Separating and Combining Fiscal Measures: Musgrave's Proposal Revisited

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Musgrave's proposal of separating fiscal measures into three independent branches, i.e. distribution, allocation and stabilization, is widely accepted by public finance theorists. This paper attempts to qualify his proposal on a reason different from Samuelson who assumes an omniscient referee to maximize the social welfare. Fiscal decisions in a democratic society must rest on the outcome of negotiation among citizens (or their representatives), and to have the minority protected the unanimity must be sought as close as possible. Musgrave argues that because being a zero-sum game a unanimous decision is not possible for income redistribution, distribution function must be separated from the allocation function and carried out through a majority decision rule before the allocation decision to take place, while the allocation branch can be carried out by the unanimous decision rule. This paper argues that the Musgravian approach unnecessarily limit the scope of fiscal activities. It is true that redistribution of income cannot obtain a unanimous approval if it is carried out independently, but if it is combined with provision of public goods, it can. Moreover, by combining income redistribution with provision of public goods, a given amount of income transferred would enable both the givers and receivers to reach higher levels of welfare than the case when they are conducted separately. The main reason is that the impact of revenue and expenditure decisions of the budget spills over to the market through changes in prices of factors of production.