Summary: CIGS Professor Jay K. Rosengard Seminar
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Background of the New Edition of "Economics of the Public Sector"

I would like to discuss the fourth edition of "Economics of the Public Sector," which Professor Joseph Stiglitz and I co-authored. This is probably the world's bestselling public finance textbook. Although I do not have physical copies of the book with me, The Canon Institute for Global Studies will be on the top of my list. My talk comes at a time when the US economy is recovering and improvements have been achieved in areas such as asset values and the unemployment rate. By contrast, Europe has demonstrated the folly of austerity politics in a recession. Abenomics is being closely watched. As an aside, the book's cover depicts Congress being thrown a life jacket.

Regarding the background of the book, the first edition was published in 1986, the second edition a few years later, and the third edition was released in 2000. The first three editions were written solely by Professor Joseph Stiglitz and I co-authored the fourth edition with him. The new edition was updated to include changes in global and domestic economics and finance, wars, healthcare systems around the world, and higher education. The new edition also reflects changes in the business model for textbooks and the publisher, W. W. Norton & Company, has tried to make it more accessible. The publication process took six years.

Joseph Stiglitz is a professor at Columbia University and a 2001 Nobel Laureate in Economics. Professor Stiglitz has served on the US Council of Economic Advisors, the World Bank, and the United Nations. For the new edition, I worked with Professor Stiglitz to learn from the recent global financial crisis about how to mitigate the effects of the next crisis. Although the fourth edition is still focused on the US, the book places the country in a much more comparative perspective with other countries. The edition has been restructured and updated with new case studies. The fourth edition also includes an updated Instructor's Manual and incorporates new technology.

Selection of Examples from "Economics of the Public Sector"

The new edition reexamines some of the fundamental assumptions on economic theory based on current research findings and empirical experience, such as the tragedy of the anticommons. The well-known tragedy of the commons refers to the depletion of common resources by individuals acting according to their own self-interest. The common response to this was conversion of common resources to private property or external regulation. Nobel Prize-winning economist Elinor Ostrom revisited these solutions because they sometimes have a negative impact, illustrated by the tragedy of the anticommons originally laid out by Michael Heller. Professor Ostrom's work introduced a third alternative, suggesting the use of community social capital to provide solutions to managing common properties.

Biomedical research also yields relevant examples, including the patenting of genes, which could lead to excessive private ownership and disrupt their benefits for the common good. Similarly, there is a new concept of global public goods related to coping with problems like public health crises, security threats and terrorism, human trafficking, and global warming. Although a country's government can regulate public resources domestically, some problems extend across national boundaries. There are not enough international institutions with the authority to deal with these transnational changes.

Another example is rooted in basic public finance and the tradeoff between allocative efficiency and social equity in estimating the optimal marginal tax rate. The basic theory states that high marginal tax rates cause inefficiency and a slowdown of economic growth. However, a move away from marginal tax rates can cause concentrations of wealth due to rent-seeking, best exemplified by the financial sector during the recent global crisis. Professor Stiglitz calls this the exploitation economy. This has led to the new conclusion that higher marginal tax rates on wealth accumulated through rent-seeking would improve allocative efficiency and equity.

One more example is the Great Gatsby Curve, which looks at intergenerational transmission of inequality. Popularized by Alan Kreuger, the Great Gatsby Curve plots the Gini coefficient, a common measure of inequality, against intergenerational income elasticity. The closer the coefficient is to 1, the more unequal the society. The US coefficient stands at above 0.4 and Japan's value is probably lower. The Great Gatsby Curve for the US shows that there is a disturbing link between intergenerational income elasticity and income inequality, which means that poverty is being transmitted from generation to generation. This inequality is now a hot topic because it is getting worse. This is also an issue in middle-income countries, such as countries in Southeast Asia, where more people are coming out of poverty but the gap between the rich and poor is growing.

The third edition discussed government failures, such as rent control in New York City. The policy tried to provide affordable housing to low-income families but took away the incentive for landlords to invest in housing. Many countries also create agricultural price supports, such as rice in Japan. Changing tastes have created decreased demand for rice but farmers are still encouraged to grow it, making this an expensive policy. Some of this research came from The Canon Institute of Global Studies.

Behavioral economics shows that some individuals do not actually work in their best interest and that perceptions are more important than facts. An example of this is savings programs in the US that appeal to common enthusiasm for discounts or special sales, such as IRAs. In addition, popular perceptions of inequality fueled by the mass media can be more powerful than neutral data.

Managerial capitalism describes when value is maximized for a company's management rather than the shareholders. The concept can explain the behavior of senior managers, who sometimes prioritize short-term interests over the long-term to increase their direct compensation. I would like to point out that although what I am saying may seem provocative, I am making my comments in a constructive manner.

Real-World Applications of Economic Theory

I will now discuss applications of economic theory in the real world, focusing on the appropriate role of the public sector in the context of a crisis. One side says the problem is the government and the other side says the short-term solution is government. Although the US did not enact austerity politics like Europe, it did enter into two long and expensive military engagements. The cost of the wars has been gravely underestimated, which Professor Stiglitz and Professor Linda Bilmes examined in "The Three Trillian Dollar War." One costly factor that is left out of the estimates is long-term care for returning soldiers.

The first edition of "Economics of the Public Sector" had more information on pre-expenditure analysis over post-expenditure analysis. Countries and organizations need to examine how to get more value out of the money they already have. An example of a solution is CompStat, which uses data to create better management and allows evaluation of the value received for public money. Another example is the Affordable Care Act, which targets the 40 million members of the working poor who were previously not covered under any healthcare.

Another interesting example is conditional cash transfer programs or contingent welfare programs. Instead of giving unconditional cash transfers like in the US and Japan, these programs try to catalyze behavioral changes and give people the tools to be independent.

Good tax administration is another example, with some tax systems serving as "incubators of corruption." Case studies from the IMF also show that austerity programs in already shrinking economies often lead to contraction by reducing incomes and raising unemployment.

I have also collected data from the IMF and the World Bank concerning spending priorities around the globe, revenue from goods and services taxes, and general government debt. The US prioritizes spending on healthcare and defense, gets comparatively little revenue from goods and services taxes, and does not see an equivalent return on its high education spending. Japan has a very high general government debt and a high GERD (gross domestic expenditure on research and development).

I will conclude with information on the e-book version available for the fourth edition. It can be viewed on any device and allows digital mark-up and sharing. There is also an updated instructor's manual.

Q&A Session

Question 1: Can you please elaborate on allocative efficiency and finance concerning issues such as education, healthcare, and security? I would also like to point out that China is famous for its violations related to the tragedy of the commons.
Answer 1: The value for money is of upmost importance, including performance-based contracting and social impact bonds. The costs are easier to identify than the benefits. I disagree about China. Medical benefits to society are as important as encouraging innovation and investment in research and development.

Question 2: Can you please elaborate on the Great Gatsby Curve and Japan?
Answer 2: Japan has a lower Gini coefficient than the US but has shown movement towards inequality.

Question 3: Has Japan's preference for equality slowed the growth brought on by economic reform?
Answer 3: I am not an expert on Japan but I would like to point out that some countries that place a premium on equity, such as countries in Scandinavia, have achieved faster rates even with aging populations.

Question 4: Can you please talk about Japan's structural reform? Could the

centralization of research and development by the government lead to growth in Japan?
Answer 4: Reform is very difficult in all countries because changes lead to winners and losers. Regarding the centralization of research and development, it could lead to growth if it was designed in a way that prevented rent-seeking. The best time to enact change is during a crisis.

Question 5: Can your book teach the Japanese government how to move forward?
Answer 5: Not entirely because it is not really a textbook on monetary policy. Although explaining the economics is simple, the politics are complex. There are many brilliant economists in Japan, including those at the Ministry of Finance and the Bank of Japan, but Japan will have to wait for the next crisis for a change.

Question 6: Can you please elaborate on Japan and its money supply situation?
Answer 6: Quantitative easing is not sustainable.

Question 7: Can you please compare Japan’s situation and the imminent crisis in Europe and protests over austerity plans?
Answer 7: Japan is different from Greece because it fully controls its currency. Greece lost monetary policy when it joined the Eurozone but Japan still has full control over its fiscal and monetary policies.

Question 8: The third edition of the book is not useful for solving Japan’s issues. In addition, the Japanese translation is not good.
Answer 8: I was told this.

Question 9: Can you please go into detail on government debt and Japan?
Answer 9: There is no iron rule for debt and it really depends on the country. There are both good and bad things in the new Japanese budget. However, despite improvements, the budget will be financed with new debt. By contrast, in the US a case can be made for increased debt to fund basic infrastructure investments.

Question 10: Have you referred to Thomas Piketty? Has his new book been translated into Japanese?
Answer 10: Piketty is kind of a rock star of economics. His new book is a bestseller and it focuses on inequality. It has been translated into Japanese.