

ILLUSTRATION BY BINAY SINHA



Restraining Leviathan

James M Buchanan's work on restraining the predatory state has great relevance for India, says Deepak Lal

Last week yet another great economist, Nobel laureate and friend, James M Buchanan, was gathered by the Grim Reaper. I got to know him in the mid 1980s when I was the Research Administrator at the World Bank, and he and his long-time collaborator Gordon Tullock got in touch after reading my *The Poverty of "Development Economics"*. Both have been friends ever since.

Buchanan was a socialist, he said, till he studied economics at the University of Chicago under "his professor" Frank Knight and learnt how markets work (see his *Liberty, Market and State*). But his realisation soon afterwards that the same theory of price that he had learnt could also be applied to the political process would eventually lead him and Gordon Tullock to develop what came to be called "the new political economy", and later public choice. The central assumption of the prevalent neoclassical theory of public policy, particularly of public finance, was that governments were benevolent and their agents could be looked upon as "platonian guardians". But no explanation was offered as to how the same individuals shed their benevolence and came to serve their self-interest once they participated in the market. If human beings were not schizophrenic, the same self-interested motives that were the underpinning of price theory should apply to the political process. Buchanan's work over 40 years, along with his collaborators, has worked out the implications of this unity of motives in the economic and political spheres.

The starting point of his political economy is Hobbes' insight that, in a state of anarchy, life will be "nasty brutal and short". To provide order there must be a state provided with the monopoly of coercion — a Leviathan. But this monopoly also entails the "power to take" by Leviathan from its citizens. Whilst some of these takings (taxes) are needed to provide the instruments of order (the pure public goods like police, courts, armies for national defence), what is to prevent the

resulting self-interested Leviathan from taking more than is needed for this purpose and maximise its revenues for its own discretionary ends?

It is in answer that Buchanan's "Virginia" public choice theorists have introduced the importance of constitutional rules. Since they are concerned with US political institutions, they have used the artefact of the social contract to ask, in the words of Buchanan and Geoffrey Brennan, "Would citizens voluntarily agree to allow the government to exercise power quite unreservedly, or would they rather seek to impose constraints on the behavior of governments?" (*The Power to Tax*). Adopting Knut Wicksell's famous unanimity rule for social choice, as an idealised benchmark to determine "that all governmental actions represented genuine 'improvements' (or at least no damage) for all persons, as measured by the preferences of the individuals themselves" (page 6), Buchanan and Gordon Tullock, in their *The Calculus of Consent*, derived constitutional fiscal rules for the real world where — because of transactions costs and free rider problems — such unanimity will have to be traded off for "workability in political processes".

Though the public choice framework was developed by Buchanan and his associates explicitly for the particular political arrangements of the US, the logic of how a revenue-maximising sovereign could be restrained to only take enough to provide the essential public goods is common to all political systems. In *The Political Economy of Poverty, Equity and Growth* (co-authored with Hla Myint), I had developed a whole range of models applicable to various political configurations, with the revenue-maximising sovereign being the "predatory state". This is an obvious designation for absolute monarchs and dictators. But on the "median voter" theorem for democracies of the political scientists, even the US and Indian majoritarian democracies will be predatory states — with the predator being the median voter.

It would take me too far afield to detail the fiscal constitution that Buchanan derived in his various works, using the framework developed in *The Calculus of Consent* to restrain Leviathan. But it may be useful to outline some that are of relevance in the current policy debates in India and the US.

Taxes on capital (including inheritance taxes currently being advocated in India) — unlike taxes on current flows, of income and consumption, which can be avoided by appropriate actions on the part of taxpayers — are levied on the outcome of past decisions of taxpayers, which by and large cannot be undone to avoid the levies. In the pre-constitutional state of nature, the citizen would want to guard against this by not granting the government the power to levy taxes on capital.

The same argument applies to government borrowing, which also allows governments to appropriate current resources against taxes on future incomes. With uncertain tenure, predatory governments have no incentive to resist such extraction of future resources for their current purposes. Balanced budgets and restrictions on the government's power to borrow except in exceptional circumstances — like wars and depressions — would also be part of the fiscal constitution. These are very much the principles of Gladstonian finance.

A collectively financed safety net "to prevent the possibility of [the individual] falling into dire poverty in some unpredictable periods in the future" (*The Calculus of Consent*; page 193) would also be part of the fiscal constitution. To ensure that bureaucrats, in fact, make the desired transfers to the poor, rather than expand the welfare bureaucracy, transfers in kind would be limited, and the public provision of services to the poor that could be provided by the private sector would be prohibited, and the poor would be empowered to purchase by state-provided vouchers (as is proposed in India by the Aaadhaar scheme). Non-monetary transfers for the consumption of specific merit goods, such as education and health, would also be provided through vouchers.

I hope this is enough to show that Buchanan's work, apart from its theoretical innovations, remains powerfully relevant for the most important problem of economic policy: how can Leviathan's fiscal privileges inherent in a government's power to take, and give to whom it chooses, be limited? It is a question that continues to haunt the Indian polity, and for which reading Buchanan remains essential.