Introduction

> "*There is now widespread agreement that countercyclical discretionary fiscal policy is neither desirable nor politically* feasible" *(Martin Eichenbaum (1997*)).

The Study of the public Sector is the domain of Public Finance, or as it has become known in the 20th century as Public Economics. Whether one calls it public finance or public economics, the ingredients are the same. The study entails a description of instruments under the disposal of governments in the nation states, with the stated objectives of addressing "macro" problems such as unemployment, stability of the macro-economy and the "optimal" allocation of society's resources between private use and public use.

Every text book of Macroeconomics, especially introductory texts, devotes at least one chapter of the book to the study of the public economy. Beginning students of economics are acquainted with the public sector instruments, such as taxes, transfer payments and expenditures, including the so called the "multiplier" variable at the introductory level of their study of macro-economics. At this level students are not particularly made aware of the public economy as a separate, although intertwined, entity in the nation's economy. Government's tools are viewed as exogenous variables (taking as given) to analyze their impact on macro or micro variables. The public debt, an instrument of the public economy, rarely appears as a variable in the study of the macro economy.

Several introductory macro-economic texts however, have dealt with the public economy as a separate but integrated entity of the private economy. In building a macro economy model, even at its simplest level, specifications of the public sector instruments were needed to analyze policy impact, using the "multiplier" concept, on national income and its growth path. Beyond descriptive analyses of the public sector tools: government spending, taxes and transfer payments, and the underlying multipliers, the typical macroeconomic text does not dwell on the public economy. The student however is made aware of the link between public sector instruments and the future path of the economy. Tax cuts and an increase in government spending raise national income. On the other hand, a tax increase and or a cut in government expenditures would have the opposite effect. The public debt and its accumulation especially as related to the aggregate economy may or may not be an issue to be addressed at the introductory level.

The dominance of the "Keynesian's" theory of employment (Keynes 1936) in older versions of macro-economic textbooks had the effect of putting "fiscal" policy on the economist's map. Students of macroeconomics learned about discretionary fiscal policy as well as automatic stabilizers as part of a study of the time path of the aggregate economy. Discretionary fiscal policy requires positive actions; changes in fiscal instruments such as taxes and expenditures, whereas automatic stabilizers are built into the economic system structure.

Beyond the undergraduate level of the study of economics, students are made aware of the public sector as a separate structure with a whole body of knowledge developed to analyze its instruments as well as its impact on the national and the international economies.

In late 1950's and in the 1960's whether at the undergraduate or graduate levels, the study of the public economy took on a life of its own. Students of economics as well as political science were apprised of the public economy in that it is a "fixture" of the world we live in. Once society has organized itself around groups to transact goods and services among themselves, the need of a super structure outside of the individual was needed to smooth out the functioning of the new structure, address communal as distinct from individual needs, and safeguard against a predatory behavior of a minority at the expense of the majority. This new structure has become known as the "public economy". The economic and social science literature going back to the 19th century is our guide to the study of public finance, especially its major ingredient, "fiscal policy". It was evident from early on in the 20th century, that one could not fully appreciate the development or the role of the public sector and the use of its instruments without knowledge of developments in other fields of study.

A most significant development that had a lasting impact on the study of the public economy is the emergence of a competing view of society following the publication of James Buchanan and Gordon Tullock, the Calculus of Consent (1965). This path breaking study in the field of public choice, have had a major effect on the study of the public sector. Since that time, the study of public finance has been augmented with the study of public choice. In the public choice school of thought, the tools of analyses common to the study of the public sector, taxes and spending, that are akin to understanding the public sector behavior have been supplanted by the study of rules in the context of social choice.

Looking back at the historical development of the field of public finance, one event stands out—the publication of Richard Musgrave (1959), The Theory of Public Finance: A Study of Public Economics. Following Musgrave's comprehensive exposition of the public economy, the public finance field gained prominence in the social sciences. Musgrave's theory divides the study of the public sector according to the tasks it performs. Hence, three functions were highlighted: the provision of goods, "Public" goods and "merit" goods, and secondly, the use of a set of instruments; taxes and transfer payment to affect the distribution of society income. The third function is one where the government relies on its instruments, purchases and taxes to stabilize the aggregate economy. This third function is what is known as fiscal policy.

In its simplest description, fiscal policy is a study of the interrelation of the private and the public economy. Its focus is on smoothing out the path of the national economy during "booms" as well as "recessions". As the world became more and more integrated, a nation's economic prosperity or decline, had repercussions outside its sphere of influence, it became evident, that fiscal policy pursued by one nation was no longer confined within its national borders. Hence, public finance had to address the "spillover" effects associated not only with national economic events but also with the fall out of policy pursued by members of the world economy.

The study of fiscal policy has dominated both the fields of public finance and macroeconomics, thanks to Keynes's (1936), The General Theory of Employment, Interest and Money. Keynes contribution to the study of fiscal policy and the field of public finance is undoubtedly attributed to his policy prescription as to the use of fiscal instruments to stimulate the aggregate economy during recessions. Keynes, advocacy of the use of fiscal policy to smooth out the path of the aggregate economy became established, as a macro policy for the nation. Hence, public policy; taxes and spending were viewed as essential tools to stabilize the macro economy.

To review the development of public finance and the use of public sector instruments to affect the path of the aggregate economy, one is well advised to start with Musgrave's study of the public economy. In his Theory (1959), Musgrave laid out the key functions of the state and the principles that ought to guide its operation. He divided the fiscal function of the state into: allocation, distribution and stabilization. The third function, stabilization, is commonly referred to as fiscal policy; it is designed to influence the path of the aggregate economy. Accordingly, when the economy is below its full employment or growth path, fiscal policy would call for tax cuts, or increases in government spending financed by debt. These acts were referred to as the stabilization role of the government.

With the emergence of the Public Choice School following the publication in 1965 of Buchanan- Tullock's Calculus of Consent, and, the stellar rise of monetary economics; monetary policy actions, especially the setting of interest rate, became the dominant features of macro policy. In lieu of budget actions to deal with the state of the economy, all eyes and ears turned to the actions of the Federal Reserve's interest rate policy. Nonetheless, and especially in the past ten years or so, fiscal policy has seen a revival, both in academic research and for its use as an instrument of public policy. The task of this volume is to provide a modest Journey through the history of economic thought on compensatory fiscal policy.

The Book is organized as follows: Chapter 2 provides a historical review of the development of a theory of the public economy. The review begins with the writing of the classical economists of the 19th and the early 20th century, whose views provided the foundations of the modern theories of the public economy. Chapter 3, put forth the ingredients of modern theories of the public economy, notably Musgrave's Theory of Public Finance (1959), and Buchanan- Tullock's The Calculus of Consent (1965). Chapter 4 offers a description of the public economy of a nation (using the U.S. as an illustration) and identifies the tools that are used to accomplish the nation's objectives. These objectives are more or less universal to the conduct of governments; the provision of goods and services that are not provided by the private economy, insuring an equitable distribution of the national income, and through the use of its fiscal instruments insure the stability of the aggregate economy. Chapter 5 puts the public sector of a nation in the context of the global economy. In this chapter recognition of spillovers from one economy to the rest of the world, and how these spillovers affect a nation' public sector's activities are incorporated. Chapter 6 presents a summary of empirical findings reported in recent studies on the use of public sector instruments, especially the effectiveness of the so called "automatic stabilizers". Chapter 7 revisits the alternative model of the public economy—the Buchanan-Tullock model to inquire as to whether its framework of analysis of the public economy makes room for an active rather than a passive fiscal policy. Chapter 8 provides the author's assessment of the role that fiscal policy would likely play in the 21th century, as a stabilizing tool for the macro-global economy. As such an assessment must be based on forecasts of the path of the national and the international economies; it should be viewed as tentative at best. The final chapter, chapter 9 is the conclusion.