

The Leviathan Hypothesis

Buchanan and Brennan

The government as a whole acts as a monopolist.

They extend rent-seeking to its logical conclusion, it is not that individual politicians and bureaucrats act as rent-seekers, rather the govt. as a whole acts as one.

If true, this has strong implications for taxation and government policies.

Assumptions of the Model:

Rational ignorance, information asymmetries, etc. all exist

Thus voters can only constrain govt. to a limited extent

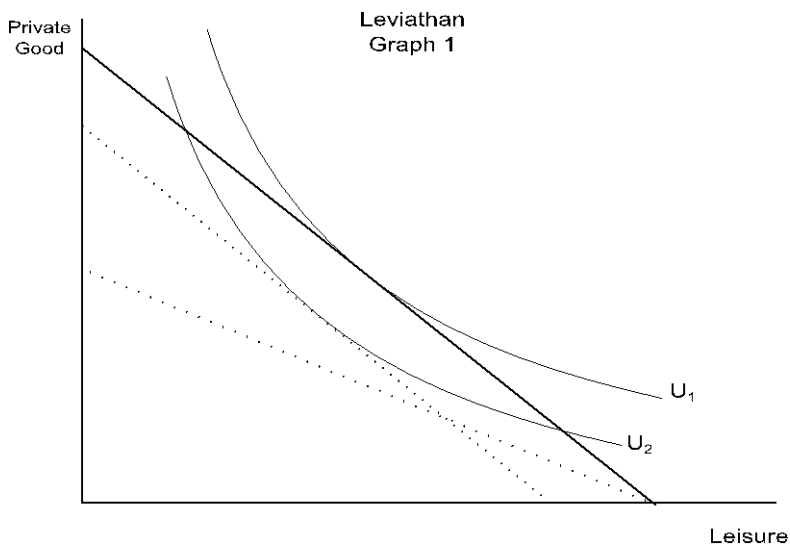
Thus, citizens “set up the govt”, which then acts on its own agenda

Implications of the Model:

The only effective way to control the size of government is through constitutional constraints. Otherwise govt. will “blow through” mere political constraints.

In this model, then, you have to control the size of government. You do so by controlling the governments powers to tax, borrow, and create money.

Example: Taxing Income and Leisure



Assume two Goods: Income and Leisure

The government must raise a fixed amount of revenue

In a perfect world: tax “earned and potential income”, then no substitution effect (example of taxing potential income: imputed income for child support)

Our budget line would shift in by a fixed amount, equal to needed “Tax”, this is the dotted line parallel to the initial budget constraint.

This would minimize distortions to the economy, but utility would drop from U_1 to U_2

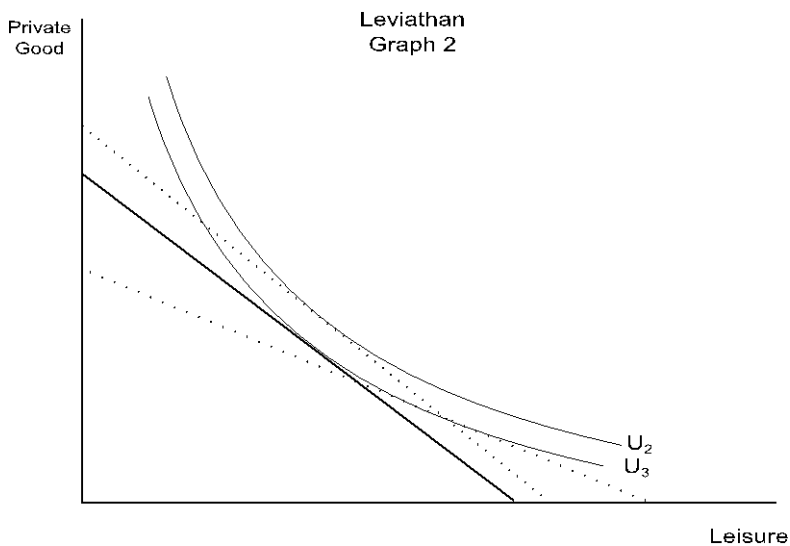
But our world is not perfect, we can't tax “potential income”, i.e. leisure.

So our new budget line, which includes Taxes, pivots downwards, the other dotted line

People substitute out of it, into the relatively cheaper good, leisure.

Government thus has to raise taxes higher, To get the same amount of revenue

So we now end up at U_3 , shown in the graph below.



In this graph, U_3 is our utility, because we can't tax leisure. But what if we could?

In that case, our budget line would shift from the more horizontal budget line (repeated from graph 1), that is tangent to U_3 , to the one that is tangent to U_2 (U_2 and its associated budget line are taken from graph 1). Utility could be increased.

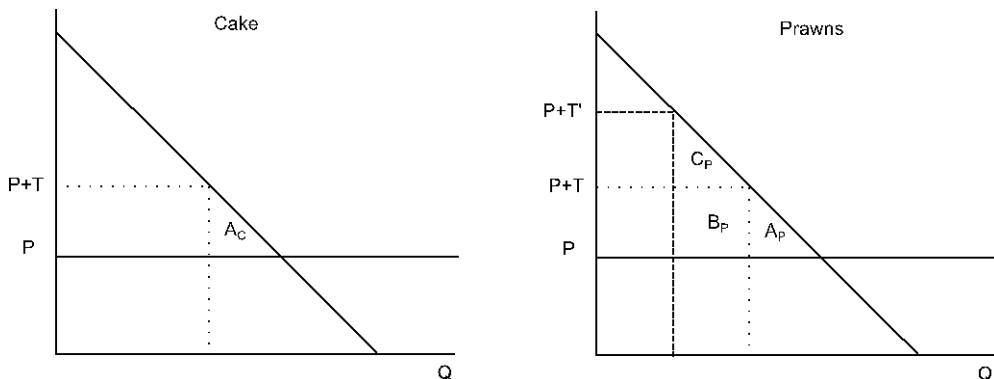
Buchanan/Brennan ask a simple, but very important question. Since the voting public has already revealed that it will vote for taxes that lower utility to U_3 , why would we assume that if the government could change the tax system to a more efficient one, it would do so in such a way as to limit its size, and increase our utility? Isn't it more likely, that they would lower taxes on goods, but raise taxes on leisure, such that we are now on the solid line above – which leaves the public's utility unchanged, but increases the government's revenue?

Discussion.....

(be sure to note growth of govt. notes: the “technology” hypothesis, rent seeking and Niskanen bureaucrats)

Implications of this view for Public Finance.....

Imagine that the government must get its revenue from two goods with identical demand elasticities. We will use the example of Cake and Prawns.



In most standard Public Finance treatments, we would want to impose an identical tax on both goods, represented by the difference between P and $P+T$. This means a deadweight loss of A_C and A_P . If we instead put all the tax on prawns (doubling that tax, and eliminating the tax on Cake – we are assuming these goods are NOT substitutes for each other), we would change the deadweight loss from $(A_C + A_P)$ to $(A_P + B_P + C_P)$, doubling our deadweight loss. This is bad.....

Note in the above, the more inelastic demand, the less the deadweight loss for any transfer to the government, so we can minimize deadweight losses by taxing goods with an inelastic demand, and by putting into place a low, but very broad tax.

Buchanan/Brennan would agree with all this, so long as a transfer to Government is just that, a transfer. But what if it is just dissipated rent seeking? Money used to oppress us? The means by which a Niskanen bureaucrat provides us with goods of little, or negative, marginal benefit?

Or, in other words, “yes Pharaoh, I would love another pyramid”.

If we view the government not as benevolent, but as out for itself....

In that case, are the transfers “good”?

In the above two graphs, the transfer to the government can be minimized by only having one tax.

Thus, we don't want to tax goods with inelastic demand – we can't escape that tax

Tax the goods with elastic demand – only this will constrain government

Taxes should be linked to the good provided – tolls

Now, to collect the tax, the government must provide the good