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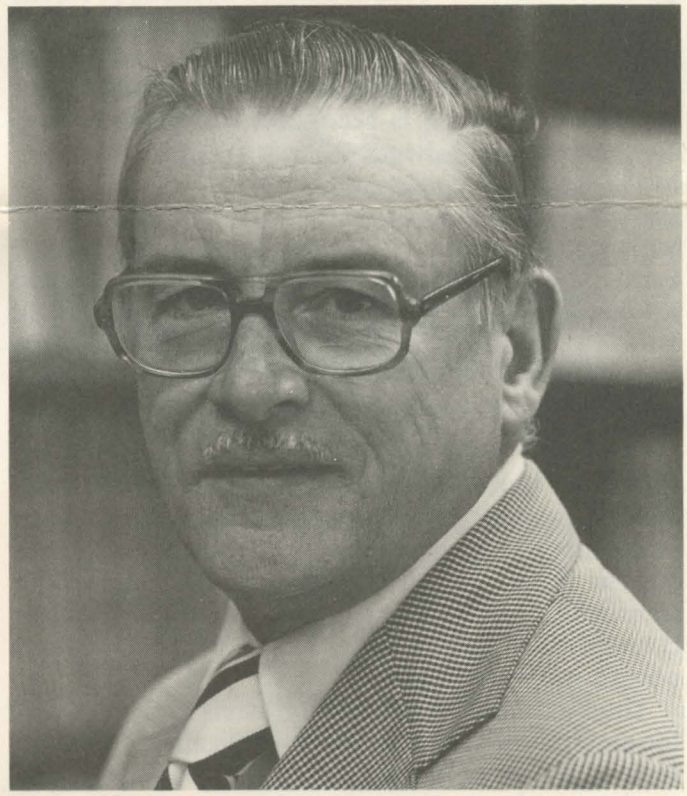
The Deficit and our Obligation to Future Generations

By James M. Buchanan



Editor's Preview: Can we, in good conscience, force our children to pay for our current spending policies? Does this make good fiscal, let alone moral, sense? For James M. Buchanan, head of George Mason University's Center for Study of Public Choice whose work recently earned him the Nobel Prize in economics, the answer is a resounding "no."

Yet our government continues to engage in the disastrous practice of deficit spending. The national debt exceeded the trillion dollar mark a long time ago; and still, the trend is to spend more and more with faint sense of obligation to succeeding generations which will be forced to pay for our profligacy. Borrowing is simply a much easier expedient than cutting spending or raising taxes. How can we stop this dangerous cycle? "The basic moral dimension of fiscal policy must be elevated to center stage" says Professor Buchanan. "In no other way can we begin to determine what constitutes responsible collective behavior." The implication is, of course, that we must reject one of the principal elements of Keynesian economics which regards deficit spending as a morally acceptable proposition.

Introduction

Philosophers and social scientists alike have seemed surprisingly reluctant to discuss the modern practice of continuous deficit financing in intergenerational terms. In part, this reluctance stems from the long-continuing confusion in economists' understanding of the elementary principles of government borrowing. Until and unless economists get their theory of public debt in order, we can scarcely criticize the philosophers for failing to examine the moral content of the behavior that debt represents. So long as economists suggest that the relevant variables are levels or rates of change in the national product, national income, consumption, saving, investment, and capital formation, they will necessarily concentrate attention on *secondary* rather than *primary* consequences of deficit financing.

Whether the borrower is an individual, a corporation, or a government, borrowing, as an institution, allows the borrower to shift patterns of outlay over time; borrowing makes spending possible now, but eventually the time comes when the incurred debt must be paid off or rolled over and upon which interest must be paid. This elementary logic holds regardless of the usage to which borrowed funds are put.

With an individual or a firm there is, however, a direct linkage between the act of borrowing and the accompanying assignment of liabilities, a linkage that operates to insure that the institution is not abused. The prof-

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ligate individual who incurs debt to expand current consumption suffers the consequences; he alone is liable for interest-amortization charges later. This responsibility to pay the price for borrowing is recognized by both the individual and his potential creditors. And the corporation knows it must put borrowed funds to productive use in order to survive in a competitive economy.

But there is no such burden of responsibility when it comes to the national debt. A government may expand current rates of spending by borrowing the funds, but those persons who, as agents for the state, make fiscal decisions do not face obligations to repay its creditors. If the borrowed funds are used to finance current rates of public consumption (including transfers), the decision makers, personally and/or through their constituents, secure benefits *without* directly suffering losses.

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There are two closely related reasons to suggest why the government's, i.e. our, sense of obligation is so faint. First of all, we as individuals do not live forever, and our interests in our progeny may be somewhat less than our interest in ourselves, especially when we may not have any children at all. Secondly, some of us may desire to leave negatively-valued "bequests," even for our own progeny, a desire that the institution of public debt can satisfy. My point here can be put simply in a comparative illustration. If I borrow $1000 personally, I create a future obligation against myself or my estate in the present value of $1000. Regardless of my usage of the funds, I cannot, by the act of borrowing, impose an external cost on others. Unless I leave positively-valued assets against which my debts can be satisfied, my creditors cannot oblige my heirs to pay off their claims. By contrast, suppose I "vote for" an issue of public debt in the amount of $1000 per person. I may recognize that this debt embodies a future tax liability on *some* persons, but I need not reckon on the full $1000 liability being assigned to me. If I leave no positively-valued assets, the government's creditors can still enforce claims on my progeny as members of the future-period taxpaying group. Further, the membership in the taxpaying group itself shifts over time. New entrants, and not only those who descend directly from those of us who make a borrowing-spending decision, are obligated to meet debt interest and amortization charges.

In sum, the institution of public debt introduces a unique problem that is usually absent with private debt; persons who are decision makers in one period are allowed to impose possible financial losses on persons in future generations. It follows that the institution is liable to abuse this and overextend its borrowing practices. There are moral and ethical problems with government deficit financing that simply are not present with the private counterpart.

About the Author

A year ago this month, the *New York Times* profiled Nobel Laureate James M. Buchanan, Harris University Professor of Economics and general director of the Center for Study of Public Choice at George Mason University as one of the leaders of a "quiet revolution in politico-economic thinking;" a revolution which, the *Times* noted, "focuses on the political process particularly;" and in Buchanan's words, "on structure, on how the rules work and how they can be changed." Professor Buchanan has written a number of books, including *Liberty, Market and State* (1985), and he has co-authored a number as well, most notably: *Calculus of Consent* (1962), *Democracy in Deficit* (1977) and *The Political Economy of Budget Deficits* (1986).

Classical Precepts and the Keynesian Revolution

The simple logic of public debt, sketched out above, was fully recognized in classical public finance theory, and its implications were embodied in classical norms for the debt issue. These norms justified financing government outlay by borrowing only in two circumstances, (1) when the funds were devoted to capital investment projects, and (2) when there were extraordinary demands on revenues, such as war emergencies. In either of these settings, resort to public debt allows for a closer matching of the time patterns of costs and benefits than seem to be available through tax financing. In all other settings, whether through formal constitutional restriction or through voluntary adherence to rules for fiscal prudence, governments were not authorized to borrow to cover revenue needs.

The Keynesian revolution in the theory of macroeconomic policy essentially repealed these classical norms. This paper is not the place for me to detail the many intersecting confusions that this theory of macroeconomic policy reflected. Suffice it to say

that, as interpreted by practicing politicians in democracy, the effects have been indeed dramatic. Since roughly the early 1960s, political decision makers have felt free to finance outlays by debt, quite independently of the classical restraints. As a result, in the 1980s much of our current public consumption is financed by debt. We are, as members of the body politic in 1986, currently enjoying the benefits of public outlays that must be paid for by those who come after us. We are imposing external costs on future generations.

The Benefit Principle of Taxation

Here, I want to look critically and carefully at the moral dimension of the debt issue, and, specifically, at the moral and ethical foundations of the classical norms of government spending. Why should public debt be limited to the financing of either capital projects or extraordinary revenue needs? Why should not we, as citizens in the 1980s, finance current benefits by imposing taxes on those who will pay taxes in the 2000s? What theory of rights allows us to say that the classical principles are justified? Or, to repeat the title for this paper, what are our obligations to future generations in these respects?

The classical norms are based on the same ethical foundations as the benefit principle to taxation, which states that those who enjoy the benefits of public spending programs should be those who are required to pay the taxes necessary to finance them. This precept reflects a straightforward extension of the commutative justice of market exchange to the public sector, and it finds its most sophisticated exposition in the Wicksell-Lindahl model of fiscal process.

There is moral and ethical content in the *quid pro quo* of market dealings, and this content applies to strictly voluntary exchange of the marketplace to the implied voluntary exchange that takes place in the public sector. This conceptualization, in its turn, embodies a theory of the state itself. The state is conceived as the means or instrument through which persons cooperate to secure benefits that cannot be secured efficiently in the market sector. Conceptually at least, the individual's claims are both prior to and separate from the collectivity in which he has membership.

If this essentially Lockean theory of the state is accepted, the exchange or benefit principle for taxation seems a natural consequence, and the classical norms for public debt fall clearly into place. Indeed, these norms are simply the temporal extension of the benefit principle. Those who exist *when* the benefits from public spending are enjoyed should be required to pay the taxes necessary to finance such benefits. To depart from this putative exchange nexus of costs and benefits, save in the two circumstances noted, violates the founding principles and values of a society of free persons.

Or so it should seem. The analogy with the benefit principle of taxation should, however, give us pause. We must acknowledge that, in the mainstream of normal public finance over the last century, the benefit principle has not been universally applied, and perhaps has not even occupied a dominating place among alternatives for tax share allocation. The most familiar alternative has been "ability to pay." Progressive or proportional rates of taxation to finance genuinely redistributive transfers could never be derived from any simple application of the benefit principle. There is no *quid pro quo.* Taxes *take* from the rich; transfers *give* to the poor. Any ethical justification for this sort of fiscal action must be informed by a different argument than the benefit principle.

Can we possibly justify current debt financing of public spending on some grounds analogous to those advanced in support of the modern redistributive fiscal regime? Transfers occupy ever-increasing shares in the budgets of modern governments, and, as noted, taxes to finance such transfers could never be justified on any simple application of the benefit principle. The first point to be made here is that the debt financing of current-period consumption is a temporal tax-transfer system in many respects akin to the within-period tax-transfer system of the modern welfare state. Persons who enjoy the benefits of the spending now do so at the expense of persons who will, in subsequent time periods, be required to pay the taxes required to meet the interest and amortization charges.

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Justification of In-Period Redistributive Transfers

If, as both normative and methodological individualists, we refuse to acknowledge the existence of some organic collectivity that has purpose apart from those of its members, we must try to locate any justification of an in-period tax-transfer system in some conceptualized contractual agreement among all members of the polity. A multi-period perspective must be taken, and it is necessary to distinguish carefully between the choice of rules or institutions that remain in force over many periods and the choices made under the operation of a specific set of such rules within a single period.

That is to say, we must adopt what is essentially a "constitutional" perspective.

If we do this, it does become possible to derive an ethical argument in support of fiscal redistribution, and, indirectly, of those institutions of taxes and transfers that facilitate such redistribution. The individual who chooses among basic social institutions that are expected to remain in existence for some time is necessarily operating behind a veil of uncertainty; he cannot fully identify his own position in any one future period during which the chosen institution will be operative. In this setting, which was introduced by myself along with Gordon Tullock in *The Calculus of Consent* (1962), the individual may prefer some institutional-constitutional arrangement that will involve some elements of an in-period tax-transfer system. The analogous setting for constitutional choice, in which the veil of ignorance becomes more central, was used by John Rawls in *A Theory of Justice* (1971), to derive the ethical argument for some fiscal redistribution.

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The economy grows through time, and because persons in future periods will be wealthier than persons who live now, the postponement of the tax payments for currently enjoyed spending will embody a rich-to-poor redistribution that may be dictated by the same precepts applied to the in-period model.

The logic seems straightforward. Consider a highly simplified two-period model in which there is only one person alive at any period, and where persons live for only one period. Suppose that the income in Period 1 is 100 units, and that in Period 2 is 200 units. These income flows are known, but the selector among institutions remains totally ignorant as to whether he will be alive in Period 1 or Period 2. In this setting, it seems plausible to predict that some adjustment of income between periods would be preferred if institutional arrangements could be made to facilitate such adjustment. If spending in Period 1, over and beyond 100 units, could be financed by some borrowing against the income of Period 2, the individual chooser, when adopting the constitution, might well authorize such an institution.

But should this argument be taken seriously? Before we do so, it is necessary to consider the sources of economic growth and the attitudes of the individual toward such growth. Suppose we remain with the one-person-per-period, two-period model, but that we postulate that economic growth is dependent upon the resourcefulness and behavior of the person alive during Period 1. Suppose, further, that this person saves one-half of his income of 100 units, invests this in productive capital, which yields a rate of return of 100 percent. The potential consumption of the person alive in Period 2 is then 200 units, as in the first model examined. But would an individual, behind the intertemporal veil, prefer an adjustment in the income levels between the two periods? Would the individual authorize an institution that facilitated borrowing against Period 2 income to finance a potential rate of consumption greater than 100 units in Period 1? If it turns out that he is alive in Period 2, then clearly the debt financing of Period 1 consumption would have undesirable consequences.

Since economic growth is dependent upon the behavior of persons in the economy, there seems to be no contractarian argument that will justify the constitutional authorization of the debt financing of current period consumption. Separated in time or by generation, individuals cannot be considered as players in the "same game." So any other arguments in favor of equal opportunity, redistribution and "fairness" lose much of their meaning as well.

Pollution and the Fiscal Environment

I have suggested that there is no plausibly supportable ethical justification for imposing net fiscal charges on persons who pay taxes in future periods. I have not directly addressed the more difficult question concerning our positive obligations to future generations. We live in an era characterized by mounting concern over environmental quality that is presumably motivated in part by a sense that our generation should not so despoil the atmosphere as to make living less pleasant for those persons who will follow us. Note that this expression of concern implies that we have an obligation toward future generations in our capacities as citizens, as members of the body politic, and that where required, we should, and do, act collectively through our government to implement such an obligation, even if constraints are placed on our individual liberties to act.

It is surely singular, if not bizarre, that alongside our

concern for environmental pollution we observe an historically unique record of fiscal profligacy. Our record suggests an absence of concern for the well-being of future generations. Debt financing of currently enjoyed public program benefits imposes charges on all future taxpayers, just as surely as pollution exacts a toll on their welfare. Why do we observe such an apparent disparity in both public attitudes and in political response? Why is there so much political support for toxic waste cleanup and so little for reforms like budget amendment?

There are at least three separate arguments that may explain the differences here. First of all, the modern concern over environmental quality is motivated, at least in part, by an anti-capitalist, or anti-market, mind set. The "evildoers" are business firms seeking profits, not the benevolent government. With deficit financing, by contrast, no fingers can be pointed directly at profit-seeking business firms, or even at persons in their private capacities. The costs that deficits impose on future generations are imposed by government, by the working of democratic political process, by duly elected political representatives of the people who are electorally responsible to us all. We should not, therefore, be much surprised that the Ralph Naders of the age should remain relatively silent.

A second, and possibly much more important reason for the relative disparity in concern lies in the widespread confusion among economists, noted at the outset of this paper, that has resulted in a neglect of the intergenerational effects of debt financing. A third reason prompts both the economists' confusion and the public's failure to express indignation at the gross violation of norms for intergenerational equity that the deficit regime embodies. There is no counterpart to the observable physical deterioration of the atmosphere that persons may see and that the scientists can measure. The piling up of claims against future-period incomes of taxpayers does not physically enter the consciousness of present-period persons; these claims do not float about for all to see. This difference suggests that the pollution of our fiscal environment is all the more pernicious. No present person's laundry gets dirtier, yet many persons clearly secure net benefits.

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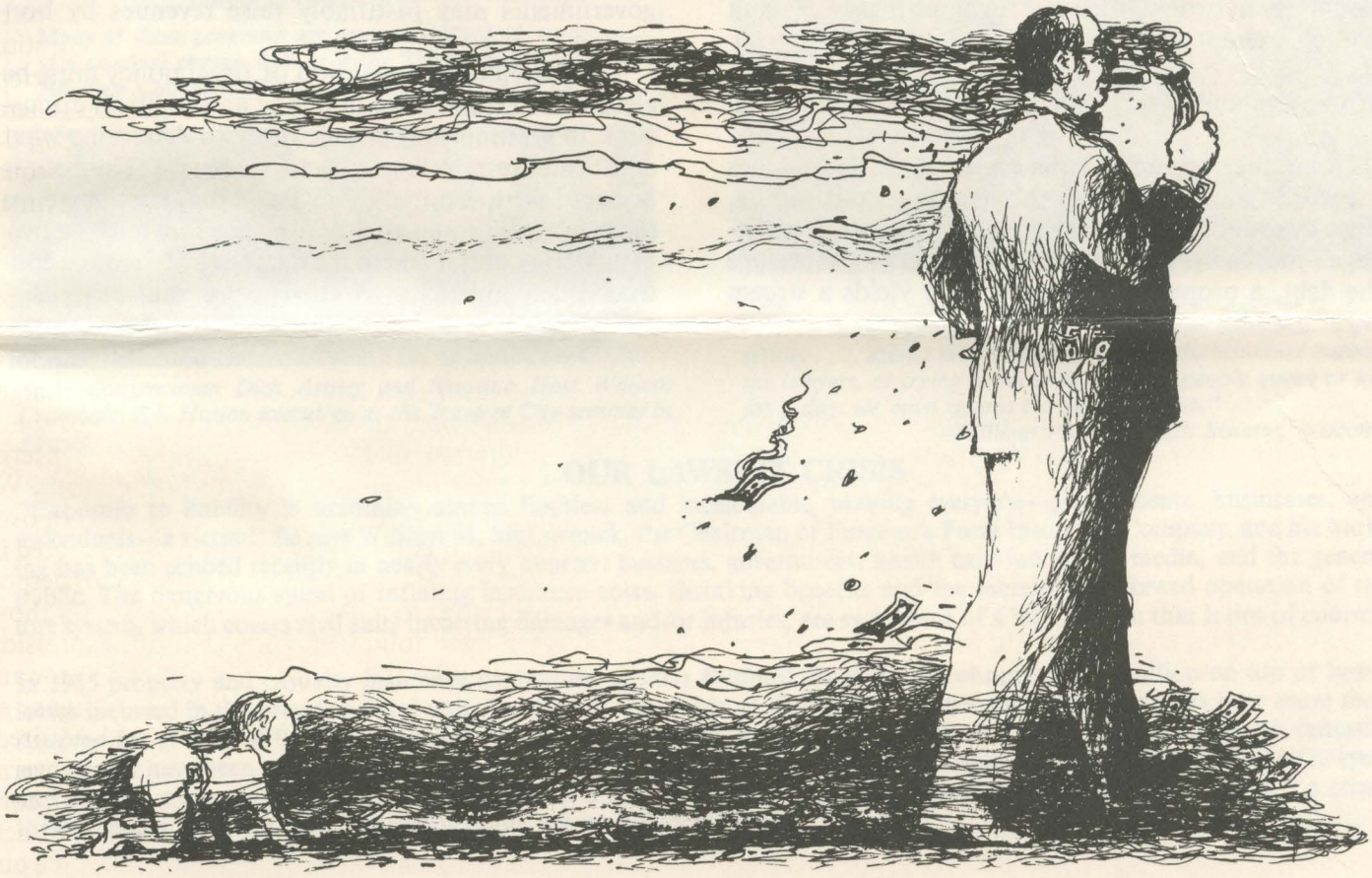

Debt, Default, and Future Generations

Does the last reason noted give pause when we compare fiscal with atmospheric pollution? Precisely because the claims against the incomes of future taxpayers are just that—claims—has there been any actual destruction of value involved in the whole debt-deficit operation? Must the financial levels attainable for persons of future generations be lower as a result of the deficit regime than they might have been under a balanced budget? To raise this question prompts attention to possible default. What would occur if future taxpayers, or rather, if the government acting on their behalf, simply refused to pay the claims? What if the government, say in the year 2000, repudiated all of the debt claims held against it, and indirectly, against those who would be subjected to the taxes required to meet these claims?

In such a scenario, future generations of persons, as taxpayers, would, indeed, escape damage. But persons play several roles simultaneously, and those members of future generations who are bequeathed government securities (bonds, notes, bills) held against the government would find them subject to capital-value confiscation. These persons, rather than the more inclusive group of taxpayers, would be the losers in the process. These future creditors of government would be the persons on whom the final incidence of payment for the benefits of currently enjoyed spending rests. In effect, these future creditors, future taxpayers themselves, would pay in two ways for our fiscal profligacy. Default doesn't exempt them from bearing our costs.

Mortgages and the Destruction of Capital

In another version of this paper, the title includes the word "mortgage." But this analogy is misleading, since by standard dictionary definition the word "mortgage" means the conveyance of a property that secures the debt, a property that presumably yields a stream of value to the user. The use of the mortgage analogy to apply to government debt would indeed be appropriate if the debt was created in the process of financing a genuine capital investment project, but no pretense is made that the outlays financed are anything other than ordinary expenses of government, expenses required to provide the goods and services and transfers for the various interest groups who are successful in getting their demands met by politicians. There is no capital value against which the debt claims are or could be offset. Nothing of lasting value emerges from the fiscal operation that will make the servicing of the debt claims easier or less onerous for those members of future generations who will be faced with the tax charges. Not only do current debt-financing schemes fail to yield capital; they destroy opportunities to create it.

Our Obligation

I have tried, throughout this paper, to avoid the sometimes murky discourse on the general question concerning our obligations to future generations. I have restricted my remarks to the currently observed regime of debt-financed current public consumption and to the implications of this single institution to the larger and more inclusive question. I have tried to demonstrate that there is little or no ethical justification for such an institution, and that the classical principles for public debt issue carefully specify the circumstances in which governments may justifiably raise revenues by borrowing.

The basic moral dimension of fiscal policy must be elevated to center stage in public and political discussion. In no other way can we begin to determine what constitutes responsible collective behavior. The hour is late and we have already inflicted major damage on those who will come after us, damage that must be *permanent.* Let us not add to the damage by tolerating continued debt financing of current program benefits.

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