The Collected Works of
James M. Buchanan

VOLUME 8
Democracy in Deficit

James M. Buchanan and Richard E. Wagner,
Big Sky, Montana

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The Political Legacy of Lord Keynes

James M. Buchanan and
Richard E. Wagner

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Foreword

Democracy in Deficit, by James M. Buchanan and Richard E. Wagner, represents one of the first comprehensive attempts to apply the basic principles of public choice analysis to macroeconomic theory and policy.[1] Until the 1970s, macroeconomics was devoid of any behavioral content with respect to its treatment of government. Government was simply treated as an exogenous force ($\overline{G}$), which behaved in the way prescribed by a given macroeconomic theory. In this approach, government invariably acted in the public interest as perceived by the host theory. Both the so-called Keynesian and monetarist approaches were beset by this problem, although it was the inherent contradictions of the Keynesian theory that attracted the attention of Buchanan and Wagner.

Democracy in Deficit led the way in economics in endogenizing the role of government in discussions of macroeconomic theory and policy. The central purpose of the book was to examine the simple precepts of Keynesian economics through the lens of public choice theory. The basic discovery was that Keynesian economics had a bias toward deficits in terms of political self-interest. That is, at the margin politicians preferred easy choices to hard ones, and this meant lower taxes and higher spending. Thus, whatever the merits of Keynesian economics in using government fiscal policy to "balance" the forces of inflation and deflation and employment and unemployment in an economy, its application in a democratic setting had severe problems of incentive compatibility; that is, there was a bias toward deficit finance. And, of course, there is no need to reiterate here the evidence in the United States

1. James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977), volume 8 in the series.

and elsewhere for the correctness of the Buchanan insight on Keynesian economics. It is all too apparent that the thesis of this book has been borne out.

Democracy in Deficit led the way to modern work on political business cycles and the incorporation of public choice considerations into macroeconomic theory. For example, there is a literature today that discusses the issue of the time consistency of economic policy. Does a conservative incumbent who cannot stand for reelection run a deficit in order to control spending by a liberal successor? One can easily see the hand of Buchanan in such constructions. In this example, term limits (a public choice phenomenon) are at the center of a macroeconomic model.

Moreover, monetarism has not escaped the inspection of public choice analysis. Buchanan and others have pioneered work on the behavior of fiat money monopolists. This public choice work stands in stark contrast to earlier work by Keynesians and monetarists who supposed that economists stood outside and above politics and offered advice to politicians and central banks that would be automatically adopted. Otherwise, policymakers were misguided or uninformed. If they knew the right thing, they would do the right thing. This approach to macroeconomics is now largely dead, thanks to books like *Democracy in Deficit.* Today, the age-old adage that incentives matter is heeded by macroeconomists, and it is recognized that political incentive—not the ivory tower advice of economists—drives macroeconomic events.

Democracy in Deficit is also closely related to Buchanan's interest in fiscal and monetary rules to guide long-run policy in macroeconomics. Such rules are needed to overcome the short-run political incentives analyzed in this book and to provide a stable basis for long-run economic growth. Buchanan's lifelong dedication to the goal of a balanced budget amendment to the United States Constitution and to a regime of monetary rules rather than central bank discretion can be seen in this light.

The real alternative to fiscal and monetary rules is, after all, not the perfection of economic policy in some economic theorist's dream. It is what the rough and tumble of ordinary politics produces. The problem is to find a feasible solution to long-run economic stability and growth. Viewed in this way, there is really no conflict between rules and discretion, and, thanks in part to Buchanan's insistence on this point, the world today seems poised to have more rule-based economic institutions. *Democracy in Deficit* is but one of Buchanan's many intellectual efforts toward this end.

Robert D. Tollison
University of Mississippi
1998

Richard E. Wagner

The analytical core of the argument in *Democracy in Deficit* is simple and straightforward. Indeed, the argument is perhaps the single most persuasive application of the elementary theory of public choice, which focuses primary attention on the incentives faced by choosers in varying social roles.

Richard Wagner and I did not sense any purpose of the book beyond that of laying out the elementary propositions along with the implications. Wagner, as colleague and coauthor, was helpful in placing the concept into its history-of-ideas context, and in his continued insistence that even the simplest arguments must be elaborated to be convincing to skeptics.

Neither Dick Wagner nor I suffer fools gladly, but without our mutually enforcing constraints, a book by either of us would have surely lapsed too readily into polemics.

James M. Buchanan
Fairfax, Virginia
1998

Preface

The *economics* of Keynes has been exhaustively discussed, in the popular press, in elementary textbooks, and in learned treatises. By contrast, the *politics* of Keynes and Keynesianism has been treated sketchily and indirectly, if at all. This is surprising, especially in the light of accumulating evidence that tends to support the hypotheses that may be derived from elementary analysis. Our purpose is to fill this void, at least to the extent of initiating a dialogue. We shall advance our argument boldly, in part because our central objective is to introduce a different aspect of Keynesianism for critical analysis. Those who feel obligated to respond to our prescriptive diagnosis of economic-political reality must do so by taking into account elements that have hitherto been left unexamined.

The book is concerned, firstly, with the impact of economic ideas on political institutions, and, secondly, with the effects of these derived institutional changes on economic policy decisions. This approach must be distinguished from that which describes orthodox normative economics. In the latter, the economist provides policy advice and counsel in terms of preferred or optimal results. He does not bother with the transmission of this counsel through the processes of political choice. Nor does he consider the potential influence that his normative suggestions may exert on the basic institutions of politics and, through this influence, in turn, on the results that are generated. To the extent that observed events force him to acknowledge some such influence of ideas on institutions, and of institutions on ideas, the orthodox economist is ready to fault the public and the politicians for failures to cut through the institutional haze. Whether they do so or not, members of the public "should" see the world as the economist sees it.

We reject this set of blindfolds. We step back one stage, and we try to observe the political along with the economic process. We look at the *political* *economy.* The prescriptive diagnosis that emerges suggests disease in the political structure as it responds to the Keynesian teachings about economic policy. Our specific hypothesis is that the Keynesian theory of economic policy produces inherent biases when applied within the institutions of political democracy. To the extent that this hypothesis is accepted, the search for improvement must be centered on modification in the institutional structure. We cannot readily offer new advice to politicians while at the same time offering predictions as to how these same politicians will behave under existing institutional constraints. By necessity, we must develop a positive theory of how politics works, of public choice, before we can begin to make suggestions for institutional reform.

In our considered judgment, the historical record corroborates the elementary hypotheses that emerge from our analysis. For this reason, we have found it convenient to organize the first part of this book as a history of how ideas developed and exerted their influence on institutions. We should emphasize, however, that the acceptability of our basic analysis does not require that the fiscal record be interpreted in our terms. Those whose natural bent is more Panglossian may explain the observed record differently, while at the same time acknowledging that our analysis does isolate biases in the fiscal decision processes, biases which, in this view, would remain more potential than real.

Some may interpret our argument to be unduly alarmist. We hope that events will prove them right. As noted, we are pessimistic about both the direction and the speed of change. But we are not fatalists. This book is written in our faith in the ability of Americans to shape their own destiny. We hope that the consequences predicted by the logic of our argument will not, in fact, occur, that our conditional predictions will be refuted, and that institutions will be changed. Indeed, we should like to consider this book to be an early part of a dialogue that will result indirectly in the destruction of its more positive arguments. We offer our thoughts on Keynesianism and the survival of democratic values in the hope that our successors a century hence will look on the middle years of the twentieth century as an episodic and dangerous detour away from the basic stability that must be a necessary element in the American dream itself.

Our analysis is limited to the impact of Keynesian ideas on the United States structure of political decision making. The "political legacy" in our subtitle should, strictly speaking, be prefaced by the word "American." We have not tried to incorporate a discussion of Keynesian influences on the political history of other nations, notably that of Great Britain. Such a discussion would be valuable in itself, and the comparative results would be highly suggestive. But this extension is a task for others; we have chosen explicitly to restrict our own treatment to the political economy that we know best.