

**The Continental Tradition in the Theory of Public Finance:  
An Exercise in Mapping and Recovery**

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**Abstract:**

In this essay, we offer a survey of some general features of continental public finance analysis as distinguished from Anglo-Saxon public economic theory. Starting from the cameralist origins of public finance, we move on to discussing the science of state-approach, the contributions by Knut Wicksell and a catallactical public finance, Italian fiscal scholarship, and fiscal sociology. The purpose of this essay is to introduce the reader to a tradition in public finance analysis that has largely disappeared from contemporary text book treatments.

Keywords: Cameralism, Catallaxy, Fiscal Sociology, Public Choice, Public Entrepreneurship, Science of State

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## **The Continental Tradition in the Theory of Public Finance: An Exercise in Mapping and Recovery**

The commonplace proposition that winners write history surely holds as well for intellectual history. The historical development of a discipline or field is reflected through the predominant theoretical presumptions at the time the history is written. The central division between classical and neoclassical periods in the history of economics supports the currently predominant theoretical presumption that the primary object of economic theorizing is resource allocation. An alternative theoretical orientation that locates the theoretical core of economics as the governance of human interaction would generate a different ordering of the history of economic analysis. What holds for economic theory in general holds as well for the theory of public finance.

The predominant theoretical presumption in the theory of public finance is that government is an acting and choosing creature that stands outside of and apart from the ordinary members of society. This Anglo-Saxon tradition of fiscal theorizing operates with a model of an autonomous state. Within this tradition, public finance is the study of government intervention into the economy to pursue objectives desired by that autonomous creature. This model of the autonomous state is not the only articulation that finds expression in the theory of public finance. An alternative to the autonomously intervening state is a model of a participative state, where government is treated as a network of relationships and a process of interactions—as a form of catallaxy. Within the contours of this

model, which we denote the continental tradition, public finance is the study of how people participate through government in the ordering of their affairs and activities. One significant feature of this continental tradition is that the topical organization of fiscal theorizing changes as changes occur in the patterns of institutional arrangements that govern human relationships within society; the underlying conceptual principles don't change, but the particular instantiation of those principles varies across institutional contexts. By contrast, fiscal theorizing within the Anglo-Saxon tradition is independent of those institutional arrangements.

In this paper, we seek first to sketch the contours of our claim that there is a distinct continental tradition in public finance. The bedding ground of this tradition can be reasonably well located in the penumbra that would surround a traveler who took a journey to visit four capital cities: Rome-Vienna-Berlin-Stockholm. We can associate these stops with an explicitly political approach to public finance, with a Schumpeterian or fiscal sociological emphasis, with an emphasis on the science of state, and with an approach to introduce the principle of consensus characteristic of market exchange into public sector decision making. While our primary interest is in sketching some central features of this continental tradition, particularly where it differs from the Anglo-Saxon tradition, we also have a secondary interest in giving some account for the eclipse of this continental tradition since the mid-1930s. The continental analytical orientation has a rich intellectual heritage that has been largely buried by two events. One is the neoclassical ascendancy in economic theory, with its elevation of price and

allocation theory over the organizational and institutional architecture of human governance. The other is the cataclysmic pattern of events that Adolph Hitler set in motion. While the obliteration of a continental tradition of public finance is magnitudes of order smaller than the other obliterations that occurred then, it is nonetheless an element of that larger obliteration. Many of the prominent contributors to continental public finance were either killed or quit their scholarly activities. Numerous others migrated, mostly either to the UK or the US. In their adopted homelands they adopted English as their language of scientific discourse and, at the same time, shifted the orientation of their theoretical thinking toward the Anglo-Saxon tradition. In consequence, the continental tradition was restated, reinterpreted, and lost. Recovery of that tradition is, however, a worthwhile activity, as we seek to explain here, in what is a preliminary report on what we, both severally and jointly, envision as a larger scholarly project. This project is necessary, since much of the literature which we are surveying here is not yet available in English, and therefore inaccessible to the majority of public finance scholars now working in the field. Until about 1937, German was the primary scholarly language in public finance, Goldscheid, Justi, Schumpeter, Wagner, Wicksell, and even Wolff published their main public finance-related contributions in German. As a consequence of the political turmoil set off by Hitler's policies, massive scholarly migration ensued, and with it a language shift. First emigrants obviously adopted the language of their new host countries, notably English (in Britain and the U.S.), and to a lesser extent Spanish. This led others to switch to English, too – scholars notably in the

Netherlands and in Scandinavia ceded to publish in German. This generation, of course, did not lose its ability to read the German classics. They passed on their knowledge to the next generation of students, who therefore had mainly second-hand knowledge. By now, the generation of emigrant scholars has almost completely disappeared, and with them has the ability to access the classical texts in German. For this reason, the arduous task of making these contributions available to the international community of scholars is now unavoidably upon us.<sup>1</sup>

### **The Cameralist Origins of Public Finance**

As a field of systematic academic inquiry, public finance arose before economics or political economy. For instance, more than 90 professors in public finance had already been appointed, more than 30 chairs established in Europe, before the first chair was established in political economy (Backhaus 2002, p. 615). The first scholars of public finance were the cameralists, who emerged in central Europe in the 16<sup>th</sup> century. For a long time after its cameralist founding, public finance was conceived as a multi-disciplinary field of study, and most certainly not simply a subset of economic theory. Actually, the obverse would rather be true. Public finance in the cameralist tradition included the starting points of what later became economic theory, but it included much more. The object that public finance scholarship examined, the public household, was examined in a manner that sought to integrate the economic, political, legal, and administrative elements of public finance.

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<sup>1</sup> This is the purpose of the annual Heilbronn Symposia in Economics and the Social Sciences, which have been regularly conducted since 1988. The 17<sup>th</sup> upcoming symposium is devoted to the work of Veit Ludwig von Seckendorff. See also Wolfgang Drechsler (1997).

Joseph Schumpeter (1954, pp. 143-208) described the cameralists well when he referred to them as “Consultant Administrators.” They were both consultants and administrators. They were consultants to the various kings, princes, and other royal personages who ruled throughout those lands. Justi is a good case in point. When he was appointed in Vienna, he was appointed in two capacities. On the one hand, he was to give lectures (in political rhetoric) at the Theresianum, a school the queen and empress had founded for the purpose of training future civil servants. Secondly, he was appointed a super-intendant of mines. Hence, he prepared two inaugural lectures to be delivered in front of the empress, one outlining what would become his entire rather complex system of cameralism and public administration, based largely on Wolff’s work but not acknowledging it, the other on the subject of the organization of mines.<sup>2</sup> Indeed, the term cameralist derives from camera or kammer, and refers to the room or chamber where the councillors to the king or prince gathered to do their work. The cameralists were not, however, anything like contemporary academic consultants. They were real-world administrators as well. They were engaged in such activities as managing mines or glass works. Many of the cameralists also held academic posts. The first chairs of cameral science were established in 1727, in Halle and Frankfurt on the Oder, and by the end of the 18<sup>th</sup> century 23 such chairs had been established (Backhaus 1993).

Cameralism has often been described as a Germanic version of mercantalism, which is quite inaccurate and is perhaps another illustration of the

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<sup>2</sup> Since the first lecture in less than 20 pages contains the entire system already in a nutshell, we plan to re-publish it shortly: Jürgen Backhaus and Eric Reinert (eds.) Johann Heinrich Gottlob von Justi. Hildesheim: Olms.

proposition that winners write history. While cameralism has points of contact with mercantilism, it is something else entirely.<sup>3</sup> Cameralism and mercantilism both originated within authoritarian political regimes, and they represented efforts to give good counsel to the heads of those regimes. In other respects, however, the differences dominate the similarities. Mercantilism arose among big players on the international stage. The English, the French, the Spanish, and the Dutch, the primary nations with which mercantilism is associated, were not price takers on the international scene. The ability of these powers to reach throughout the world to influence events and terms of trade provided the background for mercantilist thought and practice. The stress upon taxation and the prevalence of rent-seeking and other forms of venality were products of the big-player standing of the mercantile empires.

There were no such powers within the cameralist lands. Cameralism arose under conditions of high political fragmentation. The cameralist lands were necessarily insignificant price takers on the international scene. A cameralist land faced a totally different setting than the mercantile regimes faced. There was no concern within the cameralist lands about influencing terms of trade, about the use of colonies as instruments of policy, and about one's relative standing among the preponderant powers. The focal point of cameralist concern was on survival of the regime. Survival, in turn, required a military capacity and economic development, which in turn required the acquisition of improved

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<sup>3</sup> For valuable, general surveys of cameralism, see Dittrich (1974) and Small (1909). Shorter and more focussed, but also highly valuable is Tribe (1984) (1995, Ch. 2). On cameralist public finance, see Backhaus and Wagner (1987) and Wagner (forthcoming). For a bibliographic compilation of some 14,000 items, see Humpert (1937).



technologies, the improvement of human capital within the population, the creation of new enterprises, and the growth of population.

It is particularly characteristic of Wolff's approach that he insisted on a duty of the prince to create conditions under which the citizens would be able to discharge what he conceived as of their own duty to experiment with more efficient ways of producing and developing new technologies and innovation (Backhaus 1998).

This concern about development took place within regimes that were both absolutist and severely constrained. The prince was the ruler of his lands. He did not have to worry about surviving periodic elections, and he could hope to pass his principality along to his eldest son. His ability to do this, however, varied directly with the extent of economic progress within his land. A prince whose land was supporting a growing population of energetic and enterprising subjects would both be wealthier and face better survival prospects than a prince of a land where the population was stagnant or declining, and whose subjects were dull and lethargic. Furthermore, population was mobile in fact, even if it was mostly tied to the land at law through feudal restrictions. Distances between lands were typically short. A peasant who traveled to a new land was not likely to be returned. In fact, it was the common law at the time that after a year plus a day, a peasant who had left the land and stayed in a city, would be granted citizen's rights there and never be returned. The rulers of the cameralist lands faced a competitive labor market. Indeed, the cameralist lands represented a kind of

competitive industry among localized governments, much as Tiebout (1956) tried to characterize some 300 years later.

Cameralist public finance treated state lands and enterprises as principal sources of revenue; taxes were a distinctly secondary source. If one were to construct a model of the cameralist vision of the state, it would look like a model of a business firm. The state's lands were potential sources of revenue. Forests could be harvested, game could be caught, and mines could be built and worked. The prince would also sponsor an assortment of commercial enterprises, including such things as the operation of a glassworks or a brewery. Taxes occupied a secondary position as a source of revenue. Taxes were a last resort option for public finance, and not the first source of revenue. Indeed, Wolff introduced the distinction between taxes and contributions. Contributions could be voted as one-time measures in order to finance emergencies. The amount, date, and assignment of the contributory duties were all stipulated in the same measure that the estates had to vote on. Taxes, on the other hand, Wolff taught were never to be levied, as he emphasized the disincentive effects of taxation. This he did although in some states the excise tax was already a frequent fixture.

The cameralists' general predisposition against taxation as an instrument of public finance reflects an orientation that the state acts as a participant within the economic order. Individuals had their property and the state had its property. The state should be able to use its property to generate the revenues required to finance its activities. Or at least those enterprise revenues should support the major portion of state activity. Some of the cameralists argued that taxes should

be earmarked for the support of the military, while all activities concerned with internal development should be financed from the prince's net commercial revenues. In any case, a state contains many business enterprises within its boundaries, and with the state itself operating a subset of those enterprises. It was understood that the state would have significant expenses associated with its activities. These expenses, however, were not to become drains upon the private means of subjects. They were to be met from the lands and enterprises that constituted the state's property. In order to achieve a particular objective in a sustainable way, it was rather common to assign a revenue source such as a vineyard to a public hospital. The hospital would then be public not in the sense of being part of a monolithic state. Rather the state as such does not even exist as an organization. The state is a concept, a paradigm to think about the different public institution all fulfilling public functions. Wolff goes even one step further and, in formulating the principle of subsidiarity (now prominently embodied in the Maastricht Treaty) emphasizes the public functions of the extended household, where the primary task of producing both public and private goods lies. Only if a task goes beyond the capacity of a household or an association of households, has a larger entity to be found (Backhaus 1997, Backhaus 2001).

Revenues, of course, are only one side of the fiscal account. The cameralists also devoted much thought to the expenditure side. Much of that discussion had a kind of capital-theoretic quality to it, where programs of expenditure today would generate increased revenue tomorrow. A great deal of the cameralist emphasis was placed on what is now called human capital, though

it would not be appropriate to import too much of a conceptual framework into the cameralist works. A good deal of this emphasis stemmed from the concern with population. A growing population was desirable, to be sure, but that population in turn had to possess useful skills and talents, to be healthy, and to possess an industrious attitude.

The cameralist foundations of public finance theory that infused the continental tradition, and the distinction between this tradition and the Anglo-Saxon tradition, was noted clearly by Richard Goode (1970). There, Goode compared the treatment of public finance in two different social science encyclopedias, written a generation apart. One of these was the *International Encyclopedia of the Social Sciences*, which was published in 1968. The other was the *Encyclopedia of the Social Sciences*, which had been published in 1930. While Goode duly noted the theoretical advances that had occurred in economics between 1930 and 1968, he also lamented the narrowing of the subject matter of public finance. Goode concluded his lamentation on the state of public finance by asserting that “a sophisticated and unified treatment of the economic, political, legal, and administrative elements of public finance is needed. Unification would represent a return to a tradition as old as that of the cameralists, but for modern readers sophistication can be attained only by rethinking old problems and using new techniques. There is much to be done and work for a variety of talents” (p. 34). Our call for a recovery of the continental tradition resonates well with Goode’s appraisal. We can only join and support this proposal, since even entire subfields of public finance analysis, such as fiscal sociology have virtually

disappeared as a consequence of the advent of functional finance and public economic theory.

### **From Cameralism to Staatswissenschaften**

The absolutist regimes that were present at the beginning of the cameralist period began in the 19<sup>th</sup> century to morph into various forms of democracy and limited monarchy. Coincident with this political transformation was a metamorphosis of cameralism into Staatswissenschaften, which continued the multidisciplinary character that begun with cameralism. The scholars within the Staatswissenschaften tradition sought to reorient their fiscal scholarship to reflect the institutional changes that were taking place, while at the same time keeping the multidisciplinary focus on the architectonics of human governance.<sup>4</sup> Outside the Staatswissenschaften tradition, however, fiscal scholarship continued to treat the phenomena of public finance as arising from some autocrat's optimizing choices, which evoked Knut Wicksell's (1896 (1958, p. 82)) complaint that the theory of public finance "seems to have retained the assumptions of its infancy, in the seventeenth and eighteenth centuries, when absolute power ruled almost all Europe." Indeed, although the rulers might have deemed themselves absolute, the purpose of cameralist theorizing was to point out the extreme limitations which their powers had. The cameralist states were in intense competition among each other. They could not hope to tax heavily for fear of losing their subjects. They could not hope to raise high customs duties for

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<sup>4</sup> For a symposium on the contemporary relevance of Staatswissenschaften, see the September 2001 issue of the *European Journal of Law and Economics*.

fear of diverting trade. They could not hope to debase the currency since people would do their transactions in a more stable currency, and use the debased one only for purposes of paying their dues to the state itself. The rational policy then is to maximize the seignorage by maximizing the volume of currency in circulation, which in turn can only be done by keeping the gold or silver content stable and reliable.

The transformation of cameralism into Staatswissenschaften occurred in response to a transformation in the pattern of property relationships and associated patterns of human governance. The sphere of private property had been expanding while the property holdings of states had been contracting. Taxes were becoming more significant sources of revenue while state enterprises were declining in significance. Even in the late 19<sup>th</sup> century, however, enterprise revenue maintained several times the fiscal significance in the formerly cameralist lands than they held elsewhere in Europe. Adolf Wagner (1883), perhaps the best known figure in the Staatswissenschaften tradition, took account of these changes in political and property relationships, while at the same time carried forward the cameralist orientation of the state as a participant *within* society, as against being an intervening agent that acts *on* society. In particular, Wagner conceptualized the state as a type of enterprise located within the economy, though it was of a different sort from most commercial enterprises. In fact, and Wagner in his text book which went through numerous editions emphasizes the point frequently, social policy objectives can also be assigned to public enterprise, such as the railroad, the mines etc. in order to force the private

competition to adhere to the same standards of conduct, such as job safety (Backhaus 1997).

To modern readers, Adolf Wagner is best known for what is now described as Wagner's Law of the increasing relative size of government. The articles that have been published on Wagner's law number in the hundreds, and we would not be surprised to find that someone has been awarded tenure based on a few such publications alone.<sup>5</sup> These days, Wagner's law is uniformly presented as meaning that the income elasticity of demand for state services exceeds unity. A huge literature has emerged over roughly the past half century that brings increasingly sophisticated econometrical techniques to bear on probing the income elasticity of demand for state output, as a means of testing the applicability of Wagner's law.

The first thing that should be said about this is that no such formulation appears in Adolf Wagner. He presented no quantitative statements whatsoever pertaining to income elasticity of demand. What Wagner did was engage in a probing analysis of the changing patterns of property relationships that had occurred over the preceding few centuries, and explored what he thought were their implications for human governance. Over those centuries, state-held property had diminished in economic significance. At the same time, the sphere of alienable private property had expanded. This led to Wagner's effort to articulate a process of qualitative change in the types of activities undertaken by governments. Qualitative changes might, of course correspond to quantitative increases in some measure of relative economic size, but they need not.

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<sup>5</sup> A Google search on 10 March 2004 came up with 631 references.

The difference between Adolf Wagner's qualitative formulations and the subsequent reinterpretation into purely quantitative terms illustrates nicely the disjunction between the governance orientation of continental public finance and the allocationist orientation of Anglo-Saxon public finance. It also illustrates the loss through reinterpretation of the continental tradition in the post-Hitler period. The allocationist orientation proceeds in terms of public-private allocations, as illustrated by theories of public goods. An increasing extension of state activity can only mean a shift in the public-private mix within an allocationist orientation, for there is nothing else of analytical interest to examine. Adolf Wagner's reasoning, to the contrary, has just the opposite emphasis. The further and further extension of the tasks of the state (*Aufgaben* in German) may very well involve an increase in state spending (*Ausgaben* in German), but this will have to be accomplished in ways that are not counterproductive. This is why he emphasizes public entrepreneurship, which he sees as a likely force in technological innovation and a revenue source at the same time. Indeed, when he taught this, half of the revenues of the Kingdom of Prussia stemmed from its railroad.

It is different for the governance orientation of the continental tradition. Perhaps most significantly, the disjunction between public and private goods is transferred to the analytical background. The analytical foreground is populated instead by concerns of attaining good patterns of governance, and in a context where many people occupy the same area. We are social creatures, only we are not like ants, so require property to order our relationships peacefully and



commodiously. The setting for analysis is achieving good order for the public square, for it is on the public square that life is lived. Good order on the public square, moreover, has little to nothing to do with allocative controversies about private and public goods, simply because of the ubiquity of public goods, many of which are organized through market transactions. Indeed, the pure example of a private good would be a person alone in his room. Other than this, life is always lived in some kind of public setting, only there are myriad such settings and numerous different ways in which they are organized and governed. This is the challenge of what Wolfgang Drechsler calls “structured living-together” in his contribution to the aforementioned symposium on Staatswissenschaften. Such considerations as these would form part of the qualitative material of which Adolf Wagner wrote, but would be simply orthogonal to any considerations grounded in income elasticity of demand.

Joseph Schumpeter stands at the end of the Staatswissenschaften tradition. His position at the University of Bonn was as a professor of public finance, and his scholarly work on the tax state evoked the Austrian economist Rudolf Goldscheid to coin the term fiscal sociology.<sup>6</sup> Schumpeter stood firmly within the continental tradition of public finance, yet Richard Musgrave, at a conference of the International Schumpeter Society, claimed that Schumpeter’s contribution to public finance had been minimal.<sup>7</sup> Musgrave’s claim speaks to our claim about the reinterpretation of the continental tradition to meld it into the Anglo-Saxon tradition. Musgrave was, of course, raised in the continental

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<sup>6</sup> Schumpeter’s essay along with several of Goldscheid’s are collected in Rudolf Hickel (1976).

<sup>7</sup> This report from the Kyoto meeting appears in Shionoya and Perlman (1994).

tradition. After his emigration to the United States, his doctoral dissertation at Harvard presented some central features of that tradition to the Anglo-Saxon community (Musgrave 1938). Musgrave, along with Alan Peacock, also organized the translation and publication of a number of works within the continental tradition (Musgrave and Peacock 1958). Yet Musgrave's (1959) own capstone statement placed the theory of public finance squarely within the Anglo-Saxon allocationist tradition. Strangely, Musgrave who includes the Keynesian model into his public finance text, in doing so adopts a functional finance approach and thoroughly ignores the alternative approach suggested by the German "Keynesians" who emphasize stabilization and recovery through state entrepreneurship and infrastructure investments in order to enhance the productive base of the economy (Backhaus 1985). There would surely be little argument against the proposition that the two premier contributors to the theory of public finance during the second half of the 20<sup>th</sup> century were Musgrave and James Buchanan. It is perhaps paradoxical only on the surface that it is Buchanan (especially (1960) and (1967)) and not Richard Musgrave who more fully reflects the continental tradition of public finance.

Strangely, Musgrave even de-emphasizes Schumpeter's contribution to public finance. He went so far as to say that Schumpeter made contributions in this field only to income tax analysis where he over-emphasized the excess burdens. In fact, Schumpeter's contributions to public finance were all published in German. They can be largely classified as being in the area of fiscal sociology, starting with his work on war finance, his attempt to pass a budget as the first

Austrian minister of finance, his extensive discussions of the fiscal consequences of the peace treaties of Versailles and St. Germain and the astonishing seventh chapter of his *Theory of Economic Development*, in which he tries to outline a type of analysis which combines economic, political, and sociological theory<sup>8</sup>.

### **Knut Wicksell and Catallactical Public Finance**

Knut Wicksell's contribution to public finance, *Finanztheoretische Untersuchungen* (1896), contained three essays, the second of which made Wicksell a household word among public finance scholars after it was translated and published as "A New Principle of Just Taxation" in *the Classics in the Theory of Public Finance*, edited by Musgrave and Peacock. The first of Wicksell's three essays undertook an analysis of tax incidence while making use of Böhm-Bawerk's framework of a structure of production. Wicksell's third essay, which occupied nearly half of the book, was a long examination of Swedish fiscal history, where Wicksell tried to show that the New Principle he articulated in his second essay was congruent with various strands of Swedish historical tradition, as well as being capable of implementation in the Sweden of his time.

Wicksell's (1958) second essay, on a new principle of just taxation, has been the overwhelming source of Wicksell's reputation in public finance. This essay asked what kind of institutional framework for parliamentary governance might make it possible for the state to act as a productive participant within the economic life of a society. Hardly anyone would dispute the statement that a government should expand its services so long as the value that is created

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<sup>8</sup> The seventh chapter has now been translated into English (Backhaus 2003).

exceeds the cost that people must bear through the value they must sacrifice to pay for those services. But how might this outcome be achieved? Wicksell sought to describe an institutional framework that would promote such an outcome, and in so doing showed how the Pareto principle could be made applicable to the state, which is something that Pareto did not think possible.<sup>9</sup>

The Wicksellian approach construes the state as a participant within the economic process. The state itself is a process or a framework of rules and procedures that governs human relationships. Fiscal phenomena do not result from the optimizing choices of some exogenous being, but rather emerge through interactions among participants within various fiscal and political processes. Those interactions, in turn, are shaped and constrained by a variety of conventions, institutions, and organizational rules. Fiscal phenomena, like market phenomena, are catallactical and not choice-theoretic phenomena.<sup>10</sup> The size and extent of governmental activity, within the Wicksellian orientation, is to be explained with references to the same principles that are used to explain other features of economic activity within a society. The same categories of utility, cost, demand, supply, productivity, and the like are to be brought to bear upon the explanation of fiscal phenomena as are brought to bear on the explanation of market phenomena.

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<sup>9</sup> On Wicksell and Pareto in this respect, see Hennipman (1982). More generally on the Pareto principle, see Backhaus (1980).

<sup>10</sup> We should note that we are not using catallactical as a synonym for voluntary, but as an antonym for choice. Fiscal phenomena involve a mixture of exchange and duress, both of which we regard as catallactical, as distinct from choice-theoretic phenomena. See, for instance, Wagner (1997a).

Wicksell's particular institutional interest was his effort to describe a network of institutional relationships that would make it possible for people in their capacities as taxpayers reasonably to say that their tax payments were directed as they wished. The ability for people to say this would locate government on the same plane as other economic participants. Wicksell assumed that through proportional representation it would be possible to select a parliament that would serve reasonably well as a miniature model of the Swedish population. If this parliament were then bound by a rule of unanimity, its decisions would conform closely to unanimity within the underlying population. The state would participate within the economic process on the same terms as other participants. Its size relative to that of other organizations in society would depend on the effectiveness of its officers in gaining acceptance for proposals in parliament, relative to the ability of other producers to gain favor from people.

Wicksell articulated a principle of unanimity, which he relaxed to a practical rule of approximate unanimity. Wicksell recognized that this shift to approximate unanimity involved the creation of a tradeoff. True unanimity would insure that people would not have to pay taxes for activities they were not willing to support. But it would also prove costly to any effort of trying truly to work out arrangements for collective support. Some modest movement away from unanimity might, Wicksell thought, be a reasonable compromise to expediency. James Buchanan and Gordon Tullock (1962) subsequently converted this compromise to expediency into a framework for constitutional analysis, and which can be traced through to the contemporary scholarship on public choice

and constitutional economics.<sup>11</sup> In any case, Wicksell accepted Wagner's treatment of the state as a form of enterprise, and sought to articulate a framework for governance that would bring principle and practice more closely together.

There is an often overlooked relationship between Wicksell's new principle of just taxation and the older tradition from Justi to Wagner emphasizing state entrepreneurship. When the crown offers a particular public service for adoption, it has to propose a scheme of taxation that closely fits the beneficiaries of this service. In this sense, near unanimity can be secured in parliament. This requires, however, that the landscape of political parties closely corresponds to different social groups which can be clearly distinguished in terms of their demand for particular services, and for purposes of taxation. When that approach fails, and unanimity cannot be secured, the only recourse left is for the crown – thought of as the producer of goods and services for the public – to organize state entrepreneurship and finance the production through the revenue of the state enterprise. These revenues do not entail excess burdens, and conform to the new principle of just taxation.

### **Italian Fiscal Scholarship**

At the other end of our scholarly railroad from Lund and Stockholm stands Rome. The period roughly bounded by 1880 and 1940 was one of great

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<sup>11</sup> For an examination of the relation between Wicksell, Buchanan and Tullock, and contemporary scholarship on public choice and constitutional economics, see Richard Wagner (1988).

flourishing for Italian scholarship on public finance.<sup>12</sup> Despite various differences in emphasis from other contributors to the continental tradition of public finance, the classical Italian scholarship stands squarely within that tradition. The Italian scholars treated public finance not just as one specialized field among several within economics, but as an independent object of study, partly in economics but also concerned with politics, law, and administration as well. Central to their analytical framework was the incorporation of the state into the economic process, along with the universal application of such economic categories as utility and profit across all organizational arrangements within society.

For instance, the ability of political enterprises to expand will depend on their ability to attract patronage. They might attract that patronage through their ability to exploit economies of scale or to provide services that people are willing to support, but which were somehow not being otherwise provided. They might also attract patronage through subsidizing supporters at the expense of other, less influential members of society, as noted with particular clarity in Giovanni Montemartini (1900, translated in Musgrave and Peacock). The central analytical task in any case was to render sensible the entire economic organization of society, which is an analytical posture that denies the Anglo-Saxon analytical framework of there being some outside authority that intervenes into society but is not shaped or influenced by society.

The classic Italian orientation toward public finance is catallactical. The phenomena of public finance arise through interaction among fiscal participants.

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<sup>12</sup> See, for instance, the special 2003 issue of *Il pensiero economico italiano* devoted to “The Theory of Public Finance in Italy from the Origins to the 1940s.”

Those participants might comprise only a small subset of the society, as illustrated by models where ruling classes govern the masses. In other settings, those participants might even include everyone in society, as illustrated by models of cooperative democracy. In any case, fiscal phenomena are objects to be subjected to scientific explanation just as surely as are market phenomena. The size of state budgets, the distribution of those budgets across programs, and the sources of revenue that are used are all objects for fiscal explanation within the Italian orientation.

The Italian tradition in public finance has been soberly realistic. Whether people will support market or state provision of particular services will depend on which source of supply is less expensive to them. State provision may be cheaper for some people while being more expensive for others. If so, divisions of opinion will exist, with the outcome to be resolved through the exercise of political power as this is channeled and organized within some particular political framework. Whether the resulting outcomes are thought to be beautiful or ugly when appraised against some normative standard is beside the point.

For instance, Maffeo Pantaleoni (1911) treated the state as generating a system of political prices that existed parasitically upon the system of prices that were generated through market relationships. For the most part, each buyer pays the same market price. For political pricing, however, each buyer may well pay a personally unique price. Political prices are in any event discriminatory prices, with the pattern of discrimination dependent on the particular pattern of taxation being employed. In Pantaleoni's model, political prices could only exist



parasitically, with market prices serving as the host. One of the interesting features of Pantaleoni's formulation, noted in Wagner (1997b) is that there is a kind of natural limit to the extent of political pricing that inheres in the parasite-host relationship that political pricing through taxation entails.

The sharp differences between the continental and Anglo-Saxon traditions of public finance is revealed in the dueling book reviews that accompanied the publication in 1934 of Antonio De Viti De Marco's treatise, *Principii di economia finanziaria*, a book whose central arguments were first formulated in his 1888 book, *Il carattere storico dell'economia*. De Viti's treatise was a major statement of the continental tradition of public finance. It was reviewed in the August 1934 issue of *Economica* by Fredric Benham, who asserted that De Viti's book "is probably the best treatise on the theory of public finance ever written." Benham laments that sorry state of public finance in England, which was dominated by the choice-theoretic orientation that Wicksell decried, and which could be improved greatly through a strong infusion of De Viti's orientation. Benham also noted the strong complementarity between the approaches taken by De Viti and Wicksell.

In sharp contrast, Henry C. Simons reviewed the English translation of De Viti that appeared in 1936, in the October 1937 issue of the *Journal of Political Economy*. Simons began by observing that "the Italian literature of public finance has long been held in high esteem; but its claims to distinction have rested mainly upon works which have been inaccessible to those of us who lacked facility with the language. The translations [both German and English

translations were being reviewed by Simons] of De Viti's famous treatise are thus doubly welcome, for they will make possible a more informed consensus, both as to the merits of Italian economics and as to competence of the interpretation and appraisal which it has received in other countries."

After describing this initial sense of eager anticipation, Simons offered his judgment: "Careful reading . . . has left the reviewer with no little resentment toward the critics who induced him to search in this treatise for the profound analysis and penetrating insights which it does not contain. The *Principii* is revealed to him, not as a great book, but as a . . . monument to . . . confusion." Simons continued by asserting that "there is not a single section or chapter which the reviewer could conscientiously recommend to the competent student searching for genuine insights and understanding."

Simons concludes by taking on Benham's review three years earlier: "If his book is 'the best treatise on the theory of public finance ever written,' one hopes that it may be the last. . . . To say that it is distinguished among treatises in its field is to praise it justly and, at the same time, to comment bitterly on the quality of economic thought in one of its important branches. To call it a great book, however, is a disservice to the cause of higher standards and better orientation in economic inquiry."

That two reviewers, each so prominent in his time, can be so opposed in their appraisals can only testify to a sharp clash in the presumed domains of fiscal inquiry. De Viti and Benham shared an orientation toward the domain of public finance that was antagonistic with Simon's orientation. De Viti and

Benham operated within the continental tradition of public finance, whereas Simons stood squarely within the Anglo-Saxon tradition. De Viti and Benham, and the participants in the continental tradition, engaged in a multidisciplinary study of what might be called generative social science, where the institutions of society co-evolve through complex interactions among a society's myriad participants. Simons, and the participants in the Anglo-Saxon tradition, have looked to government as an object distinct and apart from such other abstract objects as economy and society, and with government then using power autonomously to intervene and shape society according to one kind of vision or another.

### **Fiscal Sociology and the Organization of the Common Weal**

Fiscal sociology is a term coined by the Austrian economist Rudolf Goldscheid, whose work centered in the place of different types of property relationships in securing human governance, and with allocative patterns being simply emergent features of those property relationships. In sharp contrast, the contemporary theory of public finance has been woven largely around an allocative theory of public goods. A dichotomy between private and public goods seems to map directly and immediately into a dichotomy between markets and governments as methods of economic organization, with markets organizing the supply of private goods and governments organizing the supply of public goods. The effort to work with this dichotomy has spawned much analysis and disputation about the public or private character of numerous goods and

services, most of it relatively inconclusive. Fiscal Sociology, in contrast, deals with the ramifications of public financial activity into broader realms of policy and society. By thinking in terms of the dichotomy of private and public goods, all these aspects are blocked out from view (Backhaus 2002).

The theoretical dichotomy is sharp, the seminal articulation of which is Paul Samuelson (1954)(1955). The aggregate consumption of a private good is determined by addition across the amounts consumed by different individuals. For public goods, however, what is produced is equally available to everyone. If the mere production of a good is to render it available to everyone, one might reasonably wonder how its production would be paid for. Some would argue that so long as the equivalence of fences can be placed around public goods, markets can organize their supply and the problem posed by public goods vanishes. Not quite, though, at least with respect to the requirements of Paretian welfare economics. A fence will keep out people who aren't willing to pay the price of admission. But no cost is involved in excluding someone, so exclusion violates one of the standard first-order conditions for Pareto-efficiency.

Short of its capacity, an auditorium that shows a film is providing a public good. If the capacity is 500 and if 300 people pay the \$10 admission fee, the outcome is Pareto inefficient so long as there are people who would be willing to gain admission for something less than \$10. To label this situation as inefficient, however, does not imply that there is any better way of organizing the supply of movies. For one thing, a private vendor has strong incentives to expand patronage so long as the resulting marginal revenue exceeds marginal cost,

which itself is presumed to be zero in the theoretical formulations. What this means is that some system of multiple pricing will typically be established in these circumstances, with the enormous variety of airline fares on a single flight serving as a fine illustration. This does not imply that profit maximization gives the same allocative outcome as Paretian efficiency dictates after all. There is simply no way to know, and in this realization lies the primary infirmity of the common dichotomy between public and private goods: its inability to address in any reasonable way questions concerning the organization of production within a society.

There are numerous instances where similar enterprises are organized in both market-based and politically-based manners. Just as there are privately organized hospitals, so are there governmentally organized hospitals. There are tennis courts and golf courses organized by governments, and there are also golf courses and tennis courts organized through governmental arenas. It is the same for parks and other recreational facilities more generally, for libraries, and for educational services. There are governmentally-sponsored enterprises that seek to help people learn foreign languages, and there are market-based enterprises that seek to accomplish the same thing. It is the same for the provision of security services. Indeed, private policing services probably exceed both in number of people employed and budgets the aggregate volume of policing services provided by governmental bodies. In short, the theory of public goods would seem to have little if anything to do with the phenomena of public finance. The dichotomy between public and private goods seem to map naturally

into a disjunction between domains, with government providing public goods and market-based organizations providing private goods. This disjunction, however, does not conform at all well to reality; there are simply too many conceptual inadequacies for it to do so.

Perhaps it is the very dichotomy between private and public goods that is disabling, particularly in the resulting shift of attention away from concerns about institutional arrangements onto concerns with resource allocation. What has resulted is a kind of mixed economy model: markets arise through polycentric ordering processes, with government sitting in hierarchical fashion on top of the market economy, so to speak. An alternative approach would start with people distributed over space, and would note the complex variety of connections and organizational patterns that people generate.

The extent of the public sphere is surely broad and not narrow. Most economic activity takes place in organized public arenas. Places of commerce are public arenas. A public exists whenever a multiplicity of people come together. In many instances, the composition of a public is continually changing, as illustrated by the customers of a retail store. And yet those customers do constitute a public. Anyone who has been disturbed in a theatre by someone talking nearby can attest that watching a movie in a theater is a public experience, in contrast to watching it at home. Similarly, such an archetypical market transaction as eating a meal in a restaurant is a public experience replete with public goods interactions organized contractually. For the most part, the organization and governance of a wide variety of publics is secured in open and

polycentric fashion, and not through the hierarchical ordering suggested by formulations from the theory of public goods.

Within the contemporary theory of public finance, government is almost universally construed as a unitary being that intervenes into society both to correct and to complete. On the one hand, government is construed as that agent which corrects what the analyst regards as the failures of market processes to generate Pareto efficient allocations of resources. On the other hand, government is construed as completing the productive structure of hypothesized allocative efficiency by providing public goods that the analyst presumes would not be organized efficiently otherwise. This hierarchical and unitary vision of government and its public economy is clearly simple and elegant, as all hierarchical and unitary visions must be. A polycentric vision necessarily is more complex and less elegant. It also removes government as a locus of ultimate knowledge and final authority within the analyst's model. With this removal, moreover, analytical closure or a point of invariance is removed as well.

The object of study in the catallactical orientation is not how government can intervene into the economy to promote some fiscal philosopher's objective function, but rather is how people participate through government to achieve their various ends. The state does not stand above the market economy and its participants. The same people who participate in the market economy participate in state governance as well. Fiscal phenomena are not the product of some ruler's maximizing choices, but rather emerge through interaction among people

(Wagner 2002). This interaction might be beneficial for everyone or nearly everyone, or it might be beneficial for only a few, and costly for many others. The state is treated not as a person, but as a nexus of contractual and exploitive relationships in which everyone participates to varying degrees. The extent to which those relationships are contractual or exploitive depends on the constitutive structure of governance that is in place.

As a matter of general principle, political relationships are both contractual and exploitive. It is fine to say that taxes are the prices we pay for civilization. This doesn't mean, however, that the relationship between citizens and state is the same as the relationship between customers and the retail outlets they frequent. A customer can refuse to buy and, moreover, generally can return merchandise that turns out to be defective or otherwise unsatisfactory. There is little or no option to do this in politics. To say that civilization is being priced too highly and to withhold payment will only land the protester in prison. And there is certainly no point in asking for a refund by claiming that the state's offerings weren't as good as its advertisements claimed them to be.

To speak of a catallactical approach to public finance is not to claim that the phenomena of public finance arise through voluntary interaction among people. It is only to say that those phenomena arise through interaction among people, the very same people as who interact with one another within the market economy. Much of the phenomena of public finance surely arise through duress and not through genuine agreement. This aspect of duress was given particular stress in a good deal of the Italian scholarship on public finance, and which is



surveyed in James Buchanan (1960), as well as in Richard Wagner (2003). A catallactical approach toward the organization of the public economy leads directly into a conceptualization of polycentric public finance. Within that conceptualization, there is open competition within the public square for the organization and operation of enterprises that provide services to clients and offer returns to sponsors, all mediated within an institutional framework of civic governance within the public square.

A general treatment of a polycentric public economy leads to a recognition that many different enterprises are involved with the provision of services within the public square. As Vincent Ostrom (1962) explains, it is not the case that water is supplied either by market-based organizations or by governments. Rather, it is that myriad different enterprises participate in the provision of water, and these enterprises operate under a variety of organizational frameworks. It is a straightforward matter to conceptualize a municipal services industry, as this was articulated by Vincent Ostrom, Charles Tiebout, and Robert Warren (1961), and elaborated further in Vincent Ostrom (1973).

The continental tradition of fiscal theorizing would replace the hierarchical orientation toward government, which is common to the Anglo-Saxon tradition, with one of polycentric and competitive organization and administration of enterprises within the public square. Fiscal theorizing within the Anglo-Saxon tradition gives analytical primacy to the allocation of resources. One major problem with this approach is that resources cannot allocate themselves. Only people can do this, and how they do so is governed both by what they know and

how the institutional arrangements within which they operate channel and constrain their actions. In the allocationist-centered approach to public finance, government is construed as an instrument of intervention to correct what would otherwise be misallocations. In an alternative, institutionalist-centered approach, government is simply a subset of the myriad arenas for human interaction within the public square.

The revival of the continental tradition of public finance which we hold in our sights could well be called an enterprise-based theory of public finance. The key unit of analysis in an enterprise-based theory of public finance is the political enterprise, which is the political equivalent to the firm within the context of market theory. What we call the state or government is an arena within which enterprises are created, exist, operate, and even die. All enterprises are public creatures, in that they involve a multiplicity of people, a public. To call that multiplicity a public does not mean that they constitute a government in the sense used within the theory of public goods. There are numerous specific ways through which the governance of the myriad publics that comprise a society can be constituted, the examination of which forms a good part of the domain of a science of human association. In this connection of a recovered continental tradition of public finance with a science of human association, we conclude with reference to another renowned continental scholar, though not a scholar of public finance, Alexis de Tocqueville.

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The theory of constraints refers to the fact that every process in a manufacturing or services business consists of a sequence of interlinked activities. The optimization of the performance of a process as a whole requires that every link in the sequence must serve its purpose as proficiently as possible. Basically, the idea proposed in the theory is that if the effective management of weak links or limiting factors is undertaken, the overall performance of any business process could be enhanced which may result in improved production of goods and services, increased revenues and higher return on investment. This essay surveys some general features of continental public finance analysis, emphasizing its distinctiveness from Anglo-Saxon public economic theory. Starting from the cameralist origins of public finance, we examine the science-of-state approach, the catallactical approach to public finance associated with Knut Wicksel, Italian fiscal scholarship, and fiscal sociology. The purpose of this essay is to introduce the reader to a tradition in public finance analysis that, while having experienced a diminished presence in contemporary text book treatments, nonetheless offers high potential. As reforms of public finance management are a priority task in the field of institutional changes in the Russian Federation, the precise conceptual framework is of vital importance for identification the object of the reform. It should be noted that the theory of public finances is a constituent of economy of the public sector. Public finances are given a multivalued treatment. Using the experience of institutional reform in Russia and the experience of western countries in carrying out administrative and budgeting reforms, it is our understanding that it is relevant to apply the term "public finances"