

Rationality, Political Economy, and Fiscal Responsibility: Wrestling with Tragedy on the Fiscal Commons

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Abstract

The continuing budget deficits and accumulating public debt that commonly plagues western democracies reflects a clash between two rationalities regarding human governance: one of private property and its conventions and one of common property and its procedural framework. Democratic budgeting creates a form of fiscal commons whose governance is subject to the tragic outcomes depicted by Garret Hardin (1968). To be sure, tragedy can be avoided as Elinor Ostrom (1990) explains, but only to the extent that the fiscal commons is governed in a manner consonant with Antonio De Viti de Marco's (1936) model of the cooperative state. While the tragedy of the commons that results from this tectonic clash is an inherent feature of democratic political economy, that tragedy can nonetheless be limited through reasserting the conventions and institutions of a constitution of liberty.

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Modern democratic regimes are dominated by budget deficits and the accumulation of public debt. The European Union seeks to restrict its members to deficits that do not exceed three percent of GDP and to public debts that do not exceed 60 percent of GDP. When Greece's budget deficit exceeded ten percent of GDP in the summer of 2010, the American budget deficit was even larger. Deficits are prevalent in democratic budgeting; surpluses are rare. This bias toward budget deficits cannot be attributed to the complexity of public budgeting, even though such budgeting is complex. Complexity means simply that the estimates of revenues and expenditures on which budgets are based will be subject to error. But errors can be of two types. Where a balanced budget might be projected, the actual budget might turn out to be in deficit through some combination of revenues being less than projected and expenditures being higher. As a purely technical matter, however, it is equally likely that the actual budget could be in surplus through some combination of revenues being higher than projected and expenditures being lower. Technical complexity has nothing to do with recurring budget deficits.

If recurring deficits are not an accidental feature of the complexity of modern budgeting, they must be a *systemic quality* of democratic budgetary processes. This paper probes that systemic quality and locates that quality in a clash between two modes of rationality, with that clash generating a form of societal tectonics along certain fault lines within a society as conveyed by

Young's (1991) treatment of tectonic policies. What distinguishes governments from other corporate bodies is the attenuated form of property rights within which they operate. Ordinary corporate bodies operate within a framework of private property, wherein the actions of those bodies are limited by the superior property rights of the people who participate in those bodies. Within this institutional setting, those corporate bodies tend strongly to engage in what will be described below as responsible budgeting. In contrast, governments, especially national governments, operate within a framework of collective or common property, which means that the claims of private property are generally inferior to and give way to the claims of collective property. To be sure, this inferior status operates more fully at national levels than at local levels of government, and which works against responsible budgeting in any case.

This paper starts by contrasting formal and substantive orientations toward rationality in human action, and locates substantive rationality within the arena of practical action which, of course, is a quite different arena from that within which economic theorizing commonly takes place. Within this arena of practical action, all action, including so-called policy action, takes place at the micro level of society. The macro level is not a place of action but rather is a combination of statistics, projections, and ideologies. Within this framework of society as an ecology of plans, clashes between the two rationalities are sources of turbulence within societies. This turbulence is illustrated for credit markets, after which this orientation is extended to budgeting and public debt. Growing turbulence is a quality of the clash of rationalities, which makes it a systemic

feature of modern systems of political economy. That turbulence, moreover, cannot be eliminated but can only be mitigated through reestablishing conventions and institutions compatible with a constitution of liberty.

1. Two Rationalities for Human Governance

Economists typically work with a purely formal notion of rationality as conveyed by a pure logic of choice where agents are presumed to make consistent choices that maximize given utility functions. The growing interest among economists in behavioral ideas has maintained the purely formal characterization of rationality, only the behavioral literature has presented findings that individual action sometimes fails to conform to such rationality requirements. Despite these behavioral challenges, something like the purely formal notion of rationality is required to maintain the standard presumption that economic observations pertain to states of equilibrium. The macro-level presumption of equilibrium combined with the method of comparative statics requires event regularity as an implication of the equilibrium framework. Those event regularities in turn compel a framework of deterministic choice as characterized by the pure logic of choice. Hence, a set of particular theoretical presumptions fit together within a mutually reinforcing organon of thought, as Wagner (2010: 1-26) explains.

In contrast, I treat rationality as substantive and not merely formal. Rationality is concerned with the use of reason as a tool to operate successfully in the particular social area in which an actor is situated. Rationality thus pertains

to practical action as a logic of practice (Bourdieu 1990) as conveyed by the idea of praxis or praxeology. With respect to human practice there can be different rationalities, as illustrated by Alasdair MacIntyre's (1988) treatment of the contrasting rationalities of excellence and effectiveness, as well as by Robert Pirsig's (1974) charming treatment of a similar theme in *Zen and the Art of Motorcycle Maintenance*.

With respect to arenas of human practice, this paper treats commerce, politics, and the intersection of the two as conveyed by the hybrid term political economy. A logic of practice is still an abstraction from the practice itself, yet practitioners should be able to recognize some contours of his or her activities within the theoretical framework being presented. Such an approach to theorizing seeks to penetrate reality rather than to disengage from reality, to use a distinction that Elinor Ostrom used to describe her work when interviewed by Aligica and Boettke (2009: 142-59). Economics is thus the science that studies the practice of commerce and industry while political science is the science that studies the practice of governing. The compound term political economy would thus denote the practice of acting within the intersection of those two arenas. I should perhaps also note that the relevant human actions are not decisions as such but are transactions between or among people, which is reminiscent of Commons's (1934) treatment of a transaction as the basic unit of analysis and is conveyed also in Buchanan (1964).

These contrasting rationalities of action and interaction play out in terms of two distinct institutional configurations or arrangements, both of which are

presented as ideal types. One is private property, which is the abstract framework to which the theory of markets pertains. To speak of a market economy is to invoke an abstraction wherein people relate to one another through the principles of private property and freedom of contract and association. In no society are human relationships governed exclusively by this framework, for societies also entail a collective commons, with actions undertaken on that commons often though not always trumping actions undertaken within the framework of private property. To think of commons is, of course, almost instantly to think of tragedy (Hardin 1968). Yet Ostrom (1990) explains that numerous commons settings operate without signs of tragedy because the participants have developed methods, institutions, and practices of governance that avoid tragedy.

Still, the requirements of practical action and interaction differ when human relationships are governed by the principles of private property than when they are governed by the principles of common or collective property. Those different people, moreover, occupy the same social space, creating societal tectonics in the process. For instance, and looking ahead, the observation that commercial disputes overwhelmingly are settled without going to trial is a feature of rational conduct within a framework of private property. Within that framework, the parties to the dispute can keep their various legal expenses by settling their dispute without going to trial. This is not the case if one of the parties is a public entity operating within a framework of collective property. In this instance, settlement does not create a residual to claim. Pursuing a trial, moreover, can

serve as a form of investment in seeking higher office or an alternative position through the attention-gathering and publicity-generating potential of going to trial. Rational practice under collective property can differ from rational practice under private property, and with societal tectonics resulting when the two rationalities collide.

In this respect, Maffeo Pantaleoni (1911) describes a society as containing two price systems, a system of market prices and a system of political prices. Consistent with the economic theory in play at the time, Pantaleoni characterized market prices as being equal to marginal costs and so were constant across buyers. In contrast, political prices were discriminatory and with the type of price discrimination depending on the type of tax system in place. Under a flat-rate tax on income, political prices would vary in proportion to income. A further feature of Pantaleoni's analysis is the parasitical character of political pricing. Collective property cannot generate prices, for the generation of prices requires exchange and the alienability of property rights. Within this framework, there will always exist margins of action where the two pricing systems collide as increased resort to political pricing takes away from the market pricing that is necessary for the political price system to operate. What results is a form of predator-prey relationship where steady-state equilibrium would be a historical accident and variability in activity between the two pricing systems would be the norm (Wagner 1997).

2. Political Economy within an Ecology of Plans

To carry forward an orientation suitable for analyzing differences among substantive rationalities of practical action requires an analytical framework that is not grounded in a presumption that systemic observations pertain to states of equilibrium. For this to happen, individual actions and plans cannot all be mutually consistent, which, in turn, requires something like what Wagner (2010) describes as a neo-Mengerian framework where at most systemic equilibrium might be an emergent quality of social interaction, in contrast to the standard neo-Walrasian framework where the presumption of equilibrium is imposed on the analytical material.

Within this alternative analytical framework, all action is local or micro. There is no such thing as global or macro action. Figure 1 illustrates what I mean by this distinction. That figure distinguishes between a micro level where all action takes place, both commercial and political action, and a macro level which is a compound construction that consists of such things as statistics, projections, and ideologies. Within this framework, the macro level supervenes on or emerges out of micro-level interaction. The relation between micro and macro is one of parts-to-whole, only there is no reduction of the whole to a part because the whole exhibits qualities that are not contained within the parts but rather emerge through interaction among the parts. For instance, Leonard Read (1958) explains that no single person knows how truly to make a pencil in the sense of being able to create a set of instructions for owners of all the necessary inputs that if followed in the right sequence will result in a pencil being produced. The

ability to produce pencils is a quality of a nexus of relationships where various nodes in that nexus contain some, but only some, of the relevant knowledge required for the production of pencils. The production of pencils is a product of a network of relationships within society and is not a product of some particular individual's rational action. The qualities of societal interaction depend in turn on the constitutive principles by which that network is assembled.

The lower part of Figure 1 depicts the micro level of action as comprised of two types of actors, one type denoted by circles and the other by triangles. Let the circles denote market-based entities organized according to principles of private property while the triangles denote polity-based entities organized according to principles of collective or common property, as sketched in Wagner (2007) and developed further in Eusepi and Wagner (forthcoming). The source of public debt resides at the micro and not the macro level because the macro level is just a compilation of statistics, projections, and ideologies. James Coleman (1990: 28; Coleman's italics) puts well the central point of Figure 1: "the only *action* takes place at the level of individual actors, and the 'system level' exists solely as emergent properties characterizing the system of action as a whole. It is only in this sense that there is behavior of the system as a whole."

Societal characteristics and qualities are not direct objects of choice but are emergent products of interaction. Thomas Schelling (1978) presents several illustrations of this treatment of the micro-macro relationship wherein macro patterns are products of interaction and not products of choice. This does not mean that societal characteristics are incapable of being influenced. Not at all. It

means only that those characteristics emerge through interaction and are not imposed or selected by some social planner. Power might act, and if it does it can do so only at the micro level. But people can also speak and react in many ways to Power, which still leaves societal characteristics as an emergent quality of interaction within some structured nexus of relationships.

Public debt, for instance, is not a direct object of choice but rather is an emergent quality of interaction among interested parties who interact within a framework of collective property. To be sure, public debt can be influenced by changing the rules that govern micro-level interactions; however, to influence a pattern is not to choose a pattern. A constitutional requirement of budget balance might be imposed, but this is only a point of departure and not a point of arrival. For instance, officially recorded expenditures can be reduced by creating off-budget entities. Expenditures can also be reduced by imposing requirements on private entities. In this manner, a government could reduce or even eliminate its spending on schools by requiring parents to send their children to approved schools. The effort to enact such a requirement might well incite civic unrest, but that too would illustrate the central point of Figure 1.

Standard equilibrium theory within the neo-Walrasian framework portends societal placidity unless society is buffeted by external shocks. Yet such shocks seem to appear continually, which might lead a perceptive person to wonder about the cogency of a theoretical framework where everything interesting takes place outside and not inside the theory. In this respect it is useful to remember that the Ptolemaic maps were made to work up to the time of Copernicus. Within

the neo-Mengerian framework, by contrast, societies are naturally turbulent and not placid. This turbulence, moreover, has two broad sources. One source resides in market interaction and is due to conflicts among plans, which generate volatility as some plans fail and are abandoned while other plans thrive, only later to give way to yet other plans. The other source, which is the one that receives most attention here, resides in conflicts between the practical imperatives of enterprises organized within different frameworks of property rights. In this respect, Jane Jacobs (1992) describes a well-working society as containing distinct moral syndromes, which she characterized as commercial and guardian. She also noted that excessive mixture and interaction between carriers of the two syndromes can create “monstrous moral hybrids.” Furthermore, Carolyn Webber and Aaron Wildavsky (1986) describe budgeting throughout western history as rooted deeply in conflict among people over how they are to live together in geographical proximity to one another. In this formulation, budgeting is both rooted in conflict and promotes future conflict because it is unlikely that there is ever a final resolution to conflict as against there being momentary quiescence.

3. Credit Markets as Sites of Tectonic Clashes

Ricardian equivalence characterizes all credit transactions organized within an institutional framework governed by private property, including public debt if liability for repayment is assigned individually at the time the debt is created (Wagner 1996). Someone who borrows to buy an asset is rearranging a balance sheet but is not changing net worth. Any choice entails rejection of an

alternative that could have been chosen but wasn't, and the anticipated value of this rejected alternative represents the cost of the choice made (Buchanan 1969). Responsible budgeting simply means that a choice to borrow now and pay later rather than paying now is nothing more than a rearrangement of a balance sheet. The conventions of private property are synonymous with responsible budgeting, regardless of whether that budgeting is undertaken by private persons or by associations created by private persons. Any choice involves a rejection of an alternative option, and responsibility requires a simultaneous facing of value and cost. When seen in this manner, responsible budgeting may be said to be present whenever *ex ante* Ricardian equivalence characterizes the process and institutional framework through which credit is created.

Responsible budgeting *ipso facto* pertains to credit transactions organized through what are *genuine* market transactions. The reference to *genuine* is to acknowledge that "market" is a term that is used in many and contradictory ways. One use of market would pertain to transactions and associated organizations that operate universally within the framework of private law. Within this framework, credit transactions are wholly between a borrower and a lender. If a contract is concluded between the parties, the contract goes forward under those terms. Such terms of contract as rate of interest, provisions for repossession, procedures for settling disputes, among numerous other possibilities are matters of interest only to the parties to the contract. The set of transactions made within this framework of wholly private law could be designated as a credit market.

These days, however, credit arrangements are governed only partially by private law, as public ordering also intrudes into credit markets. Yet we still describe those arrangements by the generic term “credit market.” Hence, the term “market” has no precise meaning as economists use this term. Market instead refers to a set of transactions independent of the institutional framework within which those transactions are governed. Among other things, this common usage makes market failure a meaningless term because it conveys no knowledge about just what it is that is thought to have failed. Failure might be attributed to some quality of private ordering, but it could also be attributed to the public ordering component of actual market arrangements.

In contemporary economies, a particular credit contract is never between a borrower and lender only. At multiple places third parties inject their interests into credit contracts. Many of these third party interests take shape through regulation. For instance, lenders are often required to demonstrate various “fairness” characteristics within their portfolio of loans, which operate to change the pattern of loans from what they would otherwise have been. What results is a type of regulation-induced tie-in sale where it is no longer the case that Ricardian equivalence pertains *ex ante* to each transaction. It is still possible to speak generically of a market for credit, only the framework of rules that govern those transactions are an admixture of private and public ordering, which operates in turn to reduce budgetary responsibility.

Once various fairness or distributive requirements are imposed on the loan portfolios of market-based providers of credit, credit transactions are no

longer the province of the borrower and lender. As a purely formal matter, the two parties must still agree to the transaction. Only now a lender's denial of credit does not end the matter because a denied borrower can seek reversal by appealing to a collective entity that is not a residual claimant to the transaction. The imperative of rational conduct will typically differ for the representative of that collective entity than the rational imperative that guides action within a framework of private ordering. To the extent collective property trumps private property, market transactions will take on different patterns than would otherwise have prevailed.

For instance, people who are judged by lenders to be bad credit risks and so might be rejected for credit might be granted credit under regulation even though Ricardian equivalence does not characterize that transaction *ex ante*. To provide a simple illustration, suppose a bank has deposits of \$1,000, chooses to keep reserves of \$400, and lends out \$600 in six loans of \$100 each. Further suppose that all borrowers have net worth above \$X, or have posted equivalent collateral. In contrast, those who were denied credit all had net worth below \$X. Within a framework of private ordering, that would end the matter. To be sure, private ordering is consistent with rejected borrowers offering to pay higher interest to increase the willingness of lenders to accept their proffers. The response of the lender to such a proffer would be for the lender to determine, and would do so as governed by the principle of residual claimacy. Still, within a framework of private ordering some people would receive loans and others would be denied. A credit contract, after all, is not a sales contract, even though it is

treated this way in much of the literature on credit rationing. It is instead a form of rental contract, and all rental contracts entail the possibility of asset conversion against which the lender must seek protection.

To simplify the point, suppose all those who were denied credit had net worth below \$X. Further suppose that that public ordering requires that any bank's portfolio must have at least 20 percent of its volume extended to loans where borrowers have net worth below \$X, and with banks being prohibited from charging differential interest rates between the two categories of borrower. For borrowers below the regulatory threshold, Ricardian non-equivalence would be expected ex ante. The price charged to borrowers above the threshold would also rise to reflect the higher cost of doing business, leading to a regulation-induced decrease in the total volume of credit. Ricardian equivalence would still exist at the aggregate level of the bank, but it would no longer pertain to individual loans.

Furthermore, banking under the mixed scheme of private and public ordering would exhibit more turbulence than banking organized fully under private ordering, especially once it is recognized that borrowers insert their loan proceeds into an ecology of plans, thereby influencing other participants within that ecology by changing the web of expectations that is in play within that ecology. Private ordering would still exhibit turbulence within the ecology of plans, but the intrusion of public ordering would increase the turbulence because public ordering riskiness in the operation of banks. This increased riskiness would shrink the total volume of credit from what it would have been under wholly

private ordering. To be sure, the intrusion of public ordering is invariably justified on the grounds of reducing riskiness. As Pareto (1935) recognized in his perceptive treatment of ideology, and with Pareto explored further in McLure (2007), the challenge faced by governing elites is to craft derivations that resonate sufficiently with prevailing sentiments to lead people generally to support actions they would reject if they were faced directly with the choice. An ideological framework that treats all so-called market outcomes as if they were products of private ordering when they are not is one that supports the desires of governing elites.

4. Ricardian Equivalence, Responsible Budgeting, and the Fiscal Commons

Democratic budgeting presents a peculiar spectacle. We can be confident that individual politicians manage their personal budgets pretty well. At least we don't hear of politicians as a class having inferior credit ratings, higher rates of bankruptcy, and such things. But when they enter a parliamentary assembly, the quality of budgeting deteriorates. With private property, choice and liability are joined as people bear the value consequences of their choices. This joining of choice and liability is the essence of responsible budgeting. With common property, choice and liability are severed, though the extent of that severing depends on the set of rules that govern access to the fiscal commons. In the pure commons setting, there is no restriction on access. A fishing ground that is truly subject to open access will tend to become depleted as people keep the immature fish they catch rather than returning them for someone else to catch

later. This setting generates the pure form of the tragedy of the commons. In practice, such commons are subject to rules regarding when fish can be caught, how many can be caught, and the minimum size of fish that can be caught. Such regulations as these restrict exploitation of the commons without fully joining choice and liability that would result if fishing grounds were private property, as Knight (1924) and Gordon (1954) explain in their classic papers on common property.

In contrast, the fiscal commons is not a natural object on which people act but is an artifact that people create, and with that very creation being accompanied by rules regarding both the stocking of the commons and extractions from the commons (Wagner 1992) (Brubaker 1997) (Raudla 2010). While these rules restrict access to the commons, principles of common property still operate within the fiscal commons, as illustrated above by a public attorney who cannot pocket the legal expenses saved by settling a case but who can use a trial as an investment in seeking higher office. Responsible budgeting seems to be a casualty of life on the fiscal commons, though it should be noted that this does not imply the presence of budget deficits but rather involves the severance of choice from cost or liability; that severance, however, can work out in various ways, one of which is persistent deficits and accumulating debt.

In this respect, it should be noted that choice and cost pertain to individuals and not to systems of relationships because systems can't choose and so can't confront cost. With respect to Figure 1, cost and choice are pertinent only at the micro level of action, with macro-level observations emerging out of

interaction among actors at the micro level. With private ordering implying that Ricardian equivalence applies *ex ante* to all transactions, the system of private ordering will be one of responsible budgeting. In a closed system of relationships, Ricardian equivalence must characterize budgeting on the fiscal commons when that budget is projected to the macro level. There is no option to such equivalence because equivalence is a straightforward implication of double-entry accounting when aggregated over an entire system of relationships. Yet the macro level is not the locus of action but is only a summarization of systemic interactions that occur on the micro level within a particular framework of collective property. As with the illustration of the intrusion of public ordering into credit markets given above, it is quite possible for public ordering to accommodate interactions that violate Ricardian equivalence even though such equivalence remains a property of the entire system treated as a single, non-acting entity.

With respect to the lower part of Figure 1, the public budget is the aggregate of the revenues and expenditures that flow through the triangles, statistics for which can be projected to the upper part of the Figure. The operation of the fiscal commons is a feature of micro interaction, with aggregate consequences emerging out of those interactions. This bottom-up approach to fiscal matters is, of course, contrary to the common top-down approach where fiscal matters are discussed at the macro or system level as if action could occur there when it can't. At the macro level, what is appropriated must equal what is collected. Public debt changes nothing but the timing of tax collections.

This point was made in a different context by Fritz Machlup (1964: 140-66) who explained how the US balance of payments could be transformed from deficit into surplus simply by choosing among the various accounting conventions that have been in play at various times. Machlup's central point was that a balance of payments must be balanced in the aggregate, and all reference to surplus and deficit is a creature of adopting one accounting convention or another. In similar fashion, a budget must always be balanced once debt is restated as the present value of the future taxes entailed by the debt. What is relevant for action on the micro level is the perceived cost and gain of different courses of action as these are relevant to the individual actors. This doesn't mean that systemic projections are irrelevant for human action; it means only that actions depend on what actors do in response to those projections. The projections themselves don't do anything.

For credit contracts, *ex ante* Ricardian equivalence is both a requisite for responsible choice and an operating feature of credit markets organized through private ordering. The absence of Ricardian equivalence means that either theft or charity is involved. To be sure, *ex post* circumstances can differ from the *ex ante* anticipations that informed the credit transactions. This happens all the time and is an unavoidable feature of an ecology of plans where capital is committed to action in advance of subsequent market revelations about the value of that action. In consequence, various institutions have emerged within societies to mitigate the disruptions involved when plans don't work out as the parties anticipated. Thus we find provisions for bankruptcy and for business

reorganization that emerge through private ordering. With respect to Figure 1, Ricardian equivalence characterizes all transactions at the micro level and so *ipso facto* characterizes the macro level.

This situation changes with public ordering on the fiscal commons. While Ricardian equivalence must hold at the macro level, indebtedness is not a macro-level property. An entity cannot be indebted to itself. It can be indebted only to a different entity. A democratic state treated as a single entity cannot be indebted. Instead, a democratic state is a form of intermediary that connects voluntary creditors with what are often forced debtors. Public debt is a veil that covers a nexus of transactions where some people within a society become indebted to others, and often with those becoming indebted becoming so against their will. Voluntarism pertains to buying public debt but it does not pertain to becoming indebted to those who buy the debt. There are two options to increasing public debt. One is increasing taxes. The other is reducing public spending. What is called public debt is a fiscal operation that converts people who would prefer either of these options into forced debtors. Hence public debt is intimately involved in Ricardian non-equivalence at the micro level even if Ricardian equivalence must hold at the macro level, if the macro level is conceptualized rightly as pertaining to a closed system and if the accounting is done accurately.

Not all commons settings end up tragically, as Ostrom (1990) explains in her work on the governance of common property. What was common to the many cases she examined was the ability of participants to choose not to

participate in the governance arrangement. People participated in the commons only if they thought it was beneficial to do so, and it was the task of the organizers of the arrangement to secure participation. Those organizers were examples of political entrepreneurs who were acting within an institutional setting that conformed pretty well to the contours of the cooperative state that De Viti de Marco (1936) sketched. Within this setting, the claims of common or collective property were not superior to the claims of private property but were coordinate with those claims. If schooling were organized as a cooperative commons, people who chose not to participate would not be forced to contribute to support the commons. Promoters of the commons project would have to attract participation, for they could not compel it. Democratic budgeting does not operate in this manner. People cannot choose to avoid the fiscal commons. While they may send their children to an alternative school, they will be taxed all the same to support the state-organized school.

5. Irresponsible Budgeting on the Fiscal Commons

There are two options to a budget deficit: higher taxes or lower spending. Contrary to conventional macro-style thinking, however, those options do not appear as singular object of choice but are emergent qualities of fiscal interaction at the micro level where that interaction is governed by some constitutional framework that governs access to and participation in the fiscal commons. Budgeting on the fiscal commons will be irresponsible so long as people are forced to participate in the commons; however, the degree of irresponsibility is a

variable that can be influenced by those governing rules. It is all too easy and common to think of budgeting in a linear and scale-free manner. When this is done, budgeting appears to be the same whether it is done by a town of a thousand people or a nation of many millions of people. Budgeting is thus treated as scalable, much as the scale of a map can be varied. But budgeting is not like reading a map. With the map scale doesn't matter because the user can navigate between two points regardless of the scale used to draw the map.

Budgeting, however, is scale free, especially collective budgeting where there is no possibility of reducing the entity's operation to a singular measure of net income or net worth within some stipulated set of accounting conventions. The conventions of private property make it possible to reduce the activities of a firm that operates parks, libraries, and schools to a measure of net income or net worth. The firm's vector of activities can be reduced to a scalar measure of profitability. This reduction isn't possible for entities that operate on the fiscal commons. Programmatic qualities are not reducible to some singular measure of quantity; budgeting is not linear and scalable in this sense but rather is non-linear and scale free.

As an emergent feature of interaction within some parliamentary assembly, moreover, the aggregate entity described as a budget is governed by individual perceptions of cost and gain as these are intermediated within some institutional framework of collective property and not by some imagined global calculation of cost and gain. Ricardian equivalence must hold in the aggregate for a closed system even though it does not hold for the individual members of

that system. The behavior of the system, moreover, arises through interaction among the individual members; it does not arise at the systemic level because the system level merely supervenes on the interaction among the individual members of the system.

Deficits will thus arise to the extent a sufficient number of the members of a parliamentary assembly prefer borrowing to either increasing taxes (always particular taxes on particular people and not taxes in general) or reducing spending (always for particular programs desired by particular people and not for programs in general). That some people prefer the deficit option and others don't does not imply some particular outcome; it doesn't even imply that the outcome preferred by the largest number of people will be selected. It depends on how preferences are intermediated within a particular set of parliamentary rules. There is plenty of evidence as well as reason to show that deficits have strong survival value in democratic regimes, even despite legislative and constitutional rules to the contrary. In 1978 the US Congress enacted and the President signed the Byrd-Grassley public law that prohibited deficit spending after 1981. That legislation is still on the books as it has never been rescinded, as David Primo (2007: 109) notes, but neither has it served to limit Congressional action. Among the 50 American states, only Vermont lacks a balanced budget requirement. Yet only five or six of those states presently operate with balanced budgets. There is, of course, always some ambiguity about what a balanced budget actually requires. For instance, there is a big difference between a requirement that the budget approved at the start of the year be balanced and a requirement that the

accounts at the end of the year were balanced. There is also a big difference between whether a deficit in the actual accounts at the end of the year is incorporated into the budget to start the next year or is ignored.

The point in any case is that there is a political logic that leads in several directions to avoiding balanced budget requirements. It is the same with limits on the size of government. For instance, several American states have imposed constitutional limits on taxation by such general purpose governments as cities and counties. In response, the creation of special district government has blossomed. A city or county that is subject to a tax limit can avoid the limit by supporting creation of a special district. By transferring, say, library services to a special district the county gains budgetary room while appearing to conform to the tax limit (Fink and Wagner, forthcoming).

Budgeting is mired in conflict among people in how they are to live together in close proximity, as Wildavsky and Webber (1986) explore in their history of budgeting in the western world. In the presence of such conflict, outcomes are influenced by the rules within which interaction takes place. To be sure, this reference to rules does not refer only to formally articulated rules because many of the relevant rules have not been formally articulated. Again, the fate of Byrd-Grassley illustrates this distinction, for the formal rule that required budget balance gave way to the informal rules that governed political interest within the parliamentary assembly. Figure 2 illustrates how different formal rules can generate different budgetary outcomes without any changes in underlying preferences. Figure 2 shows three people with different preferences for the two

activities. One rule decides each issue separately by majority vote; in this case Z will be the budgetary outcome. The other rule requires a single vote be taken on the package of activities; in this case there is no unique outcome but instead there is a set of outcomes that vary with the particular coalitions that are formed.

Politicians are like ordinary merchants in that they are always seeking for customers-supporters. Appropriations are the prime instrument they have for seeking supporters. A balanced budget requirement would restrict that search if it were obeyed. But there is no cost to disobedience, so such requirements are avoided. Perhaps nowhere is the political logic of avoiding responsibility more apparent than in the pension fund hurricane that has been forming for quite some time. Accounting for deferred compensation is more complex than accounting for current compensation. But the added complexity isn't all that much greater. Current compensation is financed by reducing the cash account. Deferred compensation entails the creation of a liability payable at some future date or over some future time interval.

There are numerous margins along which people can differ regarding the debt option relative to reducing spending or increasing taxes. Among these are differences in time preference, age, and family status. Other things equal, older people will find debt less costly than taxation due to their having fewer years of taxpaying life expectancy in front of them: the present value of a stream of future payments is less for someone who can expect to pay them for ten years than for someone who would pay them for 40 years. People with children and in possession of altruistic sentiments may find debt more costly than people without

children or such sentiments, recognizing, moreover, that observations of actions suggest that a good number of parents are hostile to their children.

With respect to time preferences, moreover, politics is an arena of short time horizons in that there is no necessity of politicians to settle their accounts upon leaving office. In commercial settings, liabilities that are payable in the future enter the balance sheets of businesses and affect the market value of those businesses. The present owner of that business might well plan on selling that business before the liability comes due. Even if this is so, the current owner will not be able to avoid paying for that future liability because that liability will reduce the sales price of the business. Commercial practice works naturally to preserve fiscal responsibility.

This isn't the case with political practice. There is no commercial evaluation of political enterprises. A politician who seeks increased support by offering an increase in future payments will not affect the market value of the enterprise. Future liabilities might be registered in some document as an unfunded liability, but this is a fictional and not a real liability. For a liability to be real, someone has to bear it—and now. This is what commercial practice does. This does not happen with political practice, for there no one bears responsibility for future liabilities. This is what it means to operate on a fiscal commons. Future liabilities are not the responsibility of those who create them. Rather they simply become part of the environment with which those people who occupy those positions in future years must deal. Democratic budgeting is grounded in fiscal

irresponsibility because individual politicians are not liable today for their promises that take effect tomorrow.

If Ricardian equivalence must hold in the aggregate and yet does not characterize individual action, it is reasonable to wonder how this circle is squared. The answer resides in distinguishing between income and substitution effects. Suppose a room full of diners in a restaurant is governed by common and not private property. Rather than each person receiving an individual check, the total bill is shared equally among the diners. Ricardian equivalence no longer pertains to individual action as choice is severed from liability because people no longer bear the cost of their actions. Someone who chooses a \$60 item over a \$20 item will not pay the added \$40 that results from that choice because it will be distributed among all the diners.

At the end of the evening, however, the diners as a collective entity will have to settle the account within the framework of collective property by which they are governed. Each diner will pay more than would have been paid under private property, which in turn will lead to a reduction in the ability to pursue other activities due to the negative income effect. Ricardian equivalence must hold in the aggregate because the diners have no outside entity to which they can send the bill. Yet the setting is one of fiscal irresponsibility due to the severance of choice from liability. Many people have, of course, experienced a similar setting though on a small scale. A table with four or six people where the check is split evenly is a small-scale version of a room with 400 or 600 people. To the extent collective interaction is scale free, however, behavior with the small group cannot

be extrapolated to the large group. We may expect fiscal irresponsibility to characterize democratic budgetary processes, though the extent of such irresponsibility will depend in complex ways on the underlying constellation of rules, attitudes, and orientations that underpin the budgetary interactions, which is the central theme in such works as Buchanan (1967) and Brennan and Buchanan (1980).

6. Constitutional Restoration: Accomplishing More by Doing Less

In her perceptive treatment of *Systems of Survival*, Jane Jacobs (1992) explained that well-working societies operated with a delicate balance between what she described as commercial and guardian moral syndromes. While her distinction wasn't identical to the distinction between commerce and government, it was close. She also explained that when the carriers of those syndromes commingle excessively, what she termed "monstrous moral hybrids" can arise.

Rampant fiscal irresponsibility is one manifestation of that monstrous moral hybrid. Politicians manage their personal budgets in responsible fashion but fail to do so in their public capacities. This is not so much a personal failing on their part as it is a reflection their being caught up in the tragedy of the democratic budget commons. Political enterprises unavoidably engage in commercial types of activity, but they lack the tools to do so with full fiscal responsibility. The more fully governments undertake such commercial-type activity, the more fully fiscal irresponsibility will engulf democratic budgeting (White and Wildavsky 1989). To be sure, the commingling of commercial and

governmental activity is not a product of travel along a one-way street. The traffic flows in both directions, as many commercial entities also scramble for positions close to Power. Whether those entities do so out of an effort to preempt what they anticipate will be rent extraction (McChesney 1997) or whether they do so to gain advantage over competitors is probably an undecidable question as the tendency for such commingling probably inheres in human nature, as illustrated by Vincent Ostrom's (1987, 1997) treatment of the difficulty of sustaining self-governing republics.

There is a path to remedy for fiscal irresponsibility, though it is a narrow and steep path. Following that path starts with recognition that guardian-type activities are distinct from commercial-type activities. Sure, there will be points of contact. The challenge of good governance is to keep those points of contact from dissolving into rampant commingling where governments engage in commercial activities on a large scale basis. It is fine for governments to police commercial agreements regarding future promises. But as governments become increasingly involved in making similar commercial-like commitments, fiscal irresponsibility will unavoidably intrude because the commercial tools that facilitate responsible action do not operate.

Even worse, governments have strong reasons to degrade commercial activity through regulation to render commerce duplicitous on its own fiscal irresponsibility. Hence, governments do such things as modify the operation of credit markets to complement its own faux-commercial activities, just as major firms in the provision credit have welcomed the receipt of support from

governmental agencies. A constitution of liberty must be based in some manner on recognition of the principles that Jane Jacobs subsequently articulated. Those principles imply an architectural organization of governments that would limit though not eliminate the commingling of commercial and guardian activities. Over the past century or so, that architecture has been undergoing demolition. The result of this demolition to date is not pretty. Restoration of a constitution of liberty, however, won't be easy, and not just because of such things as faction and rent seeking and rent extraction, but also because of the growing sickness of the people that seems apparently to have weakened desires and capacities for self-governance. Any effort at restoration must include recognition that the fiscal problems we are coming increasingly to experience does not reflect some kind of technical failure or weakness. To the contrary, it reflects a systemic quality of life on the fiscal commons, and it gets worse as the commons becomes larger due to the scale-free quality of collective action. In short, governments will accomplish more to facilitate a robust civic life as they recede from faux-commercial activity.

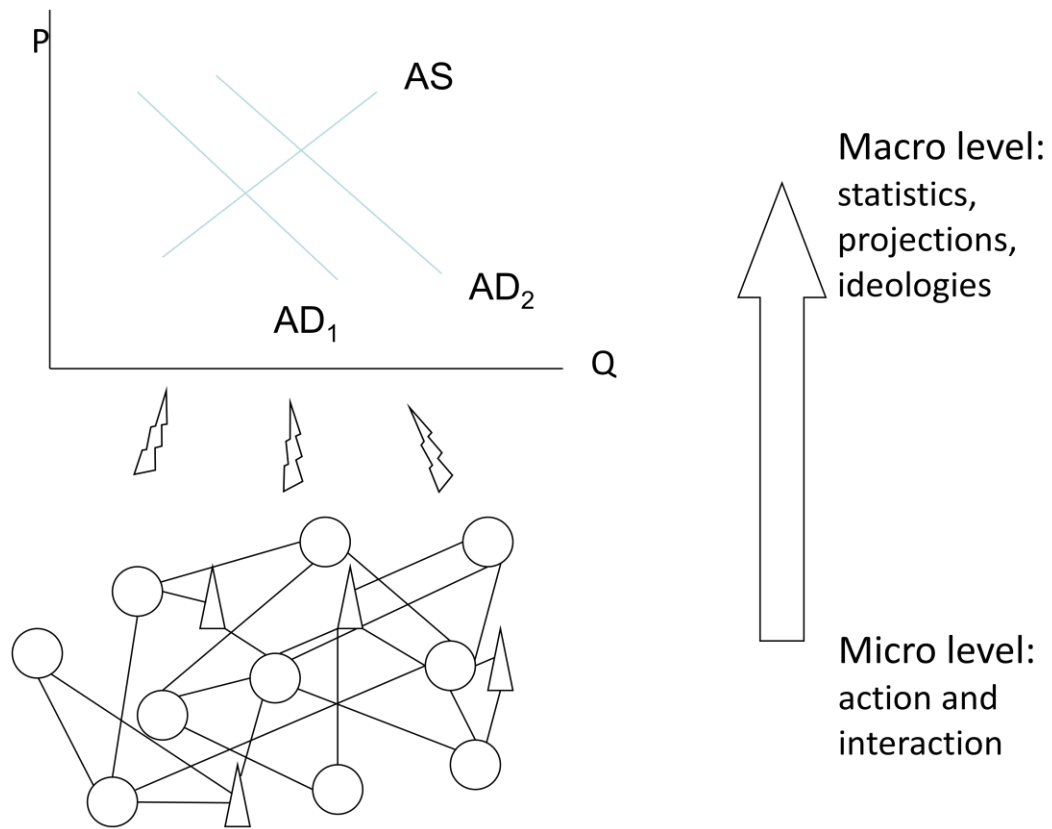


Figure 1: Micro-Macro Supervenience

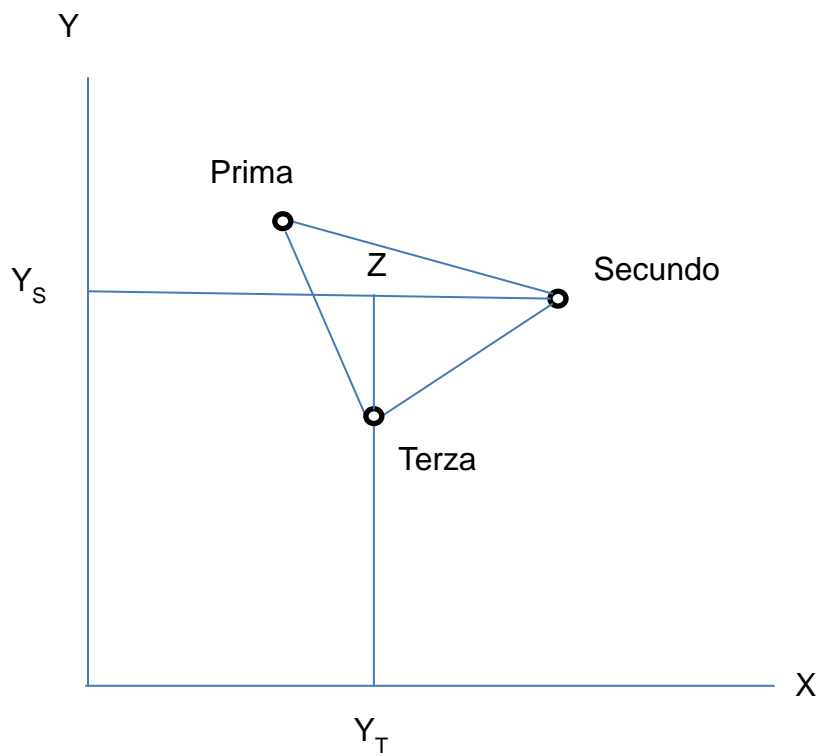


Figure 2: Parliamentary Rules and Fiscal Outcomes

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