1. CONTEMPORARY DEMOCRACY AND THE PROSPECT FOR FISCAL CONTROL: INITIAL THOUGHTS ABOUT AND FINAL REACTIONS TO THE CONFERENCE

James M. Buchanan and Richard E. Wagner

The driving motivations behind the conference on Federal Fiscal Responsibility were an interest in the reasons for and a concern about the long-term consequences of a dramatic shift in the pattern of American fiscal history that occurred during the second quarter of this century. Before the 1930s, budget surpluses were the dominant state of affairs; budget deficits have since come to dominate our fiscal life. The budget surpluses that were so normal prior to the Great Depression of the 1930s were used to amortize the federal debt that was created during times of war and recession. The federal government customarily resorted to deficit finance to pay for wars and to offset declining taxes during recessionary periods, but during normal periods the government redeemed this debt with surpluses of taxes over expenditures. In the years immediately following the creation of the American Republic, the federal budget was nearly always in deficit. As this tumultuous period drew to a close, the nation found itself saddled with a debt of $83.8 million, quite a substantial sum for those days. In response, Congress enacted the Sinking Fund Act of 1795. This act provided for budget surpluses to be generated, with the proceeds used to retire the national debt. Budget deficits once again ensued following the Panic of 1837, but with budget surpluses generally resulting thereafter until the Civil War. Between the Civil War and World War I, surpluses once again dominated budgetary policy, with the proceeds being used to reduce the national debt. And debt reduction prevailed after World War I until the onset of the Great
Depression. With the Great Depression, this uniform, recurring pattern of fiscal history – deficits created during recessions and wars, with surpluses created during normal times to amortize the national debt – ceased.

Budget deficits prevailed and public debt accumulated during the Great Depression just as was true for the earlier recessionary periods. And when World War II followed on the heels of the depression, the pattern of deficit finance and debt accumulation continued, again just as was true for other wartime periods. But with the cessation of hostilities and the return to peace and prosperity, the former budgetary pattern did not return in its full vigor. During this postwar period and running throughout the presidency of Dwight Eisenhower, an approximate pattern of budget balance prevailed. Deficits in some years were offset by surpluses in other years, but no serious effort was made to reduce the amount of national debt. The post-war level of public debt was largely accepted as permanent, and efforts were directed not at reducing this debt but at keeping it from increasing. The fading of our former, long-standing budgetary pattern had begun.

A new budgetary pattern, which may be called Keynesian, as against the earlier, Classical pattern, emerged in the 1960s, and can be principally dated from the tax cut of 1964. Our budgetary history since then has been one of almost continual deficit. Democracy in deficit has come to describe aptly our recent fiscal experience. Now, balanced budgets are envisioned during periods of full employment, with budget deficits resulting otherwise. This shift in budgetary pattern was a political consequence of the shift in generally-held understandings or beliefs about the nature of the economic order, as well as about the value of adherence to such alternative budgetary precepts as the Classical and the Keynesian. While the etiology of this shift in budgetary patterns is explored in our book Democracy in Deficit: The Political Legacy of Lord Keynes,1 a brief description would seem in order at this time because it was our initial, inchoate belief in the applicability of this theme that motivated the formation of the conference in the first place.