Comments to S J Bailey article on REPUL

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1. The issue dealt with by SJ Bailey in his article "Structural gaps in public finances: causes and remedies" and published in the Journal of Local Public Economy is important not only in regard to the finances of developed countries (DC) but also in one way for all countries. Economic theory, both for DCs and LDCs implies what the author calls the NeoLiberal thesis, but I believe that some countries would be better suited to the liberal perspective as long as they have developed their institutions and these have been endogenized.

The author tries to explain two central aspects. Firstly, that the damage of finances is structural. Secondly, that it is partly due to the logic of neoliberal policies to maintain the production of social services, *ee* the welfare state in countries with a democratic capitalism and with well established and strong institutions. Despite the fact that one could be in agreement with several of his arguments in regard to the first, the second aspect is not well argued. This is not simply because of the neoliberal thesis, but rather because it is too simple faced with the complex problems of change and institutional change and the physical limitations of infrastructure. Let's look at this second aspect first.

At the outset the work is centered on Neo-Liberals and it could be superfluous to mention the other philosophical principles but the author does so in order to understand the context of public finances in different dimensions. It is good that he introduces the theoretical distinction by analyzing the philosophical basis of these theories and in this way it could be comprehensive if he incorporated as examples the approaches of Libertarians and Collectivists. But this would lead to too many theoretical and methodological questions. Hence the article only works by centering on those philosophical questions that the author calls Neo-Liberal thinking. What is emphasized in the article are non-analogous characterizations. These are non-ontological in complete form but do have an approach to which many authors of the methodology of economic science would call theoretical and non-theoretical theories. He groups this characterization into definitive characteristics, beliefs, general implications, implications for the public sector and implications for public finance. He describes non-theoretical principles, which should be reconsidered if one is to have a more rigorous criteria when describing the philosophy of public finance. The author carries out an important exercise in attempting to understand the differences between finances in different countries. Each characterization can be questioned although this might not be as important as comparing the three theoretical approaches. More important would be to analyze a single theoretical approach, as discussed below.

2. The term Neo-Liberal, which has been overemployed particularly by politicians and economists associated to Manichean perspectives, can be distorted leading to a sea of confusion. Many aspects attributed to the term which are not pertinent. Nevertheless

the author uses the term to differentiate it from nineteenth-century liberalism. The same concept of liberalism implies differences, not only in economics but also in other sciences and in the history of each region. The Liberalism of Adam Smith is concerned with individual freedoms (necessary to complete the argument of the concurrence) and deriving from this, the connection with what some called libertarians in the work of Friedrich von Hayek. The term acquires certain precision from the liberals and is focused on economic and political phenomena of the second half of the twentieth century. But it is too complex so as to be defined by only liberal political economists and classical economists.

This opens it up a space for theoretical and ontological approaches but also for analogies, which renders the definition of Neo-Liberal more difficult. A central aspect is the theme of efficient allocations that depart from competitive general equilibrium. This evolution can be traced back to León Walras in the 19th century, who helped embed concepts of neoliberalism in economic theories. Much of what is within the twenty-first century, is in regard to the -redesign of allocations- where not does one go to the market because it is neutral for private goods, but because the market is itself subject of design in order to operate for other goods. The question of the redesign of efficient allocations allows for the creation of a context, a space for various aspects of the economic theory in juxtaposition. Not only is the theme of distribution introduced but also this allows that the controversial question of productivities can be shared through a theory which gives priority to measurement: both from a neoclassical perspective and classical political economy. This implies in turn, a theory of price. That is to say, the -redesign of allocations- not only touches on distribution, a central theme of political economy and even post-Keynesian economists, but also allows the introduction of market neutrality. The former is possible not only because the economic theory of the general equilibrium of pure private goods does not explain firms, but also because it incorporates the costs of a third party in planning and the public sector. In this way the term neoliberal as such begins to be employed in regard to privatization processes at the end of the seventies and eighties, with the aim of introducing the market as a neutral regulator. This includes the sale of public sector assets, although this is not the case when the public sector gets involved in new activities with a high degree of risk, with a long-term view of potential privatizations. That is the logic, in as far as possible, in going to a redesigned neutral market, or else, another novel mechanism of computable simulation, which leads to reallocations. In this way, the focal point is not about individual freedoms outlined by the classic theorists but rather the dynamic allocations characteristic of the end of the end of the twentieth century where governments have a central role. Yet we can hardly termn this neo-classicism either.

From all this we can deduce what the term Neo-Liberalism has evolved and precisely what it is that it should mean. Hence how can you explain that the public sector gets fatter when there is a Neo-Liberal policy? There are many critics today who believe that these policies result in weaker national states without observing that the public sector has in fact increased as well Bailey analyses very well. This also implies a larger and more expensive Welfare State that does not result in increased productivity. In itself, this is a reassignment.

3. The 4E are an aspect that can be looked at ontologically. Rather than analyzing from the viewpoint of economic philosophy, we believe that it can only be dealt with by what the author calls NeoLiberalism. As mentioned in the previous paragraph, this is better conceived as the "redesign of allocations". Pragmatically this refers to the liberalism of the 20th century. Basically, this is where the analysis of public finances is centered. What is interesting is that the author emphasizes that it is very difficult to maintain the 4E. Nevertheless it is necessary to review each

one of them, in other words, the meaning of Efficiency, Equity, Economics and Effectiveness (4E). These are all concepts that derive from the analysis of the economy (and political economy). Another aspect is whether there is methodological inconsistency.

It is observed in Bailey's analysis that these 4E vary with time and in some cases one or other predominates. Returning to the category of Neo-Liberal, the question is to determine whether there are trade offs between them and whether the role of governments is to diminish them. It may be seen that when there are problems of finance, equity and inequality are affected negatively. This is not a new discussion from the perspective of political economy and the economy (based on efficiency). In this article what is analyzed is through the lens of public finance and in this way coins the term 4E. This can help to evaluate each E, or whether each E has the same strength in the economies of different countries and above all if this widens the spectrum beyond what refers to DC. For example, the E of Economy is not so clear, because all 4Es could be Economy. More definition is observed in Efficiency and Effectiveness, where one could observe a greater interrelation with the others. Effectiveness in countries that build their institutions with high transaction costs are in themselves a field for analysis of institutional change, especially in emerging economies close to DCs.

In regard to this same aspect, Effectiveness, the author is not particularly inclined to welcome technological change in the public sector. Nevertheless this could not only increase Efficiency and Effectiveness and improve the Economy (and possibly equity and inequality). In other words, the situation where the public sector should be responsible for technological unemployment is not observed by subsidizing it, unlike the private sector, which is ultimately an opportunity cost. However social welfare is expensive, the effect of technological change in the public sector would be at the expense of an increase in productivity with the enormous difference that if there be greater clarity in promoting technological change in this sector knowing that would increase productivity there would be a final outcome of a social state with better services. Although technological change is controversial, it should not be more in the public sector than in the private sector because at least in the first there is a certainty that there would be a benefit in the production of less expensive social services. This observation would not be possible if the author had omitted the nomenclature of the 4E. Indeed, this is an important subject to discuss in future seminars. Public finances would be modified by both sides in as much as tax resources would be increasingly precise and larger, as well as a more appropriate use. The author is of the opinion that priority should be given in studying how tax resources can be better obtained, rather than how to distribute these. This in turn is strengthened with technological change.

4. Moving on to structural differences, the author makes a clear distinction and well analyzes whether the state of public finances may be called structural in developed countries, principally those of the OECD. This is based on the fact that he does not acknowledge deficits and imbalances as temporary however as a growing trend. He points out that the growth of funds for financing from income taxes but which become depleted cannot grow indiscriminately. On the other hand, the demands of social contributions increase from 5 to 9% of the GDP as an average in the countries studied (OECD). This gap is structural since it cannot be corrected from one period to the next, and above all because it might affect political stability. That is to say, imbalances persist because agents opt not to change, even though this might not be recommended from the perspective of one of the 4E simply because political variables dominate. In consequence, a low

level growth is forecast in the majority of economies, which is in accordance with recent generations who do not yet understand the implications of a population growing faster than the economy. A case in point are those generations which were born and lived through galloping inflation at the end of the seventies and eighties of the previous century.

5. There may be discrepancies in regard to how imbalances are explained. Yet what may be discerned following the sixties and the deterioration of finances, that is to say imbalances in countries and how the sale of assets affects a short-term improvement (and then only in some economies). Of course, it is well illustrated how inequality may be improved with a social welfare economy which tries to sustain itself by modifying costs to produce social benefits, whilst searching for economies measures to support this. In regard to the latter, this includes searching for competitive markets and impeding that government transaction costs increase. This often takes place at the cost of deterioration in quality, at the same time that the idea persists that with the regulation and market design (and allocations) this can be maintained. This is the antithesis of the fundamentalist complaint, from our point of view it is a more refined conception of the design of reallocations.

The author captures the attention of readers thanks to his developed capacity and the clarity of his argument, as for example the way the financing of the public sector has developed. This is relevant for states that seek greater wellbeing for their economy, which cannot be financed by tax. From this perspective, the author offers various alternatives for financing the welfare state. What is required is greater flexibility in the public sector. However, the author does not analyze the reasons why the sector itself does not change which deals with political variables rather than pure efficiency.

6. It has to be pointed out that profit seeking activities which could be increased in countries which are not considered as LDC but rather closer to DC such as Mexico, Turkey, Brazil, Colombia, Argentina where the similarity of their economies differentiate them from India or China. In these economies, profit seeking activities in governments themselves and their agents are a greater obstacle for the redesign of allocations. This may be observed be in what the author postulates but owing to the fact that he focuses on developed countries, he does not analyze this, since he considers that government involvement would not be as expensive in relative terms as the economies of the aforementioned countries. Thus, the social cost of this management could be analyzed from the Coasean perspective.

7. Another aspect that is different in each country is the difficulty to satisfy the 4Es. This implies a deeper analysis because it is not a question of a simple trade off where what is lost is equity. We need to study in more thoroughly what is within the 4E, what is meant by the Economic and if this refers exclusively to the allocations of price and productivity. Neither to we observe in this part of the Economics whether he has incorporated the variables of politics and collective action, since these could rise to an improved guidance for efficiency and effectiveness.

Transaction costs in each country are different and one could talk of a kind of benchmark of government operating costs and in this way fit the design of policies to counteract rent seeking behavior. Little is spoken about this in the analysis; neither do the conclusions take this up. For example, it is taken for granted that the growth of the economies of developed countries engaged in maintaining the production of social welfare limits the ability to grow. This would imply having a reduced view of the causes of growth. Not necessarily the savings must be channeled to consumption but this can be at the same time the engine of growth especially for short periods. This can be said to be more Keynesian, but in the end in short periods, productivity can interweave and generate growth that increases the size, consumption and production of social services. Without describing it so starkly, a part of the demand analysis is brought back.

8. The author ends with checklist on how to improve finances. In my opinion, these can be rearranged and grouped. Others are more important for some economies, and others have a different time scale. The question is whether the author proposed a taxonomy of the methodology and then another 4E taxonomy, because it does not suggest a taxonomy for the recommendations.

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