REVIEW

New Public Economics

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Modern Public Economics by Raghbendra Jha; Routledge, London and New York, 1998: pp. xv + 549, name and subject index provided, £60 (hardback), £18.99 (paperback).

MODERN Public Economics is written as a text aimed at graduate and upper undergraduate students of economics. It is very comprehensive, covering almost all the theoretical literature on this important subject (right up to journal articles in1996!) and is written in an intuitive and user- friendly manner.

The book is organised into five parts. Part I consists of three chapters and covers some basic tools of welfare economics. Chapter 1 discusses and elaborates on some well known and important results in consumer behaviour that are in public economics. These include the Slutsky Equation, Roy’s Identity, the Envelope Theorem and the like. Chapter 2 discusses Paretian welfare economics with and without certainty. The first and the second theorems of welfare economics are discussed with clarity. Contingent and non-contingent market solutions in the case of uncertainty are worked out. Chapter 3 presents a cogent analysis of social welfare functions. Topics covered include social indifference curves, inconsistencies in democratic aggregation, and empirical social welfare functions. There are excellent discussions of Arrow's Impossibility Theorem. Gibbard's Oligarchy Theorem, Sen's Impossibility of a Paretian liberal as well as the informational limitation of the Arrowian framework. Part I would be an excellent review of welfare economics in itself for courses other than Public Economics.

Part II consists of three chapters. Chapter 4 is a detailed account of the effects of Externalities and various corrective mechanisms. Bilateral and multilateral externalities, market and non-market solutions are all discussed with clarity. Chapter 5 discusses pure public goods and chapter 6 covers various topics in the theory of public goods. Topics covered include crowdable and non-crowdable public goods, marginal cost of public funds, the free rider problem and market and non- market based solutions thereto, the theory of clubs and the Tiebout hypothesis.

Part III devoted to the theory of taxation is the largest section of the book. Chapter 7 discusses the effects of taxation on savings decisions both within traditional and more recent versions of the life cycle model as well as non-life cycle models. Empirical evidence on the effects of taxation on saving is also discussed. Chapters 8, 9 and 10, respectively, discuss the effects of taxation on labour supply, investment and risk-taking. Both theoretical aspects as well as empirical evidence are discussed. Some policy issues that are relevant to improving the rate of saving and investment are also taken up. After examining the incentive effects of taxation, Jha turns his attention to tax incidence. Chapter 11 discusses tax incidence in static models. Various versions of the general equilibrium model of taxation including those with recent work on involuntary unemployment: regulation and computable general equilibrium models are discussed. Chapter 12 discusses tax incidence in dynamic models. Tax incidence in exogenous and endogenous growth models and the choice between tax and debt as instruments for financing public expenditure is discussed. The Ricardian Equivalence Hypothesis is discussed as are the new life cycle models of consumption behaviour. Chapter 13 examines standard elasticity type results in commodity tax theory. These include Ramsey and Corlett-Hague rules. Redistributive indirect taxation and the limits to such redistribution are all lucidly discussed. There is an exhaustive discussion of the Value Added Tax (VAT) as well. Chapter 14 discusses direct taxation and its information-theoretic foundations. Optimal non-linear as well as linear taxation along the lines of Mirlees-Phelps-Stiglitz are carefully analysed. Chapter 15 discusses important topics in taxation such as tax evasion, time inconsistency of optimal tax policy and the like whereas chapter 16 is devoted to a discussion of tax reform.

Part IV discusses applied problems in public economics. Chapter 17 is an exhaustive discussion of pricing in the public sector. Efficient and redistributive public sector pricing and their relation with commodity taxation are discussed. Peak- load pricing as well as pricing of joint products are discussed. Chapter 18 discusses the new and rapidly expanding area of the international aspects of taxation. Chapter 19 concerns itself with cost-benefit analysis and rules thereof.

Part V is devoted to fiscal federalism. Chapters 20 and 21 discuss principles of sharing economic power between different levels of government as well as the design of optimal grants. Each chapter is conveniently preceded by a list of key concepts and there are some excellent suggestions for readings at the end of each chapter. There is a name index as well as a subject index, an exhaustive bibliography and some really interesting problems for students to work through.

The short description above suffices to show that the book is very exhaustive in its coverage. Indeed one would be hard pressed to identify any areas in public economics that the book has not touched. Almost everywhere the exposition is lucid. An additional attractive feature of this book is that it goes through all the details of algebraic derivations so that there are no ‘missing steps’ for students and teachers to work through. These 'missing steps', one knows all too well, make journal articles and even texts such as Myles (1995) hard to read. Jha's book fills an important lacuna from the point of view of students who have had to work through texts with incomplete proofs of involved theorems and professors who have had to step in to workout these proofs in detail. Wherever possible this algebra is supplemented with well-drawn diagrams and intuition. Almost all of the important literature in public economics is covered within this book. A book such as this was sorely needed.

One of the most important characteristics of this book is that it successfully bridges the gap between the old and the new branches of public economics. It is easy to appreciate the shift-that has occurred in public economics through a caricaturisation of the monumental text. Musgrave (1959). In Musgrave's book the role of the public sector revolves around the notion of 'market failure', especially that arising from the free rider problem associated with public goods and other problems that stand in the way of full implementation of the Second Classical Theorem of Welfare Economics. There was a Stabilisation Branch entrusted with pursuing Keynesian fiscal policies. The Distribution Branch was kept separate from the Efficiency Branch. But government could not be perfect either because it could not avoided imposing distortionary taxation to raise revenues. The only non-distortionary taxation was lump sum taxation which was infeasible. This led to the design of second best policy rules which were highly complicated.

Vickrey (1961) and others had attempted a kind of solution to the free rider problem. But soon there was a realisation that not much more could be done with it unless the problem of incentive compatibility was finally tackled. This had to wait until the monumental work of Mirrlees (1971) who for the first time laid down the ground rules for optimal taxation when agent characteristics were unobservable. It turned out that (his work completely changed the way the profession thinks about not just taxation, but public intervention in the operation of the market mechanism in The challenging task before a contemporary text is to convey the movement from the old to the new public economics in a manner that will enthuse and motivate the students. This is a subtle task and Jha has accomplished this admirably: much more so than the other recent text in public economics, Myles (1995). Whether it be the theory of public expenditure in the form of the theory of clubs or provision of public goods by government funded agencies (chapter 6), or the theory of optimal taxation in static and dynamic settings (chapter 15), or the theory of tax reform (chapter16), or public sector pricing (chapter 17), or fiscal federalism (chapters 20 and 21), the impact of the transition from the old to the new public economics is very clearly worked out by Jha. This same clarity extends to the discussion of international aspects of taxation in chapter 18. Indeed, if one has to look for one single text to understand the complexity of the movement from the old to the new public economics, at present there is nothing better than Jha's book. Myles' book falters in that it treats public economics more as a branch of economic theory than as a discipline in its own right. Thus, for example, Myles is overly concerned about theorems and less about their applications in the public sector. Furthermore, these theorems are not all completely proved and each such proof has 'missing steps'. Jha's book, on the other hand, is quite conscious of the implications of public economics for public policy. But at no point does he abandon rigour. He proves all important theorems very carefully and thoroughly and at the same time brings out, in a succinct manner, their implications for public policy.

No doubt, graduate and upper undergraduate students of public economics everywhere will welcome this book. Even policy-makers and almost anyone else wanting to familiarise themselves with recent developments in public economics will find this book indispensable. It has the potential of becoming the standard reference in public economics just as Atkinson and Stiglitz (1980) was more than a decade ago. It is hard to pick faults and shortcomings in this book but one that does come to mind is that there is very little discussion of the public economics related problems of developing countries. For an Indian audience this would be relevant. But including this would have made the book very unwieldy. As it is, the book is very long. And, in any case no one should underestimate the necessity of Indian students learning good public economics theory. Having learnt the theory they can think of applications to India. In the meantime, maybe, Jha will come out with a text on public economics for developing countries just as he has for macroeconomics [Jha 1995].

Modern Public Economics is an excellent and exciting book and belongs on the bookshelf of every serious student of the effect of state intervention in the market place. It would be particularly important for university departments in India to make the transition to teaching modern public economics, particularly when they have such a comprehensive text as Jha's to teach from A thorough study of this book will not only give students an excellent introduction to the subject but will also enable them to read the current literature on public economics in a meaningful manner. No doubt this will help improve standards of research in public economics as well as public policy-making in India.

References

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