European Roots

Memorial Speech for Richard Musgrave

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Memorial Church, Harvard University

Dear Peggy, dear family members, dear friends and colleagues of Richard,

I have come to commemorate Richard Musgrave

- because he was the honorary president of the International Institute of Public Finance,
- because he was one of the godfathers of the Center for Economic Studies and the CESifo Research Network,
- because I learned Public Finance from his writings,
- because he became a personal friend

and, above all,

- because I want to pay tribute to one of the greatest minds of our economics discipline.

Let me express my deep condolences to you, Peggy. That Richard has gone is a loss for us all, but you have lost the man with whom you shared your life, with all its joys and sorrows, successes and failures. We are all grateful to you for giving Richard the strength and intellectual stimulus that kept him active into old age and for taking care of him.

You asked me to speak about Richard’s German academic roots, as others will review his life in America. I am happy to do so, as Richard built a bridge between German public finance theory and Anglo-Saxon market theory over which many important ideas have been transported in both directions.

Richard Musgrave is among the most prominent examples of the intellectual exodus from Germany and Austria after Fascism came to dominate Germany and Hitler’s brown-shirt hordes started to trample down the values of humanity. As you know, most of the emigrants were Jews as well as left-wing and liberal intellectuals. The list of famous emigrants is endless, including many economists such as

Joseph Schumpeter, Gerhard Colm, Gottfried Haberler, Friedrich von Hayek, Walther Lederer, Fritz Machlup, Ludwig von Mises, Walter Roskamp and Wolfgang Stolper. In total, about 200 academic economists emigrated at the time. 120 of them came to the United States, and one of them was Richard.

Richard Musgrave was a political refugee, and then again he was not. He went to Rochester in the Fall of 1933 with an official stipend of the German Student Exchange Service which he had been awarded the year before. He did have a return ticket. However, when he realized how things were developing in his home country he decided to stay where he was.

Richard was born in 1910 in Königstein, a small, wealthy town in the hills north of Frankfurt, and he grew up there. While half of his ancestry was Jewish, he was brought up as a Christian. His family had a strong intellectual tradition with close ties to English literature. You will hear about that in detail from Richard's nephew later on.

At the age of 14, Richard Abel-Musgrave, as his German name was at the time, was sent to Landschulheim am Solling, a prestigious private boarding school in northern Germany, because his mother had died. Although Richard did not like the school, he undoubtedly underwent a tough training programme ranging from poetry to natural sciences that gave him the intellectual foundation for his later life.

After having received the German Abitur, at that time a school-leaving degree obtained by less than five percent of his age group, he began to study economics at the University of Munich in 1930. Although he was more interested in skiing than in the subject, as he once told me, he did get a good introduction to economics. He attended the lectures of Adolf Weber and Otto von Zwiedineck-Südenhorst.

Adolf Weber taught macroeconomics, Zwiedineck-Südenhorst taught the marginalist theories of capital and distribution of Eugen von Böhm-Bawerk. Richard spoke of Zwiedineck with the highest esteem.

To commemorate Richard's Munich connections from that time and also the great help he later provided when the Munich based CESifo research network was founded, I am glad to inform you that CESifo has just decided to institute an annual *Richard Musgrave Visiting Professorship*.

Although I come from Munich, I must admit that Richard's studies became more serious after he switched from Munich to Heidelberg, with a short intermezzo in Exeter, England. In 1933 he obtained his Diplomvolkswirt degree, which is something like an MA in economics. In Heidelberg he was most influenced by Jakob Marschak, Alfred Weber and Otto Pfleiderer.

Jakob Marschak then was a young junior professor who taught the theories of John Maynard Keynes. That Richard included stabilization besides allocation and distribution in his list of state functions can be attributed to this early influence as much as to the later contacts with Alvin Hansen at Harvard.

By the way, as Richard said during the celebrations of his nineteenth birthday in Munich, the idea of separating the functions of the government into an allocation, distribution and stabilization branch had come to him after the war, on an official mission to Germany in the early 1950s. The article spelling out these functions, which bore the title "A Multiple Theory of Budget Determination," was published in German *Finanzarchiv* in 1957, the world's oldest public finance journal.

When Richard came to Heidelberg, Alfred Weber, the brother of famous Max Weber, was 64 years old. He had written a ground-breaking book on economic location theory, but he also had written books on the role of culture in economics and on public finance. Alfred Weber was a liberal who identified himself with the democratic values of the Weimar Republic, which had been created after World War I, and he was opposed to the Nazis. Richard witnessed when Alfred Weber tore down the Swastika flag raised by the SA on his institute and evicted the Nazis from the building. The opposition cost Weber and his assistant Otto Pfleiderer their jobs in 1934.

Richard often praised the liberal values of the Weimar republic, and throughout his writings he showed the social democratic attitude that had characterized that regime. Alfred Weber and Otto Pfleiderer had personalized the virtues of that state more than anyone else in Richard's life.

He considered their writings highlights of the new wave of public finance writings that had emerged in the second half of the 1920s, resuming, as he said, *"the great tradition of the 1860s to '90s when German public finance had been at its height." "Following decades of passivity, the traditional German concern with fiscal theory had again* *blossomed, public finance was a hot topic, and I was the fortunate beneficiary of that revival,”* he asserted.

Among those who had established the tradition were Emil Sax and Adolph Wagner, both of whom discussed the notion of public goods, which became so important for Richard’s writings.

Sax, a young professor from Prague, argued in his 1887 book on the theory of public finance that the tax bill for satisfying community needs should be allocated to individuals such that everyone pays what the public services are worth to him. This was the first attempt to conceptualize the doctrine of public goods from an individualistic point of view, as we are used to doing today. However, the language Sax used to make his point was rather philosophical, and with today’s eyes his book is difficult to read.

Wagner, a professor of Public Finance in Berlin, was clearer. He was one of the German Socialists of the Chair, or Kathedersozialisten, as they were nicknamed, who had prepared Bismarck’s social reforms. His 1893 book “Finanzwissenschaft” laid the foundations of public finance of his time and established the field. Wagner was important for Richard’s work because he already had a coherent notion of public goods (Gemeingüter). This becomes clearest in his 1893 *Foundations of Political Economy* (Grundlegung der politischen Ökonomie) where he defined public goods by the principles of non-excludability, joint consumption, non-rivalry and the impossibility of private provision. However, unlike Sax, he did not attribute the actual or optimal volume of public goods to individual preferences and negotiations, but rather held an organic view of the state, i.e. of a state which holds communal preferences that are not just aggregated from individual preferences, as so many of his German predecessors had also done.

Although Richard did not endorse this view, he recognized Wagner's extensive contributions frequently in his writings. And even the organic view of the state shines through in Richard's theory of merit goods.

This theory was often discarded by contemporary economists whose thinking was based on the principle of methodological individualism. However, it is now finding surprisingly strong support in the new field of behavioural game theory, which demonstrates that people indeed need guidance and that one of the functions of the state might be to provide it.

Nevertheless, for the narrower problem of public goods provision, the intellectual breakthrough came with the Swedish authors Knut Wicksell and his student Erik Lindahl, who wrote two important books in German language on the issue in 1896 and 1916 respectively. Richard was most impressed by Knut Wicksell, who developed a view of the state as resulting from a voluntary contract between the individuals and which helped these individuals solve the collective choice problem. Lindahl even tried a formal solution of the implementation problem for public goods, taking up the views of Wicksell and Sax. His vertical aggregation of individual demand curves for public goods formally came very close to the theory Richard presented in his 1939 QJE article “The Voluntary Exchange Theory of Public Economy” and to what today is called the Samuelson condition for the optimal provision of public goods.

As you know, Richard extended the positive side of the Lindahl solution in his QJE contribution, and Paul Samuelson gave Lindahl’s solution a normative interpretation. While the normative interpretation stands firmly on the ground that Paul Samuelson prepared, we know today that Lindahl’s solution was not fully incentive compatible, inducing people to misrepresent their true preferences. The true incentive-compatible solution of the implementation problem was not found until Clarke and Groves published their articles on mechanism design in the 1970ies.

To what extent Richard's positive theory will succeed in explaining what is actually happening remains to be seen. As you may know, in 1998 we had a full week of debates on that theme in Munich between Richard Musgrave and Jim Buchanan, between the European social democrat and the dyed-in-the-wool Southerner. David Warsh, the editor of the *Economic Principles* weekly, argued, quote, that these *"lectures are the most important delivered at the University of Munich since the great Max Weber gave his farewell addresses on politics and science there in 1918"*, unquote. (I am afraid that David Warsh may not have known enough about the numerous Nobel prize winners of Munich's natural science faculties that have lectured there in the meantime, but I agree that these were indeed outstanding lectures.) You can still watch the lectures as high-definition videos on the CESifo website, by the way.

Apart from further developing the theory of public goods, it was

Richard Musgrave who set the stage and defined the topics of public finance. He was too modest when he claimed that he just transported prior knowledge over the bridge he had built across the Atlantic. His writings were clearer and at the same time more comprehensive than those of his predecessors. And he added many themes that previously were not considered, including the built-in flexibility of the tax system, taxation and risk taking, the balanced budget multiplier, fiscal federalism, fiscal competition, inter-generation equity, pay-as-you-use, deadweight loss and what have you. He was able to systemize the topics with his three branches of government activity and helped us understand the diffuse reality of the state in a way that is comparable to how Adam Smith helped us understand the market.

For this he would have amply deserved the Nobel prize. I confess that I am one of the disappointed 80 German public finance professors who had proposed Richard Musgrave in vain to the Nobel prize committee some years ago.

While he did not receive the Nobel prize, no less than 6 universities decided to award him honorary doctorates, among them the universities of Heidelberg (1983) and Munich (2001), the two universities that share the privilege of having been his alma mater.

Richard did not know about the endeavours of his admirers, contenting himself with his research and the fact that the economy consisted not only of markets, let alone efficient markets, which would have made public finance superfluous. With his subtle humour he remarked in an interview he gave to Karen Horn from *Frankfurter Allgemeine Zeitung* shortly before his passing, I translate: *"I am thankful to the heavenly powers – whichever they are and if they exist at all – for having created the markets together with the market failures".*

Richard Musgrave fascinated hundreds of thousands of students throughout the world with his writings about market failure and government functions, and he effectively passed the baton to thousands of them in their research, which he himself had received from his intellectual predecessors in Europe.

Perhaps this was also because Richard admitted frankly that behind his objective reasoning there were strong political convictions. I cite this text from his Harvard Dissertation submitted in 1937. It is the mission statement which many economists of my generation, including myself, adhered to.

"Unlike some economic purists of today, I admit to more than a scientific motivation. Intelligent and civilized conduct of government and the delineation of its responsibilities are at the heart of democracy. ... This is why the field of public finance has seemed of particular interest to me; and this is why my interest in the field has been motivated by a search for the good society, no less than by scientific curiosity."