Interconnecting the political process
and economic policy

Supply-Side Economics and
The Political Order

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Is supply-side economics enough to revitalize economies that are suffering from stagnating productivity? From a strictly economic perspective the answer would appear to be unequivocally yes. Supply-side economics, despite the impression one gets from the popular press and some political pundits, is not a shallow fad that grew out of political rhetoric. Quite the contrary. Stripped to its basics, supply-side economics is nothing less than a restatement of the most fundamental principle of economics—people respond to changes in relative prices. Reduce the price of leisure and consumption relative to that imposed on production and saving, and people will produce less while attempting to consume more—an attempt that can be successful only in the short run. On the other hand, if the price of leisure and consumption is increased relative to that imposed on more productive pursuits, people will substitute productive activities for consumption activities—a substitution that will lead to more consumption in the long run.

But from the broader perspective of political economy it is not at all clear that supply-side economic policy, by itself, will be enough. The supply-side objective of restoring the incentives for productive investments by reducing the high taxes that are imposed on the return to those investments is necessarily long-run. The time required to plan, implement, and realize the full advantage from investments in physical and human capital is often measured in decades. Unfortunately the attempt to implement supply-side economic policy is being made through political institutions that provide strong incentives to focus on short-run gains and ignore long-run objectives.

To assess fully the challenge facing supply-side economic policy, one has to first understand the myopic political perspective that characterizes prevailing democratic institutions. It is also important to understand how this political myopia can generate tax burdens that discourage economic productivity to the point of actually reducing tax revenues. Not surprisingly, the political process that is capable of increasing taxes to such destructive levels is not likely to be well suited to implement successfully a serious supply-side policy.

After almost fifty years of economic policies that take production for granted and concentrate on demand and distribution, the emergence of supply-side economics is long overdue. But it takes more than sound economic doctrine to replace unsound economic policy. The political success of Keynesian economics surely has less to do with theoretical
validity than with the fact that it is compatible with the short-sighted proclivities of the political process.1 The notion that consumption is the precondition for production has much more short-run appeal than the inescapable converse that production is the precondition for consumption. If there is to be a realistic hope that genuine supply-side policy will be implemented and maintained, it is just as important to consider the implication of political incentives as it is economic incentives. As long as political institutions motivate the sacrifice of long-run objections on the altar of temporary political advantage, supply-side economics will not be enough.

I

DEMOCRATIC POLITICAL PROCESSES are inherently myopic. It is impossible to eliminate completely this flaw in democratic decision-making, some shortsightedness simply being one of the costs that come with the major advantages democracy offers over its alternatives. But improvements can be made. Professor F.A. Hayek reminds us that the ideals of democracy are not tied to any particular institutional arrangement and that some variants can be expected to perform better than others.2 Before tying this discussion back into the political challenge facing supply-side economics and suggesting possibilities for meeting this challenge, a discussion of why democratic decisions tend to be myopic is warranted.

The most obvious factor causing politicians to focus on the near term is the periodic elections they have to face. When deciding on policy they have a natural tendency to concentrate on those impacts that will come before the next election and to put much less weight on post-election consequences. Beneficial long-run effects from a political action are unlikely to redound to the responsible politician, especially if, because of the immediate costs of his action, he has been defeated at the polls.

Examples that strongly suggest political sensitivity to pre-election outcomes are not difficult to find. From 1950 (when the first major increase in social security benefits was legislated) through 1974 (after which increases in social security benefits were tied to cost of living increases) the United States Congress increased social security benefits eleven times. Eight of these eleven increases occurred during election years. With seven out of the eight election-year increases, the necessary increase in tax contributions was deferred until the beginning of the following year—after the election. Next to social security payments the largest component of government transfers in the United States is veteran benefits. The most likely time to observe a surge in these benefits is shortly before an election. According to Edward Tufte, "Since 1962, [veteran] benefits have increased an average of $660 million (at annual rates) between the third and fourth quarters of election years, but only $220 million in years without election."3

The threat of periodic elections would not explain myopic political decision-making if voters were motivated to hold their elected representatives accountable for the long-run consequences of political decisions. Indeed, giving voters the power to dismiss politicians is based on the hope that this will keep the political process responsive to the concerns of the public—concerns that surely include long-run considerations. Unfortunately, individuals have little incentive to acquire the information necessary to determine ex ante, or recognize ex post, the long-term impact of particular political decisions.

As Gordon Tullock has pointed out, public decisions are public goods.4 The benefits that are generated by informed political decisions are generally available to everyone in the polity. Becoming informed on broad political issues provides no claim on the advantages of sound policy that is not equally available to the uninformed. It is quite rational, then, for people to remain politically ignorant. People will devote their limited time to becoming informed in those areas where
they expect to realize a differential advantage from the effort. Even though an individual's well-being is much more influenced by a political decision on a major economic policy than by his choice of shoes, most people will be much less informed on the former decision than on the latter.

It is typically very difficult for even the most knowledgeable people to anticipate the long-run effects of a policy or to connect these effects with the responsible policy once they manifest themselves. Clearly, a rationally ignorant electorate is unlikely to associate particular policy decisions with their long-run consequences. The politician fully recognizes that he is much more likely to be held accountable for the near-term effects of his decisions than for the long-term effects, and he focuses his time perspective accordingly.

The political popularity of inflationary policies is a case in point. The benefits from expanding the money supply are rather immediate and easy to take credit for politically. Public projects and services can be financed, interest rates can be temporarily reduced, and employment opportunities can be temporarily increased by growth in the money supply. It is only with some lag that these benefits have to be paid for in terms of the inflationary consequences of monetary growth. And politicians have been very successful at convincing a rationally ignorant public that inflation is the result of such things as OPEC, labor unions, business profits, and irresponsible consumer spending.

Another reason for political myopia is explained by a flaw in political communication. In communicating with political decision-makers, relatively small groups with narrowly focused concerns have an advantage over much larger groups with diverse concerns. Government programs, expenditures, and protections commonly convey advantages to particular groups that are organized around a common concern. Acreage allotments for tobacco farmers, price supports for milk producers, subsidies to shipbuilders, and protection of members of the Maritime Union against foreign competition are but a few examples. Political decisions on these programs can have significant impact on the wealth of those who benefit from them. As a consequence those in benefiting groups are strongly motivated to become involved politically for the purpose of protecting and, when possible, strengthening their favored program. Being comparatively small and already organized through trade or professional associations, special-interest groups will find it relatively easy to confront key political decision-makers. And politicians will find the communication they receive compelling when it comes from a unified, tenacious, and deeply committed interest group that is fully prepared and able to reciprocate either cooperation or opposition.

Of course, special-interest programs will impose costs on the general public in the form of higher taxes, higher prices, and general economic inefficiency. It is very difficult, however, to organize the general public for the purpose of effectively communicating opposition to particular programs. The cost of a program, being spread over the entire population, will not represent a significant burden to any one individual. Also, each individual knows that he will benefit from the success others may have in resisting special-interest programs whether he contributes to that success or not. Fighting against the special programs of others is equivalent to purchasing a public good. When people organize for political action, it is almost always with the objective of securing some differential advantage for themselves, not a general advantage for everyone. So, when a program is considered that benefits the few at the expense of the many, our political representatives will hear from the few but not from the many.

The end result of this process is a pattern of governmental expenditure and involvement that would probably not be favored by anyone if judged as a complete package. Each special-interest group may
see an advantage in moderating and deferring its demands on government in return for similar moderation and patience on the part of all other groups. Collectively all may fully recognize that they would be better off if short-term political gains were passed up in return for the long-run advantages that could be realized by reducing the burden of government on private-sector productivity. Unfortunately, in the absence of well defined private property rights in political resources, the information and incentives that come from market exchange are absent. As opposed to the market process, the political process is unable to motivate individuals to communicate their preference to each other in such a way as to insure honesty and reciprocity.

Each interest group, when in a position to exploit the political process for immediate gain, realizes that refraining from this exploitation will establish no preferential claim on future benefits in exchange. The "political capital" that can be generated by prudent fiscal decisions is non-marketable. The politician who exercises the restraint necessary to maximize the present value of his contribution cannot realize this value at the end of his political tenure by selling his "political capital." Similarly, constituents who contribute to the value of "political capital" by moderating their current demands are unable to benefit from their individual contributions. Politicians, and the special-interest coalitions that support them, are in much the same position as the harpooner of whales or the exploiter of any other common property resource. They find themselves in a situation where there is little to gain, but much to lose, from taking a long-run perspective.

II

The short-sighted proclivities of governments are a crucial ingredient in understanding why supply-side economics is not enough in democratic settings, as most democracies are now structured. To appreciate fully what is in fact a political dilemma facing supply-side economics, one has to understand the short-sighted dynamics that have led us to the destructive tax burdens that supply-side policy is designed to lessen. In considering alternatives for improvement, knowing where we are is often no more important than knowing how we got there.

In order to tell a convincing story of how the democratic process leads to an excessive tax burden, a criterion for determining the appropriate, or ideal, tax burden must be presented. Conceptually such a criterion is straightforward, no matter how difficult it may be to apply in practice. The tax burden should be increased until, at the margin, the value of private productivity sacrificed is equal to the value of the public services provided. While we may never know exactly what this ideal tax burden is, it is clearly reached well below the point where tax revenues are maximized on the celebrated Laffer curve.8 Contrary to the impression left by the popular press and political rhetoric, the case for supply-side economics is simply that the tax burden is excessive. And there are strong reasons for believing that the unconstrained democratic process will invariably generate an excessive tax burden.

In order to satisfy the "urgent" demands constantly being placed on them by special-interest groups, politicians place a strong positive value on additional tax revenues. Special-interest groups do not have a carte blanche because there are political costs associated with raising taxes.9 But because tax increases will be spread over the politically unorganized public and can be imposed in such a way as to appear largely independent of political decisions, the costs of tax increases will be heavily discounted relative to the political gains from having additional revenues. This bias alone is sufficient to make the case that the tax burden is excessive. Ideally the political benefit-cost ratio will closely mirror the social benefit-cost ratio, and there will be a net gain politically to raising taxes only if there is a net gain socially. But given the
opportunities for maximizing political gains by concentrating benefits while minimizing political losses by spreading costs, the political benefit-cost ratio is distorted in favor of raising taxes and providing benefits.

The bias toward excessive taxes is strengthened by the fact that short-run political pressures cause politicians to view tax rate increases as more potent sources of revenue than they actually are. The explanation for this comes from recognizing that the relationship between tax rates and economic activity is strongly time-dependent. It takes many years before the effects of a tax increase are fully realized. Existing capital assets, both physical and human, will not suddenly diminish in response to an increased tax on the return they generate. Decisions may be made not to replace such capital assets, but the productivity of those in existence will depreciate only with time. Similarly, a tax cut may motivate a large increase in investment and productivity, but it cannot do so immediately. Realizing the full impact of a tax cut requires time for new investments in physical and human capital to be planned and implemented and to effect the actual production of goods and services.

The lag between the immediate impact of a change in taxes and the eventual impact will likely be magnified by one of the objectives of supply-side economics. That objective is to impose taxes in such a way as to lessen the resulting economic distortions, or excess burden. The standard recommendation for accomplishing this, though not necessarily the supply-side recommendation, is by choosing tax bases that are price inelastic and that lack close substitutes. But applying a tax to a base that does not currently have a close substitute does not mean that close substitutes will not be developed given sufficient time. It means only that full adjustment to a tax increase will take longer than otherwise.

The time required for full adjustment to a tax increase is further increased by the political attempt to disguise the tax burden as much as possible and to create fiscal illusion. Even though the illusion generated by particular fiscal actions will tend to break down over time, the political goal of slowing the response to tax changes can be accomplished. Thus because of unavoidable rigidities in the economy and deliberate policy choice, the complete impact of a change in tax rates will take years and, in many cases, decades. The relevant time interval here will surely extend beyond the political time horizon.

The result is an asymmetry between increasing and reducing taxes. A tax increase will increase revenues more in the politically relevant short run than the eventually relevant long run. Similarly, a tax decrease will decrease revenues more in the short run than in the long run. Obviously, this biases fiscal decisions in favor of tax increases. Much of the revenue gain from a tax increase is transitional, but it is transitional gains that energize the political process. Taxes that are obviously too high (even from the political perspective) once their long-run impact has been fully realized, will still be politically attractive to short-sighted politicians. Furthermore, those politicians who inherit the legacy of high taxes will not necessarily be motivated to reduce them. Even if tax reduction resulted in little, if any, revenue loss in the long run, a significant revenue short fall could result in the near term; and it is this latter consideration that would be politically controlling.

The importance of this short-run, long-run distinction in the impact of tax policy has been ignored by the Lafferites in their enthusiasm for extolling the immediate benefits from a tax cut. Ironically, this serves to undermine serious theoretical support for the key claim made by the Lafferites: that taxes have been increased above the level that maximizes tax revenues. If the impact of tax changes should be immediate, it would be extremely difficult to argue that government, no matter how modelled, would increase taxes above revenue maximizing limits. Whether government is a benevolent
despot, a revenue maximizing Leviathan, or something in between, why would taxes ever be raised at the expense of both the general interest and narrow political interests?

Once the time component of fiscal impacts is recognized, the possibility that taxes will be increased to the point of reducing revenues becomes plausible. One can imagine politicians, lured by the temporary revenue gains from successive tax increases, continuing to push up tax rates even though the long-run effect will be to reduce revenues. Indeed, this is likely what happened in the United States and other Western democracies in recent decades. Effective tax rates have been steadily increased over the years, often through the expedient of inflation, even though the long-run effect has surely been to retard economic productivity and possibly reduce tax revenues below what they would have otherwise been.

The argument is not that the economically destructive effects of high tax rates have in fact reached the point of reducing tax revenue, but that this possibility cannot be dismissed out of hand. The short-sighted dynamics of the democratic process are capable of driving tax rates up to the point where cutting these rates will generate a long-run increase in tax revenue. And even if that point has not been reached, there can be no reasonable doubt that short-run political considerations have propelled the tax burden to excessive levels. Can one seriously believe that the appropriately discounted gains in economic productivity, which would flow from a permanent reduction in taxes, are not greater than the similarly discounted losses that would result because of underfunded government programs?

Unfortunately, though not surprisingly, there can be little hope that the short-sighted processes that generated excessive taxes will be capable of reducing them. Even if lowering taxes would have the long-run effect of increasing tax revenue, we could still find ourselves politically unable to reduce taxes. There would be little political motivation to cut taxes since the immediate consequence would be to lower, probably significantly, the tax revenue needed to finance special-interest programs. It is this short-run impact that would weigh heavily in political deliberations, not the increase in economic productivity and tax revenue that would result in the politically distant future.

By travelling the short-sighted political path to excessive tax rates, expectations are formed that make it difficult to retrace that path, even by far-sighted politicians. The public has increasingly become aware that taxes have increased to current levels, despite their retarding economic effects, because of the short-run incentives that guide political decisions. As long as the public realizes that there has been no permanent restructuring of the political incentive structure, they will fully expect that any tax cut will be temporary. An immediate and far-sighted investment response to such a tax cut will be seen by investors as locking their wealth into a position that makes it vulnerable to the next tax increase. So the supply-side impact of a tax cut, which takes a long time under even the best of circumstances, will take even longer in the expectational environment that results from a history of short-sighted government policy.

Even a genuinely far-sighted political administration will find it difficult to hold the line against short-sighted political forces long enough for the delayed supply-side impacts of a tax cut to be realized. The expectation that tax cuts will be temporary causes delays in the response to these cuts that undermine the political support for maintaining them. Politicians in both political parties began expressing concern that the Reagan tax cuts were not working even before they went into effect, and there has been constant and significant political pressure to rescind these cuts. Obviously the political rumbling emanating from this pressure does little to encourage a genuine supply-side response to existing tax cuts.

Investors will be reluctant to respond to
tax cuts even if they have confidence in the ability and willingness of current politicians to maintain these cuts. Given the reward structure facing politicians, those who have a long-run perspective will be seen as anomalies soon to be replaced by those with a more conventional time horizon. This reluctance in investor response can make it impossible for even genuinely far-sighted politicians to stay with a tax reduction program. The expected short-sighted behavior of future politicians creates a setting in which current politicians are compelled to behave in an equally myopic way.

Thus supply-side economics finds itself trapped in a political dilemma of sorts. The public will not begin responding promptly to tax cuts unless the cuts are known to be permanent, and there is little hope that tax cuts will be permanent unless they motivate a prompt response.

III

If supply-side economic policy is to be given a chance, there will have to be constraints imposed on political discretion that will at least allow politicians to give serious consideration to the long-run impact of their decisions. We really cannot blame politicians from acting in the short-sighted way they do. Their actions are perfectly predictable given the situation in which they have been placed. When the only criterion for determining the legitimacy of a government action is the support it receives from a politically influential coalition, politicians are forced to be short-sighted if they are to survive. Limits will have to be imposed on the scope of government action if there is to be any hope that the long-run view required by genuine supply-side economic policy will prevail. But these limits will never be imposed on a democratic process that is guided by unrestrained majoritarianism. And unrestrained majoritarianism is the inevitable result when, as is almost everywhere the case in democracies, those whose political survival depends on competing for votes are also entrusted with the crucial task of determining the limits of government power. This conflict of interest arises from a failure to distinguish between the task of laying down general rules and the altogether different task of making particular decisions within those rules.

Hayek has emphasized the distinction here, although he uses the term "legislation" to refer to what might be more appropriately called "constitutional rules" or "constitutional law":

Legislation in the true sense ought always to be a commitment to act on stated principles rather than a decision how to act in a particular instance. It must, therefore, essentially aim at effects in the long run, and be directed towards a future the particular circumstances of which are not yet known; and the resulting laws must aim at helping unknown people for their equally unknown purposes. This task demands for its successful accomplishment persons not concerned with particular situations or committed to the support of particular interests, but men free to look at their tasks from the point of view of the long run desirability of rules laid down for the community as a whole (emphasis added).

Unless governing bodies are restrained by general rules, they will expand the power and scope of government, much to the long-run detriment of all, in their preoccupation with the demands of particular groups concerned with particular problems.

In a political order characterized by effective constitutional restraints on the powers of political assemblies, the long-run objectives of supply-side economic policy would weigh more heavily in political deliberations than they can under prevailing democratic orders. General rules emerging from a process divorced from considerations of particular conflicting interests can effectively restrain the short-sighted pressures on those who have to mediate these conflicts. Only when it becomes clear that politicians do not have
wide-ranging discretion to reward some at the expense of others will organizing in pursuit of special political advantage be discouraged. By discouraging such political pressure the prospects for a successful supply-side economic policy are improved by two mutually reinforcing considerations: first, by reducing the special interest demands on political decision-makers, the relative pay-off to focusing on long-run political objectives is increased; and second, reducing the profit potential in negative-sum political transfers will strengthen the supply-side incentives to invest in socially productive activities.

Bold constitutional proposals such as those advanced by Hayek have the potential for generating improvements in the social order that extend far beyond the considerations of supply-side economics. It is only through constitutional restrictions on the scope of majoritarian rule that our political and economic liberties can be maintained. It is these liberties that we ultimately value, not the material wealth that, as a fortunate by-product, flows from them. Constitutional reforms, whether those recommended by Hayek for parliamentary structures or those more directed to the U.S. context (e.g., balanced budget amendment, spending limits, tax limits, and monetary reform) find their ultimate justification in our concern for individual liberty.

The theme of this essay has centered on the prospects for supply-side economic policy, not on the prospects for individual liberty. But the prospects for the former cannot be considered independently of the prospects for the latter. The economic incentives that are essential to the success of supply-side economics depend on individuals being able to plan their activities around long-run objectives of their choice, with assurance that the return to their efforts will not be arbitrarily confiscated. Without constitutional limits on majoritarian rule this assurance cannot exist because the individual liberties upon which it depends cannot be guaranteed. Without constitutional limits on majoritarian rule, supply-side economics is not enough.

1 It has been argued that Keynesian economics is not only compatible with the short-sighted tendencies of democratic decision-making, but has indeed aided and abetted this tendency. See James W. Buchanan and Richard Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes (New York, 1977). See F.A. Hayek, Law, Legislation, and Liberty, Volume 3, The Political Order of a Free People (Chicago, 1979). 2 This example, along with the social security example, is documented in Edward R. Tuft, Political Control of the Economy (Princeton, 1978), Chapter 2. 3 See Gordon Tullock, “Public Decisions as Public Goods,” Journal of Political Economy (July/August 1971), 913-18. 4 A political machine is one way of somewhat mitigating this problem. Long-run political consequences are easier to connect to a dominant political machine than to particular policies or politicians. Machine politicians, whose political fortunes are closely tied to the viability of the machine, will find it to their advantage to give more weight to the long-run impact of their decisions than they would if they had no “property rights” in an enduring political institution. Political parties also provide incentives that extend, to some extent, political time horizons. Support for this view comes from contrasting the policies of Mayor John Lindsay of New York City and Mayor Richard Daley of Chicago. Lindsay, who was elected to his second term as an independent and who was “untainted” by machine politics, opted for “solutions” to political problems that bankrupted the city during his successor’s terms of office. During the same time Daley, the last of the machine politicians, presided over a city where future solvency was not sacrificed to short-term expediency. 5 It is probably true that most people still accept non-monetary explanations for inflation. But increasingly the public is making the connection, at least vaguely, between political decisions and inflation. As this happens there are reasons to believe that the lag between the benefits from monetary expansion and the onset of increased inflation will shorten. To the extent that this happens the political advantages from pursuing short-sighted monetary policy will be reduced. It is also true that, the shorter the lag between changes in the rate of monetary growth and adjustment in prices, the smaller the short-run political cost (in the form of unemployment and reduced economic activity) when a serious fight against inflation is made. This provides a plausible explanation for the apparent
fact that hyper-inflations have been easier to stop than moderate inflations. See Leland Yeager and Associates, *Experiences With Stopping Inflations* (Washington, D.C., 1981). Political resources are reasonably characterized as common property resources with control determined by the rule of capture. Jude Wanniski argues that the appropriate tax rate maximizes tax revenues. According to Wanniski, this is the point at which the electorate desire to be taxed. This is clearly wrong. In terms of sacrificed private productivity, the marginal cost of a tax revenue is infinitely high when tax revenues are being maximized. For this argument see Jude Wanniski, "Taxes, Revenue, and the Laffer Curve," *The Public Interest* (Winter 1978), 3-16. Here we are talking about raising taxes in the narrow sense of transferring money from the private sector to the public sector. Of course, politicians can respond to many special-interest demands by imposing regulations that often seem innocuous, but in fact destroy wealth. These regulations are certainly part of the tax burden, broadly defined, and taking them into consideration would strengthen the argument that the tax burden is excessive. Although the discussion will proceed as if taxes were being considered only in the narrow sense, it would not be materially altered by including regulatory taxes. That this recommendation puts government in much the same position as a monopolist facing an inelastic demand curve does not seem to be recognized by traditional public finance theorists. The implicit assumption behind the suggestion that government tax inelastically demanded bases is that political decision-makers, unlike their private sector counterparts, are motivated by the desire to promote the public interest. For a critical look at this assumption and traditional public finance theory, see Geoffrey Brennan and James M. Buchanan, *The Power To Tax: Analytical Foundations of a Fiscal Constitution* (New York, 1980). The public finance literature on fiscal illusion dates back to the work of Amilcare Puviani. See his *Teoria della illusione finanziaria* (Palermo, 1903). This possibility has been developed in two papers by James M. Buchanan and Dwight R. Lee. In the first paper, "Politics, Time, and the Laffer Curve," *Journal of Political Economy*, August 1982, pp. 816-19, it is shown, assuming political myopia, that a strictly revenue maximizing government will always move toward a political equilibrium where the tax is above that which maximizes long-run revenue. In the second paper, "Tax Rates and Tax Revenues in Political Equilibrium: Some Simple Analytics," *Economic Inquiry*, July 1982, pp. 344-54, the objective of government is to maximize a generalized utility function in which tax revenue enters as a good and tax rate enters as a bad. Staying with the assumption of political myopia, it is shown that political equilibrium may still call for the tax rate above its long-run revenue maximizing level. Effective not necessarily in the sense that the government collects much revenue at the high rates, but in the sense that they impose real costs in the form of economic distortions. A recent example of the ephemeral nature of tax cuts that are somehow supposed to stimulate long-term investment commitments is the move in the U.S. Congress to repeal, within 7 months of its enactment, the law permitting companies to buy or sell tax benefits that arise from depreciation on capital investment. See "Uncertainty Cripples Tax Leasing as Lawmakers Consider Changes," *Wall Street Journal*, April 5, 1982, p. 25. In the case of the income tax, the Reagan cuts really were not cuts at all. Rather they amounted to nothing more than a partially successful holding action against inflation and increases in the social security tax. See Steven A. Meyer and Robert J. Rossana, "Did the Tax Cut Really Cut Taxes?" *Business Review*, Federal Reserve Bank of Philadelphia (November/December 1981), 3-12. It is this important point that is a major theme of Hayek's book *The Political Order of a Free People*. It is this book that helped shape much of my thinking on the topic of this essay and that suggested the title I chose for it. Ibid., p. 37. This is a theme that runs through much of James Buchanan's work. See James Buchanan, *The Limits of Liberty: Between Anarchy and Leviathan* (Chicago, 1975), and James Buchanan, *Freedom in Constitutional Contract* (College Station, TX, 1977).