

WHY PUBLIC FINANCE?

GERHARD COLM *

An Apology

A METHODOLOGICAL article usually starts with an apology—for good reasons. In general, it is more important to contribute to the solution of a burning problem than to investigate whether there is a problem. Nevertheless the author feels intellectually disturbed by the fact that we are publishing books on public finance, conducting academic courses in public finance, devoting magazines to public finance¹—and the present trend in economic thinking seems to suggest that there is really no longer any *raison d'être* for such a separate field in the social sciences. Are we, in treating public finance as a separate field of study, perhaps carrying over a concept that had its justification in the past

* The author is an economist on the staff of the President's Council of Economic Advisers. The views expressed are those of the author and do not necessarily reflect the official views of the Council.

¹ This *Journal* is defined by the President of the National Tax Association, George W. Mitchell, as a "medium for competent comment on important issues in public finance and taxation." Three periodicals on public finance have been established or re-established in Europe since the war, namely, *Openbare Financien*, in the Netherlands; *Revue de Science et de Législation Financières*, in France; and *Finanzarchiv*, in Germany.

but that should be submerged in present circumstances? In this article I intend to defend public finance as a special field of study, but in my defense it may turn out that I propose some modifications in the traditional approach.

In order to make sure that we are not setting up a straw man, I shall outline briefly some of the arguments that seem to invite the conclusion that there is no longer any reason for dealing with problems of public finance as a separate field of study and training.

*The Case Against Public Finance*²

Nobody doubts the need to study tax problems or debt problems or the financial aspects of defense expenditures, public works, or any other government functions, but is there any justification for treating these problems as parts of *one* field? Tax problems are most directly related to income and price problems; government expenditures for flood control invite treatment in connection with natural resources; social security problems are

² This discussion is limited to problems of public finance on the national level. The conventional approach is much less questioned with respect to state and local finance.

closely related to employment and wage problems. Government debt management is related to general questions of credit and banking. Government receipts and expenditures are related to the flow of national income and employment. In all fields of general economics there is plenty of opportunity to deal with various types of taxation, government expenditures, and debt problems. There is a strong case for treating the effect of government action wherever it occurs in the economy.

But what is the reason for pulling these various government actions together into one field? The traditional answer to this question is, of course, that all these fields of public finance are related to the budget; and that the budget, which represents a "national program. . . our work plan,"³ is a unifying concept and a unifying institution in the area of public finance. That is, I believe, a valid answer, but before accepting it we must consider that this answer too has been challenged by rather forceful arguments.

The traditional reason for dealing with the budget as a unit, embracing expenditures of the government as well as revenues, was the belief that taxes have the prime purpose of providing the money needed to pay for expenditures and that in deciding on a feasible program of expenditures the availability of tax revenue should be a major consideration.

For the sovereign government with access to central bank credit, however, tax yields do not limit the amount of money the government can spend if it decides to do so. From this A. P.

³ President Roosevelt in the budget message of January 3, 1941, *U. S. Budget for the Fiscal Year 1942*, p. XIV.

Lerner, for example, draws the conclusion that taxation has the sole purpose of seeing to it that the people have left in their hands just the right amount of money that enables them to buy the possible output of goods for sale.⁴ As the amount of expenditures is one of the factors influencing the money people have in their hands, an increase in government expenditures *may* create a condition that requires an increase in taxes too in order to avoid inflation. But the need for an increase in taxes may also result from an increase in private business investments or net exports; or, if the increase in expenditures occurs at a time when private investments happen to decline then there is no reason for increasing taxes. Thus, according to this approach, there seems to be no more relationship between government expenditures and government taxes than there is among all other elements in the national and international economy. This reasoning may appear to lead to the logical conclusion that a budget comparing proposed expenditures and revenues no longer has any significance as a guide for policy.

The limited validity of this idea has been recognized by considering fiscal policy not merely within the frame of the government budget but within the frame of the nation's economic budget.

⁴ See, for example, *Economics of Control* (New York: Macmillan Co., 1944), chap. 24. Reference is made to Lerner because the position he takes in the chapter referred to is the most uncompromising and therefore particularly suitable for an argument about the principles. Lerner has indicated elsewhere that he recognizes that taxation has other specific purposes but can never be justified solely for the government's need for money. See also various statements by Beardsley Rumel, such as, ". . . our taxes should be as low as they possibly can be without putting the value of our money in danger of inflation." (*Proceedings of the National Tax Association*, 1944, p. 167.)

Here government expenditures as well as tax collections are viewed in their interrelationship with consumer income, expenditure, and savings; business profits and investments; and international transactions.⁵ Yet we intend to argue below that this consideration of public finance within the frame of the national economy as a whole should supplement rather than supersede a consideration of government expenditure, revenue, and debt problems as a unified field of interrelated economic and social phenomena.

Historical Origin of Public Finance

Doubts as to the justification of still treating public finance as a separate field of study may be accentuated if we look at the rather strange historical origin of this science.

Public finance has two main roots. One of them lies in the cameralism of the sixteenth to eighteenth centuries. Cameralism was developed by the advisers and panegyrists of kings and princes and by the teachers of prospective public servants of these kings and princes. It embraced all economic, social, and financial facts pertinent to the management of government affairs, and practically all economic, social, and financial facts were believed pertinent to the management of government affairs. In the thinking of these writers there was no distinction between the private and public sphere of economics.

The second root of public finance lies in the writings of the classical school and their followers. They treat-

ed government activities largely as an outside, noneconomic factor modifying price and income relations in the economic system of private enterprise and exchange. The philosophers of the classical school did not deny the importance of state activities, but their scientific interests were aroused by the ideal of a self-regulatory exchange economy. While the cameralists believed in the divine origin and mission of the monarch, the classical writers were inspired by the belief in a divine power which controls the "ordre naturel" of the economic system just as it controls the movement of celestial bodies and the growth of vegetable and animal life.

In analyzing this self-regulatory system, the effect of taxes on income distribution and prices was treated as a disturbing factor. Thus the classical school contributed directly to the analysis of shifting and incidence of taxation. Equally important, however, was its negative contribution: the fact that classical doctrine failed to give adequate attention to government transactions forced the development of a special science of public finance.

Public finance was thus developed as a special field by writers who grew up in the conviction that the analysis of the self-regulatory economic process was the main topic of general economics but who also recognized that the economic and financial affairs of the government required a special and systematic treatment in the literature and in academic teaching. Public finance was the product of a strange marriage between cameralistic tradition and classical economics.

⁵ For a survey of the use made of this approach in various countries, see Gerhard Colm, "The Government Budget and the Nation's Economic Budget," *Openbare Financien* (The Netherlands), Vol. I, 1948.

These origins are still reflected in many textbooks and curricula in public finance. The emphasis is on factual, institutional information (carried over from the cameralistic tradition) with a somewhat unrelated analytical treatment of shifting and incidence of taxation (taken over from the classical tradition). No genuine theory of the role of government within the economic process is presented because it is tacitly assumed that the only possible theory in economics is that of the self-regulatory process, which theory is treated in general economics.

It is perhaps significant that recent progress in the economics of public finance has been made largely by writers in the field of general economics rather than by specialists in public finance. The influence of Knut Wicksell, Arthur Pigou, Lord Keynes, Alvin Hansen, and Henry Simons on public finance is outstanding but they are by no means the only examples.

Today the treatment of general economic problems is no longer exclusively concentrated on the working of the self-regulatory process but gives more attention to its limitations and to the government's positive role in economics. To that extent, it appears that at least the negative reason for the development of public finance as a special science no longer exists. On the other hand, the economists treating government influences on the economy have largely neglected the essential institutional and procedural aspects of government action. That is why their analyses and recommendations are often characterized as utopian and unrealistic by the specialists in public finance. There is a wide gap between the treatment of economics of public finance and the

legislative, administrative, and sociological aspects of public finance in our books as well as in actual life. Thus there still seems to be a need for study and training in public finance that gives equal emphasis to its theoretical and its institutional aspects. What, then, is this particular institutional aspect of public finance?

Organizing Principles in the Private and Public Economy

Classical thinking tended to explain all economics in terms of one set of principles such as is implied in the labor theory of value or of marginal utility. The area of public finance presented an annoying problem to the pure theorist. He regarded public finance either as a disturbing external factor of basically noneconomic origin, or he tried to explain that phenomenon away by forcing it into a general mold of value theory.⁶

Contrary to such a "monistic" explanation of the economy, I believe a more valid theory will recognize that there are several organizing principles in our economic reality. There should be distinguished the organizing principle of the family or household economy,⁷ the organizing self-regulatory

⁶ As one example among many, I quote the following statement by Graziani: "We know that the tax tends to take away from each and all that quantity of wealth which they would have voluntarily yielded to the state for the satisfaction of their purely collective wants." See Gerhard Colm, "Theory of Public Expenditures," *Annals of the American Academy of Political and Social Science*, January, 1936, p. 1; and Richard Musgrave, "The Voluntary Exchange Theory of Public Economy," *Quarterly Journal of Economics*, LIV (February, 1939), p. 213.

⁷ The principles of the household economy which are predominant in peasant economies and have still some significance as an element even in the industrial society will not be elaborated in this article.

mechanism of supply and demand relations (in short, the market principle), and, third, the principle of the public economy (in short, the budget principle). Both the market mechanism and the budget principle are forms of organization that determine the development and use of resources (labor, material, land, technological and managerial knowledge) and the distribution of the product.

The market mechanism accomplishes the result by the interplay of millions of individuals as producers and consumers. Production is determined by profit expectations which in turn depend on demand. Demand is determined by the income derived in the process of production. The market principle is an organizing principle of such usefulness in a complex society that if we had not inherited it, its inventor today would be honored as one of the great benefactors of mankind.

Useful as it is, however, the market principle has its limitations and defects if viewed in the light of the requirements of the general welfare. It is not well applicable in some important areas of activity (e.g., road construction, multi-purpose projects of resource development); in some areas sole reliance on the market principle would be undesirable (e.g., education); in other areas its operation, under modern technological and social conditions, has undesirable consequences requiring corrective action (e.g., business fluctuations, monopolistic tendencies, property and income distribution, economic insecurity).

Therefore the market principle requires supplementary and corrective action by governments. Such actions

are largely organized according to the budget principle. [The essence of the budget principle is that the services in this sphere are not determined by profit expectation and by the willingness of individuals to spend their money for the purchase of such services, but by decisions reached through political and administrative procedures and based on common social objectives.] The benefits from these services are not necessarily allocated to those who pay the taxes to finance them, that is, the revenues may or may not be collected from those who are the beneficiaries. The distribution of the tax burden as well as the decision as to what services should be performed and who will benefit from them is a political decision.⁸

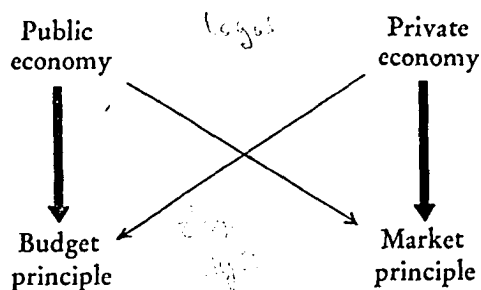
An appraisal of the performance and results of market operations, and of the character and need of supplementary and corrective government programs, is possible only if there are at least general notions of the broad economic and social objectives of the society. In other words, it is necessary for each generation to work out a concrete concept of the requirements of the general welfare. This relationship to economic and social objectives does not mean that the whole area of public finance is "controversial." As a matter of fact, most of these objectives are taken for granted at any period of time; only a relatively small, though important, fringe is controversial.

The interplay between the economic processes determined by the market principle and those determined by the budget principle is one of the main

⁸The meaning of the term "political" in this context is the same as in "political science" and is only indirectly related to "politics." See also footnote 13, below.

subjects that requires study. [Any attempt to analyze government transactions as if they were determined in the same way as private transactions omits the essence of the public operations and makes it impossible to analyze the interaction of the two principles.] Any useful treatment of the problems of public finance must be based on the recognition that the determination of public finance transactions is distinct from the determination of transactions of households and private business. The distinction follows from the political objectives and methods by which the government transactions are determined and executed.

At this point it may be useful to distinguish between a legal principle and an economic principle in defining these spheres in our economy, as is illustrated by the following diagram:



The difference between the public and private economy is primarily a legal distinction. The distinction between the budget principle and the market principle is a distinction between the principles of economic organization. It is true that in the public economy the budget principle is predominant; in the private economy the market principle predominates. But it is also true that we have in the public economy government - owned

and operated enterprises that are guided by the market in a manner quite similar to the management of private enterprises. Then we have private educational institutions or philanthropic agencies, churches, and other private associations which follow more the budget than the market principle in their activities.

Nevertheless it can be said that the public economy, which is the subject matter of public finance, is dominated by the budget principle. Even in the case of government-owned and operated enterprises there is some public responsibility and some element of control that distinguish them from private enterprises. The political nature of government decisions does not, however, place them beyond economics. Government expenditures result in competing claims for national resources. Tax policies aid in shifting claims from private to public use. The distribution of benefits and the method of taxation affect the distribution of real income. The interplay between expenditures, revenue, and borrowing, moreover, affects the whole level of economic activity. In other words, government actions are not outside the economic field but are part of it. They affect the general level of resource use, the allocation of resources to various competing usages, and the distribution of the product. We do not have a public economy superimposed on a private economy, but we have several organizing principles which in their interplay form our economic system.

Public finance then has to do with the operations of government as they are organized under the budget principle. In this respect it is a field comparable to business management. But,

as the general economist deals with the role of business in the economy as a whole, he will also deal with the role of government. It is the proper concern of general economics, or, may we say, of the science of political economy, to deal with the way in which government operations supplement, correct, or distort activities under the market system, and particularly with the way in which the two principles may be combined and integrated to accomplish the economic objectives of the nation as a whole.

Treatment of Expenditures and Program Formulation in Public Finance

Conventional textbooks of public finance have treated expenditures mainly on a historical basis. Expanding government activities were treated as data demonstrating the growing size of the task of government financing which was regarded as the real subject matter of public finance. Some more modern textbooks show the influence of Adolph Wagner's social theory of public finance or Pigou's welfare economics. They make at least some reference to the reasons why government services, under certain circumstances, increase the "social net product" as distinguished from the "private net product," and why the public sector of the economy tends to increase in absolute and relative size. Also the debate concerning the effect of taxes on the distribution of incomes was broadened from mere analysis of the shifting and incidence of taxation to consideration of the effect of government services (e.g., education) and payments (e.g., social security and interest payments) on the distribution of money and real incomes. Under the

influence of the Keynesian school, its predecessors, and successors, the effect of government expenditures, as well as of taxation and borrowing, on the level of employment has been treated in recent textbooks of public finance. As a matter of fact, it was found that even the incidence of an additional tax or a tax reduction cannot be fully analyzed without consideration of related changes in expenditures.⁹ Thus there has been a growing recognition that expenditures and revenues deserve equal attention in public finance, and that the one cannot be fully treated without the other.

The treatment of expenditures has been limited, however, largely to the compilation of historical facts, discussions of social philosophy, and, most recently, to an analysis of economic effects. Very little systematic work has been done on the development of practical criteria and procedures for appraising the justification, urgency, and priority of government programs for which expenditures are contemplated.¹⁰ Modern economics has had a very wholesome effect on recent texts

⁹ For an attempted proof of this proposition, see my article "Public Revenue and Public Expenditure in National Income," in *Studies in Income and Wealth* (National Bureau of Economic Research), Vol. I, particularly pp. 185-191.

¹⁰ A famous French engineer and economist wrote in a study on "The Measurement of the Utility of Public Works": "The legislator has prescribed formal procedures by which certain works can be declared of public utility; the science of political economy has not yet precisely defined the conditions that such works must fulfill in order to be really useful; at least the ideas that have been uttered on the subject appear vague, incomplete and often inexact." This was written in 1844. It would still be an understatement today—more than 100 years later. (Cited in "Jules Dupuit et Son Oeuvre Économique," *École Nationale Des Ponts et Chaussées* [Paris, 1945], p. 18.)

in public finance¹¹—but in embracing the *economics* of public finance, we run into the danger of neglecting the specific problems related to policy formation, management, and operation that follow from the public character of public finance.¹²

The determination of government programs is a political procedure and, as such, is carried on in a milieu, usually called "politics," which includes vote gathering, pressure by lobbies, log-rolling, competition among political rivals, etc. The political nature of these decisions has induced many scientists to conclude that the development of any rational standards and procedures would be a hopeless undertaking.

It would be quite wrong to assume, however, that, from the standpoint of the nation's economic development, the decisions of private enterprise are wholly rational, while those of government represent a sordid compromise among self-seeking politicians. There is perhaps a presumption, but no certainty, that the investment decisions of entrepreneurs result in an expansion of the nation's productive plants which according to tempo, location, and characteristics approximates the best interests of balanced economic expansion.

Through the development of budgeting and other planning procedures, we have already gone far to ensure that these "political" decisions concerning

¹¹ See the excellent book by Edward D. Allen and O. H. Brownlee, *Economics of Public Finance* (New York: Prentice-Hall, 1947).

¹² A modern text that moves in the direction of reconciling the economic and political character of public finance is Ursula K. Hicks, *Public Finance* (Cambridge Economic Handbooks. London and Cambridge, 1947). It is perhaps not entirely by chance that this book was written by an expert in public finance who is married to an outstanding economic theorist.

government programs are more fully based on economic considerations. Nevertheless, continuing analysis of past errors and future objectives must contribute to further improvement of standards and procedures for the most rational determination of public programs. It must be recognized, however, that the degree to which objective criteria can be used differs greatly according to the type of program.

Programs that by their very nature are interrelated with other economic developments can be tested as to their role in a growing economy. An irrigation program, for instance, can be tested with respect to its place in a comprehensive land and water utilization program which in turn must be related to long-range national and regional objectives for agricultural output and power production, industrial developments, and other benchmarks of economic development.

The question whether an investment will "pay" for itself is of only secondary importance in the public domain. Nevertheless, there are many functions for which the benefits can be expressed in monetary terms and in which methods for cost calculations and cost comparisons can be of use. This is especially true for expenditures related to the development of natural resources, transportation, power, etc.

Many government programs are of a multi-purpose character which renders their appraisal more difficult but not impossible.

Policy is concerned not only with the formulation of meritorious programs, but also with the tempo and timing of their execution. Assume a large program, say a \$5- or \$10-billion program for the development of river

basins, has been formulated and approved on its own intrinsic merits; then the tempo of execution must be decided. Will the program be planned to be completed in five, ten, or twenty years? This is the point at which program planning and budget planning converge. The decision requires at least a tentative notion of a sustainable size of the budget total and of reasonable allocations to various competing programs. Budget planning requires a movement from bottom to top, as well as from top to bottom. It starts from tentatively formulated detailed programs, sums them up, and then looks at the result as a whole. It also moves down from the formulation of a reasonable total and sets limits to detailed programs in a way that fits in with the budget target. This leads into the question of fiscal policy formulation that will be dealt with in the next section.

Expenditures which serve mainly social or political¹³ purposes (in a narrower definition) are less subject to the application of rational yardsticks. The main effort with respect to these programs is to demonstrate their economic and social costs in terms of alternative use that could be made of the same resources. It must be asked whether

¹³ It is annoying that the term "political" has different though related meanings. All government programs are political because they are formulated and adopted by political procedures. Political purposes, as distinct from social and economic purposes, are those which are directly related to the preservation or extension of the power of an organized nation or group of nations, such as those related to foreign policy, defense, policing, and administration of justice. This category may also include measures such as tax administration and general administrative overhead which are a means without which none of the other purposes of organized society could be fulfilled.

these programs exceed the magnitude that is compatible with existing policies and with existing economic organization; the analysis of economic and social costs includes an appraisal of the measures of government controls that may be needed if very large programs are considered.¹⁴

Besides the development of standards for appraising expenditure programs, there is the need for devising procedures of policy formulation and policy execution. These must be political procedures, that is, they must take account of legitimate interests of the people directly and indirectly concerned, and they must establish clear political responsibility for those who participate in the decision. At the same time, procedures must be devised which assure that objective standards are brought to bear to the greatest possible extent.¹⁵

¹⁴ Recent analyses of the economic impact of foreign aid and defense programs may serve as illustrations (e.g., see *The Impact of Foreign Aid upon the Domestic Economy*, October, 1947, Council of Economic Advisers, Washington, D. C.). Such analyses are not intended to suggest conclusions whether and to what extent these programs are desirable or necessary. They are intended, however, to give the legislators and the public an objective appraisal of economic and social costs, which are an important factor in the formulation of these programs. By such objective analysis the area of political controversy can be limited.

¹⁵ For the role that budget processes may play in the development of a more rational government program formulation, see Harold D. Smith's book, *The Management of Your Government* (New York: McGraw-Hill Book Co., 1945).

The program review and program recommendations required under the Employment Act may also make for progress in the same direction. Particularly encouraging in this respect is the establishment of the Joint Committee on the Economic Report. This committee, that has to deal with the broad national aspects of economically significant programs, may, by its emphasis on national needs, present a wholesome counterweight to the narrower and sometime provincial or sectional aspects that may prevail in special committees.

Not only are procedures to guide the formation of policy required, but also methods for checking on its execution. To serve the interests of the administration, the legislature, and the people progress reports, auditing reports, and other methods of program control and supervision are essential.

In the private market economy, profit expectation of business and buyers' demand provide guidance in the allocation of resources for productive undertakings. Actual profit accounts are regarded as proof of success or failure in business planning and business operations. A considerable portion of the nation's business, however, depends on public action that is determined by political processes and not by profit expectation. When the public sector was small and the main dynamic forces were carried forward by private business, it was not too costly even if "politics" was permitted to shape the actions in the public sector to a large extent. Under present circumstances, such a course would be fatal.

Though there does not exist a "scientific" determination of political decisions, scientific appraisals can and must play a decisive role in policy formulation. For this task, appropriate yardsticks and procedures must still be developed or improved. The same applies, of course, to problems of taxation and debt management.

In spite of this emphasis on economic considerations, other aspects should not be neglected. Particularly in programs that imply the use of compulsion, such as tax legislation or measures of regulation and control, public acceptability and fairness are standards at least equal to criteria of a purely economic nature.

Rules of Public Finance

The unity in government operations, discussed thus far, is of an institutional and procedural character. As government expenditures, revenues, and debt management are determined by political decisions, similar problems as to criteria of rational action and appropriate administrative and legislative procedures must be solved with respect to all of them. What about substantive unity, the interrelationship between government expenditure, revenue, and debt policy?

The era of a laissez-faire ideology developed a rather simple set of rules with respect to the interrelationship of expenditure and revenue policies of the government: (1) the lowest level is the best level of expenditures (the "necessary evil" dogma); (2) revenues should *always* equal expenditures (the "balanced budget" dogma); (3) taxes should be levied in a manner that affects existing economic relations as little as possible (the "economic neutrality" dogma).

These rules have been questioned by unorthodox writers since they were first developed, and they have been more honored in the breach than in the observance. Nevertheless, they were widely regarded as yardsticks for appraising public finance policies. Today the validity of these rules is questioned by most economists, and many doubt that any rules can be developed in place of those that have been discarded.

Are there any such rules other than those that say expenditure policies as well as revenue policies and debt management should be conducted in accord with economic requirements? In that case it would be true that expenditure and revenue policies are each

related to economic facts, but there would be no particular relationship among the elements conventionally included in public finance.

Nevertheless, serious attempts have been made in recent years to develop new guideposts for a public finance policy that could take the place of the discarded dogmas. These new guideposts, however, are not proposed as rigid rules but rather as working hypotheses.¹⁶

There can be only working hypotheses as a basis of public finance rather than iron-clad dogmas because public finance has to do with means or tools for attaining objectives that lie outside its own field. One may be dogmatic about an objective but the suitability of a means is judged on the ground of expediency. Public finance serves the government in fulfilling its various obligations of international and domestic policy, including particularly the promotion of balanced economic expansion. While one might say that the various aspects of business administration serve the profitability of the enterprise,¹⁷ there is no comparable objective such as "prosperous" public

¹⁶ An interesting and encouraging recent contribution in this respect is the publication of the Committee for Economic Development entitled *Taxes and the Budget: A Program for Prosperity in a Free Economy* (New York, November, 1947).

¹⁷ Speaking of profitability as a unifying standard of the various aspects of business management is, of course, an over-simplification. Business has learned that its profitability largely depends on general economic conditions, and that general economic conditions cannot be regarded only as a datum beyond its control. In an economy of partly "administered price" and "administered investments," business management has to take into account the effects of its action on general economic conditions as well as its direct effect on profits. To that extent, business management too transcends its conventional limits and becomes interrelated with economic policy.

finance. Thus there can be no particularly endogenous rules of public finance. The question is rather whether, assuming given objectives, it is possible to develop certain working hypotheses or rules of thumb for public finance that will be most conducive to attaining the objective.

Policy objectives and economic assumptions give a working hypothesis for appraising and formulating public finance programs. The study of the Committee for Economic Development, referred to above, proposes that long-range budget planning should aim at a moderate budget cash surplus under conditions of full employment. This implies that under conditions of sustained full employment long-run business investments will tend to exceed the sum total of business saving plus consumer net saving.

One may quarrel with this particular working hypothesis. Some people may believe, for instance, that after the end of the restocking and reconstruction boom business intentions to invest, even if encouraged by appropriate tax revisions and other policies, may somewhat lag behind the amounts business and individuals may wish to save under conditions of a sustained high level of production and income. Under that assumption, one may reach the conclusion that the government as well as business should finance some of its regular expansion by security issues rather than out of current revenues. For some countries, a continued budget surplus larger than that proposed in the CED study may be required in order to limit consumption and to facilitate the financing of continued large private capital outlays.

The CED working hypothesis concerning the desirable moderate budget surplus does not mean that there must be a budget surplus each year, or that there must necessarily be a budget surplus even over the period of a business cycle. In the short run, government expenditures and revenue are among the tools of the government for counteracting the business cycle. The CED program rests mainly on the automatic anti-cyclical effect of government expenditures and revenue. It relies on budget fluctuations which occur even without changes in government programs or in tax laws. As soon as a downswing develops, certain government expenditures, such as disbursements for unemployment insurance or farm price support payments, increase automatically, while revenue, particularly from progressive income taxes, promptly begins to drop. Thus the budget surplus will be replaced first by a balanced budget and then by a deficit in case of growing unemployment. This deficit then will act as one of the reflationary forces helping to restore a high level of economic activity.

In case of a severe depression or any other emergency, the CED program would, however, not rely exclusively on this "built-in flexibility." In case of a severe depression, emergency action, particularly a reduction in taxes, would be needed. A temporary increase in taxes would be called for in case of an extraordinary inflationary boom. The CED recognizes that fiscal measures are only one among several necessary devices designed to aid in ironing out business fluctuations.

This CED proposal is a very important step toward replacing the traditional dogmas of public finance by

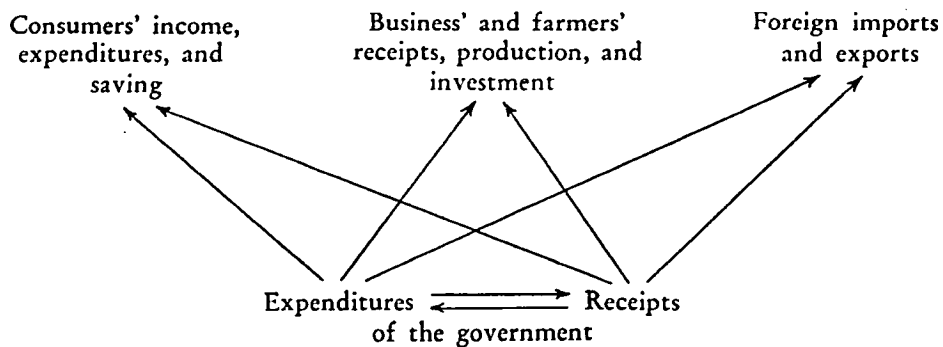
an approach that offers a rule of thumb for long-range budget planning as well as short-run budget adjustments. In detail it is not likely to be the last word. We cannot be sure, for instance, that the variation in expenditures and receipts that results from the built-in flexibility of the budget will suffice to counteract even "normal" fluctuations in private business investments and consumer expenditures. It may be doubted that keeping expenditure programs the same irrespective of the cycle is correct policy from the aspect of a rational allocation of resources. Even besides the purposes of counter-cyclical policy, it is obvious that the relative usefulness of a government program increases when it can be undertaken without bidding resources away from private use. It is a prescription not only of a counter-cyclical policy but also of merely good management that deferrable government programs should be postponed when labor and material are scarce and relatively expensive, and that government programs should be speeded up when labor and materials are idle and less expensive.¹⁸

Whatever finally emerges from the present groping for a reformulation of the rules of public finance, it is clear that programs of expenditure and revenue must each be planned with respect to their economic effect. But it is equally necessary to take the quantitative and qualitative interrelationship between expenditure and revenue programs into account. The schematic figure on page 205 may illustrate the point.

¹⁸ This argument particularly applies to Milton Friedman's reasoning in his article entitled "A Monetary and Fiscal Framework for Economic Stability," *American Economic Review*, XXXVIII (June, 1948), p. 248.

While it is true that government expenditures and revenues must be planned in relation to the nation's economic budget, it also is true that the government budget is a significant component in the nation's economic

largely economic in nature, and all public finance transactions take place in the medium of economics and have economic repercussions. Public finance essentially is the science that tries to equate a political and economic balance.



budget. And it is with this component that public finance is concerned.

Public Finance a Borderline Science

Public finance deals with the manner in which government objectives are pursued through the means of government expenditures, revenues, debt management, and related transactions. Specifically, it deals with the way in which decisions are reached in the public sector of the economy and how they are executed and controlled. It cuts across the borders of a number of traditional sciences.

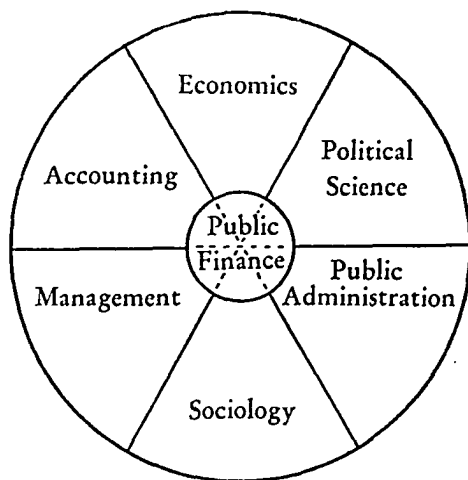
As we have seen in the preceding sections, decisions in public finance are reached through political procedures and determined by the interplay of the political and social forces in the society. Thus its analyses fall into the field of political science and sociology. On the other hand, the objectives are

The fact that public finance necessarily encroaches on so many fields may lead to the danger of dilettantism. This danger seems to be invited by the fact that in public finance we are compelled to cover aspects of political science, public administration, sociology, management and planning, accounting, and economics between the covers of one book or within one academic course.

Nevertheless the fact that an analysis of psychosomatic problems requires a knowledge of psychology as well as of physiology is no reason against an analysis of these borderline problems. The character of borderline problems makes them perhaps more difficult for our conventional approaches, but makes them no less urgent. Furthermore, a field that happens to be located on the borderline of several sciences need not cover more territory of knowledge than one that falls entirely within one of the conventional subdivisions of knowl-

edge. The accompanying figure illustrates this point in a schematic fashion.¹⁹

Our scientific approach to problems must be guided by the nature of the problem. It is the nature of public finance that it is *political* economics;



it requires a consideration of political procedures and of the forces that determine political processes, administrative procedures, and accounting procedures peculiar to this area as well as economic problems.

It follows from the borderline character of public finance that an adequate treatment of economics has to deal too with the effects of government expenditures, taxes, and debts. It also follows that the science of management cannot exclude problems of government and financial management, but none of these specialized treatments in economics,

management, and so on can do justice to the problems of public finance in their entirety and interrelationship.

Economists have, as mentioned before, made considerable contributions to the development of public finance, but it is also true that economists dealing with the public sector of the economy are not likely to give full weight to the procedural problems and therefore may often be unrealistic in their conclusions.

The conclusion that I would like to suggest is that public finance is not simply a branch of the broader field of economics as conventionally defined. It definitely transcends economics in its narrower definition. It is a branch of economics only if economics is once again defined as the science of the *political economy*. This involves more than a reshuffling of labels—it involves a modified approach. We need a consideration of the problems of public finance in the context of general economics, political science, public administration, etc., and, in addition, a pulling together of these various pieces into a whole and systematic treatment of the government's expenditure, revenue, and debt transactions, their procedure and management, their integration into the whole of the political, social, and economic life of a nation. This is a necessary major field of training for government service, but also highly useful as at least a secondary field of training for general economists and business managers who need some knowledge of the nature and processes of public finance.

¹⁹ The fact that public finance appears in the center of the figure is due less to egocentric thinking in public finance than to the exigencies of a two-dimensional presentation.