POLICY REPORT

Volume I Number 10 — A PUBLICATION OF THE CATO INSTITUTE — October 1979

Limiting Government Budgets: The Misplaced Emphasis

by Richard E. Wagner

The continuing growth of government has led to numerous efforts to limit government budgets, with Proposition 13 in California being the most widely touted success.[1] While budgetary limits have so far been imposed only at the state and local levels of government, substantial efforts are under way to have them imposed at the federal level as well. The case for limiting government budgets rests on a presumption that there is a systematic tendency for budgets to become so large that they destroy wealth rather than contribute to its creation. The public sector becomes a negative sum element in the economy, in that the cost of government exceeds its value.[2]

Economic Disruption through Excessive Budgets

Modern scholarship has pointed out that one of the salient aspects of majority-rule democracy is the use of government as a vehicle for transferring wealth.[3] A majority is able to design spending programs so that they receive the dominant share of the benefits. Likewise, a majority is able to impose on others a dominant share of the taxes to finance those programs. The public sector becomes an arena in which contestants try to form winning coalitions in order to secure desired expenditure programs and to push the costs onto a losing minority. It might be thought that this tax-transfer process is only a zero sum transfer of wealth and not a negative sum destruction of wealth, for what is gained by the winners equals what is lost by the losers. There are several reasons, however, why this process will be negative sum. The increased tax burdens reduce the return per unit of effort or saving, with the result that less labor and saving will be supplied. Also, with a growing scope for acquiring wealth through transfers, resources will be shifted into the pursuit of transfers and away from the creation of wealth. Most schoolchildren have heard at one time or another that the way to attain economic success is to build a better mousetrap. However, economic success these days can also be attained by securing restrictions on the importation of foreign-made mousetraps, or by getting a safety commission to prohibit the manufacture of cheaper, less durable mousetraps that otherwise would offer competition. Any such shift of resources from pursuing the creation of wealth to securing (as well as guarding against) the transfer of wealth represents a negative sum destruction of wealth.

> **"The public sector becomes an arena in which contestants try to form winning coalitions in order to secure desired expenditure programs...."**

A negative sum growth of government takes place because this growth temporarily provides net benefits to a particular, controlling subset of the population. Winners on some occasions become losers on others, so ultimately most people become net losers. What makes the negative sum outcome possible is that individual citizens face no quid pro quo between taxes taken and services used. Substantial taxes can be extracted from some people even though they receive little in return. Others can lose little in taxation while receiving much in return. This absence of a quid pro quo relation is, of course, the opposite of what exists in a market setting. Indeed, it is the presence of this quid pro quo relation that creates the positive sum character of the private sector. Since transfers constitute theft, the pursuit of wealth is confined to the creation of wealth. For negative sum outcomes to be possible, the quid pro quo principle must be violated. This principle is violated in the public sector, which leads to a negative sum growth of government. Limiting the size of budgets would seem to be a step in the right direction.

The Illusion of Budget Limits

Because budgets are measurable, it would seem relatively simple to control government by limiting the size of budgets. This simple appearance, however, belies a complex reality. Limiting budgets may do little to limit government and the negative sum destruction of wealth it currently promotes. Because the budget power and the police power are substitutes for each other, there

(Cont. on p. 3)

Richard E. Wagner is Professor of Economics at the Virginia Polytechnic Institute and State University. He is Editor of *Policy Report*.

IN THIS ISSUE

EDITORIAL

A New Tax on Thrift?

by Richard E. Wagner

Starting January 1, 1980, the "carryover basis" rule —part of the Tax Reform Act of 1976—is scheduled to take effect. This rule will change the way in which capital gains on inherited assets are determined under the income tax. Before the 1976 legislation, when an inherited asset was sold, only the increase in value that occurred between the date on which the heir acquired the asset and the date on which he sold it was subject to capital gains taxation. Under the carryover basis rule, however, the heir's capital gain will be the entire increase in value from the time the decedent initially purchased the asset to the time the heir finally sold it. Suppose an asset purchased by a decedent for $50,000 and worth $250,000 at his death were sold by the heir for $400,000. Today the heir would pay a capital gains tax on the $150,000 of capital appreciation from the time he took possession of the asset. Under the carryover basis rule, the heir would be taxed on a capital gain of $350,000.

There are many reasons why the carryover basis rule would make a poor provision for our tax code. It would multiply the record-keeping requirements of tax administration, for it would become more difficult to determine and defend the basis value of assets. It would be a particular curse for families, especially those of moderate means who may own a home and small business but little else. Even at the present time, the surviving spouse must often sell such assets to pay estate taxes. The carryover basis will increase the capital gains tax associated with the liquidation of assets to pay estate tax, thereby intensifying the erosion of small wealth holdings. These days, moreover, much of any increase in value is due to inflation. There may be little increase in the real value of the assets, but enormous tax burdens can be imposed nonetheless, burdens that easily can and often do exceed 100 percent. Indeed, taxes can be imposed on what in real terms are actually capital losses!

Any taxation of capital gains discriminates against saving and capital formation. The carryover basis rule will compound the discrimination that already exists. The value of any asset is simply the capitalized value of the flow of income it can generate. If an asset yields a net income of $10,000 and if the interest rate is 10 percent, its capital value will be $100,000. An increase in capital value is, in turn, simply a reflection of an increase in the annual income yielded by that asset. For instance, should the net income rise to $15,000, the value of the asset will rise to $150,000. This $50,000 increase in the value of the asset does not represent income, but rather is merely a different way of saying that income has increased by $5,000 annually; it is simply a reflection of the increase in income. Therefore, to tax capital appreciation along with the annual income is to impose a double tax burden on saving. The trouble with such tax discrimination is that it undermines the efforts of people to save and thus provide the capital equipment that enables all of us to have higher material standards of living. In light of the prevalence in our economy of tax policies biased against saving and capital formation, the increasing stagnation of our economy is no mystery. The carryover basis, if it is allowed to go into effect, will increase this excess tax burden on thrift.

There are, however, hopeful signs, since many legislators, recognizing that the confiscatory taxation of wealth has been an important element in producing our deteriorating economy, are seeking to redress these past failings. A majority of senators and representatives have already expressed their desire to rescind the carryover basis rule. As the true nature of this rule comes to be understood more widely, congressional support for rescission should increase. Congressional opposition to rescission is led by Senator Kennedy and other tax reform zealots, for whom tax reform means the imposition of even heavier tax burdens. They were able to use the House-Senate conference committee to insert the carryover basis rule into the 1976 legislation.

It is to be hoped that President Carter will reverse his suggested veto of rescission, for the carryover basis can have no place in the tax code of a nation that professes to promote rather than to erode the wealth of its citizens. ■

Government budgets (Cont. from p. 1)

need be little if any relation between the size of government budgets and the extent of government control over the use of resources.

In colonial times roads were often built by requiring able-bodied men to donate some of their time to road construction. While highway budgets were small, the impact of government upon the use of resources was not much different from what it would have been if government had paid for construction labor with taxes. Similarly, there have been instances where wars were fought by means of government requirements that citizens provide their bodies, food, clothing, and weapons. Once again, government control over resources was secured with little budgetary outlay. Alternatively, education budgets could be practically eliminated by requiring parents to send their children to school for a stipulated number of years. Legislation and regulation can accomplish the same government control over resources as can be accomplished through budgets.[4]

The police power and the budget power are interchangeable means by which government can control the use of resources. Also, since the police power is not readily measurable, it cannot be easily limited. A prominent impact of budget limits will be an increased use of regulation to accomplish the same transfer of wealth from losers to gainers, which in turn will subvert the ability of budget limits to control the influence of government over the control of resources. Government grows because it is a vehicle for transferring wealth under present institutions, and budget limits do nothing to alter this reason for the growth of government. Placing a limit on budgets will intensify the use of the police power by majority coalitions to exploit the redistributive opportunities offered by the present institutional order.

"Limiting budgets may do little to limit government and the negative sum destruction of wealth it currently promotes."

Limits vs. Institutional Orders

Budget limits seem capable of conveying little more than the illusion of control. Effective control would require elimination of the reason for the growth of government. For this, we must look to changes in the institutional order within which budgets are made. Put differently, the growth of government is only a symptom, not a cause, of our economic deterioration. The cause of negative sum outcomes in the public sector is the absence of a quid pro quo relation between taxpayers and government. To deal effectively with the negative sum features of government, some type of quid pro quo relation must be established. Defective budgetary outcomes are a natural result of a defective institutional order, and effective reform must deal with these institutional defects. Otherwise, there can be no assurance that a budget limit would reduce the negative sum impact of the public sector, even assuming that a budget limit would not be fully offset by regulation. It is even possible that a budget limit would add to the negative sum aspect of the public sector. Even though existing budget levels contain costs in excess of benefits, it does not follow that a budget reduction made necessary by a budget limit would reduce costs more than benefits. This would follow only if all taxes and expenditures were reduced proportionately across the board. Otherwise, the tax reduction could encourage consumption still further, without reducing the burdens on saving and investment. Similarly, expenditure reductions could be concentrated in the relatively productive categories of government expenditure, leaving the especially unproductive categories untouched. It is not only the level of taxes and expenditures that matters; their composition also matters.

Morever, the selection of a budget limit requires knowledge of what constitutes a best-sized budget. It is not sufficient merely to argue that a budget in which federal expenditures are 27 percent of personal income is too large, so that the imposition of a lower limit would be a movement in the right direction. It is necessary to know, or profess to know, the best-sized budget. Without this knowledge, there is no

(Cont. on p. 4)

POLICY REPORT

Published by the Cato Institute, *Policy Report* is a monthly review that provides in-depth evaluations of public policies and discusses appropriate solutions to current economic problems.

Subscriptions and correspondence should be addressed to: *Policy Report*, Cato Institute, 1700 Montgomery Street, San Francisco, California 94111. The annual subscription rate is $15.00 (12 issues). Single issues are available for $2.00 per copy.

ISSN: 0190-325X

Government budgets (Cont. from p. 3)

basis for knowing that the cut is not too severe. Suppose the limit is set at 20 percent. Without knowledge as to what constitutes a best-sized budget, it cannot be said that the 20 percent limit is an improvement over the absence of a limit. If the best-sized budget is 18 percent, a movement from 27 to 20 percent is obviously a move in the right direction. However, to be able to make this judgment, it is necessary to know what the best-sized budget is. And if this is known, why settle for an inferior limit? What if the best-sized budget turns out to be 24 percent? A budget that is too small at 20 percent may be worse than a budget that is too large at 27 percent. Once it is recognized that there is no such thing as objective knowledge as to what constitutes a best-sized budget, it is impossible to say whether a budget limit would represent an improvement. Is there not a paradox here? On the one hand, there are institutional reasons why the public sector engages in negative sum policies, which suggest an overexpansion in the scope of government control over resources. On the other hand, it is impossible to say whether a budgetary limit would lead to an improvement because there is no objective basis for saying what constitutes a best-sized budget. Fortunately, there is no paradox here, as a simple analogy can show.

What would be the best-sized budget for a winery? An answer to this question would, of course, also require apportionment among such categories as reds, whites, and fortifieds, including in turn apportionment of the red wine budget among such types as Cabernet Sauvignon, Pinot Noir, and Beaujolais. To be able to answer this question would require, among other things, omniscience about such things as the states of mind of all potential customers and coming developments in all the technological circumstances regarding the production and marketing of wine. The impossibility of acquiring such knowledge is, however, no cause for alarm. The central contribution of economics is an explanation of how, within an institutional order characterized by profit and loss and freedom of choice, the process of competition among firms for the favor of customers leads to outcomes in which the budgets of firms can be said to tend to be the best-sized.[5] Within this institutional order, the knowledge that a winery's budget was too small would be produced as a result of running out of wine before more became available. Consequently, prices could rise to

> **"...tax finance cannot generate the knowledge that can only be produced through choice and that makes possible the dominance of positive sum outcomes."**

ration the supply, and the resulting increase in profit would create an incentive to expand the budget (output). Similarly, knowledge that a budget was too large would be provided as a result of the accumulation of unsold inventory. With losses being made, an incentive would exist to reduce the budget (output). The knowledge necessary to determine the best-sized budget for a winery, or for any other firm, cannot be attained independently of the actual outcomes of the market process. Nonetheless, the existence of an institutional order based on profit and loss and freedom of choice makes it possible to infer that best-sized budgets will tend to be chosen. The reason is that this institutional order generates the knowledge necessary to determine whether budgets are too large or too small on the one hand, and creates an incentive to act upon this knowledge on the other hand. While the best-sized budget for a firm is not an objective piece of data, the potential for analysis is not destroyed, but rather is only shifted to a consideration of the institutional order within which economic action is taken. The same limitations, and opportunities, are present in the public sector; the best-sized budget cannot be calculated, but the ability of different institutions to yield such a budget can be assessed.[6]

Pricing and Positive Sum Government

Taxes and prices have generally been viewed simply as alternative sources of revenue. Actually, they form the basis for two starkly contrasting institutional orders. Pricing forms the basis of the market economy, since it determines the level at which the budgets of different firms are financed. Pricing, of course, implies freedom of choice, and it is pricing, in conjunction with profit and loss (residual claimancy), that creates the positive sum character of the private sector. The reason for this, as noted above, is twofold: *Knowledge* as to effective courses of action is generated, and an *incentive* to act upon this knowledge is created. While pricing characterizes the private sector, there is also much scope for introducing this entrepreneurial principle into the public sector. Indeed, it is only through the introduction of this principle that an institutional order for the public sector can be created in which negative sum tendencies are brought under control.

Since taxes are extracted by compulsion, tax finance cannot generate the knowledge that can only be produced through choice and that makes possible the dominance of positive sum outcomes. Even if such knowledge were somehow magically present to be utilized in a taxing system, which could never happen, the incentive to do so would be weakened by the absence of residual claimancy. Besides preventing knowledge, tax finance also weakens incentive, for any profit or loss is diffused generally over the entire taxpaying population rather than being concentrated on some responsible decision-makers. Profit and loss or residual claimancy

is a corollary of pricing, just as nonownership or common property is a corollary of tax finance. In tax finance, revenues become common property, in this case created by compulsory transfers from taxpayers. Democracy becomes a process by which people fight for shares in this common pool on the one hand, and fight to have the revenues extracted from others on the other hand. In other words, democracy becomes an arena in which there is a zero sum struggle for shares in the common pool created by taxation, which is itself the outcome of a similar struggle. The resulting outcome, however, is negative sum because of the resulting disincentives to production and the incentives to shift resources from seeking the creation of wealth to seeking the transfer of wealth. Since individual "contributions" to the common pool of revenue bear no relation to budgetary outcomes, the central budgetary problem necessarily becomes one of dividing this pool among citizens through a contest of power. As a consequence of this war among contending factions, the total amount of wealth declines relative to what it would have been. As principles of economic order, taxing is to pricing as common property is to private property. In this light, proposed budget limits can be seen as analogous to restrictions placed upon the amount of water that can be taken from a common pool, or on the number of cattle that can be grazed upon a common pasture. And just as ownership rights are superior to a restriction-bound, common property order, so the development of an entrepreneurial order within the public sector offers an alternative to budget limits within the context of tax finance.[7] Indeed, the development of such an entrepreneurial order offers the only effective way of addressing the institutional defects that promote the negative sum outcomes within the public sector.

A description of such an institutional order cannot be undertaken in the short space remaining here. Actually, many approaches are possible, and much room exists for further examination. One approach to the development of an entrepreneurial order was articulated by Knut Wicksell.[8] While recognizing that tax finance inherently creates a negative sum public sector, Wicksell suggested an approach to an entrepreneurial order based on choice and prices, which, however, retained the outward semblance of tax finance. Wicksell recognized that the negative sum outcomes could be curtailed only by injecting a quid pro quo basis into the public sector. To this end he suggested that, ideally, majority rule should be replaced by unanimous consent, which would create in the public sector the same framework of price and choice as exists in the private sector. Believing that it would be exceedingly difficult actually to secure unanimous consent because any recalcitrant person could prevent action, Wicksell went

(Cont. on p.7)

INFLATION MONITOR

A regular feature of *Policy Report*, the "Inflation Monitor" reports on the effects of inflation as a monetary phenomenon and demonstrates its distorting influence on the structure of relative prices in the economy.

	PERCENTAGE CHANGE (ANNUAL RATE)			
	Latest 1 month	Latest 3 months	Latest 6 months	Latest 12 months
M-1	14.5	11.0	4.3	4.7
M-2	14.1	11.3	6.5	7.3
M-3	11.9	9.1	6.9	8.3
PRICE OF GOLD	79.2	60.6	74.9	52.7
CPI-URBAN WAGE EARNERS	11.7	12.7	13.5	11.1
COMMODITIES, LESS FOOD	15.7	15.0	13.9	11.6
FOOD	2.0	7.3	12.1	9.9
SERVICES	12.5	13.1	11.8	10.5
FINISHED GOODS	6.2	10.2	10.5	9.6
CONSUMER GOODS, FOOD	−14.5	−10.9	3.7	6.8
CONSUMER GOODS, NON-FOOD	16.6	16.3	14.6	11.9
CAPITAL EQUIPMENT	6.1	9.3	9.5	8.8
PRODUCER PRICES, BY STAGE OF PROCESSING				
COMMODITIES				
Crude materials, non-food	39.1	20.2	24.2	21.9
Intermediate materials, less food	11.6	14.3	13.9	11.6
Capital equipment	6.1	9.3	9.5	8.8
Consumer finished goods, less food	16.6	16.3	14.6	11.9
FOOD				
Farm products	−14.2	−3.3	14.5	11.1
Consumer foods	−14.5	−10.9	3.7	6.8

All figures are taken from the *Chartbook on Prices, Wages, and Productivity* (U.S. Department of Labor), *Monetary Trends* (Federal Reserve Bank of St. Louis), and the *Wall Street Journal*.

✓ Washington Update

✓ Defense is crowding inflation and energy for top priority on Capitol Hill. The SALT II Treaty, Soviet combat troops in Cuba, and registration for the draft have all sparked intense debate on both sides of the Hill.

The House debate on draft registration (which the President can resume anytime he desires) was both acrimonious and lengthy. The House overwhelmingly defeated registration and chose instead to mandate a presidential study of registration for both military and civilian service. Chances are that registration will not be brought up again until after the elections next November, unless an international crisis occurs before then.

✓ This Congress isn't exactly doing nothing, but it is doing less than the 95th Congress. By the time they adjourned in August, Representatives had introduced 5,922 bills and Senators 1,963, which amounted to 36 percent fewer than last Congress. Out for the entire month of August, Congress will also be in recess during the first week in October. Its scheduled adjournment date of October 20 has been pushed back to Thanksgiving at the earliest, and Christmas at the latest. So far, the Senate has put in 31 percent fewer hours than in 1977, and the House, which never meets as much as the Senate anyway, 5 percent fewer hours.

✓ The long session is the result of the major backlog of bills facing Congress: the SALT II Treaty, President Carter's energy program, the second budget resolution (Congress has already missed the statutory dates for passing that), a congressional pay raise, gas rationing, an increase in the "temporary" debt ceiling of $99 billion (enough to last beyond the next election, it is hoped), the creation of a Department of Education, 10 major appropriations bills, the Panama Canal Act, the windfall profits tax, and the Alaska lands bill. Congress is acting sluggishly, presumably because most of its members are not disposed to vote in accordance with the wishes of their constituents.

✓ Tip O'Neill is going ahead with plans to tighten the House procedure in order to eliminate "dilatory" tactics by House members. The Democratic Steering and Policy Committee, headed by O'Neill, will assign priorities to legislation. The House Rules Committee, whose members are appointed by O'Neill, will start to assign to bills rules that would eliminate some debate.

✓ Kennedy's energy plan, with a price tag of $58 billion over a 10-year period, is attracting more attention in the Senate. Its big feature is conservation, not production. The "Energy Productivity Act" would give grants to homeowners and renters for insulation, and loans to owners, developers, and builders of commercial property. Anything Kennedy does is worth watching now.

✓ Speaking of loans and grants, the House Public Works Committee has reported a bill to authorize the Economic Development Administration to give grants to local economic development commissions in order to purchase equity stock in local businesses. Another proposal that will be scheduled for hearings by a subcommittee of the House Small Business Committee is a bill to permit the Small Business Administration to make loans to small newspapers and other publishers.

✓ A tax cut is increasingly unlikely this year unless the recession deepens quickly. It is much more likely next year, either in the form of an income tax cut or a social security tax cut, since next year is an election year. When Congress passed the massive social security tax increase in December 1977, it programmed the major increases to occur in years following election years. The increase that will occur in 1980 social security taxes is small compared to the massive jump scheduled for 1981, but it may still be enough to provoke action on a tax cut. Look for the Congress to try to substitute new or larger taxes for the ones being cut. One proposal gaining support is the value-added tax. One good feature of the VAT, according to its proponents, is that it will reach even those who now make up the so-called underground economy.

✓ The appointment of Charles Duncan to be Secretary of Energy has led to the Pentagonization of the DOE. Duncan has brought with him many aides from the Defense Department—a move that will hasten the blurring of the roles, which are already considerably vague, of the two departments. DOE runs so-called defense-related energy research projects, and the DOD has been increasingly put in the position of guinea pig for the synthetic fuels programs. An amendment to the major defense authorization bill directed the Secretary of Defense to use gasohol wherever possible. Rumor has it that South Africa, which leads the world in synthetic fuel production, uses natural fuels in its defense systems because of the unreliability of the synfuels.

✓ Did you work last week? How long did it take you to get to work? How many bathrooms do you have? Do you have a full kitchen? How well do you speak English? What were your utility bills last year? How many babies have you had? How many marriages? Those are questions that appear on the long form of the 1980 census, which about 20 percent of the people who complete census questionnaires will receive. For refusing to answer, they may be fined $100. For giving incorrect answers, $500. For giving incorrect answers with the intention of causing an inaccurate enumeration of the population, $1,000 and/or one year in prison.

Government budgets (Cont. from p. 5)

on to suggest that a degree of consent on the order of 75 to 90 percent would be reasonable and effective. Related to this proposal, Wicksell suggested that any proposal for government expenditure would require the sponsors also to propose a means of paying for the program. And approval of the budgetary proposal would require a high degree of consent to ensure the quid pro quo nature of the transaction. In this way, the scope for tax-transfer politics would be greatly reduced, and with it most of the basis for negative sum outcomes in the public sector would vanish.

The approach suggested by Wicksell is not, it might be noted, the only way to alleviate the institutional incongruity that creates the clash between democracy and prosperity. Other approaches are also possible, all of which would in one way or another introduce prices and residual claimancy into the public sector.[9] Within such an alternative institutional order, the distinction between the private sector and the public would lose much of its significance. These sectors are presently organized according to different institutional principles, which gives importance to this distinction, but it need not be this way. The most important institutional choice seems to be not between the private sector and the public, but between an institutional order that is consistent with the positive sum creation of wealth and an order that allows a negative sum destruction of wealth. The former requires some form of pricing and residual claimancy, though whether certain services were provided privately or by government would then be largely inconsequential. What would be important would be not the relative sizes of the private and public sectors, but the extent to which our institutional order promotes rather than hinders the creation of wealth. At base, whether one advocates budget limits or fundamental institutional reform depends largely upon whether one sees the conflict between prosperity and democracy as an inherent aspect of democracy or as the result of a particular, modifiable institutional order. If the former, the only hope for reducing the negative sum outcomes lies in attempting to restrict the range of political action, though, as explained above, such efforts seem to a large degree doomed to futility. If the latter, the pursuit of interest in the public sector becomes more harmonized with the pursuit of interest in the private sector, with both tending to promote the positive sum creation of wealth. The latter approach would seem to offer the only true hope for attaining a congruence between prosperity and democracy.[10]

FOOTNOTES

1For a general survey of evidence on the growth of government, see G. Warren Nutter, *Growth of Government in the West* (Washington, D.C.: American Enterprise Institute, 1978).

2See, for instance, Richard E. Wagner, "The Antisocial Activities of the Public Sector," *The Banker* 125 (December 1975): 1503–11.

3The revival of interest in these properties of democracy is probably most directly attributable to Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Row, 1957); James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962); and Mancur Olsen, Jr., *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

4For an examination of a variety of illustrations of the use of legal requirements as substitutes for budgetary magnitudes, see Murray L. Weidenbaum, *Government-Mandated Price Increases* (Washington, D.C.: American Enterprise Institute, 1975). The price of automobiles, for instance, was increased by about 10 percent through government regulations. Alternatively, the equipment required by the federal regulations could have been provided through the federal budget. The allocative impact is essentially the same in either case, though the measured budgetary magnitudes and, hence, the measure of the relative size of government differ according to the method used by government to influence the allocation of resources.

5On this point, see Friedrich A. Hayek, "The Use of Knowledge in Society," *American Economic Review* 35 (September 1945): 519–30.

6See Roland N. McKean, "Divergence between Individual and Total Costs within Government," *American Economic Review*, Proceedings, 54 (May 1964): 243–49; and idem, *Public Spending* (New York: McGraw-Hill, 1968), pp. 10–30.

7For a general contrast between private and common property (ownership and nonownership), see H.S. Gordon, "The Economic Theory of a Common-Property Resource: The Fishery," *Journal of Political Economy* 62 (April 1954): 124–42.

8Knut Wicksell, "A New Principle of Just Taxation," originally published in 1896, and translated and reprinted in *Classics in the Theory of Public Finance*, ed. Richard A. Musgrave and Alan T. Peacock (London: Macmillan, 1958), pp. 72–118.

9For a contrast between sovereignty and proprietorship as alternative principles for organizing a community, see Spencer H. MacCallum, *The Art of Community* (Menlo Park, Calif.: Institute for Humane Studies, 1970).

10For a perceptive treatment in a historical context of some of the issues surrounding different institutional orders for the public sector, see Jurgen Backhaus, "The Tax State and the Entrepreneurial State: A New Look at an Old Question," University of Konstanz, 1979. More general issues are addressed in Jürgen Backhaus and Richard E. Wagner, "Finanzpolitik in der Demokratie: Eine neo-cameralistische Einschätzung der Zeitgenössischen Haushaltswirtschaft," University of Konstanz, 1979.

"To be governed . . ."

It's enough to make you sick

"Jere Edwin Goyan, dean of the school of pharmacy at the University of California at San Francisco, has been appointed Commissioner of Food and Drugs, it was announced today [Sept. 8]....

"As Commissioner, Dr. Goyan will regulate all foods except red meat and poultry; all medicines, including veterinary drugs; cosmetics; medical devices; vaccines, and radiation-emitting products like microwave ovens and television sets.

"Of every dollar spent in the United States by consumers, 25 cents goes for a product regulated by the agency."

—*New York Times*, Sept. 9, 1979

Next, we audit the tooth fairy

"The New York State Department of Taxation and Finance has cracked down on a small businessman upstate who wasn't paying his quarterly sales taxes.

"It required a letter of warning. And two tax agents were sent to his home.

"But he paid up: all 64 cents due.

"It seems that the culprit, 12-year-old Jody Gerard of Eddyville, N.Y., had been selling fishing worms out of his backyard for 35 cents a dozen—and hadn't bothered to keep a ledger, file quarterly reports or collect and remit the 7 percent state and local sales taxes.

"'It seems funny now, but in the beginning I was mad—you wouldn't believe how mad I was,' said Jody's mother, Lynette Gerard. 'He was sick for a week. Migraine. He thought they were going to come and take away his bicycle and his dinghy for the taxes.'"

—*New York Times*, Aug. 25, 1979

The FICA Bandita

"Illegal aliens are helping to save the social security system from bankruptcy. According to one 1976 study, they contribute at least $500 million a year to the social security trust fund, with little or no chance of collecting."

—*The Washington Monthly*, September 1979

Or disband the Border Patrol

"According to the Congressional Budget Office, Social Security is paying out benefits faster than it is collecting taxes. Unless it wishes to risk a fiscal emergency in 1983, Congress must promptly take one of two courses: authorize new revenues or trim benefits."

—*New York Times*, Sept. 4, 1979

Sell a Chrysler horror story, get a check!

"The Chrysler Corporation's urgent plea for $1 billion in Federal aid, coupled with warnings that economic disaster is at hand, has a familiar ring in auto industry circles.... Indeed, at least twice in recent years, amid similar rumors of bankruptcy and impending doom, Chrysler unsuccessfully lobbied Congress for tax relief of various sorts.

"'Other auto manufacturers have a fall clearance,' a rival auto executive scoffed recently, 'but Chrysler follows a different strategy: Instead of trying to move customers into its showrooms, it keeps trying to move part of the Treasury to Detroit.'"

—*New York Times*, Aug. 17, 1979

Man bites dog

"A judge... upheld New York City's year-old 'pooper scooper' law, saying that dogs are not exempt from regulations that 'afflict mankind as fleas afflict beagles.'"

—*Los Angeles Times*, Aug. 9, 1979

Just like in the first 10 or 11 months

"'We were looking around madly to spend $30,000,' said the middle-level Federal bureaucrat. 'We did it in a lot of questionable ways, and then, apparently because we were so successful, we were asked to spend another $80,000 more.'

"The bureaucrat, who asked not to be identified, was describing what he called the 'worm's eye view' of his agency as the bureaucracy rushes to pump out funds before Oct. 1, the end of the fiscal year.

"At a higher level, former Treasury Secretary W. Michael Blumenthal recalled in an interview today [Aug. 15] that in the last month or two of the fiscal year 'you are literally pushing money out the door with a wheelbarrow.'"

—*New York Times*, Aug. 16, 1979

POLICY REPORT
1700 Montgomery Street
San Francisco, CA 94111

FIRST CLASS
U.S. POSTAGE PAID
PERMIT NO. 65
PALO ALTO, CA 94303

CATO INSTITUTE