in which the everyday fiscal phenomena come to pass have been studied, it remains to be examined how the laws he discovered actually operate within the multiple relationships of real life, and what causes may modify the effects of these general laws.²⁴

²³Buchanan's essay cited, p. 37.

²⁴Musgrave and Peacock's Classics...., p. 47.

If there still exists a "differential" utility in the consumption of public goods -similar to a "consumer surplus" in the consumption of private goods- it may be the result of one of the two possible circumstances:²⁵

"It will be readily appreciated that differential utility can arise from [either] faulty valuation [by public agencies] -and in that case total satisfaction of needs will be less than optimal because the result is not the intended one- or when the equilibrium of the scale of utilities is disturbed: such disturbance occurs when the agencies to which valuation is entrusted, represent the predominating interests of one class of people. Then some members of the community are obliged to devote to public goods a greater part of their resources than corresponds to the complementary utility which these goods have for them, and hence obtain less satisfaction of needs; others can retain a larger quantity of private goods, when the complementary utility necessary for private satisfactions is obtained at the expense of other economic units."

This explanation is far superior to that offered by Sax and Wieser. It clarifies Wieser's confusion regarding the seemingly strange fact that within any society there is a public economy where prices are established on different principles from those of the private economy.^(*) It also makes good Sax's theory by explaining that the prices of public goods are determined in such a way that

²⁵Musgrave and Peacock's Classics...., p. 44

(*) As presented in pp. 66-69.

each individual still pays for these goods in accordance with his own valuation as Sax required, but without subscribing to the unwarranted distinction between immaterial and material goods.

Wicksell notes, however, that despite Mazzola's placid attitude about it, coercion is still present in his theory. To Wicksell, it would be a flagrant injustice if someone should be forced to contribute to the cost of a public activity which does not enhance his own interest.²⁶ This is a serious problem and Mazzola underplays it: he expounds an economic law explaining the determination of the prices of public goods splendidly, but circumvents coercion by simply "assuming" that "...arbitrariness and error would not disturb this supreme law of the fiscal economy."²⁷ Wicksell argues that, as a result of this convenient assumption, the requirement of "just" taxation is nicely met: the validity of the law of the fiscal process in the Italian model is tied directly to the assumed ability of each economic agent (the citizen) to distribute his resources in such a manner that after the distribution all the quantities of goods used have the same degree of final utility. The maximum utility from all goods, private and public, is thus achieved and arbitrariness and error cannot disturb this tendency toward equilibrium.²⁸

²⁶ Musgrave and Peacock's Classics...., p. 89.

²⁷ Ibid., p. 81.

²⁸ Ibid., p. 43

This is indeed a deficiency of the Italian model in general and Mazzola's model in particular. According to Wicksell, this line of thinking would lead us to the following postulate:²⁹

"The imposition of taxes is just and applies without arbitrariness and error when each taxpayer succeeds in distributing his resources in such a manner that that his utility is maximized [according to Mazzola.....But] this requirement of tax policy is really meaningless. If the individual is to spend his money for private and public uses so that his satisfaction is maximized, he will obviously pay nothing whatsoever for public purposes.....Of course, if everyone were to do the same, the State would soon cease to function.....Equality between the marginal utility of public goods and their price cannot, therefore, be established by the single individual, but must be secured by consultation between him and all other individuals or their delegates. How is such consultation to be arranged so that the goal may be realized? On this point Mazzola does not say a word, as I see it, this is precisely the question which ought to be decided.

From there Wicksell goes on to develop his own theory of public goods which ingeniously provides an escape from the free-rider dilemma and which represents a major step toward the development of a "positive" theory of the demand and supply of public goods which also provides justice. As Wicksell states right at the outset, it is Mazzola's

²⁹Classics... cited, pp. 81-82.

otherwise correct theory that propels him to develop a public finance theory that combines the Italian "benefit" approach with the Anglo-Saxon approach of "ability-to-pay." Later Lindahl will complete the model and a "pure" theory of public finance will be finally born in 1919.^(*) But Maz-zola's contribution in this regard has been truly instrumental.

Unfortunately, however, Wicksell's theory too is open to criticism for his "convenient" assumption of the "perfect" competition model as the one used to explain the demand and supply of private goods.³⁰ As Buchanan points out in 1968,⁽⁺⁾ the Italian and later Scandinavian models were much more adequate than their Anglo-Saxon counterparts, which still presumed that the demand and supply of public goods behaved in the same manner as in the market for private goods. Until Samuelson's 1954 articles and Buchanan's 1968 book, a central theory of the demand and supply of public goods was nonexistent in the English language literature. To the Italians, it was quite conceivable to envisage an individual making a decision involving a public choice in the same way that he would make a private choice: in either case, the individual is making a decision as to how much of a good to "purchase" at a certain price.³¹ Naturally, the analogy is not a complete one: voluntary exchanges do not exist in the private economy and a "political" process is required.

(*) See E. Lindahl, "Just Taxation - A Positive Solution," translated from his *Die Gerechtigkeit der Besteuerung*, Lund: 1919, pp. 85-98, in Musgrave and Peacock's Classics....., pp. 168-176.

³⁰ Buchanan's The Demand and Supply of Public Goods cited, p. 97.

³¹ Ibid., especially the Preface and Chapter 1.

(+) The Demand and Supply of Public Goods cited.

General Critique of the Voluntary Exchange View.^(*)

Buchanan is aware of the absence of voluntary exchanges in the demand and supply of public goods; however, he still retains this mechanism since it produces the only available "pure" theory of public finance upon which all derivative theoretical constructions would rest. By using this pure model, Buchanan thinks that we will have a yardstick to measure the relevance of any particular model. In a similar way, in private goods models we conveniently use the assumption of perfect competition. It must be understood, however, that the conditions for efficiency in neither case are "normative:" the satisfaction of marginal conditions may or may not represent socially desirable objectives.

Even if the Italian model is rejected as being too abstract, it can always be rescued by transforming it to a "normative" one. Buchanan speculates this for De Viti De Marco's theory:³²

"The grand design of De Viti was ...to apply the marginal-productivity theory of distribution to the fiscal problem. This theory is, however, an explanation of the workings of the private market economy, given the appropriate institutional framework. Resources will tend to be paid in accordance with their marginal

(*) This section is based on Buchanan's theory as expressed in Chapter 1 of his Demand and Supply of Public Goods.

³² Buchanan's essay cited. pp. 43-44.

productivity. But the extension of this sort of analysis to the fiscal problem introduces another dimension. There is nothing inherent in the workings of the collective choice-making process to cause the marginal-productivity criteria to be met. This is the great failure of the De Viti model....[The De Vitian assumption of maximum]real social income can be made objectively meaningful only if the decision-making power is located in some [ruling class] who chooses to accept this criterion. Once this is admitted, the productivity criterion loses much of its appeal and merit. De Viti's theory can only be rescued if it is changed into a normative one. It must be presumed to define a goal toward which collective action should strive. This involves the acceptance of certain value judgments concerning social welfare...[which] must state that the only correct evaluation of real income is that provided by the currently existing value scale established."

But this problem is not peculiar to the Italian model. Modern Welfare Economics, as formalized in the "social welfare function" theory of Bergson and Samuelson, under which the social welfare function is to be taken as given to the economist by some "appropriate authority," still assumes that this function will necessarily exhibit marginal-productivity characteristics in the Paretian sense.³³ The Italian tradition is vulnerable to criticism with its assumption of the productivity criterion of the State economic activity, but it does not fare, in general, any worse than Welfare Economics, which has been dismissed by most public finance specialists as a purely

³³J. G. Head, Public Goods and Public Welfare, Durham, North Carolina: Duke University Press, 1974, p. 4.

academic exercise quite remote from the burning policy problems of our age.³⁴ What saved Welfare Economics was its authors' careful restriction of their discussions to the conditions for (or definition of) an increase in the following magnitudes: "aggregate real income"; "physical productivity", or "production of wealth" (Kaldor); "real social income" or "productive efficiency" (Hicks); and "potential real income" (Samuelson).³⁵ Restricted this way, the Italian doctrine would be much less controversial and more readily acceptable in the Anglo-Saxon world. Certainly in every society there are great inequalities of satisfactions in the private economy, whereas in the public economy goods can be consumed without causing any hardship to other users: the main reason for this strange outcome in the public economy that appalled Wieser is a purely economic one. The road to fullest total satisfaction from both private and public goods, goes through the realm of *economia finanziaria*. Moreover, the solutions are close at hand, since, according to Mazzola, who is referring to his theory of total satisfaction:³⁶

"...now we have an explanation, and the merit belongs to [this] theory of "complementarity" of public goods."

³⁴Head's Public Goods..... cited, p. 4.

³⁵Ibid., p. 13.

³⁶Musgrave and Peacock's Classics....., p. 44.

CHAPTER 4

MODERN IMPLICATIONS OF THE ITALIAN PUBLIC GOODS THEORY OF PUBLIC FINANCE

The two gaps of the post-Marshallian and post-Pigovian "normative" public finance, namely, the neglect of the expenditure side of the fiscal account and the neglect of the collective decision structure, have finally come under the scrutiny of important English-language economists in the recent past.¹ A shift in paradigm which has occurred through the incorporation of both of these elements transformed public finance from its relatively minor role as one among the many fields of applied microeconomic theory - akin to industrial organization, agricultural economics or labor economics - into "public economics," which, at least conceptually, is on all fours with "private economics."² Although the Scandinavian efforts, especially those of Wickseil and Lindahl, have been recognized as being instrumental in achieving this transformation, the truly phenomenal contributions of the Italians have been understated. Even Buchanan, a true connoisseur of the Continental authors, while exalting the "most sophisticated contributions" of Wickseil and Lindahl,

¹J. M. Buchanan, "Public Finance and Public Choice," National Tax Journal, Vol. XXVIII, No. 4, Dec. 1975, pp. 383-394, p. 384.

²Ibid., pp. 383-383.

defines the contributions of Mazzola, Pantaleoni and de Viti as "rudimentary efforts to analyze the public economy within an exchange framework."³

The Italian contributions to Public Finance, and especially that of Mazzola, were neither rudimentary nor futile. As for the futility, Wicksell himself viewed the work of Mazzola as a propelling factor for his quest of a normative benchmark (the "unanimity" rule) to complete the positive analysis of the fiscal process initiated by the Italians. As to the "rudimentary" character of the Italian efforts, it can be shown that Mazzola's equilibrium conditions of the public economy are identical, for example, to those of Buchanan expounded in his The Demand and Supply of Public Goods (1968). All it needs to be done is to apply mathematical notation to Mazzola's rather narrative model, to which I now turn.

According to Mazzola, the individual citizen derives his "total" utility from consuming public and private goods simultaneously. In other words, the total utility of each individual would reflect a perceived need for public goods and a need for private goods; consequently, he would try to equalize the marginal benefits of the two types of goods, and in equilibrium the ratio of the prices of the former goods (hence their utility) would be equal to the ratio of the components of the total expenditure of the individual. Symbolically,

³Buchanan's "Public Finance and Public Choice" article cited, p. 384.

then, Mazzola envisages total utility as:

$$B^1 = B^1 (X_1^1, X_2^1)$$

where: B^1 = total benefit of individual 1;
 X_1^1 = benefit of private good, as perceived by individual 1; and,
 X_2^1 = benefit of public good, as perceived by individual 1.

The total cost would be:

$$C^1 = C^1 (X_1^1, X_2^1)$$

where: X_1^1 = price of private good for individual 1; and,
 X_2^1 = price of public good for individual 1.

Assuming that individual 1 devotes a fixed amount of income to total consumption of goods, public and private, the cost function above can be viewed as a transformation function indicating the rate at which the private good can be transformed into the public good, and vice versa. Mazzola goes into much detail to elaborate on this issue under the rubric of "complementarity of public goods." According to him, the individual will equalize the marginal benefit and the marginal cost (or the marginal rate of transformation) of two goods. That is, the condition for individual marginal adjustment is the familiar one expounded by Pantaleoni in 1883:

$$\frac{\frac{\partial B^1}{\partial X_1^1}}{\frac{\partial B^1}{\partial X_2^1}} - \frac{\frac{\partial C^1}{\partial X_1^1}}{\frac{\partial C^1}{\partial X_2^1}} = 0$$

By using lower-case b's and c's, as Buchanan does in his work, to indicate the partial derivatives, we can simplify:

$$\frac{b^1_{X_2}}{b^1_{X_1}} - \frac{c^1_{X_2}}{c^1_{X_1}} = 0$$

where:

$\frac{b^1_{X_2}}{b^1_{X_1}}$ is the marginal rate of substitution between the public good and the private good for individual 1; and,

$\frac{c^1_{X_2}}{c^1_{X_1}}$ is the marginal rate of transformation between the public good and the private good for individual 1.

Because of the summative nature of the benefit emanating from the public good, taking two individual together:

$$\frac{b^1 X_2}{b^1 X_1} + \frac{b^2 X_2}{b^2 X_1} = \frac{c X_2}{c X_1}$$

where the two items on the left side indicate the marginal rates of substitution for individuals 1 and 2, and

where $\frac{c X_2}{c X_1}$ is the ratio of the total outlays of

individuals 1 and 2.

That is, following Mazzola's deduction, one concludes that the sum of the marginal rates of substitution between the public good and the private good is equal to the goods' marginal cost, or more properly, the goods' marginal rates of transformation. This is exactly the same conclusion that Buchanan arrives in 1968:⁴

$$\frac{u^t X_2}{u^t X_1} + \frac{u^c X_2}{u^c X_1} = \frac{f X_2}{f X_1}$$

where the lower-case u's and f are the equivalent of Mazzola's b's and c; subscripts t and c refer to

4

Buchanan's The Demand and Supply of Public Goods cited, pp. 18-22.

two individuals, Tizio and Caio, one offering a public good to the other; and, X_2 and X_1 refer to the public and private goods respectively.

Actually, the notion that the marginal benefits should equal the marginal cost in the public economy was first formalized in the English-language economic literature by Samuelson in his 1954 paper.⁵ Samuelson's model of the "demand" of public goods is also built unmistakably on Mazzola's premises, complete with the assumptions of individual valuation, non-excludability and non-rivalry, but veers from the Italian paradigm by allowing a social welfare function for the distribution of tax shares. His mathematical exposition deals with two individuals holding a given private good and a jointly-consumed public good, and shows, as expounded 74 years ago by Mazzola, that the sum of the marginal benefits of two individuals equals marginal cost in the public economy.

The crux of the matter is that Samuelson, in effect, has extended the theory of public goods to modern

⁵B. A. Samuelson, "The Pure Theory of Public Expenditure," Review of Economics and Statistics, XXXVI, Nov. 1954, pp. 387-389.

welfare economics. In this way, although not given proper credit, Mazzola's model has taken a central place in modern fiscal theory. Expanded by the use of a given social welfare function, that is, transformed into a "normative" character, Mazzola's model of public goods is shown to be instrumental in producing an equilibrium in the public economy.

In spite of this achievement, however, the theory of public goods *per se* is still anathema to the typical English-language economist. It is stated, for example, that:⁶

"[t]he theory of public goods....remains, even after the courageous attempts of Buchanan and others, a theory devoid of any *decision making mechanism*. In other words, the theory is still mainly an existence theorem of welfare economics concentrating almost exclusively on the definition of equilibrium conditions, and the refinements and generalizations which have occupied researchers in more recent years have done scarcely anything to remove this crippling and fundamental emptiness. The theory as it now stands, does not shed any light on the problems of collective choices or, to put it differently, it is still without an institutional counterpart."

The extent of the misunderstanding present in this argument is quite serious. First, the Italian model, which is based squarely on the public goods concept being criticized above, actually puts strong emphasis

⁶A. Breton, The Economic Theory of Representative Government, Chicago: Aldine Publishing Co., 1974, p. 4. Emphasis in the original.

on political assumptions necessary to render the model a workable one. As presented in the previous chapters, although not elaborated specifically by Mazzola, de Viti's and Pantaleoni's political assumptions, and the later elaborations of Barone, Cosciani and Einaudi, have indicated the need for examining simultaneously the proffered conditions of economic efficiency and the proposed political process - which might not necessarily follow the ideal Anglo-Saxon democratic institutions. This is not to say that the Italian model is non-democratic: although it might seem to be non-democratic in the participatory democratic sense because of the ruling class feature that it contains, the Italian model is nevertheless in harmony with the principles of representative government. Even in the modern Anglo-Saxon democracies, a group of politicians are given a mandate by the electorate for a given term. The Italian model, in contrast with its Anglo-Saxon counterpart, always spells out the set of fiscal and political institutions assumed to be instrumental in achieving economic equilibrium in the public economy, and it maintains that these institutions are subject to change, except for the cardinal principle that the government is receptive to political and economic signals coming from the electorate. In his way, the Italians have dealt with the implications of any given political structures and/or fiscal institutions, for both the tax and the expenditure sides of the fiscal account, much more effectively than their Anglo-Saxon or Continental counterparts.⁷

Second, the expanded version of the theory of public goods gives the financial economist considerable leeway between the positive and normative modes of analysis. Johansen, for example, analyzes the Norwegian economy, first by building a workable positive

⁷Buchanan's "Public Finance and Public Choice" article cited, p. 385.

model of public economy based on public goods theory and then by introducing facts and figures from Norway to clarify points of principle, and to illustrate the practical importance of the problems treated.⁸ In this way, the public goods theorist can go much further in the analysis of the public economy than his Anglo-Saxon counterpart whose analysis will not go any farther than studying tax incidence and shifting.

Breton's position has merit only in the sense that the Italian public goods theory does not offer an operational rule; unfortunately, the Anglo-Saxon fiscal theory does not offer it either. As for the Scandinavian theory, Wicksell's and Lindahl's contributions have also fallen short of an operational rule in that the unanimity rule (Wicksell) is equally improbable as the pseudo-tax scheme (Lindahl) whereby the electorate reallocates the "weights" of the optimal extent of the public expenditure. In other words, although the Scandinavian doctrine appears more palatable to the Anglo-Saxon student of public finance because of its characteristic of "internalization," the lack of an operational rule is present in all fiscal theories.

Fortunately, the theory of public goods is reaching a new stage. As viewed by Buchanan:⁹

"Individuals, recognizing the failure of voluntary-exchange organization, but also continuing to recognize the presence of mutual gains-from-trade in public goods, may propose [any] "rules changes" that will so modify the conditions for individual choice as to secure at least some if not all the gains-from-trade that are promised. This stage involves [first] the logical derivation of fiscal systems as a part of the whole political

⁸L. Johansen, Public Economics, Chicago: Rand Mc Nally & Company, 1968, p. ix.

⁹Buchanan's The Demand and Supply of Public Goods cited, p. 199.

order...[and, second, the derivation of a constitutional system] that describes...the rules concerning the making of budgetary choices in all aspects. These must include rules for deciding among alternative proposals that might be presented, rules for selecting which goods and services are to be supplied publicly rather than privately, rules for determining the characteristics and the extent of provision for those goods and services that are to be privately supplied, and, finally, rules for allocating the costs of these publicly-supplied goods and services among individuals and groups in the whole community...This extension of [the public goods] theory to the analysis of alternative rules or institutions is more natural in a "positive" than in a "normative" approach."

Buchanan's statement above is perfectly equivalent to the position held by de Viti and Mazzola in stressing the importance of "pure" Public Finance in providing the framework within which actual fiscal phenomena would be analyzed. Consequently, the criticism that the public goods approach "...does not shed any light on the problems of collective choices or, [that] ...it still without an institutional counterpart" is an idle objection. The public goods approach has been enriched by incorporating the many views of collective choice, transaction costs, and a gamut of decision rules. It has achieved this because of its surprising consistency with the "normative" optimality conditions of, say, Pareto, Bergson, Downs, or Buchanan and Tullock. The public finance and collective choice literature is now rich with models on voting (Riker, Kramer, ~~Sen~~, Nitzan), on constitutional rules (Buchanan, Tullock, Mueller), and on the "supply" of public goods (Downs, Niskanen, Lindsay), all of which complement the public goods approach, which is mainly based on the "demand" for such goods by the electorate.^(*) To elaborate on these

(*) See references at the end of this chapter.

contributions is beyond the scope of this dissertation. However, with the use of an example, I will attempt to demonstrate that this integrated approach is preferable to the Anglo-Saxon counterpart, which still neglects, by and large, the expenditure side of the budgetary process and the collective choice process in tackling an actual policy issue.

The Anglo-Saxon theory of public finance has developed mainly along two lines of inquiry, both based on the tax side. The first, the "positive" inquiry, consisted of tracing the effects of taxes on the citizens' welfare by applying the methods of Marshallian economics. Again, because the expenditure side of the fiscal account was grossly neglected and the collective choice considerations were almost nonexistent, the Anglo-Saxon "positive" analysis amounted to no more than the analysis of tax incidence and shifting. The second line of inquiry dealt with testing the desirability of a tax, old or new, against a set of "normative" criteria culled from Sidgwick, Edgeworth and Pigou. A tax that proved to be regressive, for example, was not acceptable since it did not conform with the principle of ability to pay. This normative discussion was much less rigorous intellectually than the positive analysis of tax incidence and shifting, and, indeed, the normative treatment of taxation among English-language economists was almost a half-century out of phase with the more sophisticated discussion of the European continent, which included the two missing

components of the fiscal process.¹⁰

Many tax reforms failed to materialize in England because one or both of these components were neglected in the analysis. As for the expenditure side, some tax proposals were rejected either because they did not fully agree with some "principles" of taxation, or because the blatantly static "positive" analysis of the particular tax in question (made in isolation from the expenditure side) proved to entail excess burden on some taxpayers, or to have undesirable effects on private saving, failing to emphasize the desirable effects that the expenditure process might bring about. A proposal envisaging a tax such as the U.S. Social Security levy, for example, would be rejected on the spot because the positive analysis would prove that it was a regressive one, therefore unacceptable from a normative point of view.^(*)

As for the collective choice front, Dalton's 1946 proposal of a new inheritance tax to replace the antiquated U.K. Death Duty, for example, died on the Parliament floor because of its proponents' inability to set in motion an auspicious political process. Although the "positive" analysis proved that the proposed inheritance tax would be much less harmful to private saving and would produce a less heavy burden on the relevant parties, the proposal, basically a Rignano Scheme,⁽⁺⁾ could not surmount criticism on

¹⁰ Buchanan's 1975 article cited, p. 384.

^(*) Buchanan makes this point in the above mentioned article.

⁽⁺⁾ as will be explained in the section following the next.

political grounds. The English Parliament attacked the obvious feature of the Rignano Scheme, which was its objective of achieving a more equal distribution of wealth, failing to realize that a more equal distribution of wealth must be considered a public good in any society.^(*) By settling for what was already in effect, it confirmed Wicksell's dictum that any action, but especially an action in the inheritance territory, taken in the name of "...justice in taxation tacitly presupposes justice in the existing distribution of property and income."¹¹ The Rignano proposal in England has shown that even a tax that passed the normative and positive musters, could still be rejected if collective choice factors have not been mobilized sufficiently. The following sections will elaborate on the issues concerning this inheritance tax proposal, as they came up in England right after the Labour Party's victory in 1946.

(*) Kalt and Zupan argue that pure ideology in voters and their representatives can be construed as having collective good characteristics since pure ideology, if it exists at all, is the manifestation of altruism in the political sector. First, the successful promotion of an ideology may give individuals the satisfaction of knowing that they have concretely improved the lot of others. Second, even if the pursuit of ideology has no effect on others, individuals may derive satisfaction from having done the right thing. (See footnote 22 on page 100 for Dalton's stand on this last point.) This preference for a particular distribution of income -whether based on "pure" ideology" or altruism- can be seen as a collective good. See J. P. Kalt and M. A. Zupan, "Capture and Ideology in Economic Theory of Politics," American Economic Review, June 1984, pp. 279-300.

¹¹ Musgrave and Peacock's Classics... cited, p. 108, in relation to Wicksell's argument against Wagner's position that the main vehicle for income redistribution should be the inheritance tax, and not the income tax.

Characteristics of the Inheritance Tax.

The inheritance tax can be considered a product of modern democracy. Although it was in effect in many European countries in the 18th and 19th centuries, this tax was viewed mainly as a probate duty, or a fee, that the heirs had to pay in order to consummate the will. There are still communities that, at least in name, retained the probate duty character of the inheritance tax. Wisconsin, Minnesota and Illinois, for example, base the tax on a "cost-of-service" concept.¹² Since the probate fee typically exceeds the cost of service in these communities, this concept is clearly inadequate to explain the *raison d'être* of the inheritance tax. In Anglo-Saxon democracies in general, however, the inheritance tax is considered to be a means of achieving more "equitable" taxation and of attaining the principle of ability to pay.¹³ In other words, the basis for the tax is (1) to moderate the effects of an "accidental income" earned without due toil; and, (2) to impose additional tax on the wealth of the heir that has increased his ability to pay. Since an income tax is already in effect, the extended ability to pay would be tackled by an additional (inheritance) tax. According

¹²E. R. A. Seligman, Essays in Taxation, New York: Augustus M. Kelly, Publishers, 1969. Footnote 2 on p. 132.

¹³Ibid., p. 127.

to Seligman, the inheritance tax, to be normatively acceptable in distributional terms, should be in accord with both the "principle of progressivity" of an income tax and the "principle of graduation^(*)" of a succession tax, a tax that has been in effect in most Continental European countries.¹⁴ Such an inheritance tax would be in harmony with a socio-legal-economic milieu where it is generally agreed that the greatest cause of inequality of incomes is inequality of inherited wealth.¹⁵ The implicit assumption made here by Seligman and Mrs. Hicks is one which views inequality of property and income as a normatively unacceptable predicament: in such a society, a tax directed to the redistribution of wealth would be in order. It can be stated quite safely, therefore, that the inheritance tax such as the one in effect in Britain, would pass the Pigovian muster since it is substantially progressive and graduated, thus in conformity with the cardinal principle of taxation, ability-to-pay.

As for the test against Marshallian teachings of incidence and shifting, Mrs. Hicks, for example, who has studied extensively the disincentives that taxes might bring about, concludes that, fortunately, even a very high rate of tax taken from inherited fortunes does not

(*)whereby the tax rate gets higher and higher as the relationship between the deceased and the heir or legatee becomes more and more remote.

¹⁴Seligman's book cited, p. 133.

¹⁵U. K. Hicks, *Public Finance*, Cambridge University Press, 1968, p. 200, quoting Hugh Dalton's *The Inequality of Incomes*. No further reference is supplied.

discourage incentive and enterprise as, say, an excessively high income tax levy would. Admitting that the current income tax is already too steep in England, Mrs. Hicks deems the inheritance tax recommendable since, "positively" speaking, it enables the State to produce a considerable amount of revenue with much less damage to savings than any other type of tax directed to wealth.

The positive analysis fails to explain, the assumption that saving is desirable notwithstanding, how the inheritance tax "...in the upper ranges of wealth has now become so high in Britain (reaching 80 per cent of the whole estate) that the process of the breakup of the property has been greatly, perhaps dangerously, accelerated from the point of view of the social provision of saving."¹⁶ The root of the problem lies in the Anglo-Saxon public finance tradition of viewing the economist as an individual who "...had no reason to inquire about the political purpose of taxation, [and] no reason to introduce external evaluation of alternative tax instruments."¹⁷ This was unfortunate:¹⁸

"In the standard discussion of fiscal reforms, merely to raise issues concerning [the inheritance and estate taxes]

¹⁶Mrs. Hicks's Public Finance cited, p. 205.

¹⁸J. M. Buchanan, Public Finance in Democratic Process: Fiscal Institutions and Individual Choice, Chapel Hill, North Carolina: The University of North Carolina Press, 1967, p. 298.

¹⁷Buchanan's 1975 article cited, pp. 383-384.

is to choose sides. And the choosing is not difficult. Those persons who identify themselves with favorable asset positions tend to argue persuasively against increases in and for reductions in such taxes. Those other persons who cannot or do not make this identification argue, with equal persuasiveness, that these taxes should be made confiscatory. The collective decision process becomes strictly analogous to a zero-sum game, and no reasoned discussion of an efficient or optimal scheme of asset transfer taxation can possibly take place."

This is exactly what happened in 1946 when the Dalton Plan was rejected on the basis of being confiscatory in nature, while the existing inheritance tax structure was not any less confiscatory. In other words, despite the normative and positive pretexts that were used, what prepared the Proposal's demise was purely political considerations. The proposal was labeled a "foreign" artifact incompatible with the British fiscal tradition, although even this argument is disputable in view of the historical background of the U.K. Death Duty.

Historical Perspective. The idea of taxing the heirs for the fortune they inherited originated in England with Bentham. He was careful not to use the term "tax proposal," however, since according to him, what he was proposing was actually an extension of escheat.¹⁹ More specifically, he argued that if an individual died intestate, and there were no direct descendants, the estate should be transferred to the State and not to a distant relative. Bentham's insistence that his scheme was not to be taken as a tax proposal was rooted in his conviction that inheritance was not a natural right, at least for a distant relative. If it were, the heir would "...look upon the whole of

¹⁹Seligman's Essays in Taxation cited, p. 128.

what is left to him as his [rightful] own, of which he is then called upon to give up a part,"²⁰ and suffer a "burden." But the heir, knowing that ordinarily he would not receive anything anyway, would not feel any deprivation.

The political implications of this simple extension of escheat were grasped by J. S. Mill, who, being free of theoretical issues that later preoccupied Pigou, and not minding the inclusion of the State as a junior partner in economic life, extended Bentham's prescription further, even in the presence of a will for collateral relatives. The only benefit that distant relatives would receive was a "reasonable provision determined and paid by the State." For a long time Mill's view was labeled socialistic since it would lead to bolstering the power of the State and to penalizing the heirs, however distant, who were entitled to inherit a fortune, albeit effortlessly. But the second half of Mill's argument tells another story: if there is a will, a man could leave his fortune to his immediate relatives as freely as acting *inter vivos*. Mill's view has developed into a full-fledged graduated collateral inheritance tax, which is still in operation in England under the rubric of "death duty."

The Anglo-Saxon argument for the inheritance tax is in direct contrast with the "family theory of property" which is entrenched in codified laws of France,

²⁰Seligman's book cited, p. 128.

Switzerland and Italy. The latter doctrine assumes that a man accumulates wealth for the sole motivation and purpose of leaving it to his children - and a small portion to his wife. The Civil Codes of these countries are full of "compulsory" shares for children, spouse, and other relatives, that are inviolable even if the will states otherwise. Yet many inheritance tax proposals, such as Rignano's, which was so radically different from the prevailing legal practice, still found fertile ground for consideration in Italy during the first decade of the 20th century.

As was seen before, the Italian fiscal theorists were used to discussing openly the fiscal and constitutional institutions of the State. They were not confined by some social "principles" deemed to be operative in the community, except the cardinal principle of *homo oeconomicus*, which was thought to be in effect both in private and in public choice, although in the latter the *homines oeconomici* were elected officials of the State who acted in accordance with the average voter demand. In a framework such as this, every social or fiscal institution was subject to change, and the State, assumed to have a "...nature which was more prospective and more richly endowed than that of the individual,"²¹ was expected to lead the citizenry towards a more satisfactory social life.

²¹M. Pantaleoni, *Pure Economics*, New York: Kelly and Millman, 1957, p. 23. Translated from his *Principi di economia pura*, Milano: Fratelli Treves, 1931, by T. Boston Bruce.

When social and fiscal institutions are in a state of upheaval politicians look more intensely for reform measures. This was so in Italy following Cavour, and also in England right after the World War II. Dalton, who had previously found that an inheritance tax of the type proposed by Rignano would be the most appropriate one, since it was considered not to discourage work and saving, and yet to be a sizeable source of government revenue, got the opportunity to put his idea into practice when he became the Chancellor of the Exchequer in 1945. His ambitious inheritance tax proposal of 1946, which was in essence a modified Rignano Scheme, however, never came into being, and it remained, in Dalton's words, "...on the list of good deeds to be done."²²

The Rignano Scheme. The time has now come to see what the Rignano Scheme is and how, if at all, it can be implemented.^(*) A concise presentation of the Rignano Scheme is in Vickrey:²³

²²H. Dalton, Principles of Public Finance, Augustus M. Kelley Publishers, N.Y., 1967, p. 232.

^(*)Eugenio Rignano, a market socialist who saw the diffusion of inherited property as the first step of socialization, was known to English-language economists, especially the Labourites. See the end of this chapter for a complete list of references on Rignano.

²³W. Vickrey, Agenda for Progressive Taxation, New York: Augustus M. Kelley, Publishers, 1972, footnote on p. 242. It is a pity that Rignano's original writings are inaccessible to me at this time and that I have to quote him through an author who resents this proposal. I am looking forward to translating Rignano's work in Italian along with that of Mazzola, into English so that Rignano's work can be compared to those of Lange and Lerner, and Mazzola's to Wicksell, Lindahl, Samuelson and Buchanan.

"The essence of the Rignano plan was that inheritance tax rates be successively stiffened with the number of transfers through which property is handed down. For example, on the transfer from A to B of wealth accumulated by A, the tax might be 50%, while on a transfer from B to C the tax would then be at, say, 75% on an amount equal to the net amount B received from A, and 50% on the remainder, if any. Rignano apparently took the transfer as the unit of succession without regard to the number of generations involved, nor was any allowance for interest earned on the estate apparently considered. Rignano also suggested that the tax be confiscatory or substantially so on the third and subsequent transfers, thus making the persistence of an estate beyond the third transfer dependent upon further accumulation by the intermediate holders."

I am inclined to think - with some reservation, since I have not done exhaustive research on Rignano's writings - that his prescription for achieving a just income distribution precedes those of contemporary market socialists like Lange and Lerner. Rignano too, although a socialist, does not reject the market mechanism, and the wealth accumulation that it would entail. However, Rignano wants the State to actively pursue the goal of redistributing the wealth thus accumulated, or in the words of Varian, the goal of "...ensuring a just distribution of initial endowments (wealth.)"²⁴

The Rignano Plan introduced by Dalton was not as confiscatory as the extant death duty in England. Yet

²⁴H. R. Varian, "Distributive Justice, Welfare Economics and the Theory of Fairness," Philosophy and Public Affairs, Spring 1975, p. 233. Emphasis mine.

the political climate was not ready for its adoption. This was paradoxical since the features of the Scheme were in perfect harmony with Pigovian-Marshallian principles of taxation. Namely, (1) it was directed to achieving justice in wealth distribution with minimum disincentive to work, to save and to accumulate further wealth, and, (2) since it taxed a man's immediate heirs much less than other relatives, it was more in line with the principle of ability to pay in that it protected the family who had just lost their breadwinner and thus their ability-to-pay had actually decreased, especially if the death had occurred at a productive age. In this connection, the extant death duty hit the family with an extremely high duty and the ability-to-pay was reduced to a meaningless pretext. Nevertheless, the death duty survived the challenge.

Conclusion. This experiment first indicates the importance of the public choice considerations at play in a seemingly purely financial measure. Although containing much economic merit, the Rignano Scheme was defeated on political grounds. Professor Tait confesses that, in spite of certain practical difficulties that it posed, he was critical of the Rignano Plan from the point of view that its aim was ultimately takeover of equities by the State²⁵—and this is anathema to a British conservative. The point is that the Dalton -- Proposal wanted to give the State the active role of redistributing wealth: after all this would be quite expected from a Labourite! Tait maintains frankly, however, that "...taxation is never popular. Taxation of wealth is for

²⁵A. Tait, The Taxation of Personal Wealth, Univ. of Illinois Press, 1967.

many the least popular of all taxes."²⁶

The second series of considerations are those pertaining to the expenditure side of the budget plan. Although the Rignano Scheme was mainly a tax on wealth, therefore directed toward altering the historical continuity and the resulting composition of British society, the expenditure side of it was not fully elaborated and publicized in the British experiment by its proponents. As Buchanan states for the U. S. Social Security taxation, straightforward extension of analysis to the "other" side of the budget would have allowed positive analysis of the effects of the public spending, earmarked perhaps for transfer to the deprived.²⁷ The Italian public goods theory, drawing direct attention both to the bridge between the tax and the expenditure sides of the budget, and to the relevant political assumptions, is in a much superior position to the British theory, to discuss both the positive and the normative considerations of any given public finance measure.

Fortunately, the student of public finance is not obliged to choose between the two camps of the fiscal doctrine. As mentioned in the second chapter, the Italian fiscal theorists have learned much from their British counterparts, especially in the field of technical analysis of taxation. On the other side of the fence, the English-

²⁶A.Tait's The Taxation of Personal Wealth cited, p. 112.

²⁷Buchanan's 1975 article cited, p. 392.

language fiscal economists have come to realize that their approach separated public finance unnecessarily from a fruitful association with political science, political philosophy and law, and thus have begun to see the State in the Italian sense, that is, as a major social institution "...behaving like more familiar economic institutions - the household, the firm - though the markets it confronts are markets for policies and for votes rather than goods and services."²⁸ The list of references in the end of this chapter is but a small portion of English-language literature dealing with this integrated approach, and the leadership in this shift of paradigm clearly belongs to Buchanan, although it must be recognized that the propelling factor in this endeavor has been Buchanan's firsthand knowledge of the continental, and above all Italian, authors of public goods theory.

²⁸ H. G. Johnson's Foreword to A. Breton's The Economic Theory of Representative Government cited, p. xii.

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EXHIBIT 1

PREFACE TO

I dati scientifici della finanza pubblica

by:

Ugo Mazzola

Translated by:

Orhan Kayaalp

EXHIBIT 1

PREFACE (*)

This work has the goal of determining the scientific foundations of fiscal economics and defining the general characteristics of Public Finance. In addition to complying with the contemporary tendency to look seriously for causal relationships among phenomena of social life, this work is a reply to a tendency that has recently appeared in the treatment of fiscal economics.

In the two learned works published almost simultaneously in the past two years, the issue was raised, with different arguments, as to whether it wasn't appropriate to integrate the treatment of fiscal phenomena with general laws governing socio-economic phenomena since fiscal science was falling behind the general progress taking place in the social sciences and was not being rejuvenated from the font of historic research and positive methodology.¹

This new approach has had a certain success and a few undoubtedly valuable and informative works have recently appeared. But as a consequence of this fad, although there has not yet been any valid argument against the prevailing doctrine,

(*) Ugo Mazzola, I dati scientifici della finanza pubblica, Roma: Ermanno Loescher, 1890, pp. vii-xi.

¹ A. Loria, La teoria economica della costituzione politica, Torino: 1886.

a certain distrust [of Public Finance] was evoked and drew the attention of some scholars. The complaint was that theoretical research on fiscal economic laws removed the student of Public Finance from research on practical and everyday matters related to urgent problems.

It is surprising that such a distrust is being created here where financial administrators and members of the Parliament are familiar with the principles of fiscal economics,² and where ministerial and parliamentary authority are vested [in such people.]

The distrust, however, is not justified: this can be clearly shown through an analogy. Political Economy, treated initially only as a political art, has developed considerably and taken shape little by little as a science: it has adopted the goal of objective investigation, and through theoretical research, it has discovered laws according to which economic events proceed and thus it is now possible to account for the strong influences beneath conflicting social interests. Political Economy did not limit research to concrete problems that occur in economic life; on the contrary, it has received new support from theoretical research [to the extent that] it is now possible to study with much benefit the problems of [money] circulation, savings organizations, insurance, transportation etc. In the science of Public Finance

²Suffice it to remember that, in the last thirty years, among the ministers were Scialoja, Sella, Minghetti, Ferrara, Magliani while in the two branches of the Parliament there were specialists such as Messedaglia, Luzzatti, Ellena, Lampertico, Boselli, Saraceo, and others and others.

the search for general principles either was given secondary place or was mingled with extraneous judicial and political elements. For example, the problems of the "most equitable" taxation were being discussed without investigating first the causal links on which facts were based. Now we do not have a prejudice against practical work. On the contrary, we are in favor of finding practical solutions to urgent problems, and would like pure scientific research to have a major part in disclosing the true state of [fiscal affairs.]

In any case, the distrust must be dispelled since it comes from authoritative men to whom it would be puerile to give an arrogant theoretical answer, attach the epithet of incompetence and walk away. It is necessary, instead, to make a very careful response and show that the methodological difference is a mere division of scientific work, to indicate that a simple methodological change should not imply a scientific revolution, and to show lastly how this change has been developing for a long time and how much it is needed. It is necessary to show, with special attention to particular fiscal problems, what benefit science and life may receive from a more objective investigation and demonstrate how only through the application of discovered principles to various problems can empirical solutions be obtained.

In this work, in addition to the principal objective, I am addressing myself to some of these tasks

hoping that other authors will eventually follow the lead.

The order of this book is the following: first some notions regarding the general characteristics of scientific research and some fundamental economic principles that apply in the fiscal field are postulated; then the characteristics of public wants, which are the fundamental elements of the science, are defined, the qualities of [public] goods that satisfy such wants are established, and then the determination of the utility and prices of such goods is examined. In the appendix is presented a brief argument on materiality of goods and services where I reaffirm some principles that seem to be correct and valid.

Among the multiplicity of reasons that hasten me to publish this book is my dissent, which is manifest in many places in the book, from a brilliant Austrian author's theory which has been accepted and diffused in Italy by one of our valuable economists.^(*) It seems to me that that theory, in spite of its ingenuity and the logical as well as doctrinal acumen with which it has been expounded, does not merit our endorsement - nor, incidentally, did it find endorsement even in its motherland. And as I see from recent works that its principles have been accepted but its defects have not been pointed out; any further delay in declaring my dissent would have serious consequences.

(*) Mazzola is referring, of course, to Sax and Ricca-Salerno. See E. Sax, Grundlegung der theoretischen Staatswirtschaft, Wien, 1887, and G. Ricca-Salerno, Scienza delle finanze, Firenze, 1888. Ricca-Salerno, who studied economics under A. Wagner in Berlin, was the foremost proponent of the German "organic" view of State in Italy. until 1883, at which time, upon the publication of Sax's Grundlegung... he switched to the voluntary exchange view, although he remained outside of the general Italian fiscal doctrine until his death in 1912.

It is up to the reader to judge which of the two expositions is correct. I would like to warn the reader, however, that even if he finds that theory deficient he should nevertheless admit that those authors have enriched the science with works on transportation³ and on the history of fiscal doctrine in Italy.⁴

I note in conclusion that some of the concepts exhibited in this work carried my signature in an earlier unpublished manuscript given to some of my friends; however, having modified the manuscript extensively, I assume the sole responsibility for the opinions expressed in this publication.

Pavia, July 1889

Ugo Mazzola

²E. Sax, Die Verkehrsmittel in der Volks- und Staatswirtschaft, Wien, 1878-79.

³G. Ricca-Salerno, Storia della dottrina finanziaria in Italia. Memorie della R. Accademia dei Lincei. (Place and year of the publication not given.)

EXHIBIT 2

Selected National Bodies of Public Finance Theory

ANGLO-SAXON SCHOOL

Historical View

Sidgwick, Edgeworth, Pigou, Marshall, Dalton

General framework	Individual choice behavior is irrelevant in the public economy sphere. The State provides certain services for historical reasons, mainly because no one else would provide those services more efficiently. The State must cover the expenses that it incurs in providing public services and each individual must sacrifice (pay taxes) according to his ability to pay. Since the offering of public services entails sacrifice, the main concern of the tax assessor must be to collect taxes in an equitable manner.
Who provides public goods?	The State provides public goods but it does not act as a "producer" of these goods. The State is a "caretaker" offering a very limited number of them and does not hesitate to transfer the provision of them to the private sector.
Who does the valuation of public goods?	The individual. After all, he is paying something from his private income or wealth for something which is inherently unproductive, therefore not offered by the private sector. The individual taxpayer must consider what is the "proper" premium to pay after considering his ability-to-pay and the status quo that he wants to retain.
Economic efficiency	It is a moot issue: the State activity is unproductive to begin with, and ought to be minimized.
Coercion	Not an issue: the public expenditures must be covered one way or another. This is understood by the public. Anyway, State services pertain to a minimum number and extent of public services.
Expenditure side	Not important since public services are so few and take place in generally unproductive fields, such as diplomacy, as determined by historical reasons. The public revenue raised is not large and is not channeled to fields that affect the citizens' lives.
Fiscal doctrine	Public finance is generally normative in that it is mainly concerned with how taxes should be imposed so that the tax burden (sacrifice) is minimized. However, to arrive at a socially acceptable conclusion, the examination and the predictions of the effects of alternative taxes must be done scientifically. In other words, public finance consists of the normative and positive analyses of taxes.
Particular problems	How to determine the amount of "sacrifice:" equal absolute, equal proportional or equal marginal?

GERMAN SCHOOL

Organic View

Schaeffle, Ritschl, Mohr, Wagner

General frame-work	The individual behaves in one way when he is making a private choice and in another when he is making a collective choice. This is so because "social" wants are of a different nature than "private" wants. The State, like all social organizations, has goals that are different in kind from the individual goals of the citizens (members) who make up the State (organization). Because of this dichotomy, the individual perceives that he is not competent to make collective choices and leaves collective decisions, including the fiscal ones, to the public authority.
Who provides public goods?	The State provides public goods. This cannot be left to the discretion of individuals acting alone or acting collectively in the direct democratic manner. A governing body must be given the proper authority to carry out social, here fiscal, goals.
Who does the valuation of public goods?	The State, or better, the governing body does the valuation of public goods, after considering various criteria which transcend the limited perceptions of the individual citizens. Additionally, only the governing body has access to public records which are necessary to do the valuation properly.
Economic efficiency	Economic efficiency is not a necessary criterion, although it is a desirable one.
Coercion	All must contribute to the common purpose. The citizens do not resent the fact that the State operates in the public economy with due authority and expects from the citizens due compliance. This might lead to coercion only in those cases where the citizen has not yet acquired the desired organizational formation.
Expenditure side	Not elaborated. The extent of the expenditures are determined exogeneously by the governing body in accordance with some relevant social, political or ethical criteria.
Fiscal doctrine	The analysis of the fiscal process is done according to the principles of <i>Gemeinwirtschaft</i> , or communal economy. The mere extension of the economic principles to public finance would be inadequate. Public finance must be studied as a unique process (<i>Staatwirtschaft</i>) complete with its economic, social, political, ethical and legal aspects.
Specific problems	Not elaborated.

AUSTRIAN SCHOOL

Individual Valuation View

Sax, Wieser, Menger

General frame-work	Public wants are not homogeneous. Some public wants belong to the "collective needs realm" where the individual cannot make a comparison with his private needs. Some other needs, although public, allow for the imputation of specific, measurable benefits to the individual. In the latter category, or the <i>partikulare</i> realm, the determination of the prices of public goods (taxes) must reflect the relative valuation of the individual anticipating a personal benefit. In the former category, the tax shares are determined on a purely collective basis, either by direct democracy, or by the governing elite <i>à la</i> organic view.
Who provides public goods?	The State provides all the public goods that fall into the collective needs realm. The State also offers the <i>partikulare</i> public goods, but this occurs because it facilitates the process. For the <i>partikulare</i> category, citizens must be confident, however, that the price of the public good in question will not exceed their relative valuation.
Who does the valuation of public goods?	The valuation of public goods belonging to collective needs proper transcends the subjective reasoning; therefore it is done by the State. In the <i>partikulare</i> realm, valuation consists of the perceived utility and cost by the individual very much like in the valuation of private goods.
Expenditure side	Public expenditure is productive, but the nature of the public good is that of an "immaterial" good, or service; therefore, its productivity depends on the intensity of the need felt by the individual (Mercantilist dichotomy).
Economic efficiency	Economic efficiency is achieved in the <i>partikulare</i> territory. By virtue of comradeship, individuals understand the relative importance of common purposes and go along with majority decisions. The individual is forsaking a lower ranking private need for a higher ranking public need. The individual is his own tax assessor deciding how much he would pay relative to his own particular need and ability (<i>Umlagen</i>):
Fiscal doctrine	The framework for analysis is that of Political Economy for the <i>partikulare</i> goods since the valuation of the public service depends on the intensity of the need felt and ability to pay, the degree of "publicness" notwithstanding.
Coercion or particular problems	Coercion is not a relevant issue both in the <i>partikulare</i> and in the collective realms. In the former, the market mechanism is at play, and in the latter, the State acts in accordance with the German concept of <i>Staatswirtschaft</i> . No specific problems.

ITALIAN SCHOOL

Benefit View

Pantaleoni, De Viti De Marco, Mazzola, Einaudi

General frame-work	Taxes are a price for public goods as determined by taxpayer demand. The benefit approach is not used as a standard of justice but as a condition of economic equilibrium. The State offers these public goods and the tax shares are determined within a political, not market, process; however, they are traced to individual preferences by the agencies of the State (elected officials).
Who provides public goods?	The State. The goods that it provides are either for the citizens' consumption (parks, street lights, asylums, etc.), or for facilitating the production of private goods (roads, ports, water services, etc.) In either case, the State has a tax claim on the use of the public goods it offers.
Economic efficiency	The individual valuation is a condition for efficient allocation. Therefore, the political process must be directed to elicit and publicize the various individuals' preferences of public goods so that social wants can be determined and satisfied accordingly.
Coercion	Although the fiscal decision making is delegated to a ruling class, the producer-State represented by this class is made up of elected members. If the agents resort to coercion or other types of abuses of power, or deviate grossly from the electorate wishes, they will be replaced by another set. The organizational goal is a composite of individuals' public wants, and the State compares the cost and benefit of alternative fiscal decisions, considering the average voter's satisfaction as this represents the general mandate given to it by the populace.
Expenditure side	Expenditure is as important as the revenue side. This is a corollary of the concept of the producer-State which assumes that the <i>raison d'être</i> of the State is enhancing the satisfaction of the citizens by complementing their satisfaction from private goods with public goods.
Fiscal doctrine	The market mechanism is not appropriate for determining the most efficient allocation of public goods. The properties of public wants include indivisibility, non-excludability and non-rivalry; therefore, the analysis of the fiscal process must be left to the <u>science</u> of Public Finance.
Specific problems	To reconcile the "cooperative" State concept of Pantaleoni, De Viti and Mazzola with the "oppressive" State theories of coeval Italian Theorists such as Pareto, Mosca and Barone.

SCANDINAVIAN SCHOOL

The "Just" Taxation View

Wicksell, Lindahl, Johannsen

General frame- work	The market fails to elicit individuals' preferences of public wants, so a political solution is required. Although an efficient allocation is required, this must be achieved with justice. The citizen who doesn't want to surrender his private funds for public purposes must be protected (Wicksell). But this can be achieved either by adopting the "unanimity" rule in political decisions (Wicksell) or by creating a political process based on economic decision rules directed at achieving an equilibrium of the supply and demand of public goods (Lindahl).
Who provides public goods?	The State announces a new public service, but the desirability and the extent of the total outlay are determined by the electorate.
Valua- tion	The State registers the individuals' demand for the public service under consideration, and bills each citizen according to his declared "marginal" valuation (Lindahl Solution).
Economic efficiency	The citizens decide what the total outlay for the project will be, what should be the proportions of the total outlay among various public goods, and who should pay how much tax according to their registered preferences. This process leads to economic efficiency, which is also an equitable one.
Expendi- ture side	Fully considered both in terms of total public outlay and in terms of allocation of the public outlay into various projects.
Fiscal doctrine	Combines the Italian "benefit" concept with the Austrian concept of individual valuation, and further combines the voluntary exchange-benefit approach with the Anglo-Saxon view of ability-to-pay in that the latter approach is adopted in the determination of tax shares. The mechanism adopted resembles the market mechanism with its demand and supply features. The pseudo-tax scheme of Lindahl works like the price of a private good that brings efficiency and justice in terms of the status quo.
Specific problems	Assumes that true preferences are revealed. The voter will not reveal his preferences since this would be tantamount to inviting the State to tax him.
Coercion	No coercion, this is a system where an efficient taxation is coupled with a just taxation. Each taxpayer purchases the same social good at a different price reflecting his own valuation.

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