from the people should be expended on services so equitably that it would be a matter of indifference where the last rand was spent. The last rand spent on one item would be equivalent in social utility to the last rand spent on any other item.

The marginal concept of public expenditure was further developed by Wicksell (1896) and Lindahl (1910), who conducted a detailed examination of the main differences between the satisfaction of private wants and social wants. (1) Like the Austrian school, Wicksell and Lindahl accepted the view that a subjective evaluation of benefits was paramount for both private and social wants, but whereas the satisfaction of the former was achieved through an open market mechanism the satisfaction of the latter had to be accomplished by a political process. Several continental economists made substantial contributions to this aspect of choice, and ultimately it came to be commonly accepted that the exercise of social choice by elected representatives through a budgetary process was the equivalent in the public sector of free market choice in the private sector. The theory of social choice is dealt with more fully elsewhere. (2)

Early twentieth century writers on public finance such as Nicholson (1901), Dalton (1922), Shirras (1924), Pigou (1928) and Guest (1927 acquiesced generally in

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1. Richard A. Musgrave, <u>The Theory of Public Finance</u>, Chapter 4.

2. See Chapter III, Sections 3 and 4.

the marginal utility theory of public expenditure, with varying emphasis. Dalton stated that the marginal utility to the community of all forms of public expenditure should be equal, and the distribution of a given total of expenditure between different objects is thus theoretically determined. (1) Pigou stated that expenditure between battleships and poor relief should be distributed in such a way that the last shilling devoted to each yields the same return of satisfaction. (2)

3 Other Theories of Public Expenditure

Reference will now be made to the views of several economists who wrote on public finance and who dealt with the question of public expenditure in various ways. Bastable, the well-known English economist devoted much attention to the subject of public expenditure but he virtually ignored the marginal concept and returned to a classification basis similar to but much more extensive than that put forward by Adam Smith. He appeared to agree with the earlier view of Leroy-Beaulieu that public finance is primarily a matter of income. (3) Shirras also devoted most of his treatment of the subject to classifying the various items of public expenditure into categories e.g. primary and secondary. (4) It was characteristic of the works of this period that attention

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1. Hugh Dalton, Public Finance, p. 18.

2. A.C. Pigou, A Study in Public Finance, p. 31.

3. C.F. Bastable, Public Finance, p. 149.

4. G. Findlay Shirras, The Science of Public Finance, Chapter 5.

was devoted mostly to the nature of public expenditure, its relationship to private expenditure and its growth.

A more pragmatic approach was adopted by the American economist, H.C. Adams. Writing in 1898, he stated that a starting point should be the determination of the fund of wealth at the disposal of the nation and then the allocation of expenditures between the various forms of consumption in such a way that the life of the people shall be nourished and the organs of the nation developed at the point where nourishment and development are most needed. Just as a larger percentage of the income of the poor man is expended on the necessities of life than on luxuries, so a poor State will be called upon to spend relatively more on the primary governmental functions than on those which come at a later stage in development. A theory of public expenditure must be a theory of the evolution of the collective wants of individuals, and there should be no fixed limit to government functions. (1)

Guest emphasised the importance of phychological forces in expenditure choices. He stated that although the problem of public expenditure could be tackled as an aspect of value theory, it was necessary to appreciate the difference between individual expenditures and those with a social character. To ascertain the true nature of the expenditures of governments it was necessary to look at the science of human nature, to study social attitudes and social behaviour, and understand how they find expression in social demand. Expenditures of governments are the expres-

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1. Henry Carter Adams, <u>The Science of Finance</u>, Book 1 passim.

sions of the wants, desires, hopes, fears, habits, impulses and customs of human beings and must be studied as such. [1] Publ c expenditures are made by agencies of government which represent the State in action. They are the products of social choice and social behaviour, and can only be understood in the light of social phycology. Guest concluded that the concepts of marginism do not conform to the facts of public expenditure and a new type of social accounting is necessary. [2]

4 Public Expenditure and Welfare Economics

During the nineteenth century economics was regarded fundamentally as a science, concerned primarily with laws governing the production and distribution of wealth. Economists were expected to study causes and effects and it was not their function to give advice on practical situations; the government or other agencies should act in this field. This reclusive attitude changed towards the end of the century under the impact of the writings of Adams and others, but it was Pigou who contributed the first clear statement of the view that economics should embrace the study of welfare as well as wealth. He believed that economists need not pursue knowledge only for its own sake, but for the sake of the good things to which it leads, and it leads to fruit as well as to light. [3] Advice should be given, judgment pronounced, and State aims prescribed. He saw his own task as being the study of certain important groups

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1. Harold W. Guest, Public Expenditure, p. 10.
2. ibid. p. 170.
3. A.C. Pigou, The Economics of Welfare, p. 3.

of causes that affect economic welfare in actual modern societies. (1)

World War I and its aftermath of reconstruction caused a substantial rise in State expenditure in all Western nations. Budgetary policy came to play a part in the national economies of nations unheard of at the beginning of the century. The economic scene was dominated by Keynes whose fiscal theories were aimed at mitigating the impact of economic fluctuations. Towards this end he advocated far-reaching controls by the State. The Great Depression of the nineteen thirties intensified the demand for control. The public budget became entrenched as an instrument of economic planning. Keynes' General Theory, published in 1936, justified even further State intervention, to the point of influencing the propensity to consume. The Government should take full responsibility for a policy of full employment and exercise a guiding influence over private consumption through taxation, fixation of the rate of interest and other means. (2) Beveridge's policy of full employment, published in 1944, embodied even greater controls over economic policy. He stated that no power less than that of the State can ensure adequate total outlay at all times. The State should control the use of land and the location of industry in the general interest. To ask for full employment while objecting to these extensions of

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1. Ibid, p. 11.

2. John Maynard Keynes, The General Theory of Employment Interest and Money, p. 378.

State activity is to will the end and refuse the means.[1]

The post World War II era was thus one in which a high degree of State intervention in the planning of public expenditures was taken for granted. History proves that war is the most important single cause of rising public expenditure. Necessary expenditure on armaments is replaced by necessary expenditure on housing, and expenditure levels reached during war tend to be sustained. After 1945 there was growing concern over the magnitude of public spending and several notable works on the growth of public expenditure were published.[2] Of greater importance in the context of the present study, however, are the works on public expenditure analysis, too numerous to mention here but which will be referred to frequently in the chapters which follow.

5 <u>The Gap between Expenditure Theory and Practice</u>

In spite of the many theories of public expenditure which have been propounded, the application of these to real situations has met with difficulties. Several writers who endorsed the marginal concept as a basis for private choice have commented on the problems of applying the theory to social choice. Pigou, for instance, stated that there is an underlying assumption that the community is a unitary being for which the government acts as a brain. Battleships are a collective good, to be used

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1. William H. Beveridge, <u>Full Employment in a Free Society</u>, p. 36.

2. For instance, A.T. Peacock and J. Wiseman, <u>The Growth of Public Expenditure in the United Kingdom</u>; B.U. Ratchford, <u>Public Expenditure in Australia</u>; T. van Waasdyk, <u>Public Expenditure in South Africa</u>.

in the general interest by the government which simply cannot balance at the margin each man's desire to buy battleships against his desire to buy clothes in the way that an individual balances his desire for clothes against his desire for coal. (1) Robbins, who is credited with being one of the first to help bridge the gap between economic theory and practical problems, saw danger in assuming that certain developments in modern economic theory could furnish in themselves a set of norms capable of providing a basis of political practice. In particular, he referred to the law of diminishing marginal utility when used as a criterion of all forms of political and social activity affecting distribution. (2)

Under the stimulus provided by welfare economics and the macro-economic theories of Keynes and post-war studies of public expenditure, the usefulness of some of the axioms of economic theory has increased to a stage where government officials consider them to be of operational interest. (3) Economic analysis on an ad hoc basis has over a long period been used in public expenditure projects, but in the particular sphere of budgetary choice there has remained a serious gap between theory and practice. Some writers have described the problem of

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1. A.C. Pigou, A Study in Public Finance, p. 31.

2. Lionel Robbins, An Essay on the Nature and Significance of Economic Science, p. 136.

3. Alan T. Peacock and D.J. Robertson, Public Expenditure Appraisal and Control, p. VII

applying economic doctrine to political choices as insoluble: others have stated that public decision-making can be improved not only by the application of economic analysis, but by a revision of the entire budgetary process to make choices clearer. These aspects are the crux of the present study, and are examined in succeeding chapters.

CHAPTER III : EVOLUTION OF BUDGET CONCEPTS

Expenditure decisions in the public sector are reached through a political process. It is through budgeting that the specific decisions are made. Although budgeting goes back far in history, theories of optimal resource allocation are of comparatively recent origin. This is a natural consequence of the attitudes to public finance discussed in the preceding chapter.

The concept of programme budgeting emerged only during the past two decades. It involves changes in budget concepts and in budget formats. The evolution of the former will be discussed in the present chapter, and the latter will be covered in the next chapter.

1 Brief History of Budgeting

The procedure of (a) preparing public estimates and (b) accounting for public receipts and expenditures goes back to the dawn of history. When people first settled in communities the need for public services arose and these services had to be paid for either in kind or in cash. The receipts and payments accounts of early times were simple documents because the needs and resources were limited. In the Athens of Pericles and the Rome of Caesar warfare, public buildings, roads and aqueducts absorbed most of the revenues. Administrative expenses were low.[1] These relatively simple systems collapsed with the Roman empire, and the Dark Ages descended on public

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1. Tenney Frank, Economic History of Rome, p. 195.

finance as on the arts and sciences in general. Under the Feudal System there was little need for public accounting because services were decentralised; military service was an obligation to the feudal lord.

When nation-states came into being in the sixteenth century, fiscal administration became an important arm of government. The rising cost of mercenaries was a contributory factor. Bureaucracy grew and interest was aroused in economic systems.(1) However, in the many treatises written between the era of the Physiocrats and the end of the nineteenth century, budgetary theory as such was little discussed. This was due primarily to general disinterest in public spending and the consequential slow development in national budgeting systems.

National budgets were first prepared in Britain in 1688 and France in 1789. This development was the result of a popular demand for constitutional control over public monies. No financial burdens should be imposed on the people without their consent as expressed through legislative assemblies. Parliamentary control of finance became established in most European countries by the beginning of the nineteenth century. Comprehensive national budgets were first introduced in England in 1822, Canada in 1867 and U.S.A. in 1921. Two important reasons for the late development of national budgeting in the U.S.A. were (a) the expanding and abundant revenues during the nineteenth century with an associated

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1. J.L. Sadie, Inleiding tot die Suid-Afrikaanse Staatfinansies, Chapter 2.

nonchalance towards fiscal control and (b) the hostility of Congress to greater powers for the executive. (1)

The word budget is derived from the old French <u>bougette</u>, meaning a small bag, in which the Minister carried his proposals for financing government expenditure. The word was first used in England in <u>circa</u> 1733. It was later applied to the budget proposals themselves, and came to mean any statement of plans and expectations for a future period in both public and private institutions. The word has been introduced in most languages. (2)

A budget in its simplest terms is a financial plan for a specified period of time. Households, business firms, industries, governments all prepare budgets. The national budgets of one hundred years ago were not as complex as they are today, for there was a very limited field of State activity. The enormous rise in government expenditures, noted in the preceding chapter, changed this. Governments of today, with the approval of the people, are committing between one and two fifths of the national income to the satisfaction of communal wants, far beyond the restricted scope of tangible services rendered a hundred years ago. Much of this high commitment is due to the macro-economic aim of creating economic stability. It is appropriate, therefore, to consider the extent to which compensatory finance is relevant in the sphere of municipal budgeting.

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1. <u>Encyclopaedia of the Social Sciences</u>, Vol. 3, p. 40; John F. Due, <u>Government Finance</u>, Chapter 4; Jesse Burkhead, <u>Government Budgeting</u>, Chapter 1.

2. Royal Institute of Public Administration, <u>Budgeting in Public Authorities</u>, p. 13.

2 Public Budgeting and Compensatory Finance

The relevance of the general postulates of budgetary theory to municipal government will now be considered. The first step is to examine the nature of a national budget, a clear exposition of which is contained in Musgrave's multiple theory of the public household. [1] This is a study of an optimal budget plan. It is a normative theory which describes what a budget policy would be like if an optimal result were to be achieved, unlike the fiscal political theories which examine why existing policies are pursued and predict what policies will be pursued in the future. Musgrave states that although operations of the public household involve money flows of receipts and expenditures, the basic problems are not issues of finance involving money, liquidity and capital, but rather of resource allocation, distribution of income, full employment, price-level stabilisation and growth. [2] He then sets out three clear objectives of budget policy (a) the allocation of resources (b) the distribution of income and wealth (c) stabilisation. These are briefly discussed below.

The theory of resource-allocation is of cardinal importance in any thesis on budgeting. The modern concept of programme budgeting has as its keystone the identification of public wants and the means of satisfying them. Resources are withdrawn from the private sector by a tax-purchase mechanism, and choices then

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1. Richard A. Musgrave, op. cit. Part 1, Chapter 1.
2. ibid.

have to be made concerning the application of scarce resources to desired ends. In the public sector the budget is the vehicle of allocation - at central government, provincial and local level.

The State also uses the budget to shift resources from the disposal of one individual to that of another by means of a tax-transfer system. In this case taxes are levied not to pay for the services associated with the activities of government, but to secure certain social ends. There are also other ways of achieving these ends such as minimum wage legislation, subsidies, and tariff protection.

The budget may also be used as a means of stabilising the economy. Compensatory measures may be put into operation to avoid inflation, to raise the level of employment and to sustain economic growth. Monetary measures may also be used to achieve these ends.

The distribution and stabilisation functions of the budget are not relevant to the present study. The extent to which local authorities can participate in any national anti-cyclical budgetary policy is clearly limited. In South Africa, for instance, the gross fixed investment of local authorities was 18,8% of the total public sector in 1970 (including public corporations).[1] Furthermore, redistributional aspects of taxation are insignificant in South African local government: transfer expenditure in 1970 amounted to approximately 4% of the total current ex-

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1. C.W.G. Browne, <u>I.M.T.A. Conference Proceedings</u> 1972, p. 6.

penditure of local authorities (excluding trading enterprises).[1] Distributional adjustments on the Musgrave pattern thus play little part in local budgets. Therefore, the only aspect of budgetary theory which need be considered in the present context is that which relates to the satisfaction of public wants. The general theories thereanent are germane to any study of local budgeting. Several writers see a clearer manifestation of public want-satisfaction when collective needs are of a local character, rather than nation-wide.[2]

The theories of budgetary choice may now be considered unencumbered by wider macro-economic considerations. The problem was clearly posed by V.O. Key in 1940 thus: 'On what basis shall it be decided to allocate X dollars to Activity A instead of Activity B?'[3] Pigou referred to a choice between battleships and poor relief, and Due between shade trees and fire protection.[4]

3 Private Wants and Social Wants

Only in the last quarter of the nineteenth century was interest seriously focused on the extent to which resources should be diverted from private to public use, and how the resources so diverted should be allocated to satisfy competing social wants. Adam Smith's approach had

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1. ibid. p. 2.

2. Gustav Cassel, The Theory of Social Economy, Vol. 1, p. 70; Richard A. Musgrave, op. cit. p. 88.

3. V.O. Key Jr., 'The Lack of a Budgetary Theory' The American Political Science Review, Vol. XXXIV, 1940. p. 1137.

4. A.C. Pigou, A Study in Public Finance, op. cit. p. 31; John F. Due, op. cit. p. 23.

been sociological and institutional, unsustained by any clear economic theory. The theories propounded during the nineteenth century were focused mainly on the revenue side of the budget. Examples are the doctrine that the cost of public services should be distributed to cause the least total sacrifice, and the doctrine that taxes should be paid in accordance with ability to pay. The rise of a broader concept of maximum total welfare led to a consideration of benefits as well as sacrifices, and marginal benefits as well as marginal sacrifices. Consequently the allocation of resources to public expenditure categories came to be viewed in an entirely new light, and questions were raised which had not been raised before. What distinguishes social wants from private wants? How are social wants evaluated? Are there rules for social choice? Attention was first devoted to these questions by Continental writers towards the end of the nineteenth century. English writers tended to neglect the subject, one reason being the predominance of the ability to pay doctrine and the relative neglect of the benefit approach to taxation. (1)

The writers who made substantial contributions to the literature on social choice were Pantaleoni (1883), Mazzola (1890), Sax (1890), Wicksell (1896), and Lindahl (1919). (2) They adopted a strictly individualistic view of social wants, a consequence of the subjective theories

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1. Richard A. Musgrave, op. cit. p. 68.

2. Richard A. Musgrave and Alan T. Peacock, <u>Classics in the Theory of Public Finance</u>, passim.

of value of the late nineteenth century. They saw a direct link between the satisfaction of social wants and the satisfaction of private wants. Taxes they regarded as a price for public services which would be paid in accordance with the individual's evaluation of the benefits he derives from the services. This would lead to a state of fiscal equilibrium between social and private wants, and efficient allocation of resources would ensue. The only difference between allocation in the private and public sectors lay in the fact that the former is accomplished automatically through the market mechanism whereas in the latter a political process is necessary. Space does not permit a consideration of the works of all these writers, but brief reference will be made in the paragraphs which follow to those principles which are pertinent in the context of budgeting.

Sax distinguished between two kinds of collective needs, (a) those for which a specific benefit-share can be imputed to the individual, and a comparison thus made with individual needs and (b) collective needs proper where individual shares cannot be determined, where no comparison can be made with individual needs, and which must therefore be dealt with on a purely collective basis. He gave as an example of the latter the control of epidemics in which 'everybody is saved from infection, nobody more or less than anybody else. It is right therefore to speak of these benefits as indivisible'. (1)

Wicksell did not accept the view that an individual

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1. ibid. p. 183.

can equate the utility derived from his expenditure on public and private services and so bring about a state of fiscal equilibrium. An individual need not reveal his preferences, nor will he contribute to the supply of public goods voluntarily. If the individual is to spend his money for private and public uses so that his satisfaction is maximized, he will obiously pay nothing whatsoever for public purposes, except where direct charges for services are involved. Whether he pays much or little will affect the scope of public services so slightly, that for all practical purposes he himself will not notice it at all. (1) The task of maximising satisfaction, Wicksell said, must therefore be accomplished between voters. In any determination of budget policy the usual simple majority vote is inadequate and a principle of near unanimity should be enforced. (2)

The essence of these earlier theories was that satisfaction of social wants must be based on the individual preferences of consumers or voters. Individual evaluation of benefits was paramount. During the past fifty years the earlier theories crystalised into two main streams. Firstly, there was the view that social wants differ so basically from private wants that any link with individual preference theory is invalid. This theory is akin to Sax's emphasis on the need to satisfy group needs by group decision. It is also exemplified in Ritschl's distinction between an exchange society and a communal society, the former being dominated by self

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1. ibid. p. 81.
2. ibid. p. 87 ff.

interest and the latter by community of interest. There is a cohesion in the latter which distinguishes it fundamentally from a market economy. (1) The second point of view was a compromise between the extremes of Ritschl's organic view of the State and a system of social choice based on consumer sovereignty. Under such a compromise individual preferences would still be taken into account and the essentially political character of social choice would be recognised. The voter who takes decisions as a consumer and as a political being are different persons.

Current thought seems to favour the more pragmatic approach of ascertaining individual preferences and fusing them into rational social choice. This involves close attention to the decision-making process. Problems of social choice will be discussed in the section which follows, and systems of budgetary choice will be covered thereafter.

4 The Theory of Social Choice

A reference to the earliest forms of society such as totemism, patriarchy or theocratic despotism will reveal that there were few problems of social choice. Decisions were made under conditions of dictatorship. Social choices were based on the preference of one man or a small group of people. In the Greek city-states, however, individual preference came to be seen as a desirable element in the conduct of government. Citizens met together in

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1. ibid. p. 234.