

Can Policy Activism Succeed? A Public Choice Perspective

James M. Buchanan

CENTER FOR STUDY OF PUBLIC CHOICE
GEORGE MASON UNIVERSITY

1. Introduction

The question posed in the title assigned to me presupposes the existence of an ordering of options along some scale of presumably agreed-on preferredness or desirability. Only if this presupposition is made does it become appropriate to ask whether or not politics, as it operates, can be expected to select the most preferred option on the ordering, or, less ambitiously, to select, on average, options that would allow the pattern or sequence of “choices” to be adjudged “successful.” The generalized public-choice answer to the question, given the required presupposition, is reasonably straightforward, and it is essentially that of classical political economy. Those who make political decisions can be expected to choose in accordance with agreed-on or “public interest” norms only if the institutional structure is such as to make these norms coincident with those of “private interest.” The public chooser, whether voter, aspiring or elected politician, or bureaucrat, is no different in this role than in other roles, and if incentives are such that the coincidence of interest is absent, there will be no “successful” political ordering over the feasible options. I shall return to the possible coincidence of interest following Section 2.

The more fundamental question to be asked, however, involves the appropriateness of the required presupposition—that concerning the possibility of any meaningful ordering of policy options, quite independently of any problems of implementation. This question has been obscured rather than clarified by those economists who resort to “social welfare functions.” These functions impose a totally artificial and meaningless ordering on “social states” without offering any assistance toward facilitat-

ing choice from among the set of options feasibly available to the public chooser. Section 2 examines this fundamental question in the context of the issues that prompted the assigned title.

2. Is It Possible to Define an Ordering of Policy Options Along an Agreed-on “Success” Scalar?

In this section I propose to ignore totally all problems of policy implementation—all public choice problems, if you will. For simplicity, assume the existence of a genuinely benevolent despot, who sincerely seeks to do that which is “best” for all of those who are members of the political–economic–social community. How can we describe the utility function of this despot? It is easy, of course, to list several desired end-states. Full employment, stable and predictable value in the monetary unit, high and sustainable rates of economic growth, stable international order—these may be mutually agreed-on objectives for policy action. But there may be conflict among the separate objectives (to raise a topic of much debate—discussion of the 1950s that has been relatively neglected in the 1980s). How are we to model the trade-offs among the objectives within the utility function of the benevolent despot, if indeed such conflicts should arise?

I presume that the despot can act so as to influence macroeconomic variables in the economy; I leave possible rational expectations feedbacks to the other paper in this session. But how “should” the despot act, and, in this model, how “will” he act? There is no definitive answer to these questions until and unless the utility function is defined more fully.

There is, of course, an empty response to the question posed in the title to this section. Clearly, if the despot can, by our presumption, influence macroeconomic variables by policy action, then, by some criterion of his own, he can be “successful.” But presumably we seek to employ a more objective criterion for success, one that can at least conceptually be observed by others than the despot himself.

For simplicity, let us assume that the despot is concerned only about domestic employment and monetary stability; we ignore all nondomestic considerations, and we put aside problems of growth. Further, let us restrict attention to standard macropolicy tools. The despot here is assumed to be unable, at least in the time frame of the policy under consideration, to modify the structural features of the economy. With these simplifications, we can go further and specify the objective function more precisely. Let us assume that the despot seeks to guarantee that level of employment that is consistent with stability in the value of the monetary unit, given the institutional structure of the economy. The objective reduces to a single price level target.

Even in this highly restricted setting, which is by no means that which might command consensus as a normative posture, the despot cannot simply “choose” the ultimate end objective from an available set of options. That is to say, “stability in the value of the monetary unit” cannot be selected as if from off a policy shelf. The despot is further restricted by the tools of policy available, which in this setting are those of the familiar fiscal (budgetary) and monetary instruments. Nominal demand can be increased, directly or indirectly, or reduced, directly or indirectly, by the use of fiscal–monetary tools, either separately or in some mix. Even if we ignore, as indicated, the expectational-induced feedbacks generated by resort to any instrument, there remains the task of predicting accurately the relationship between the instrument, economic structure, and ultimate objective. The structural features of the economy are not invariant over time, and a policy thrust that might be successful under one set of conditions, say in t_0 , may fail, say, in t_1 , because of structural shifts. At best, therefore, the truly benevolent despot can only be partially successful, even given the most clearly defined target for policy.

3. Monolithic and Nonbenevolent Despot

The presumption of benevolence on the part of political agents is not, of course, acceptable within a public-choice perspective. It is precisely this presumption that has been a central focus of the overall public-choice critique of the theory of economic policy. Political agents must be presumed to maximize personal utilities in a behavioral model that is invariant, as between public and private roles or capacities. The structure of decision making may, however, affect utility-maximizing behavior through shifts in the effective constraints on choice.

In this section, I shall discuss briefly the simplest possible decision structure, one in which political decisions are lodged within a single monolithic authority (in the limit in one person) which (who) is not directly accountable to or subject to constituency pressures, whether or not these be explicitly “democratic” (electoral) in nature. In this model, it is evident, quite apart from any historical record, that the despot will find it advantageous to resort to money creation over and beyond any amount that might characterize the “ideal” behavior of the benevolent counterpart considered above. This result emerges, quite simply, because incentive effects must be taken into account, and the despot, even if totally immune from constituency pressures, must reckon with individual adjustments to alternative revenue-generating instruments. Through a policy of revenue-maximizing inflation, defined in a dynamic sense, the despot can extract the full value of monetary structure (that is, the value differential between a monetary structure and a barter structure).¹

The amount of revenue that may be potentially raised through money creation is, of course, finite. And the totally uncontrolled despot may seek to utilize the taxing and debt-issue power over and beyond the inflationary revenue limits. The precise features of the despot's policy mix will depend, in part, on his time horizon in relation to the behavioral reactions of the population. These features need not be examined in detail here. It is sufficient, for my purposes, to conclude that the monolithic despot will be successful only in terms of his own criteria, and that by any of the more familiar criteria for policy success, the failure would be manifest.

4. Monolithic and Nonbenevolent Agent Subject to Electoral Constraints

The analysis becomes more complex once we introduce electoral feedback constraints on the behavior of the monolithic political agent. Assume now that decision authority remains concentrated, but that the holder of this authority is subject to potential electoral replacement at designated periodic intervals. In this model the "governor" cannot expect to use his authority for personal enrichment for any extended period. Under some conditions, simple wealth-maximizing strategy might involve revenue-maximizing exploitation during the period of office, with no attention to possible reelection. In other conditions, the wealth-maximizing strategy might involve the effort to remain in office, in which case, short-run revenue maximization via inflation, debt creation, and taxation will be mitigated. If the agent is modeled as a simple revenue maximizer, it seems unlikely that his pattern of behavior would be adjudged "successful" by external criteria under either of these circumstances.

The more interesting model is one in which the agent is motivated by other considerations than wealth, the simplest model being that in which political position is itself the single maximand. The agent's behavior will, in this case, be constrained by expectations of electoral support. The question then becomes one of determining to what extent voters, generally, or in a required winning coalition, will support or oppose patterns of policy outcomes that might be deemed "successful" by external criteria. Given the postulated motivation here, the agent will base behavior strictly on constituency response.

Consider this question in the terms introduced earlier, that of a unique objective of monetary stability. Will a sufficiently large voting constituency support a regime that seeks only this policy objective? This question may be examined in the calculus of the individual voter or potential voter.

Two separate difficulties arise. The first involves the absence of individual voter responsibility for electoral outcomes in large-number constituencies. Even if the individual knows that the agent elected is fully responsive to the electoral process, because he knows that his own voting choice will rarely, if ever, be decisive, the individual may not vote. And if he does vote, he has little or no incentive to become informed about the alternatives. And if he votes, and even if he is reasonably well informed, there is little or no incentive for him to vote his "interests" rather than his "whims." Hence, there is only a remote linkage between what might be defined by the observing external "expert" as the "interest" of the voters and the support that is given to a prospective political agent who promises these externally defined "interests." This difficulty alone suggests that political agents cannot be "held responsible" by the electoral process nearly to the extent that is suggested by naive models of electoral feedback.

A second difficulty emerges even when the first is totally ignored. Even if all individuals are somehow motivated to vote and to do so in terms of their well-considered interests, these interests will not be identical for all voters. There are differentials among persons in the relative benefits and costs of any macropolicy action. Even the ideally responsive political agent will meet only the demands of the relevant coalition of voters, as determined by the precise voting rules.

Consider a single political agent who must satisfy a simple majority of constituency voters. If voters' interests in the employment-inflation trade-off can be presumed to be single peaked, the political agent's optimal strategy requires satisfying the median voter. It seems likely that this median voter will tend to be *myopic* in his behavior in the electoral process. He will place an unduly high value on the short-term benefits of enhancing employment relative to the long-term, and possibly permanent, costs of inflation. He will do so because, as a currently decisive voter, he can insure the capture of *some* benefits in the immediate future. By foregoing such short-term benefits in a "rational" consideration of the long-term costs, the currently decisive voter *cannot* guarantee against the incurrance of such long-term costs in future periods. This asymmetrical result follows from the potential shiftability of majority voting coalitions. A subsequent period may allow a different median voter or coalition of voters to emerge as dominant—a decisive voter or group that may choose to inflate from strictly short-term considerations. To the extent that this takes place, all of the initial benefits of policy prudence may be offset. In the recognition of this prospect, why should the decisive voter or coalition of voters in the initial period exhibit nonmyopic "rationality" in the sense indicated?²

The ultimate answer to the assigned question is clear in this highly simplified model for "democratic" politics. Policy activism cannot be successful if the criterion of success is long-term monetary stability, a cri-

terion that seems most likely to emerge consensually in a constitutional process of deliberation.³

5. Nonmonolithic and Nonbenevolent Agents in a Political Structure Subject to Varying Electoral Constraints

The political models examined in sections 3 and 4 were oversimplified in the assumption that authority was placed in a single agent or agency. As we approach reality, it is necessary to recognize that policy-making authority is likely to be divided among several agents or agencies, who (which) may be subjected to quite different electoral controls or constraints and, hence, potentially affected by differing electoral pressures. For example, fiscal or budgetary policies may be made in a wholly different process, institutionally, from monetary policy, and, even within the institutional structure of budgetary policy, authority may be divided between executive and legislative branches of government, subjected to varying electoral constraints, as defined by such things as breadth of constituencies, length of terms of office, voting structure within agency (in legislatures and committees), legally defined responsibilities, and so on.

The direction of difference in effects between this more realistic political model and the monolithic model previously examined seems evident. To the extent that policy-making authority is divided, the proclivity toward response to short-term pressures is increased. Any array of results along the success criterion indicated would indicate that the divided-authority model ranks well below its monolithic counterpart.

6. Nonbenevolent but Monolithic Agent Divorced from Direct Electoral Constraints but Subject to Legal–Constitutional Rules against Personal Enrichment

If there is little or no basis for expecting political agents to express benevolence in their policy behavior, and if, as suggested, the standard “democratic” controls will not themselves insure patterns of outcomes that meet reasonable criteria of success, alternative institutional structures must be analyzed. Consider, first, a model in which decision-making authority is lodged in a single agent or agency and one that is specifically divorced from the electoral process—an agent or agency that does not face continual electoral checks. To prevent that potential for excess under the model discussed in section 3, however, suppose that the agent or members

of the agency are placed within enforceable legal–constitutional limits with reference to his or their personal or private enrichment, either directly or indirectly. That is to say, the agent or members of the agency cannot use the money creation and/or taxing power to finance their own private consumption needs or accumulation (e.g., Swiss bank accounts) desires. Beyond this restriction, however, we shall assume that the agent or members of the agency is (are) not limited in behavior except in the overall and general mandate to carry out “good” macroeconomic policy.

This model can, of course, be recognized as one that is closely analogous to the monetary authority of the Federal Reserve Board in the United States. Some elements of the model discussed in section 3—that of the nonconstrained despot—describe the existing structure, and, more importantly, some political controls are exercised; but, for my purposes, the existing monetary authority fits the model reasonably well.

The problem becomes one of predicting the behavior of such an agent and of assessing this behavior in terms of the success criterion introduced. Neither economic nor public-choice analysis is capable of being of much assistance in this respect. To make a prediction, one must get inside the utility function of the agent (or of those who participate in agency decisions). In particular, it would be necessary to know something about the internal rate of time preference that will characterize behavior. If, as we have assumed, demand-enhancing action is known to generate short-term benefits at the expense of long-term costs, the behavior of the monopolistic and discretionary agent in making this trade-off will depend strictly on his own, private, rate of time preference, as expressed “for” the community. That is to say, under the conditions indicated, the agent will not, personally, secure the benefits or suffer the costs. By definition, the agent is not *responsible*, in the sense of a reward–penalty calculus.

This absence of responsibility itself suggests that the behavior of the discretionary agent is likely to be less carefully considered, to be based on less information, and hence to be more erratic than would be the case under some alternative reward–penalty structure. The model further suggests that the agent here is more likely to be responsive to the passing whims of intellectual-media “fashion” than might be the case in the presence of some residual claimancy status. To the extent that the agent is at all responsive to interest-group pressures, such response seems likely to be biased toward those groups seeking near-term benefits and biased against those groups that might be concerned about long-term costs, if for no other reason than the difference in temporal dimension itself. Organized pressures for the promotion of short-term benefits exist while there may be no offsetting organization of long-term interests. This bias might well be exaggerated if the agent or agency is assigned functions that cause the development of relationships with particular functional groups in the

policy (e.g., banking and finance). In sum, although there is really no satisfactory predictive model for behavior of the genuinely discretionary agent or agency, there are plausibly acceptable reasons to suggest that policy failures will tend to take the directions indicated in the discussion here.

Viewed in this perspective, and in application to the Federal Reserve agency in the United States, and perhaps notably after the removal of international monetary constraints, there should have been no surprise that the behavior exhibited has been highly erratic. Any other pattern would indeed have required more explanation than that which has been observed. From both analysis and observation the ultimate answer to the question concerning “successful” policy activism in this model, as in the others examined, must be negative.

7. Nonbenevolent and Monolithic Agent Divorced from Electoral Constraints but Subject to Legal-Constitutional Rules Against Personal Enrichment but Also to Constitutional Rules That Direct Policy Action

The generally negative answer to the question posed in the title prompts examination of still other institutional structures that do not involve attempts at “policy activism,” as such, but which, instead, embody sets of predictable and directed policy actions in accordance with constitutionally specified rules. In familiar terminology, if “policy activism,” when applied in a setting of *discretionary authority*, must fail to meet the success criterion, can a setting of *rules* do better? It would be inappropriate to discuss at length the relative advantages of alternative regimes or sets of rules. But it is clear that almost any well-defined set of rules would eliminate most of the incentive and motivational sources for the failure of discretionary agency models as previously discussed.

In a very real sense there is no agency problem in an effectively operating rule-ordered regime. A fiscal–monetary authority, charged with the actual implementation of policy, but only in the carrying out of specified rules, defined either in terms of means or objectives, cannot itself be judged on other than purely administrative criteria of success or failure. More ultimate criteria must now be applied to the alternative sets of rules, with success or failure accordingly assigned. And working models of such alternative sets might be analyzed, just as the models of a discretionary agency have been analyzed here. But there seems to be a closer relationship between the rules that might be selected and the success criterion adopted than there is between the latter and the pronounced goals of a discretionary agency.

The potential for success of rule-guided macropolicy depends, in large part, on the *absence* of policy activism, not only for the removal of the potential for self-interested behavior on the part of discretionary agents, but also for the built-in predictability of such action that is inherent in the notion of rules, as such. The relative advantages of rule-guided policy over agency discretion could be treated at length, but this effort would carry me well beyond my assignment in this paper.

8. Fiscal Policy and Monetary Policy

There are two distinct policy instruments, or sets of instruments, in both the familiar textbook terminology and, indeed, in the overall subject of this conference: fiscal policy instruments and monetary policy instruments. To this point I have made no distinction between these two sets, and I have avoided altogether any discussion of relative efficacy as well as relative vulnerability to the sorts of influences on behavior that are emphasized in a public-choice approach. It is time to explore some of the differences that are directly relevant to the arguments that I have advanced.

Fiscal policy involves budgetary manipulation and, hence, a necessary linkage between any macropolicy objectives and the whole process of public-sector allocation. Given this necessary linkage, and given the institutional-political history, it seems totally unreal to suggest that any shift of authority over fiscal policy would be delegated to either discretionary or even to rule-bound authority. It seems highly unlikely that fiscal policy, in any sense, would be removed from the ordinary procedures of democratic decision making, with divided legislative and executive responsibilities and roles in its overall formulation. It becomes unrealistic in the extreme to presume that we, in the United States, would transfer to an agency immune from electoral constraints any authority to manipulate either side of the budget in accordance with rules or intentions to improve macroeconomic performance. Decisions on tax rates, spending rates, and, in consequence, deficits and borrowing requirements, are likely to remain within the responsibility of “democratic” determination, with the predicted result that any meaningful success criterion will fail to be satisfied. There will be a bias toward “easy budgets,” with higher-than-desired deficits, to the extent that any considerations of macroeconomic policy enter the policy argument.⁴

Given this predicted bias, and quite apart from any consideration as to the independent efficacy of budgetary policy in effectuating desired results, any genuine hope for “success” in macroeconomic policy must involve a reduction or removal of budgetary manipulation from the

potentially usable kit of tools.⁵ If “fiscal policy” can be isolated so as to insure that its operation does not make the task of monetary management more difficult, a major step toward genuine reform will have been made. It is in this context that the argument for a constitutional rule requiring budget balance becomes important in macroeconomic policy discussion.

If fiscal policy is so isolated, the task of policy action is left to the monetary agency or regime. A monetary agency can be made effective if the discretion of the agent is limited by the imposition of legally binding and enforceable rules for policy actions. These rules may take on any one of several forms, and it would be out of place to discuss these alternatives in detail here. The monetary agency can be directed to act on the defined monetary aggregates so as to insure prespecified quantity targets (as in some Friedman-like growth rule). Or the authority might be directed to act so as to achieve a specifically defined outcome target, such as the maintenance of stability in the value of the monetary unit. In either case the structure of the rules must be such as to invoke penalties for the failure of the authorities to act in accordance with the declared norms. Some allowance for within-threshold departures from targeted objectives would, of course, be necessary.

But only with some such feedbacks in place can the persons in positions of responsibility as monetary agents be expected to perform so as to further the success criterion that is implicit in the imposition of the rules. It seems at least conceptually possible to build in a workable reward–penalty structure for the compensation and employment of rule-bound monetary agents. And, in the limiting case, such a reward–penalty structure, appropriately related to the achievement of the desired policy target, may obviate the need for explicit definition of a rule for policy action. For example, if the compensations of all employees of the monetary authority should be indexed so as to insure personal penalty from any departures from monetary stability, perhaps nothing more need be required by way of rules. (Such a scheme might involve the maintenance of fixed nominal salary levels against inflation, and double indexing of salaries against deflation, or some more sophisticated formulae.)

If no incentive–motivational structure is deemed to be institutionally and politically feasible, under the operation of any fiat money regime, the argument for more basic regime shift in the direction of an automatic or self-correcting system based on some commodity base is substantially strengthened. The relative advantage of all such systems lies in their incorporation of market-like incentives to generate behavior that will tend to generate at least long-term stability in the value of the monetary unit.

9. Conclusion

In this discussion, as elsewhere, the primary implication of public-choice theory is that institutional–constitutional change or reform is required to achieve ultimate success in macroeconomic policy. There is relatively little to be gained by advancing arguments for “better informed” and “more public-spirited” agents, to be instructed by increasingly sophisticated “economic consultants” who are abreast of the frontiers of the “new science.” All such effort will do little more than provide employment for those who are involved. It is the *political economy of policy* that must be reformed. Until and unless this step is taken, observed patterns of policy outcomes will continue to reflect accurately the existing political economy within which these outcomes are produced. And we shall continue to have conferences and discussions about the failures of “policy activism.”

Notes

1. For further elaboration and analysis, see Geoffrey Brennan and James Buchanan (1980) Chap. 6; and (1981).

2. For further elaboration of the analysis, see Geoffrey Brennan and James Buchanan (forthcoming), Chaps. 5 and 6.

3. I shall not develop the argument in support of the contractarian–constitutional criterion for measuring policy success or failure. Let me say only that such a criterion must be used unless we are willing to introduce external and nonindividualistic standards of evaluation.

A more controversial position is the one that suggests that the monetary stability criterion would, indeed, be the one that would emerge from the ideally constructed constitutional setting. I shall not develop the argument in support of this position, although I think it can be plausibly made.

4. For an early statement of this point, see Buchanan (1962). For a more extended discussion, see James M. Buchanan and Richard E. Wagner (1977, 1978).

5. Keynes and the Keynesians must bear a heavy responsibility for destroying the set of classical precepts for fiscal prudence that had operated to keep the natural proclivities of politicians in bounds. By offering what could be interpreted as plausible excuses for fiscal profligacy, modern politicians have, for several decades, been able to act out their natural urges, with the results that we now observe. For further discussion see Buchanan (1984).

References

Brennan, Geoffrey, and James M. Buchanan. 1980. *The Power to Tax*. Cambridge: Cambridge University Press.

- _____. 1981. *Monopoly in Money and Inflation*. London: Institute of Economic Affairs.
- _____. n.d. *The Reason of Rules*. Cambridge: Cambridge University Press, forthcoming.
- Buchanan, James M. 1962. Easy Budgets and Tight Money. *Lloyds Bank Review*. 64: 17-30.
- _____. Victorian Budgetary Norms, Keynesian Advocacy and Modern Fiscal Politics. Prepared for Nobel Symposium on Governmental Growth, Stockholm, Sweden, August 1984. Center for Study of Public Choice Working Paper No. 4-02.
- Buchanan, James M., and Richard E. Wagner. 1977. *Democracy in Deficit*. New York: Academic Press.
- _____, eds. 1978. *Fiscal Responsibility in Constitutional Democracy*. Boston: Martinus Nijhoff.