THOUGHTS ON WRITING A PUBLIC FINANCE TEXT

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As with other topics, I may, perhaps sound like a voice from the past especially since the 4th and last edition of the Musgrave and Musgrave undergraduate textbook appeared nearly 20 years ago.

Let me first talk a little about the genesis of our text. Of course, in a way it was an easy call since the inspiration and foundation for it grew out of Richard's 1959 graduate text *The Theory of Public Finance*. That was, I think, more than a graduate textbook. For the first time, it brought together many strands of theoretical, empirical, and philosophical scholarship, both historical and contemporary—which were pertinent to the economics of the public sector, supplemented by Richard's own extensive work in such diverse aspects of public finance as social goods, taxation, public debt, macroeconomics, and fiscal federalism. I think the main accomplishment of that book was to meld together all that hitherto scattered work both on the expenditure and tax side into a coherent whole. The book defined the fiscal functions of government and built public finance into a unified theory of the public sector, as the private market economy had for long been blessed with a consolidated body of theory and practice, thanks to the contributions of such renowned scholars as Adam Smith, David Ricardo, and Alfred Marshall. In addition, Richard recognized the philosophical and political ingredients which necessarily shape the public sector in a democratic society. It was in this spirit that we wroteour undergraduate text *Public Finance in Theory and Practice*, which first appeared in 1973.

(As an aside, I think Richard felt that the competitive market ecoonomy, while important for economic growth and progress, was based on the premise of individual self-interest, a somewhat less attractive motivation than are those of cooperation and concern for the welfare of others, which are necessary motivations for an efficient and equitable public sector. Hence he regarded work in or on the public sector to be a noble calling and was the source of his inspiration throughout his academic life.)

Turning now to the basic principles we firmly believed, and I still believe an undergraduate text on public finance should cover. First, students should be given a broad and integrated approach to the study of public finance rather than a set of case studies on the activities of government, thereby missing a systematic view of the public sector's role as an essential complement to that of the private sector. This is especially crucial in an age where there is a tendency to say that "government is not the solution but the problem" and that "the smaller the public sector the better." So we began with the thought that undergraduates should derive from their study of public finance a view of why the public sector in a democratic society has a vital role to play—first, in providing certain goods and services with characteristics that render provision through the market impossible or inefficient; second, in correcting unacceptable inequalities in income distribution that result from the free play of the market; and third, to secure low unemployment and price stability, as well as stability in economic relations with the rest of the world. You will recognize these as the three basic fiscal functions—allocation, distribution, and stabilization. We may include in the allocation function the correction of certain inefficient behaviors in the private sector with regulations that supplement the two basic tools of expenditures and taxation to implement public sector policies.

Although in practice the government budget is not neatly divided up into these three branches, it nevertheless is a useful way of classifying the different activities of the public sector. Many expenditure and tax policies of government perform more than one function, sometimes serving one function while simultaneously disserving another. But this classification provides a unifying structure to the body of knowledge which we call "public finance." This is not to say that the private and public sectors exist separately and independently. There are many interdependencies; and at the theoretical level, many of the analytical tools of microeconomics may usefully be applied to the public sector's activities. The allocation function of government arises from the existence of social goods, non-rival in consumption (often called pure public goods) that cannot be provided by the private market. There are also goods which may be rival in consumption but which are technically non-excludable and again must be provided by the public sector. To these must be added the existence of externalities (both beneficial and harmful) which require correction by government. The secular growth of populations and their ever-increasing interactions lead to rising externalities especially at the international level, which foretell an increasing need for government measures to correct them, whether at the local, national, or international level.

Next there is the public sector's more controversial role as an agent in the distribution of income. I believe that an undergraduate text on public finance should make the point that while a private sector based on an efficient, competitive market system is necessary for the achievement of efficiency and growth, it is, in and by itself, not a sufficient condition for reaching an equitable distribution of income as desired in many modern democratic societies. This is a time-honored problem in public finance and is still with us today. In an introductory textbook the topic should be treated both theoretically and empirically, showing how before-tax income is distributed in the United States today and historically, as well as with international comparisons. Then estimates should be provided of the effects of federal, state, and local government budgets on the income distribution, particularly of taxation and transfer payments.

A word should be added about those goods and services provided by government that have been coined by Richard Musgrave as "merit goods" or, as he preferred, "merit wants." They have been a controversial concept among public finance economists since they do not readily fit into the conventional framework of micro-theory with its premise of consumer sovereignty. They are, thus, thought by some to imply a paternalistic government as provider rather than a government responding to individual preferences. Though awkward for those of us who prefer to think of publicly provided goods and services as a reflection of individual preferences adhering to the principle of consumer sovereignty, merit (or demerit) goods undoubtedly exist and form a significant part of the government budget. They may be said to reflect community values that may override individual choices in certain circumstances. They range from in-kind (categorical) transfers to restrictions on harmful practices to certain health and education expenditures which reflect underlying community values. The concept of merit wants can provide a good topic for class discussion, but I notice that the term "merit goods" or "merit wants" has more or less disappeared from the lexicon of recent public finance texts.

One of the difficulties in writing a good public finance text is to take a measured view of the latest theories that may not have a long useful life. In no field is this more true than in macroeconomics and the role of fiscal policy in performing its stabilization function. It is put very well by George Akerlof in the March '07 issue of the *American Economic Review*, where he evaluates the many rivals to Keynesian theory that have arisen in recent decades and that, some feel, have left macroeconomics in disarray. As a result there now is a tendency to give little attention to stabilization policy in public finance texts. Nevertheless I think the Keynesian approach to stabilization policy still deserves a primary place in the public finance textbook because the mechanism remains operative, with some modifications called for by currentresearch. In recent years the heavy reliance on monetary policy and the unnecessary downplay of fiscal policy for stabilization purposes, perhaps for ideological reasons, has created problems. These problems include the part played by the public debt and its relationship to the balance of payments and the exchange rate.

Of course there is also an important place for intergovernmental fiscal relations in a public finance text, indeed it may deserve a text of its own to cover the subject adequately. It is a topic especially crucial for a U.S. text (i.e., to deal with the internal fiscal relationships among states and between states and the federal government). The principles underlying a well-functioning decentralized fiscal system are applicable elsewhere in the world and in this context become ever more important as regional interests are more strongly expressed. Indeed, they are increasingly applicable to international fiscal relations, an area that calls for greater attention.in the future

Having dealt with the public sector in this broad, unified manner, the text should then introduce the empirical and institutional material to give it real-world relevance. Taxation of course deserves a section on its own, first discussing the various types of taxes, their incidence, their multiple functions, and empirical importance. The individual and corporate income taxes, their structure and problems should be given emphasis. The institutional background to these taxes, including the legislative process and its implementation as well as the institutional background to the federal budget, are other areas to be addressed.

A chapter on cost-benefit analysis provides a good accompaniment to the allocation function since it illustrates how a degree of efficiency can be secured in the evaluation of public projects. In my experience, students usually show great interest in this topic and along with taxation, it lends itself conveniently to hands-on experience with problem sets.

The subject matter of public finance inevitably extends into and is enriched by adjoining fields of sociology, philosophy, and political theory; and an undergraduate text in public finance should incorporate these extensions where appropriate. For instance, the new field of public choice offers insights to the process of fiscal choice through the political process, though perhaps some of the work under its rubric takes too pessimistic a view of the public sector and makes initial assumptions of imperfection that are difficult to correct. The controversial question of income redistribution can also be approached in various ways; but. basically in a democracy, it reflects the philosophical preferences of the electorate and it is worth looking at the opinions of philosphers of today and in the past in this respect.

Finally, some would assert that consideration of how an efficient and equitable public sector *should* behave, the normative approach, is hardly worth the time. But I think that it should be pointed out to students that unless we have a normative framework that permits us to organize and analyze the wealth of empirical observations, how can we know how to take care of imperfections? Democracy through which the people's preferences are registered and given expression is a complex and some would say messy process. Yet there is nothing more important than to do what we can to smooth the path to the good society.

References

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