

A Condition of Small and Balanced Budget

—An Interpretation of the Japanese System—

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§ Introduction

The Reasons for the deficit in the budget of national government in modern democracy—as revealed in the U. S. for these twenty years—are stated by some leading public choice economists as follows:

(1) All people involved in formation of macro-economic stabilization policies have failed to see that Keynesian theory of economic policy from which actual macro-economic policies are derived has the assumptions that those policies should be implemented by clever statesmen.

(2) In actual world, politicians, voters and bureaucrats are not the inhabitants in Harvey Road. Politicians are easily sensible to the pressures from citizen voter expecting to obtain the maximal support from them. Such incentives and behaviors of politicians would result in the immediate adoption of the tax cut and the increase of the government expenditures in depression. Asymmetrically politicians would find it very difficult to increase tax and/or to decrease government expenditure in boom, facing the fear of losing the votes.

(3) Firms and individual voters and their pressure groups are usually myopic seekers of their own benefits. That is, they know that their pressures for large budget are likely to lead to deficit, which in turn brings out the burden of refunding the borrowing and paying the interest on their future generation. But they don't regard such burden as their own. Public debt burden falling on future generation is not included in their costs of obtaining benefits through the government expenditures.

(4) All bureaucracy seeks to maximize the amount of the budget appropriated to their bureau, even though part of the national budget is financed by the issue of public debt.

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本学会への出席を勧誘して下さい、大会では私の分科会の座長として御教示いただいた Western Economic Association の現会長 Gordon Tullock 教授、私の出席に際して御高配をいただいた副会長の Eldon J. Dvorak 教授、拙論に対して有益なコメントをしていただいたジョージメイソン大学の W. H. Winegarden 教授に厚く御礼を申し上げます。

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§ A Model for a Large Economy with Deficit Budget

A simple model describing a large economy where domestic market dominates, and as a consequence of political actions among economic subjects, government leads to deficit budget can be easily described. In this model economic subjects are classified into 4 groups.

(1) Individual voters; their utility level U_i , is a function of the level of national economic activities Y that immediately represents the level of employment, the level of individual income and the Individual tax T_i .

(2) Firms; their utility level U_f , depends on favorable domestic economic condition E that in turn depends on government expenditure, the level of national economic activities that are mainly affected by E , not by foreign markets by assumption, and the corporation tax T_f .

(3) Politicians; their utility level U_p , simply depends on the votes from individual voters V_i , the support from firms in terms of monetary contributions and other organizational back-up V_f , and the cooperation that politicians obtain from the bureaucracy as the skilled technocratic group V_B .

(4) Bureaucracy; its utility level U_B depends on the size of the governmental budget, because it is the basic foundation of each bureau's power. Therefore we can form a model for a large economy with deficit budget.

$$(1) \quad U_i = U_i(Y, T_i), \quad \frac{\partial U_i}{\partial Y} > 0, \quad \frac{\partial U_i}{\partial T_i} < 0$$

$$(2) \quad U_f = U_f(Y(E(G)), T_f), \quad \frac{\partial U_f}{\partial Y} > 0, \quad \frac{\partial E}{\partial G} > 0, \quad \frac{\partial Y}{\partial E} > 0, \quad \frac{\partial U_f}{\partial T_f} < 0$$

$$(3) \quad U_p = U_p(V_i(U_i), V_f(U_f), V_B(U_B)), \quad \frac{\partial U_p}{\partial V_i} > 0, \quad \frac{\partial U_p}{\partial V_f} > 0, \quad \frac{\partial U_p}{\partial V_B} > 0$$

$$(4) \quad U_B = U_B(G), \quad \frac{\partial U_B}{\partial G} > 0$$

$$(5) \quad G - B = T_i + T_f$$

We denote budget deficit, i. e., the issue of public debt in a year B .

In this model, politicians of ruling party arrange public policy and budget policy in order to be elected or reelected. In turn they need to maintain U_i , U_f and U_B at correspondingly high levels.

Note that we assumed that individuals, bureaucrats and firms have myopic view as to their interests. Future tax burden that is expected to be fallen on the future generation is not included in all utility functions of economic subjects.

In this political economy model, politicians of ruling party are assumed to select policy variables G , T_i and T_f in a way to maximize votes and supports V_i , V_f and V_B from other groups. Equation (5) is definitional one, which determines the value of B as only balancing factor of the national budget. By assumption, politicians and other subjects do not give their attention to the burden on future tax payers, arising from the existence and

the accumulation of B .

In the case where this economy can somehow keep a steady growth, Y would be mainly determined by the resources available and the progress of technology of production. In this case, however, B may be positive with inflationary pressure. In the period of depression, this economy will bring out much more budget deficit. In the period of boom, however, this economy will not see a large curtailment of deficit. Therefore, on average, this economy suffers from continuous inflationary pressure. By the assumption that economy has large domestic market, there will be no balance of trade difficulties. Even in such a case, not only politicians but individuals and firms prefer inflation to unemployment.

§ A Model for an Export-orientational Economy —the case of Japan—

In this section the relevant economic subjects are the same as in the last section. Basic behavioral assumptions are also the same. However, equation (2) is changed a little in order to consider the role of export in this economy. The level of national economic activities Y , depends heavily upon exports X , which are related to exogeneous state of world economy \bar{E} , and the domestic price level P . Domestic price level in turn is mainly determined by the size of budget deficits. Here we neglect monetary policy. We add to a special institutional condition as the equation (6); That is budget deficits are limited to a given amount \bar{B} by so-called fiscal constitution.

Therefore in this case, a simple model can be described as follows;

$$(1)' \quad U_i = U_i(Y, T_i)$$

$$(2)' \quad U_f = U_f(Y(E(G), X(\bar{E}, P(B))), T_f), \quad \frac{\partial Y}{\partial X} > 0, \quad \frac{\partial X}{\partial P} < 0, \quad \frac{\partial P}{\partial B} > 0$$

$$(3)' \quad U_p = U_p(V_i(U_i), V_f(U_f), V_B(U_B))$$

$$(4)' \quad U_B = U_B(G)$$

$$(5)' \quad G - B = T_i + T_f$$

$$(6)' \quad B \leq \bar{B}$$

In principle, these equations determine, in the same way as before, the amounts of seven variables Y , G , E , T_i , T_f , B and P . Seemingly this model also leads to the creation of budget deficits till the limit of B is reached. However I want to stress the relation between B and P . The seeking of self-interest among individual and firms might bring out the deficit of national budget. But these processes are usually followed by inflation. That will give an unfavorable effects on the level export of this economy. Recall that the prosperity of this economy relies heavily on the promotion of export. Thus the process of inflation will be constrained by the economic calculus of each subjects.

It might be argued that if this economy should bring out inflation as a result of political process it could promote its exports by the reduced rate of foreign exchange. However, inflation brings out social tension between employer-employee relation, distortion of resource allocation and conflict through the redistribution of incomes and stocks among peoples. Therefore this economy prefers promotion of export under the circumstances of a stable price level by means of improvement in the quality of goods exported and reduced

export prices through production cost decreases.

Of course in this economy, the issue of public debt will be seen in the period of depression. But so long as this economy want to keep the stability of prices as the condition for increase in export, in the phase of prosperity the issue of public debt will be reduced sharply. Therefore in this economy we can expect equilibrium amounts of B to be less than \bar{B} .

§ Existence of Fiscal Constitution

In this small and export depending economy, the government might be controlled by the Fiscal Constitution. Indeed, Japanese economy is under such constitutional control. Immediately after world war II, Japan obtained so called new democratic constitution. At the same time Japanese government set up the fiscal constitution where the balanced-budget principle is strongly declared. The fourth article of the fiscal constitution says that the national government must obey the principle of balanced budget, with only exception that the government be able to issue the public debt in order to finance the public investments. Therefore public debt to finance government consumption is constitutionally prohibited.

In emergency, for example after the oil crisis in 1974~80, the government could rely upon the issue of public debt beyond the amount of expenditures for public investments. In that case, the government makes a law that says that the government itself violates the fiscal constitution, and present the law to the congress to get permission from the congress. Therefore, in that case, many relevant people involved in the formation of budgetary policy have the sense of doing illegal issue of public debt.

§ Obedience to Law or Economic Reason ?

In this paper I pointed to two reasons for balanced budget in export orientational economy like Japan. One is the consciousness to the stability of domestic prices which is the consequence of the nature of export-economy. Another is the constraint of fiscal constitution which prohibits budget-deficit as unsound and illegal.

In my opinion, I take the economic reasons more fundamental. Surely in Japan, relative position of bureaucracy in the process of public policy formation is higher than in other countries of democracy. And bureaucracy has the most proclivity to obey the law and set up regulation. However, even in Japanese economy without economic consciousness toward price stabilization on the business world, keeping small and balanced budget in the long run would be difficult.

Though I did not consider in this paper, I want to note another economic reason for a long range balanced budget. That is the fact that Japan is becoming to an ageing society. This fact brings out almost unanimous opinion among policy-minded people that if the government now continues to issue the public debt, tax burdens of future generation should

be very high due to funding the debt and inevitable increase in government expenditures for social security.

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