

**Economics 849
Public Finance
Fall Semester 2011
Thursdays 1630-1910
Enterprise Hall 318**

**Professor Richard E. Wagner
Office: Enterprise Hall 334
Hours: Thursday afternoons
Phone: 703-993-1132
email: rwagner@gmu.edu**

This course brings a catallactical-institutional orientation to bear on the theory of public finance. Governmental activity, mostly taxing and spending, but also regulation because whatever can be accomplished through budgeting can also be accomplished through regulation, comprises the subject matter of public finance. There are, however, two distinct analytical windows through which the subject can be examined. The most commonly used window treats public finance as applied statecraft, with the aim of public finance being to instruct governments on what they should do. The alternative window, the one used in this course, treats public finance as operating in parallel with market theory, with both types of theory seeking to explain the coordination of economic activities when no entity in society possesses the knowledge necessary to achieve that coordination. The analytical objective at which this course aims is the creation of a theory of collective activity grounded on ideas of spontaneous ordering and invisible hands and not on presumptions of collective control and planning. In this respect, you should all read Leonard Read's essay *I, Pencil* (available from the FEE web site). My ambition is to extend that same orientation to collectively-sponsored activity.

The course text is my *Fiscal Sociology and the Theory of Public Finance*, which is now available in paperback. The course will *not* proceed by reviewing what I wrote there; instead it will use that material as a point of departure for exploring public finance through an explanatory rather than hortatory analytical window. The book's subtitle describes it as "An Exploratory Essay." In his review of the book [*Quarterly Journal of Austrian Economics* 12 (2009): 88-94] http://mises.org/journals/qjae/pdf/qjae12_1_9.pdf, Adam Martin took issue with the subtitle, saying that "it reads more like a manifesto for a budding research program than an exposition of particular propositions." Martin also closed his review by asserting that "the good news for young scholars seeking inspiration is that its [the book's] ideas tend to be more under- than over-developed." The accuracy of Martin's judgment is something each of you will be able to test for yourself.

I regard graduate-level courses as venues for exploring new lines of thinking where we are looking for ways to articulate what has not yet been articulated, and not as venues for explaining what is widely regarded as settled knowledge. You need to survey what is regarded as settled, but that serves only as a point of departure for scholarly work. If we were playing music, I would like to think that we resemble a jazz quintet where I insert some riffs here and there and not a sympathy orchestra where I am the conductor.

It is important to read widely, but I don't supply lengthy reading lists even though it would be easy to do this just by taking bibliographies from some of my publications. Rather than trying to get everyone on the same page, so to speak, I find that wrestling with different articulations stimulates the imagination. For this reason, I try systematically to err on the side of under-specifying your reading. While I will suggest readings throughout the semester, you should also create your own readings in light of your particular interests. If you haven't already done so, you might want to look at and reflect upon that well known cover from a long ago issues of *New Yorker* that portrayed a map of the United States looking west from Manhattan. You should aspire to construct your personal maps that orient your scholarly activities, rather than letting the *Journal of Economic Literature* dictate an orientation to you through its JEL Codes (though in submitting papers you will have to assign JEL codes).

A dozen items to read are listed after the course schedule. These are all books that treat broad themes related to the course material, and each is available in paperback. While I hope that you will examine some of these, I also hope you read other materials as well and, more significantly, mix those readings with your imaginations to generate new insights that might lead to interesting places. Students become accustomed to reading published work with an eye to taking exams. While I recognize that exams are part of our educational system, though not in this course, I suggest you cultivate the practice of reading with an eye that continually is looking for new ideas that you can articulate, as against absorbing old ideas that you can recollect.

With respect to our work over the semester, let me offer two quotes for you to keep with you on your journey: they should stand you in good stead.

- The first is buried in my long ago past. I believe I read it in a biography of Isaac Newton, but I wouldn't swear by this: "To see what all have seen; to say what none have said." This is mostly what I think we are trying to do in escaping the shackles of conventional thought. The phenomena are in front of us, plain to see, but we have to articulate them differently as suitable for a framework of limited and distributed knowledge. Look at Archimedes: he most certainly was not the first person to have taken a bath, yet he is surely the world's best known bather.
- The second comes from Albert Einstein via Roger Koppl: "If we knew what we were looking for, we wouldn't call it research, would we?" If you feel confident about where you are heading before you start writing, you might be doing journalism but you aren't doing research. You need to learn to live with the ambiguity that the quote implies; indeed, you should learn to revel in that ambiguity, for only in the presence of such ambiguity is it possible that you are traveling someplace different.

We have 14 sessions, starting 1 September. The first 12 sessions will be divided into six units of two weeks each. Each of us will have work to do for each of these units. I will take the lead during the first session of the unit by presenting some of the background and penumbra of associated ideas that are in play (though not engaging simply in presenting an alternative rendition of standard textual material, for this you can, and should, read on your own). Part of my presentation will entail a discussion of some bullet points I will send you as illustrations of ideas that might be relevant for a conference devoted to that unit's theme. In this respect, quite a number of conferences are organized each year where the organizer invites people to submit proposals for papers.

The second session of each of those six units will be devoted to presentation and discussion of your proposals, which you will thus have a week to prepare and will leave with me at the end of class. Within a day or two, I will send you my evaluation of your proposal, written from the perspective of a conference organizer. These six essays collectively will count for 40 percent of your course grade. My standard of grading will be that of a conference organizer who is looking for creative and thoughtful work, particularly work that contains surprises in contrast to well-constructed work that nonetheless has a pedestrian quality. A grade of A indicates that if I would invite you to present the paper. A grade of B indicates that I wouldn't invite you but that I acknowledge that the proposal exhibits decent understanding and workmanship all the same (but it doesn't contain imagination-induced surprises). A grade of C is a residual category whose meaning you can infer (and with a grade of F being attached to no-shows and their equivalents). While I think in this discrete fashion, almost invariably there will be cases that hover near some borderline which compel me to affix a plus or a minus to the grade.

These essays should be in the vicinity of three pages of text in standard manuscript format, followed by a brief bibliography that testifies further about your orientation toward the topic. You should keep in mind that one of the things a list of references accomplishes is to situate your paper within an appropriate circle of scholarship. You should also keep in mind that I don't accept late work nor do I assign incomplete grades. If you have a proposal accepted for presentation at a conference but don't finish your paper, the conference won't be delayed so you can finish your paper. The conference will go on without you, and you will suffer the reputational consequences. A significant part of graduate education lies in cultivating the scholarly patterns that promote success. Tardiness and unreliability are not practices of successful people.

Another 40 percent of your course grade will be given for my judgment about the quality of a research paper you will write. The same publication-based grading framework will apply to these papers as I will apply to your shorter essays. This paper should run in the relatively standard 20 pages or so length, submitted in standard manuscript format (double spacing, normal margins, etc.). For this assignment you should think of me as the editor of a *Handbook of*

Enterprise-Based Public Finance, where I have issued a call for contributions. What I mean by enterprise-based public finance should be clear from *Fiscal Sociology and the Theory of Public Finance*, as well as from my forthcoming book *Deficits, Debt, and Democracy: Wrestling with Tragedy on the Fiscal Commons*, which I will send you. This paper is due at the time the final exam is scheduled for this course, 15 December at 1630. You can submit it electronically if you like.

The final 20 percent of your course grade will depend on my evaluation of your contributions to classroom discussion throughout the semester, including your contributions to the seminar sessions during the final two sessions where each of you presents your research papers. These final two sessions will occur on a Friday in December, either the 2nd or the 9th, and will run roughly between 1000 and 1500 in Enterprise Hall 318. Which of those dates it will be is something we will decide on 1 September. This Friday session is made necessary because there will be two Thursdays during the semester that I will be away. As compensation for the inconvenience of meeting on a Friday, I will provide lunch.

Course Schedule

Unit # 1: *Human Nature, Property Rights, and Public Finance*
FSTPF, Chapters 1-3; DDD, Ch. 1

The contemporary theory of public finance is heavily normative in its orientation, and with the work done through choice-theoretic modeling of equilibrium states. The theory is used to address questions like how much should a government spend on education. The alternative theoretical framework I pursue asks questions like how much will a government spend under alternative institutional arrangements, along with a whole plethora of questions that arise once you try to give a bottom-up, emergent account of the continual evolution in patterns of collective activity. Carl Menger argued that property rights, markets, and polities all originate in scarcity and the potential conflict that looms. This insight suggests an orientation toward public finance quite different from the standard Anglo-Saxon orientation. What is called for, I believe, is ultimately a different articulation of the theory of property rights, which can be seen by reflecting on the common roots of property and propriety, by reflecting on what it means to treat economics truly as a social science as distinct from a science of household conduct or rational action, and by exploring the tangled relationship between conflict and cooperation and between markets and states.

Unit #2: *Politics, Entrepreneurship, and the Ecology of Enterprises*
FSTPF, Ch. 4; DDD, Chapters 2-3

The theory of public finance typically embraces a theoretical antinomy wherein market activities are spontaneously ordered through entrepreneurial

action while collective activities are organized through collective planning. This unit will pursue an alternative orientation where polities themselves are represented by an ecological configuration of enterprises that are generated through entrepreneurial activity, and with relationships among those enterprises often being intensely competitive. In other words, a polity is characterized not as a single enterprise but as a collection or order of enterprises: a polity, too, more fully resembles a jazz quintet than a symphony orchestra.

Unit #3: *The Economic organization of political enterprises*
FSTPF, Ch. 5; DDD Chapters 4-5

While the establishment of an enterprise reflects some form of entrepreneurial vision, any such enterprise must confront a variety of challenges that are present in any framework of team production. Among other things, problems of agency must be dealt with, cash flows must be generated and distributed, and dispersed knowledge must be assembled and put to use. For market-based enterprises, the presence of transferable ownership does a good deal of work in securing well-working teams. For politically-based enterprises, ownership is not transferable so a different approach must be taken to the organization of team production, one that seeks to take account of parasitical interaction between market and collective entities: collective entities require market entities while they also degrade them through a form of predator-prey interaction.

Unit #4: *Revenues & Expenditures: Bridging the Budgetary Gap*
FSTPF, Ch. 6; DDD, Chs. 6-7

I have variously described a parliamentary assembly as a peculiar investment bank and as a peculiar market bazaar, though I would also note that I think that all modern polities face pretty much the same budgetary setting. Somewhere I recall Joseph Schumpeter describing a state's budget as pointing to its essence once the accompanying ideological cant had been stripped away. While plenty of ideological cant accompanies democratic regimes, similar cant accompanies other regimes as well. In this vein, Carolyn Webber and Aaron Wildavsky, in their lengthy treatment of budgetary history, described budgeting as an on-going conflict among people over how they are to live together. This unit will seek to take that peculiar investment bank analogy further than it has been taken so far by exploring budgetary processes within an explanatory vein where conflict, in contrast to usual presumptions of harmony, run deeply through society.

Unit #5: *Federalism and interaction among governments*
FSTPF, Ch. 7

Most work in public finance treats government as a single entity. It is rare, however, that a person faces a single government. The more common situation

is to face a multiplicity of governments, each with some ability to tax, spend, and regulate. Governments and their enterprises come continually into contact with one another. This situation likewise characterizes market-based firms, only the institutional frameworks within which agreements are made and conflicts settled (or not) differ. I would note also that I regard relationships among national units of government as much a suitable subject of examination as relationships among governments within a nation.

Unit #6: Constitutional Foundations of Public Finance
FSTPF, Ch. 8; DDD, Ch. 8

Almost all of the contemporary theory of public finance has been written from a normative orientation of seeking to advise or tell governments what should be done to achieve some end. In contrast, I emphasize positive analytical issues. At the same time, however, positive analysis can carry normative oomph, often more strongly when it is not couched in directly normative language. Ludwig von Mises on several occasions said something to the effect that if you wanted peace and prosperity embrace capitalism, while if you wanted famine, pestilence, destruction, and death, embrace socialism [at this point, though, you might want to recall G. B. Shaw: “a socialist is a communist who lacks the courage of his convictions”]. In doing this, Mises was stating a purely positive conclusion of economic analysis and not making a normative argument. Something similar is my object of aspiration in this unit. Economics, after all, is a science that treats matters of general public interest, so explanatory efforts should make contact with normative concerns as illustrated by my use of “social agriculture” in the title of Chapter 8 of FSTPF.

A Dozen Valuable References for this Course (all available in paperback)

1. James M. Buchanan, *Public Finance in Democratic Process*; James M. Buchanan, *Demand and Supply of Public Goods*. These books were originally published in 1967 and 1968 respectively, well before such fields as public choice and constitutional economics appeared on the intellectual landscape. These books are now available inexpensively from Liberty Fund. These books sought to pursue a positive theory of public finance at a time when the intellectual environment was much more hostile to such efforts than it is now. Buchanan’s work subsequently moved in a more normative and constitutional direction. On several occasions, I have thought of *Fiscal Sociology and the Theory of Public Finance* as an effort to bridge a 40-year gap in the articulation of an alternative vision for a theory of public finance.

2. Gordon Tullock, *The Politics of Bureaucracy*. This book is available inexpensively through Liberty Fund as an item in Tullock’s Collected Works. While the subject is bureaucracy and team production, Tullock is not concerned to develop comparative static statements about equilibrium conditions. Rather, he is concerned to explain the characteristic features of team production

processes in the absence of market prices and firm values, and to do so within an environment where there is rivalry within organizations and not just rivalry among organizations. In other words, Tullock's theory of bureaucracy is situated within a treatment of polities as orders and not as organizations.

3. Vincent Ostrom, *The Meaning of Democracy and the Vulnerability of Societies*. Ostrom is cited often throughout *Fiscal Sociology*, and I have great respect and affinity with his approach toward this material. If there is any place where I differ from Ostrom, it is probably in my elevation of some such construction as civil society or civic republicanism over democracy. In any case, Ostrom is well worth reading on the problems and challenges of liberal governance. I should also mention two other books by Ostrom: *The Political Theory of a Compound Republic* and *The Intellectual Crisis in American Public Administration*. Both of these works operate from a framework of distributed knowledge and treat polities as orders and not organizations.

4. Elinor Ostrom, *Governing the Commons*. Ostrom presents a variety of cases where people have been able to work out arrangements for governing a commons that encompasses the participants. What she describes is quite at variance with portraits of the tragedy of the commons. What enables commons governance to proceed well in some cases and tragically in others will be a prime topic of exploration this semester in light of my conceptualization of budgeting as taking place on a fiscal commons.

5. Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World*. This is a fine book, full of interesting and thoughtful material. But it's lengthy, about as long as *Human Action*. It is a history woven around a presumption that societies are arenas of continuing contestation, which I find far more appealing and enlightening than presumptions grounded in concord and the placidity of equilibrium where everything of interest is an injection into rather than a feature of the conceptual framework that the analyst is using.

6. Norbert Elias, *The Society of Individuals*. Elias was a sociologist from the early to middle 20th century who worked with notions of spontaneous order (which have been pretty much absent from sociology for a good half-century, though a revival seems in the offing), and who was deeply thoughtful about the reciprocal character of the I-We relationship. He is best known for *The Civilizing Process*, which is much longer and which is a spontaneous order treatment of the evolution of manners. Elias was displaced to London in the 1930s, where he roomed with Asik Radomysler, who died way too young, having published but one paper, in *Economica* in 1946, and which I commend strongly to all of you.

7. Ernest Gellner, *Conditions of Liberty: Civil Society and its Rivals*. This book advances a concept of civil society as a form of human governance, and which he contrasts with three other forms of governance. In 1944, Abba Lerner

published *The Economics of Control*, and contemporary public finance has developed mostly as exercises in the economics of control. My alternative vision is a public finance of liberty or civil society, as sketched in Chapter 8 of DDD and in contrast to the widespread treatment of a public finance of control.

8. Jane Jacobs, *Systems of Survival: A Dialogue on the Moral Foundations of Commerce and Politics*. This book unfolds as a dialogue among several characters over the claim that human action and social life involves a continuing contest between two moral syndromes, which she labels as commercial and guardian. She also explores what she calls “monstrous moral hybrids” where the syndromes commingle.

9. Mitchel Resnick, *Turtles, Termites, and Traffic Jams*. Resnick argues that people are overly eager to attribute what they sense to be orderly patterns to some source of organizing power. He describes this willingness as “the centralized mindset.” This centralized mindset is at work in political economy and public finance. It appears most prominently when theorists attribute collective outcomes to a median voter. It is through trying to articulate an enterprise-based public finance that I am seeking to escape the centralized mindset.

10. Thomas Schelling, *Micromotives and Macrobehavior*. This has become an iconic work on how macro-level patterns can emerge that can provide no information about the underlying micro-level actions or preferences that generated those patterns. Most economic theory reduces macro to micro by invoking equilibrium and a representative agent. Schelling sketches an alternative program of emergence-based theorizing, and Resnick proceeds in this framework.

11. David Primo, *Rules and Restraint: Government Spending and the Design of Institutions*. This book treats government not as an acting entity whose actions reflect some objective function but as a process of interaction among many participants where the course of that interaction is shaped by some framework of governing rules. This framework fits well my enterprise-based orientation toward public finance, particularly with its focus on process and not equilibrium states.

12. Walter Hettich and Stanley Winer, *Democratic Choice and Taxation*. This book seeks to explain tax structures as equilibrium responses to competition among politicians and parties within a framework of probabilistic voting. While this framework does not mesh well with my enterprise-based framework, it does raise interesting questions worth further thought about taxation as providing the means by which the fiscal commons is stocked.