

Fiscal Bargaining and the Implicit Fiscal Constitutions of Liberal Democracies: A Public Choice Perspective

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Abstract

This paper analyzes the nature of intragovernmental bargains in settings where there are democratic pressures that motivate or constrain the procedures and constraints that the legislature and bureaucracy use for adopting fiscal policies. When democratic impulses are strong, the procedures will tend to align the interests of both the legislature and bureaucracy with general voter interests. When they are weak, the procedures will tend to favor special interests over general ones. When democratic pressures are substantial, the result is a pattern of taxation and expenditures that is at least as stable as the interests of voter interests. Electoral pressures and the stable procedures through which fiscal policies are adopted thus generate a complex political bargaining equilibrium—which to the extent that such equilibria are stable can be regarded as a nation’s fiscal constitution.

Key Words: Public Choice, Fiscal Constitutions, Delegation, Rational Ignorance, Public Finance in Democracies.

JEL Codes: H1, H3, H5

I. Introduction

All democracies determine public policies in a manner that ultimately rests on the approval of voters, and so in that sense, their fiscal policies are democratic. However, fiscal policies can be more or less consistent with the shared interests of voters. The extent to which this occurs is partly determined by the extent to which fiscal policies are salient issues for voters in national elections and partly by the standing procedures through which policies are chosen. The more competitive elections are and the more central fiscal policies are to electoral campaigns, the greater is the degree to which such policies tend to be democratic, which is to say grounded in electoral outcomes and approval by a majority of voters.

The alternatives voted on tend to be broad policy programs, which are not necessarily those that voters would have selected themselves. Moreover, voters cast their votes based on imperfect understandings of the policy proposals of candidates and parties. After policies are adopted and their effects become more obvious, electoral approval may be withdrawn. Ex post approval is better informed than ex ante approval, because the effects of the policies

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adopted can be observed either directly in one's own experience or indirectly through news accounts.

However, *ex post* approval is only indirectly indicated by electoral outcomes because voting is only partly retrospective. Voters assess how well the party in power did during its term of office but also try to predict how well it will do during the next term relative to the alternative(s). Moreover, the promised platforms are rarely fully implemented; thus current "campaign promises" provide only rough approximations of what a party or candidate will do if elected. To the extent that some promised reforms are blocked by rival parties, as tends to be the case with divided and coalitional government, this implies that past results do not fully allow voters to judge the performance of their present government.

The extent to which the general character of fiscal policies are well aligned with the interests of voters varies with electoral pressures, voter expectations, and the standing procedures through which policies are determined. These procedures reflect past bargaining within the bureaucracy, between the bureaucracy and the legislature, within the legislature, and the constraints placed on those bargains by a nation's constitution, partisan agendas and internal politics, and electoral pressures. It also reflects the elected officials' expectations about the reactions of voters.

It is through such bargaining that a nation's "fiscal constitution" is developed—that is, the more or less routine bundle of services provided and funding methods that remain in place for decades at a time. Any nation that has a stable pattern of taxation and expenditures may be said to have a fiscal constitution—although it is normally an unwritten one.

This paper reviews the public choice literature on the main steps in this process. It discusses why the results tend to generate an informal fiscal constitution when voters are reasonably well informed and corruption is not a major problem. It also discusses steps that are normally taken to make this process better align with the long-term interest of pivotal voters. Pivotal voters are normally, although not always, moderate voters, which is to say voters with approximately median preferences over fiscal policies.

It should be acknowledged that the analysis that follows reflects my perspective on the main results of the past 50 years of research and so gives my research a bit more attention than others might. However, this paper is not simply a review article; it attempts to combine results in a manner that provides a coherent view of democratic politics and its underlying stability. Several new points are made in the course of doing so.

The main body of the paper articulates a "neo-Downsian" fiscal equilibrium whose center of gravity is characterized by a collection of median voters, some more informed than others. The analysis is motivated by Anthony Down's model of electoral competition among more or less pragmatic politicians that wish to hold on to their offices. That classic analysis is extended to take account of differences in the extent of voter knowledge about the details of public policies. That neo-Downsian analysis is further extended by discussing why the limits of voter knowledge implies that "depoliticizing" some areas of policy can—perhaps surprisingly—improve the correspondence between public policies and voter interests.

This analysis is followed by discussion of various risks associated with fiscal policy de-

cisions concerning stability and sustainability in well-functioning democracies. Some fiscal policies are sustainable in the short and medium run but not in the long run.

II. Bargaining among imperfectly informed voters and agents

The process through which a democracy's vector of fiscal policies is determined can be approximated as follows:

- (i) Bureaus make proposals to the legislature for funds and in some cases enabling rules that advance the bureau's mission and/or the interest of senior members of the bureaucracy (those who can make such proposals).
- (ii) These in turn are evaluated by elected members of the government and revised in various ways. How this takes place depends on the institutional structure of the various "levels" of government. In some cases, as in the United States, the legislature plays the dominant role in this process. In others, as in England or Japan, the executive plays the dominant role. In either case, the proposals of the bureaucracy are evaluated and revised in various ways to advance the interests of those officials, including their interest in holding office after the next election.
- (iii) After the vector of policies has been implemented, voters decide whether to vote in favor of the incumbent government or some alternative. The interests that voters have in mind are normally longer term than those of elected officials, who tend to focus on near-term results, including those associated with the next election.¹
- (iv) Electoral pressures encourage elected officials to adopt and implement policies that moderate voters prefer over those of the parties out of power. If they did not do so, they would be almost certain to lose office after the next election.

The remainder of this section provides an overview of these various interests and how they tend to produce stable public policies in well-functioning democracies. Although the work is grounded in mainstream public choice research, that research rarely attempts to provide an overview of the process of government decision making but rather typically analyzes different—often narrow—aspects of it. Several new insights emerge from the synthesis undertaken in this section and the next.

The bargaining equilibria that tend to emerge from each of these discrete steps is analyzed in reverse order, as required to characterize a subgame perfect equilibrium—although the analysis is informal and intuitive, rather than formal and mathematical.

¹ This characterization reflects practice rather than formal constitutional doctrine. In principle, elected officials make laws that are then carried out by the bureaucracy; however, in practice those laws and budgets are usually those recommended by the bureaucracy. In addition to its authority to propose budgets for their own agencies, the bureaucracy also has authority to make laws and regulations in policy areas delegated to them in the past. However, the main interest of this paper is on fiscal matters, so it is the bureaucracy's budgetary recommendations, rather than its regulations, that are of greatest interest for the purposes of this paper.

II-1. Imperfectly Informed Voters

The interests and understandings of voters are a constraint on all that transpires inside political systems whose most powerful office holders are selected via elections.

As true of most work in economics and public choice, we begin with the assumption that voters are forward looking and take steps to advance their interests. They take the best steps in their private lives to advance their interests—at least insofar as they understand their interests and relevant possibilities—and similarly in their roles as voters. In most theoretical work, it is assumed that voters fully understand both their interests and the steps that may be taken to advance their interests. However, that assumption is widely recognized to be a simplifying assumption.

In most cases, individuals do not fully know their interests or the best means of advancing them. Instead, they know a bit about their long-term interests in safety, health, and material comforts and have some imprecise ideas about how to advance those interests in the circumstances in which they find themselves. This knowledge problem is greater with respect to public policy than in private life, as noted by Downs (1960), because the issues are generally more complex and the incentives to be well informed are weaker. A consumer controls exactly what goes into his or her shopping cart but has far less control over the portfolio of policies implemented by his/her government or who will hold elected office.

That smaller influence on results weakens incentives to be well informed, although it does not eliminate all interest in policy-relevant information. Some policy information is personally important (Congleton 2001); so, both general and specific information is collected and analyzed. Not all details are equally important to all people, however, and so the specific knowledge collected varies substantially among individual voters.

In most public choice and rational politics models, the interests to be advanced are taken as given and treated as abstract demands for pure public goods or externality-reducing regulations. However, when ignorance is acknowledged, this implies that changes in information about policy alternatives or consequences affects each voter's policy preferences and voting behavior.

For example, managing risks associated with ignorance and nondeterminism is an important part of life and new information about risks can induce significant changes in behavior. Thus, as voters become convinced that some risks are greater (or less) than they formerly believed, their demands for public services and regulations tend to change. Voters favor a variety of insurance-like services from government because the latter can reduce their effective risks from (i) others in their community, (ii) diseases that are costly to treat, and (iii) economic shocks that reduce their income and wealth. New information about such risks may induce changes both in voters' most preferred policies, political parties, and candidates.

The best strategies for managing risks are rarely obvious. These strategies tend to evolve with experience and with indirect experiences provided by stories from friends and family, theories learned at school and through reading, and mass media accounts of the news of the

day. One may change one's diet, for example, after learning a new theory about which foods are best for one's health and longevity, without changing one's job or moving to a new apartment or house. One may vote for stronger environmental regulations when new information suggests that risks are greater than previously thought, or for weaker regulations when new information suggests that risks are smaller than previously believed.

With respect to votes among candidates or political parties, voters with stable understanding of their short- and long-term interests may cast their votes for the same party for decades at a time and for the same sorts of candidates within such parties. However, new information or events may induce individuals to reconsider their policy and/or candidate preferences. For example, a regulatory failure such as those associated with the 2011 Fukushima nuclear plant crisis triggered jointly by a tsunami, poor design, and regulatory errors may create a new demand for both new forms of crisis management and better regulation of nuclear facilities. This in turn tends to encourage innovation by government officials to satisfy that demand, as has been the case in Japan.²

Similar information-driven shifts—albeit less dramatic and sudden—in voter assessments about governmental policies with respect to health insurance and environmental regulation have taken place during the past half century as concerns about health and environmental risks have gradually increased and our ability to moderate them has improved. Tolerance for national debt—whether wisely or not—has also evidently increased during the past half century, although this may reflect complacency rather than new information.³ Narrower bits of information such as those revealing scandalous or meritorious behavior by elected officials may also alter voter support for particular officials and parties, even if their stated policy positions have not changed.⁴

As the perceived interests of voters change, there will be good reasons for government officials to change policies. However, as long as understandings (beliefs) about governmental risk management and of the net benefits of other services are stable, so will patterns of voting with respect to those issues and so will a nation's fiscal policies. Demands for most services tend to rise with income; thus, stability in voter demands for public services tends to generate a stable trajectory or path of gradually expanding government services, taxation, and debt.

Survey evidence suggests that most voters are aware of only the broad outlines of most public policies. A typical voter's demand for services is general rather than specific, and his/her policy preferences in the short run tend to favor "more" or "less" of relatively broad categories of expenditures already in place, such as health care, tax-financed retirement bene-

² See for example, this recent article in the *Japanese Times* for an overview of steps taken in the past eight years: <https://www.japantimes.co.jp/news/2019/03/07/national/eight-years-triple-meltdown-fukushima-no-1s-water-woes-slow-recede/#.XQJA-HlhKiUk>.

³ A series of influential books and papers by Reinhart and Rogoff suggest that the accumulation of national debt, especially that held by persons outside the nation of interest, tends to produce financial crises in the long run. See, for example, Reinhart (2002) and Reinhart and Rogoff (2009a, 2009b).

⁴ Fear of scandals can have a strong disciplining effect on politicians who are not personally involved in a present scandal because behavior that may generate future scandals may undermine future re-election prospects. See, for example, McCubbins and Schwartz (1984) or Hopenhayn and Lohmann (1996).

fits, environmental regulation, and national defense, rather than detailed policy demands for specific programs in such areas.

However, there are exceptions. A subset of voters may have particular concerns about health risks, for example, and may have clear preferences for expanded coverage of particular medical treatments. Similarly, a subset of voters whose wealth or income is directly affected by relatively narrow provisions of the tax code or details of regulation may have clear, detailed preferences with respect to tax and regulatory policies on those issues (but not the entire body of tax or regulatory law).

Only subsets of voters are aware of the details of most policies, and only those voters will vote with particular policy details in mind. The demands of such narrowly informed voters tend to influence the details of public policy, because they are the only voters whose votes are affected by such details. Other voters will tend to be entirely unaware of such details.⁵

In normal times, changes in both general and particular interests occur only at the margin as a voter's information, tastes, and circumstances change; so considerable stability exists with respect to their perceived interests. It is partly for this reason that rational choice models of politics often assume that voter interests are completely stable.

II-2. Imperfectly Informed Elected Officials

We next turn to why elected officials attempt to address the concerns of voters and the extent to which elections, per se, tend to induce such behavior. This behavior is implied by the assumption that elected office holders want to retain their offices. Many politicians attempt to make politics their lifetime career. To win elections they (or their parties in proportional representation systems) have to adopt policies that tend to produce sufficient support from voters to return them to office. Of course, those running for office do not know exactly what voters want; so, they tend to rely upon past experience and opinion polls to determine the broad outlines of the policies preferred by their own supporters and/or mainstream (moderate) voters.

As a rule, elected officials govern by modifying existing programs rather than creating new ones, because it is existing programs—in most cases—that voters have demanded in the past and want to retain. Major reforms are rarely demanded by voters according to polls; moreover, major reforms risk failing to achieve the promised ends. In the latter case, even relatively uninformed voters may place blame on incumbents for policy failures and end their support for the candidates or parties holding positions of authority in the next election. Moderate voter sentiment and risk aversion on the part of elected officials account for much of the stability of fiscal policies in well-functioning democracies.

Even contemplating major new policies or major reforms of long-standing policies is

⁵ See Congleton (2001, 2007) for mathematical and simulation analysis of how and why this tends to imply that public policies are based on better information than one might expect based on surveys of voter knowledge but tend to favor policies that confer benefits on such informed voters. More on this will be developed in the next two subsections.

normally a sign that democracy is not working well or has not worked well in the past. It is a sign of major mistakes in policies—which is to say policies that are not well aligned with the interests of pivotal voters, who in most cases tend to be moderates by the evolving standards of the electorate. Anthony Downs (1957a, 1957b) demonstrated that two-party competition for voters whose ideal policies differ tends to converge toward the median voter's ideal.

Downs, however, implicitly assumed that apart from voters' ideal points, voters were basically similar with respect to their propensities to vote, information, and partisanship. Such differences affect the extent to which party platforms converge through effects on the identity of the median voter. However, Down's median voter hypothesis can be generalized to account for such differences. (The same Downsian logic and generalization of it can be used to characterize competition between two stable coalitions in multiparty states.)

Assume that two parties, A and B, have converged to identical platforms at the median voter's ideal point for the population of all voters, V^{All} . Suppose that some voters are more likely to turn out and vote than others and that the median preference of the most likely voters to vote differs from that of all voters. A party that takes a position between the median ideal point of all voters, V^{All} , and the median of the group that is likely to vote, V' , will win the election over a party that takes position at the median of all voters. Once this difference is recognized by both parties, the median voter of the entire electorate will be ignored and convergence toward the median ideal policy of the voters that actually turn out, V' , will tend to take place under the usual Downsian assumptions (pragmatic candidates for office, voter knowledge of his or her own ideal points, the platforms of candidates running for office, and spatial voting).

Now suppose that the population of voters also varies with respect to their understanding of the details of policy. Suppose that all voters know the general outlines of all policies, but only relatively small subsets of voters understand the details of particular areas of policy. To simplify assume that several distinct subsets of voters exist, each knowing the details of a particular area of public policy, but no group exists that knows all such details. Now suppose that the candidate or party platforms have converged to V' and one of the parties adjusts the details of policy j toward the median of the subset of voters that are informed about policy j , V_j' . That candidate will not lose any votes as long as the general outlines of policy are those of V' but will win additional votes from group j and thus win the election. When both candidates do so, the broad outlines of policy will remain those associated with V' , but the details of policies in area j will reflect those of informed voters in that policy subarea. A similar competition takes place for the votes of all the distinct informed subsets of voters the result is policy that generally reflects the overall median voter, the details of which reflects the interests of the various subsets of informed voters. The vector of policy details promised thus reflects the median interest in each of the informed subgroups of voters—who in most cases will be a relatively small, but not trivial, subset of the population of persons casting votes.

The result is an equilibrium similar in spirit to the one characterized in Down's path-breaking paper and book. However, in this case, the median of the group of persons

casting votes determines the broad outlines of policies and the median of informed subgroups of voters determine the details. The latter implies that many of the details of public policy will reflect relatively narrow interests rather than general interests. (Such informed persons are often members of organized Olsonian [1965] interest groups, who are informed about the details of policies by publications of their group's organization.) In such cases, the details of policy are based on a more thorough understanding of the issues than implied by public surveys of voter knowledge, but the details of most policies reflect the interests of relatively small groups of especially interested voters.⁶

This neo-Downsian equilibrium assumes that those running for office are well-informed about voter interests, information, and propensity to vote or not (turnout). In general, officials running for office are reasonably well-informed about voter preferences and turnout, although not perfectly informed. There are error terms associated with even the best surveys that can be devised. In addition, differences among surveys will produce differences in candidate expectations about voters that will affect their policy positions across the board. Moreover, there are subgroups with bimodal rather than unimodal distributions of ideal points with respect to policy details, and candidates may focus on one or the other of the modes of the distribution of ideal points rather than the median because small differences in policy may not be recognized by "marginal" voters.

Thus, the complete convergence of platforms predicted by Downs can be regarded as a first approximation, and the neo-Downsian equilibrium characterized in this paper can be regarded an improved second approximation for what actually occurs.⁷

The neo-Downsian hypothesis implies that electorally driven public policies generally tend to please mainstream (moderate) voters. Mainstream voters determine the broad outline of public policy and the details in areas in which most voters are reasonably well informed. In less known (obscure) areas of policy, it is the median voter of the informed subsets of voters that determine the fine details of policy. Such voters are often members of well-organized interest groups that provide them with detailed information about how particular policies will affect their interests, which are often economic ones. Here one may think of a farmer's far greater awareness of agricultural policies than an urbanite, or a labor union member's knowledge of policies with respect to unions relative to a nonmember, or a schoolteacher's awareness of policies with respect to education relative to persons without children in school, or an environmentalist's awareness of the details of emissions standards for automobiles relative to non-environmentalists, and so forth. In many such cases, the de-

⁶ See Congleton (2001) for a more careful development of this point. See Congleton (2007) for some simulation exercises that show how natural and rational ignorance affect electoral results.

⁷ If complete convergence did occur, there would be no policy-based rationale for voting. Instead, voting and votes would reflect perceived differences in candidate competence or trustworthiness, rather than policy differences.

A noninformational rationale for differences among parties (and dominant coalitions of parties serving a subset of the electorate) also exists; see, for example, Duverger (1959). Duverger argues that differences between candidates and parties might be retained for the purposes of motivating voters and party members. When the broad outlines of policy are similar among major candidates, parties, or coalitions, policy differences would no longer motivate party members. For the purposes of the present analysis, partisanship is treated as an informational difference between party activists and loosely affiliated members. Party activists tend to be unusually well informed about party-relevant policy details.

tails of public policy will reflect the interests of relatively extreme, but small groups of informed voters rather than the median of all voters.

The neo-Downsian equilibrium is stable but not static. As information about services and risks change through time, so will voter demands. However, except in times of crisis, such changes tend to be gradual as new information is taken into account and voters—when they can spare the time—think a bit more about their policy preferences in various areas of public policy.

As long as moderate voter conclusion about the broad outlines of policies remain stable, public policies remain stable—although not static—and reflect the interests of mainstream voters. Why? Because this is what it takes to win the next election and so hold onto elective offices and their associated control over policy. It is also how candidates and parties avoid scandals in which policies previously unknown to voters suddenly become the focus of attention and reveal either corruption or incompetence—neither of which is in the interest of moderate voters.

II-3. Imperfectly Informed Elected Officials and the Bureaucracy

All governments have unelected employees, whose main job is to implement the policies and laws adopted by elected officials. However, the limited information of elected officials implies that those employed to implement public policies always have some discretion over how this is done.

Part of that discretion is intentional, because many of the laws and policies adopted include provisions that characterize domains of bureaucratic authority. Those who write the law recognize that expert knowledge and knowledge of the details of particular international, financial, or regulatory settings is often better in the bureaucracy than in the legislature, so legislators grant unelected persons (bureaucrats) or governmental departments and agencies authority to adopt “implementing rules” of various types (subject to a veto by elected officials or the courts). Other discretion exists because it is implicit in the resources allocated to specific agencies and tasks assigned to bureaus. Some freedom to target resources to problems normally exists—as when police invest more effort in enforcing some laws than others or teachers spend more time on some subjects or parts of subjects than others. The services ultimately provided by a bureau or agency is thus partly the result of bureaucratic decisions authorized by elected officials.

There is also a residual of unintended discretion. It is impossible for elected representatives to directly monitor the activities of all government employees—or even those they directly appoint—because of other duties that consume most of their time and attention. The extent to which this unintended discretion causes problems depends largely on the incentives of the bureaucratic organization, the extent to which honest, dutiful employees are recruited, and the clarity of their jobs (duties). Shirking and corruption are not unknown in even generally efficient bureaucracies in both the private and public sector.

For the purposes of this part of the analysis, it will be assumed that the problems of se-

lecting and incentivizing government employees have largely been solved and that relatively little shirking or corruption takes place—not zero, but simply little enough that it can be ignored for purposes of this public choice overview of contemporary liberal democratic governance.⁸

With respect to policy making, government agencies also normally make proposals for budgets and for policy changes to the legislature and/or executive branches of government. These have to be acceptable to the subset of elected officials with the ability to accept and/or modify recommendations from specific bureaus and agencies. Naturally, much of the review process within a bureau or agency is done with the assessment of relevant elected officials in mind. Although there is some scope for attempting to mislead such officials (see, for example, Niskanen 1968, or Breton and Wintrobe 1975), their proposals cannot be grossly misleading without undermining their credibility and thereby the extent to which their recommendations are given serious attention by relevant policy makers.

To be acceptable, the recommended budgets and policies thus tend to be incremental reforms of past practices: a percentage increase in funds for various projects, some rule changes, and an occasional recommendation to begin a new project or two. The proposals cannot be extreme or they will simply be rejected by elected officials (unless such changes are perceived to advance voter interests, which is rarely the case). Thus, continuity is the norm, rather than the exception in every bureau's recommendations. Accepting extreme proposals would place elected officials at risk of losing their positions, and so tend to be rejected out of hand.

To be acceptable, the proposals made by the bureaucracies of liberal democracies must at least implicitly account for both the general policy knowledge and interests of relatively uninformed voters and the policy interests of groups of informed voters considered large enough to make an electoral difference. Narrowly well-informed voters include such persons as schoolteachers (with respect to educational policies), members of the military (with respect to salary, pensions, and military procurement), and increasingly, doctors and nurses whose incomes are increasingly determined directly or indirectly by government healthcare policies. The same may be said of employees of larger industries and labor unions with respect to trade, immigration, and labor policies.

Bureaucratic discretion of all three sorts tends to be a source of stability insofar as government employee interests are stable through time.⁹ Budget proposals will tend to follow a

⁸ Whether this is so or not evidently varies by country, period, and culture. See, for example, Rose-Ackerman (2002), Wallis (2005), or Carron (2011).

⁹ Niskanen (1968), Breton and Wintrobe (1975) and Migué, Belanger, and Niskanen (1974) have all argued that there is at least one aspect of bureaucratic interests that is very stable through time. They argued that bureaus all have an interest in greater resources—whether because their employees have internalized the mission of their bureaus or because of narrow self-interest in working conditions and opportunities for promotion. Bureaus thus routinely request more than they expect to need for their proposed programs and also propose programs that are larger than might most advance the interest of pivotal voters in the next election. This imparts an upward bias to government expenditures unless it is counted by decisions of elected officials—who, it should be acknowledged, often also benefit from increases in the resources disposed through government policies. Weingast and Moran (1982) argued that this very interest in budgets can be used as a method of controlling bureaucracies. Congleton (1982) illustrates how the delegation of authority produces bureaucratic inertia for given budgets.

pattern as noted above. Changes adopted by the executive or legislative branches that are not approved of by those tasked with implementing them may be implicitly countermanded through use of bureaucratic discretion. That discretion allows employees to ignore marginal changes in policies that are adverse to their interests—whether these be ideological or philosophical ones or simply their interest in more comfortable routines and working conditions (Congleton 1982). This source of bureaucratic inertia—although it has disadvantages—also tends to stabilize public policy.

II-4. Persuasive Campaigns by Nongovernmental Interest Groups

Although voters, elected officials, and government employees are all groups with interests in public policies, the political science and public choice literatures usually distinguish between those groups and members of organized groups that “lobby” government officials and voters to adopt policies that advance their interests. These organized groups normally comprise persons outside government that also vote but whose impact on policy outcomes tend to be larger than those of ordinary voters because of the influence that their persuasive campaigns and other efforts (campaign contributions, bribes, etc.) have on policy choices made by voters, elected officials, and members of the bureaucracy.

Persuasive campaigns would not have much effect on public policy were it not for the limited information in the minds of voters, politicians, and bureaucrats. By strategically changing those information sets, organized groups hope to change policy decisions with respect to the details of tax, expenditure and regulatory policies. Persuasive campaigns have impacts on policies that are analogous to those of informed voter groups (indeed their members are such informed voters), but they do so by changing perceived policy interests rather than casting votes. Their coordinated efforts to directly influence ideas about public policy and bargaining within government tend to give them greater impact on public policies than their numbers would warrant.

In areas in which mainstream voters are largely uninformed and persuasive campaigns are taken by a variety of groups, the details of public policies are adjusted to reflect the equilibrium persuasive efforts of rival groups (Peltzman 1976, Becker 1983, Congleton 1991, Muller and Stratmann 1994). These details are often economically or ideologically important for such groups—far more so than for mainstream voters.

However, in areas in which mainstream voters are reasonably well informed, policies cannot be changed without electoral losses, unless the persuasive campaigns succeed in changing the perceived policy interests of a substantial number of voters.

III. Equilibrium Policies as an Implicit Fiscal Constitution

A political constitution characterizes standing procedures and constraints for adopting public policies. A fiscal constitution is generated by the subset of those procedures and constraints that affect expenditures and taxation. These standing procedures are partly charac-

terized by constitutional documents, partly by other formal rules that characterize formal processes within the executive branch, the legislature, and the bureaucracy and, partly, informal rules that fill in gaps and help motivate cooperation within those formal procedures. All well-functioning (stable and durable) democracies have fiscal constitutions in this sense, although they are rarely if ever written down in detail. In this sense, they are implicit rather than explicit constitutions. They emerge from standing policy making procedures and stable patterns of interest among voters, politicians, bureaucrats and interest groups.

The model of policy formation sketched out in the previous section of the paper characterizes how the standing procedures and constraints in a typical democratic system and generate public policies. Day-to-day policy decisions normally run from interest groups and the bureaucracy to elected officials and finally on to voters. That is to say, proposals for reforms normally arise from organized groups inside and outside government who make recommendations to persons with some direct influence over public policy. For example, budget proposals normally begin with “last year’s” expenditure levels; to continue providing the same services will require an increase equal to the inflation rate for the inputs used to produce those services. To provide expanded services will require a somewhat larger budget. Explicit and implicit negotiations take place within the bureaucracy and among elected officials as a series of decision makers evaluate the arguments provided by “lower” levels of the bureau, its own policy experts, and interest groups.

No proposal is acceptable if it will clearly reduce prospects for re-election by incumbent officials. Only policy proposals and other laws that are neutral or thought likely to increase incumbent prospects for re-election are of interest. Thus, proposals from both the bureaucracy and interest groups are ones that tend to improve the electoral prospects of incumbents. To be given serious attention, the supportive “general interest” arguments must not be obviously false to elected official, who generally have a clear understanding of how mass elections operate. To be acceptable, the proposals must be in the interest of pivotal voters in the electorate as a whole and within the various informed subsets of informed voters—at least as they are understood by members of the governing party or parties. The veto power of elected officials thus induces self-restraint on the part of both bureaucracies and interest groups who expect to influence public policy as opposed to those who simply attempt to please their donors and members. To be taken seriously, the broad outlines of policy—although not necessarily all the details—have to be pleasing or at least acceptable to moderate voters—both those who normally vote and those who might be induced to vote if policy issues seem to be more important (or scandals more significant) than usual.

Elections serve as a constraint on fiscal policies that induce the broad outlines of public policies to reflect moderate voter interests. The details that most voters are unaware of have to be such that they can be explained to such voters in terms that they will find acceptable if for one reason or another an obscure area of public policy comes to broad public attention—as for example was the case after the Fukushima meltdown with respect to nuclear regulations. If policies cannot be explained in plausible general interest terms, officials face the risk that a news source will focus attention on them in a manner that suggests incompetence

or corruption. Such details may promote profits for some firms or industries or increase wages within particular specializations, but the rationale for such policies must plausibly advance the interests of mainstream voters—at least at first pass—in well-functioning democracies.

In a full policy-making equilibrium with well-informed elected officials, every proposal will be tailored to advance the electoral interests of those in office, and incumbents will win all elections, because their policies (and speeches) demonstrate that they understand and can promote voter interests. When elected officials are less informed, mistakes will be made in their assessments of both the proposals that emerge from the budgetary process and in the manner that they are described to voters. Such mistakes, as well as scandals and unexpected shifts in voter interests, can cause incumbents to lose elections.

A nation's fiscal stability is thus largely the result of bargaining equilibria that emerge within its standing procedures for making public policies. The outcomes of those procedures characterize the standing sources of revenue and pattern of expenditures and informal constraints on how much government debt is to be used. Its stability reflects the stability of voter interests, efforts of interest groups, interests of the bureaucracy, and risk aversion associated with self-acknowledged ignorance by everyone in the system. When stable, the standing pattern of expenditures, taxation, and debt can be regarded as a nation's fiscal constitution.

The same risk aversion that characterizes voter demands for risk management and insurance services from government and the private sector also tends to reduce incentives for elected officials to experiment with different tax systems. For example, no country has adopted a carbon tax, although voters and interest groups both express concerns about global warming that can be ameliorated by such a tax, which could be used to reduce or eliminate other taxes. Instead, various forms of income taxes together with a national sales or value-added tax tend to be the dominant sources of revenue for most national governments and have been for more than a half century. (Income taxes became commonplace among industrialized countries in the late 19th century. VAT taxes were widely adopted after World War II.)

Overall, the equilibrium trajectory of expenditures, taxes, and debt reflects stability in the explicit and implicit bargains reached in the more or less hierarchical process through which policies are chosen, revised, and implemented. The upward trajectory of expenditures in most programs is consistent with increases in voter income, a leftward drift in moderate voter ideology, and with the budget-increasing proclivities of elected and unelected government officials. The stability of the overall fiscal package of OECD countries is evident in national expenditures and debt levels through time, most of which can be well-explained with a simple autoregressive model.

The success of the fiscal constitutions of well-established democracies—which tend to be members of the OECD—is evident in their associated wealth, relatively stable fiscal policies, and broad popular support for their form of government—although not all of their policies.

IV. Other Aspects of Successful Fiscal Constitutions

To achieve a stable trajectory of taxation, expenditures, and debt is a nontrivial accomplishment. Public choice models suggest that stability is unlikely for governments that make extensive use of majority rule in elections, in the legislature, in committees, and subcommittees. Black (1948) and Arrow (1951/2012), for example, both implied that, except in cases in which voter preferences are essentially one-dimensional and single peaked, majoritarian cycles and instability will be commonplace. The same tends to be true of coalitional governments formed among disciplined parties. (See, for example, Shepsle (1974 or Brams, Jones, and Kilgour 2002.) The institutions and norms that solve these problems are of major practical and historical importance.¹⁰

Stability is arguably the first challenge that a democratic fiscal constitution faces. Other challenges involve sustainability and alignment with the long-term interest of voters.

It bears noting that in cases in which there are median voter equilibria (or variations of it as developed above), two properties of medians tend to promote stability. The first is the tendency of median voters (or other moderate voters) to be pivotal in elections, which tends to moderate policies and stabilize them as long as the interests of such voters are themselves stable. Shifts in the positions of relatively extreme voters tend not to matter or at least not very much if elections are competitive and there are two national parties or relatively stable coalitions that compete for authority.

The second is a property first noted by Condorcet in the late 18th century, when thinking about jury outcomes, later rediscovered by Galton in the late 19th century when thinking about the properties of medians, and subsequently rediscovered by public choice scholars such as Grofman et al. (1983) and Nitsan and Paroush (1982). What became known as the Condorcet Jury Theorem implies that median voter outcomes have properties similar to those of median estimators. They are accurate assessments of a median voter's true underlying demands for policies, indeed, more accurate than any single voter's assessment.

These properties help assure stability in two ways. First, median voter interests are more stable than those of any single voter and more stable than the average voter. Median estimates tend to be robust and unbiased. Second, insofar as voter ideal points with respect to policy are more or less unimodal with the great mass of voters within a standard deviation of the median, most voters will be reasonably satisfied with the results generated by competitive elections. They will not be ideal for many voters, but major mistakes will be uncommon and the policies will be acceptable—although not perfect—for a supermajority of voters. The latter tends to reduce pressures for constitutional reforms and revolution.¹¹

¹⁰ Rules adopted by legislatures and executives and within political parties also stabilize policy making in well-functioning democracies (Shepsle and Weingast 1981). These, in turn, are buttressed by rules internalized by individuals holding offices of authority and by voters, most of whom are guided and constrained by a variety of internalized norms, including ideas about the merits of democratic governance and the minimal requirements for those to function.

IV-1. Information Problems and Systematic Mistakes

In spite of the Condorcet Jury Theorem, mistakes are still possible. When moderate voters are not broadly informed on public policy issues, they may share biases about the consequences of the policies before them and favor policies that are less than ideal. As the consequences of such policy choices unfold, a majority of voters may have regrets about the policies undertaken in the past.¹²

Note that scientific advances in both the physical and social sciences imply that past theories by even well-informed voters were mistaken in significant ways. Insofar as a typical voter's models of man and society are a bit mistaken, so are the forecasts grounded on them. Indeed, when significant disagreements exist about "the" correct explanation for an individual or social phenomenon exists, at least some of these theories must be wrong in the sense that using them generates biased forecasts.

The Condorcet Jury Theorem suggests that, in areas in which voters are broadly informed, such mistakes are less likely when choices are made via majority rule than when they are made individually; however, it does not eliminate the possibility of systematic mistakes in policy areas in which most voters are not broadly informed (e.g. ones in which voters are ignorant of important details), because in such instances biased forecasts and mistakes are commonplace (Congleton 2007).

IV-2. Time Horizons and Ex Post Regrets

Another source of ex post regrets is the time horizon of a typical voter's or government official's assessment of policy alternatives. The best long-term strategy is not always the same as a series of best short-term strategies. Thus, when relevant decision makers emphasize short-term over long-term interests, ex post regrets may emerge even when short-term interests have been accurately and correctly assessed. Even a series of glasses of an excellent wine or whiskey may give you a hangover the next morning.

The effects of many public policies emerge over decades—as with policies regarding infrastructure, public education, and national debt—or centuries—as with policies regarding research and development, economic development, culture, and environmental concerns. Focusing on immediate effects rather than longer-term effects in such areas is very likely to be associated with ex post regrets.

Shorter-than-ideal time horizons are partly consequences of imperfect information. Vot-

¹¹ This argument is weaker in cases in which the distribution of voter interests is bimodal unless the two modes are reasonably close together. In other cases, moderates tend to be a minority and their pivotal role will not please the more extreme voters away from the median. Such extreme voters may together be a supermajority, but neither group would constitute a majority by itself—that is, without the support of moderate voters.

¹² There are various limitations to this result (Congleton, 2007); these imply that in any area of policy in which voters are not reasonably well informed, the resulting policy choices tend to be error prone in that they do not truly advance moderate voter interests.

ers and elected officials usually have a far better understanding and estimates of short-term effects than long-term ones. Shorter-than-ideal time horizons are also associated with electoral cycles, which have to be reasonably short to allow past mistakes with respect to the choice of representatives to be corrected. Elected officials—it should be noted—normally have much shorter time horizons than voters insofar as what matters most to them is their own and their party's success in the next electoral contest.

Shorter-than-ideal time horizons are also associated with the human life cycle. Although parents do consider the effects of policies on their children and grandchildren, they cannot really fully understand what the interests of their descendants will be or the potential technologies that will be available to their descendants for use in their private lives and for addressing public policy concerns. How many voters or government officials in the year 1900 would have anticipated antibiotics, jet airplanes, computers, open heart surgery, robots, the Internet, cell phones, and the relatively long, healthy, and comfortable lives of their descendants? It would have been impossible to do so, given what was known at that time.

V. Methods for Reducing Systematic Errors (and Regrets) in Public Policy

The ultimate source of ex post regrets by voters is their own ignorance and the biased expectations associated with that ignorance. So, any policy that improves the breadth and depth of voter knowledge tends to improve the performance of democracy in the sense that mainstream—moderate—voters will have fewer regrets about the outcomes of their government's policy choices. Stable democracies thus subsidize education and libraries, allow public debates over policies, have a more or less free press, and allow a more or less unrestricted access to Internet sources of information. Such policies tend to induce more informed policy choices and generate outcomes that most voters will be reasonably satisfied with. The policies and outcomes are less than ideal, but acceptable.

To address policies in areas in which educated voters are not well informed—but able to recognize their own limitations—they often rely on various forms of delegation. The use of elected representatives is one obvious form of delegation, but there are many others.

In many policy areas, voters may have general ideas about the results they desire but little or no knowledge of how to assure those results. For example, few voters will have studied monetary economics, but most will prefer a society with low inflation to one with high inflation. With this in mind, elected representatives may create an independent central bank to manage the financial sector with the aim of assuring low inflation, stable and low interest rates, and moderate business cycles. Although the bank's policies are not likely to be closely monitored by the average voter, their results can often be directly observed. Similar delegations to experts also occurs with respect to international affairs, the military, highway construction, and so forth.

Voters may also realize that they are occasionally tempted to place their short-term interests first and adopt constraining rules that reduce this temptation. Formal constitutional constraints are one such mechanism, delegation is another. For example, voters may realize that

they might be tempted to suppress information that conflicts with their current views, and agree to eliminate that temptation through laws that assure freedom of expression, association, and dissemination—except in extreme cases. Similarly, delegation may be undertaken in durable forms that are difficult to reverse quickly, as with long terms of office for judges and for appointees to “independent” agencies.

There are essentially two sorts of delegation used to address information problems within a well-functioning government: delegation with respect to policy recommendations and delegation with respect to policymaking authority.

V-1. Delegation of Advice

The use of advisors is an ancient institution and one that is used by a full spectrum of governments. Virtually all authoritarian regimes and democracies use advisors of various kinds, who are acknowledged to be more informed about particular issues than is the person with authority to make policy decisions. By drawing on the knowledge and advice of such persons and groups of such persons, a rule maker is able to make better decisions than he or she otherwise could have. Moreover, the rule maker’s breadth of experience and knowledge of tradeoffs implies that the decisions reached are likely to be better than could be contrived by a narrow specialist. It is for this reason that generalists rather than experts normally govern. (Casual reading of memoirs by chief executives of large corporations suggests that this is true in the private sector as well, at least for the most part.)

Within democratic governments, this implies that unelected experts normally have more influence than a typical voter has, but insofar as his, her, or their advice improves the decisions of elected officials, their advice must on average improve the results for moderate voters and thereby the electoral interests of those in government. Otherwise, their advice would not be given significant attention. In such cases, the use of advisors is consistent with democratic governance.¹³

V-2. Delegation of Authority

Delegation of authority to experts or persons with more knowledge of particular details is also an ancient practice and one associated with the entire spectrum of governmental types. Delegation differs from advice, in that experts are given discretion over policy within a limited domain. In hierarchical organization, this includes discretion about how to “manage” or incentivize those “below” them in the hierarchy. In some cases, the expertise is simply better knowledge of the circumstances to be addressed. A janitor has discretion over cleaning methods because he or she knows the problems that need to be addressed in partic-

¹³ Of course, taking advice from experts is not an easy task to undertake and there is always some risk that the advisors will co-opt or manipulate their advisees. However, the persons in authority that receive advice can listen to a multiplicity of advice in order to reduce this effect and also improve the extent of the information implicitly taken into account when reaching a policy decision.

ular times and places. In others, it is better knowledge—generally acquired through training and experience—of the alternatives for advancing policy goals within their domain and of their consequences. A maintenance supervisor tasked with managing a team of janitors has better knowledge about the best combination of methods and chemicals to clean various types of surfaces and messes than a typical janitor.

Of course, delegation in a contemporary government that provides a broad array of services is a much more complex process than asking a person to clean up a particular room—although it is essentially similar insofar as particular individuals or agencies are assigned a domain of authority and tasked with solving a variety of problems associated with that area of responsibility.

The delegation of greatest interest for the purposes of this paper involves control over decisions that have major consequences for citizens or the performance of government. For example, legal decisions are normally depoliticized in liberal democracies by creating an “independent judiciary,” which entails the delegation of most decisions about whether a particular law has been violated or not, who violated it, and how those violating the law should be punished or the problem remedied. The independent judiciary produces “law and order” by topping up and reinforcing the order that would emerge from a citizenry’s internalized norms. It also sees that the laws and regulations adopted by elected government officials and senior bureaucrats are enforced. A similar delegation of important responsibilities takes place when an independent central bank is established and given discretion to “manage” inflation, interest rates, or the money supply.

Such high-level depoliticization of policy areas is not complete. The senior officials tasked with the responsibility for making decisions in those areas are normally appointed by elected government officials and can be replaced—albeit normally not easily—by the same officials (or other appointees) for poor performance or violating the law.

The democratic defense of “depoliticizing” such areas of policy is that it generates better results for the average or median citizen than direct control by elected officials or voters themselves (through referenda). There is empirical evidence that this is the case for both an independent judiciary and monetary policy. (See for example Feld and Voigt (2003) or De Haan et al. (2001).

V-3. Self-Restraint and Procedural Stability

Ultimately, all these policies for reducing systematic errors can be reversed, but the time and attention required for such reversals implies that long-term interests tend to govern such efforts. Thus, policies that tend to increase voter information and understanding and those that delegate advisory and regulatory decisions tend to be stable through time.

Other policies that tend to increase support for constitutional procedures and results tend to protect minority welfare in various ways. The takings clauses of most liberal constitutions do this by restricting the majority’s ability to simply take wealth from members of the minority. Rules allowing freedom of belief (political and religious) tend to so by restricting the

majority's ability to impose severe restrictions on the ideas that individuals may hold, develop, or espouse.

VI. Innovation and Crisis

All the above helps to explain why fiscal policies tend to be stable through time in well-functioning democracies. The interests of moderate adult voters tend to be stable and long term. Elected politicians tend to adopt policies that advance those interests. Some groups—relatively informed voters and interest groups—have more influence over policy than ordinary voters have; however, as long as their interests and relative influence are stable, the details of policy that they favor will remain in place. (That the details of policy have varied far more frequently than the broad outlines of policy suggests, however, that this is not generally the case.) In addition, both the discretion of the bureaucracy and the advice given by experts in cases in which a consensus exists among such experts tend to reinforce stability. The latter may improve policy in areas that affect voters, especially when most voters are not very well informed about those policies. Errors in expert judgement, nonetheless, will be punished at the polls if and when they are discovered.

Overall, the results for well-functioning liberal democracies have been very good since 1950, when judged from the perspective of voter opinion and world history. However, fiscal constitutions have not been entirely stable in that period.

Major innovations were adopted in the period between 1960 and 1980, as what has been termed the welfare state expanded in all OECD countries and as environmental regulations intensified. Once initiated, those new services and the taxes to finance them were relatively stable, although not entirely so (see Congleton and Bose 2010). This trajectory doubtless reflected increases in median family income, as well as shifts in ideas, as the ideology of mainstream votes gradually shifted to the left during the post-war years.

Other changes were induced by crises of one or another, the most obvious were major recessions. For example, Sweden reined in the expansion of its welfare state programs in the early 1990s to sustainable levels, because its debt became increasingly difficult to sell on international markets. The great recession of 2008 induced many OECD countries to at least temporarily expand their national debts—motivated partly by the advice of macro economists.

Such policy reforms imply that the stability of a fiscal constitution is not simply a sign of what might be termed social or political inertia. Rather, it is a consequence of stable bargains negotiated explicitly or implicitly under stable political procedures and natural laws with the interests of moderate voters at heart. Those policies can be changed when voters are persuaded that it is important to do so, as in the crises mentioned in the previous paragraph.

A fiscal constitution can be amended—but major reforms require either significant changes in voter interests or a crisis that calls for or appears to call for “radical” changes in that constitution. (The latter probably accounts for overuse of the term “crisis” by persons

and groups lobbying for major reforms.)

It is unlikely, however, that every reform adopted during a crisis is an improvement. The speed of reform during a crisis often indicates that the effects have not been thought through and may well produce problems in the future. The great expansion of public debt over the past half century may at some point generate a financial crisis for Western democracies, as suggested, for example, by Reinhart and Rogoff (2009). However, it should be acknowledged, “so far, so good,” as far as moderate voters are concerned.

VII. Conclusions: Bargaining Equilibria as Fiscal Constitutions

A formal fiscal constitution consists of equilibria associated with its written and unwritten political constitution. It emerges from standing procedures for adopting and revising tax and expenditure policies, and it, like a political constitution, also specifies durable constraints for the fiscal package to be delivered.

Formal political constitutions are rarely complete in the sense that a single internally consistent document fully specifies all the procedures through which policies are made. Election law, for example, is rarely fully specified in democratic constitutions. Indeed, it often not mentioned in formal constitutional documents except as a task delegated to the government characterized by those documents. That aspect of liberal democracies—arguably one of their most distinguishing features—emerges from bargaining within government and between governments and voters through procedures created by those laws and by other aspects of the formal constitution specifying the division of authority among the various branches of government.

In this respect, what I have termed the fiscal constitutions of liberal democracies are similar to their political constitutions. Major elements of fiscal constitutions emerge from bargaining—both explicit and implicit—within governments and between governments and their voters. In both cases, the overall set of procedures that generate public policies can be regarded as “good,” if they are (i) stable, (ii) yield predictable results, and (iii) are well aligned with the interests of moderate voters. Stable does mean static, but predictable and reasonably easily so. In statistical terms, the form of predictability that I have in mind is analogous to an autoregressive process such as $G = a + bG_{t-1} + e_t$, a process that can in fact account for most of the path of expenditures and debt over the past half century in most OECD countries.

The existence of a fiscal constitution does not, of course, assure that the results are good or sustainable in the long run—both of which are concerns of constitutional designers and reformers. These depend on a number of factors, but first and foremost, the interests of mainstream or moderate voters whose policy preferences tend to determine the broad outlines of fiscal policy, including the general pattern of expenditures and the manner in which expenditures are financed. If voters make significant mistakes, either because of their lack of information or due to a short time horizon, the long-term results will be unsatisfactory and pressures for reform or revolution will emerge within otherwise well-functioning democrat-

ic systems of governments, and few would survive in the long run. Their success and stability for the past 70 years suggests that this problem has been avoided in Western democracies—at least with respect to the broad outlines of fiscal and other public policies.

The second most important cause of mistakes involves areas in which policies are overly “depoliticized” through delegation. If elected officials take advice from or delegate too much to experts or to the wrong experts, mistakes may emerge from that process as well. It is important that the interests of such experts be aligned with the long-term interests of moderate (pivotal) voters both to improve long-run governance and to reduce tensions within democratic polities.

Fiscal constitutions are amendable and are generally amended as voter interests or expert advice changes through time. Thus, there are durable changes in the fiscal packages that occur every few decades. Not all such changes are sustainable or good for moderate voters (Buchanan and Wagner 1977, Buchanan and Brennan 1977), but other changes may please voters such as those associated with the rise of the welfare state in the 1960-1985 period. There are long-term risks associated with that great expansion of the welfare state, but the results to this point have been very popular among moderate voters. Among those long-term risks are changes in norms that undermine prosperity and sustainability (Lindbeck et al 1999), and a tendency toward greater debt finance of these programs and others than prudent given long-term risks associated with government debt (Reinhart and Rogoff 2009). If such problems are recognized, the fiscal constitution can be amended again, although the necessary reforms may be more difficult to implement than the amendments that initiated the welfare state and debt finance.

It is the general stability of the “rules of the game,” rather than a completely static character, that is the most important characteristic of political and fiscal constitutions. Within the West, fiscal constitutions are the norm rather than the exception. Although they have been amended from time to time as voter interests and expert theories changed, they have been remarkably stable for the past seven decades.

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