

COMMUNICATIONS

THE NATIONAL BUDGET REFERENDUM: PROCEED WITH CAUTION

Bruce R. Bolnick

In the Fall 1982 issue, Roger A. Arnold and Thomas L. Wyrick¹ (hereafter referred to as A&W) propose a National Annual Budget Referendum (NABR) "to increase the efficiency of the *public sector* at satisfying the desires of the *public*," permitting citizens to "play a more direct role in defining the types of activities that the government is allowed to undertake" (p. 645). A&W propose that a brief report be distributed to the voters each June, explaining the distribution of authorized government expenditures by functional category, together with budget recommendations from Congress and the president for the forthcoming fiscal year. Each voter would then be allotted 100 "expenditure points" to allocate by functional category, or to the category "Refund." Aside from interest obligations on Treasury debt, Trust Funds, or special expenditures authorized by a two-thirds vote of both houses of Congress, the pattern of government expenditures would then be determined by the voters through their allocation of expenditure points.

A&W conclude that the NABR "is a fairly costless move in the direction of direct democracy . . . in an area where reform is most needed" (p. 652). With declining public confidence in government, deteriorating tax compliance, and the frustrating inability of the pub-

Cato Journal, Vol. 5, No. 1 (Spring/Summer 1985). Copyright © Cato Institute. All rights reserved.

The author is Assistant Professor of Economics at Northeastern University.

¹Roger A. Arnold and Thomas L. Wyrick, "Budgetary Referenda: An Efficient Alternative to Representative Democracy," *Cato Journal* 2 (Fall 1982): 637-52. Page numbers shown in parentheses in the text refer to this source.

lic to express its preferences through the ambiguity of the ballot box, it would indeed be highly desirable to find some means to enhance the degree of public control over government budgets. However, the NABR proposal is fraught with serious problems that caution strongly against instituting such a referendum as a binding determinant of budget allocations.

To begin with, the NABR would shift power to the voters only with regard to the broad allocation of the budget by functional category. The nuts and bolts of every tax and expenditure decision would remain beyond their direct control. As a result, the "binding" referendum could easily be circumvented. Broad functional categories are highly susceptible to fiscal gerrymandering; who would doubt, for example, that determined politicians could rationalize food stamps under the allocation for defense if pressed to do so? Also, Trust Funds, which are exempted by A&W from the NABR, could proliferate. Straightjacketing a sandpile can be problematic.

Suppose, though, that the NABR were to succeed in constraining fiscal decisions. The result could be far from wholesome. If final budget allocations were to be fixed by the rigid arithmetic of a referendum, much of the serious and complex work of debate and compromise on the budget nuts and bolts would have to be compressed into the brief period after referendum results were tabulated—hardly a blueprint for good government.

Similarly, administration of authorized programs, and compliance with statutory commitments could be impaired (barring a two-thirds vote of Congress). Granted, programs "ought" to grow or shrink in line with preferences of the electorate. A binding referendum, however, leaves no buffer to control for aberrations in poll results, swings in the public mood, or within-year changes in circumstances. To the voter sitting at home fiddling with the figures, a 1 or 2 percent reallocation of expenditures—or even 5 percent—may be treated very casually. Yet on such budget whimsy could swing tens of billions of dollars of funds. It is easy to imagine a NABR disrupting the administration of veteran's benefits or the judiciary, or alternatively flooding these activities with excess funds. Inconsistencies can be especially acute in the case of entitlement programs involving obligations that fluctuate with the condition of the economy.

Serious problems would arise also in the form of inefficient policy designs provoked when NABR restrictions conflict with political exigencies. For example, farmers' incomes can be supported through surplus purchases, or government-imposed cartel quotas. Unemployed steel workers can be assisted through retraining programs or restrictions on imports. Water quality targets can be met through

government programs or through regulations imposed on the private sector. Often the policy options that conserve on budget funds impose the greatest social costs. With a binding NABR the system would lose degrees of freedom in choosing *how* to skin the policy cat, with potentially perverse results.

Strategic voting problems would introduce another arbitrary element.² Suppose that one individual's true preferences were those shown in column A of Table 1. If this person expects the actual vote will be something like that in column B, he may very well choose to vote as in column C, despite the fact that he would be horrified to find column C actually adopted.

Now consider the community of five people (I through V) shown in Table 2, with person I being the one whose strategic voting decision has just been examined. The NABR would result in the budget allocation shown in the "Average" column even though *every* individual prefers less to be spent on natural resources and environment. In the extreme, strategic voting could result in no funds at all for defense if everyone believed everyone else would support it. Though contrived, these cases serve to demonstrate the dubious normative significance of the budget referendum.³

TABLE 1
AN EXAMPLE OF STRATEGIC VOTING

Program	Expenditure Allocation (in points)		
	A	B	C
Defense	30	35	0
Natural Resources and Environment	10	5	100
Education	15	15	0
Health	15	15	0
Income Security	30	30	0
Refund	0	0	0
Total Allocation	100	100	100

NOTE: A = true preferences of voter in question; B = voter's expectation of referendum result; and C = voter's strategic allocation of expenditures.

²See Dennis C. Mueller, *Public Choice* (Cambridge: Cambridge University Press, 1979), pp. 56-58, 198-9 regarding strategic misrepresentation of preferences.

³A&W discuss the strategic voting problems which can occur in a three-way, winner-take-all election, with the result that such elections "may provide false or misleading signals to policymakers" (p. 641). However, they do not recognize that the same problems will distort the results of the NABR. Indeed, under their proposal policymakers would not just be "misled," but would be bound to the results of the referendum.

TABLE 2
EXPENDITURE ALLOCATIONS FOR A FIVE-VOTER COMMUNITY

Program	Voter I	Voter II	Voter III	Voter IV	Voter V	Average
Defense	0	20	30	50	25	25
Natural Resources and Environment	100	20	5	0	5	26
Education	0	20	20	15	10	13
Health	0	20	20	15	10	13
Income Security	0	20	25	20	10	15
Refund	0	0	0	0	40	8
Total Allocation	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

Another consideration is that with each vote being "worth" \$4000 or more in terms of control over government expenditure, there is considerable scope for abuse of a mail-in referendum. An active market would arise in which those who stand to benefit from government programs endeavor to accumulate ballots in exchange for cash payments.

On a more technical level, the NABR as proposed entails a hidden bias toward reducing the size of government—a result which may be desired, but hardly in accord with the premise of direct democracy. Specifically, by designating expenditure points for "Refund," voters can opt to reduce government expenditures. However there is no symmetrical device for a voter to opt for an increase in the overall scale of government activity. When votes are averaged, there will *always* be a decline in total government spending as long as there is *anyone* who wants a Refund. In Table 2, four of five people prefer no reduction in total expenditures, yet voter V manages to mandate an 8 percent reduction in spending. If these preference patterns persisted, this result would recur year after year. After 10 years total spending would have declined by 56 percent, against the will of 80 percent of the electorate.

Even the seemingly unobjectionable stipulation that "all eligible voters" be allotted 100 expenditure points turns out to cause problems. With the distribution of tax obligations being very skewed in comparison to the distribution of voting rights, a direct budget referendum in which each voter counts equally could result in a major reshuffling of power between blocs of voters. If everyone were to vote, the bottom quintile of families would command 20 percent of the budget allocations, while paying less than 1 percent of federal taxes. The NABR could actually aggravate the sense of alienation on

the part of those who bear the greatest tax burden. If so, the NABR is no palliative for A&W's concern that Americans are "losing control of their lives and property" (p. 638). For just such reasons, our bastion of democracy has never favored a simple democratic decision rule for multilateral agencies such as the International Monetary Fund or the World Bank.

On the other hand, if the exercise becomes too complex the NABR could end up being an instrument of elitist, not populist control. Adopting the broadest classification scheme used by the Office of Management and Budget, voters would be confronted with 16 broad functional categories of government activity. If, for the sake of greater precision, expenditures were disaggregated one step to the level of major program categories, fully 70 options would vie for each voter's attention.⁴ Faced with a list of bewildering variety, or with a limited number of extremely broad options, many eligible voters might shun the whole process. After all, each individual's preferences would have a weight of roughly one one-hundred-millionth.⁵ And many of those who do vote might do so carelessly for the same reasons.

Moreover, given that the list of categories cannot be elaborated too finely, some of the sorest spots in the present budget process would remain unremedied by the NABR. A major source of dissatisfaction involves program-level allocations rather than broad functional allocations of budget dollars. For example, people outraged at government spending on abortions may not wish for less spending on health care services. The more aggregated the referendum format, the more limited the benefits of reform.

Thus, although the NABR proposal points in an attractive direction, the architecture of reform needs extensive rethinking. Fundamentally, the budget determination system must be far more flexible. It might appear that increased flexibility conflicts with the objective of the reform, which is to shift power away from the representatives. What is most important, though, is to strengthen, from a very low base, the effective degree of public control over the scope and struc-

⁴See *The United States Budget in Brief: Fiscal Year 1984* (Washington, D.C.: Executive Office of the President, 1983).

⁵A&W (on p. 648) argue that if 100 million citizens participate in the budget referendum on over \$400 billion of expenditures, each citizen is directing the allocation of \$4000 worth of government activity. Hence, they say, the incentive to vote and to do so intelligently is strong. Their arithmetic is right, but not necessarily their conclusion. Suppose I am one of those 100 million voters and that without my vote exactly 25 percent of government spending would go to defense. If I were to vote for no allocation at all to defense, its share would drop to 24.99999997 percent. Some voters may diligently allocate their \$4000, but I may be unmoved at the option of influencing directly the tenth decimal place of the budget allocation.

ture of government activities—not to give the voters total control. In a world of complex and interactive issues and interests, there are benefits to having representatives who specialize in policy analysis, deliberation, compromise and debate of the sort that occurs within Congress. Hence a more limited referendum might be most desirable.

For example, an abstract of the Current Services Budget for the forthcoming fiscal year could be distributed with IRS tax forms each January, accompanied by supporting information and guidance. The referendum could then entail having each voter specify a *reallocation of dollar amounts among categories*, constrained by the consistency condition that the changes add to zero. Voters could be given the discretion of defining changes by aggregates or by program, and permissible votes could cover the gamut from raising spending and taxes, to cutting outlays and the deficit, or simply reallocating funds among spending categories.

For a direct democratic budget vote, the referendum would have to be tabulated with each ballot weighted equally. On the other hand, it would be logical to use weights according to tax payments,⁶ if the desire is to return to citizens a greater measure of control over the use made by government of their property. With an advisory, non-binding referendum, *both* sets of tabulations could be processed. Though budget *control* would remain in the hands of representatives, information from the referendum would greatly enhance public influence over the budget. The key here is the word “influence.” The “will of the people,” clearly expressed, would provide a strong lever for swinging votes. This sort of an indicative referendum would require no institutional or constitutional change, and, being inherently flexible in its link to the budget, would avoid all of the substantive problems associated with A&W’s NABR. Then, as experience with the referendum accumulates, the quality of the results could be monitored to evaluate whether and how the link to the budget could be strengthened.

In summary, it would be highly desirable to find an effective means to increase the degree of public influence over the scope and structure of government activities. But the NABR mechanism proposed

⁶In this case the referendum returns could be tied to tax returns. As a by-product, tax compliance could improve if citizens saw a direct link between filing taxes and voting in the budget referendum. Though I am not aware of any test of this hypothesis, it would be remarkable if tax compliance were not affected by frustration and anger over how one’s tax dollars are spent. The feasibility of the type of referendum instrument suggested here has been tested and reported in Robert P. Strauss and G. David Hughes, “A New Approach to the Demand for Public Goods,” *Journal of Public Economics* 6 (1976): 191–204.

by A&W is not the right solution. A more flexible instrument is required, generating regular and systematic information on citizens' budget preferences far superior to any now available. Such information could only enhance the public's influence on congressional action. Indeed, experimentation need not begin at the federal level. Innovative state or local governments can lead the way toward budget reform.

CONTINUING THE DEBATE ON NABR: REPLY TO BOLNICK

Roger A. Arnold and Thomas L. Wyrick

As the owners of government, it is entirely appropriate for voters to participate in the public-choice process unless they choose not to. Our nation's heritage and the history of Western civilization suggest that the idea of *representative* democracy is based more on practical considerations than a philosophical rejection of *direct* democracy. In other places and times (Swiss cantons, New England town meetings) direct methods of public policy making have been utilized with considerable success. Today in the United States, though, most people are too busy and lack the detailed information necessary to run the federal government on a daily basis. From this perspective (which we accept), if some means could be found that avoids or greatly diminishes the practical problems associated with direct democracy, then a move in that direction would be desirable.

In our original article on budget referenda,¹ we proposed a means to achieve greater voter participation in the democratic process: the National Annual Budget Referendum (NABR). Under our proposal voters would allocate funds among broad categories of federal expenditure. We provided a number of reasons why the NABR proposal would solve many of the problems that now exist in the public-choice process.

Professor Bolnick is critical of our NABR model for a number of reasons,² though he provides no empirical basis for his criticism. In

Cato Journal, Vol. 5, No. 1 (Spring/Summer 1985). Copyright © Cato Institute. All rights reserved.

Roger A. Arnold is Associate Professor of Economics at the University of Nevada-Las Vegas and Thomas L. Wyrick is Associate Professor of Economics at Southwest Missouri State University. The authors wish to thank the Southwest Missouri State University Foundation for funding the NABR survey.

¹Roger A. Arnold and Thomas L. Wyrick, "Budgetary Referenda: An Efficient Alternative to Representative Democracy," *Cato Journal* 2 (Fall 1982): 637-52.

²Bruce R. Bolnick, "The National Budget Referendum: Proceed with Caution," *Cato Journal* 5 (Spring/Summer 1985): 337-43.

reply to Bolnick, we first address his major points of disagreement with our analysis and then offer some empirical evidence in support of our NABR proposal. It seems clear to us that Bolnick's problems with our proposal stem not so much with disagreements of a fundamental nature, but with a basic misunderstanding of the elements of our NABR model.

Bolnick raises the following seven points in his criticism of the NABR proposal.

1. Bolnick worries that the broad functional categories of spending associated with NABR voting could be circumvented. "[W]ho would doubt," he asks, "... that determined politicians could rationalize food stamps under the allocation for defense if pressed to do so?" First, if food stamps were presented to voters as a defense activity, then our original proposal to separate government spending into distinct *functional* categories has been breached. Second, and more important, while we agree that some politicians and bureaucrats might try their best to place food stamps in the defense category (to stay with the example), we doubt that they would be successful. This is because those who are pro-defense would likely work hard to prevent the placing of an item under the heading of defense that might anger the expenditure-allocating public.

2. Bolnick claims, "If final budget allocations were to be fixed by the rigid arithmetic of a referendum, much of the serious and complex work of debate and compromise on the budget . . . would have to be compressed into the brief period after referendum results were tabulated—hardly a blueprint for good government." But Bolnick overlooks the fact that under NABR, balloting is the penultimate step in the process, and follows (rather than precedes) debate and compromise. Within our proposal the Congress would (as today) decide which activities have a higher priority than others, and would provide that information to citizens prior to the balloting date. Additionally, elected representatives would indicate to citizens the relative shares of total spending they (that is, the representatives) feel should be devoted to each area of activity. Under these arrangements, we would expect that elected officials would spend more time thinking through and debating the budget under NABR than they do now. Under NABR, unpopular spending programs—if left in the budget—would be more likely to impact other programs (those in the same functional category) than is the case today. For this reason, we believe there would be more thought and discussion relating to the formation of a budget that the public would prefer to "purchase." We hold this to be a move in the direction of better government.

3. Bolnick feels that if NABR closes one door to officials who want to grant political favors, they will find another way of accomplishing the same thing. For instance, he states: "Unemployed steel workers can be assisted through retraining programs or restrictions on imports. Water quality targets can be met through government programs or through regulations imposed on the private sector."

We completely agree. But this is an issue we addressed in our article. We can do no better than refer Bolnick (and others) to the discussion on pages 650-1 for our response.

4. Bolnick seems troubled with the idea that under NABR persons paying little in taxes would have the right to allocate the same dollar amount of government spending as those persons who carry a heavier tax burden. He proposes, instead, a weighted voting scheme. According to him, "... it would be logical to use weights according to tax payments..." We are less certain of the logic of weighted voting than Bolnick. This country has a long history of one man-one vote; said differently, all citizens have equal ownership shares in their government. Providing for unequal voting rights in NABR (or any other voting plan) would make it unconstitutional—and therefore irrelevant.

5. Besides the weighted voting scheme, Bolnick proposes that a non-binding referendum take the place of a binding NABR. Then, "Though budget *control* would remain in the hands of representatives, information from the referendum would greatly enhance public influence over the budget."

Public opinion polls already provide the non-binding referendums that Bolnick describes. For instance, polls taken over the years show that the American public consistently and overwhelmingly favors a balanced budget. If this has had any influence on public policy (as contrasted with political rhetoric), it is not apparent to us. Bolnick appears to believe that current problems are informational and nothing more. Our belief is that certain difficulties in the public choice process—special interest lobbying, logrolling, and so on—have helped create the problems that now exist, and we think NABR would help remedy some of them.

6. Bolnick criticizes NABR on the grounds that it "entails a hidden bias toward reducing the size of government." By "designating expenditure points for 'Refund,' voters can opt to reduce government expenditures. However there is no symmetrical device for a voter to opt for an increase in the overall scale of government activity." While the latter statement accurately describes the NABR ballot, we do not agree with the conclusion that bias is involved. The total amount of government spending (under our proposal) remains in the hands of

Congress and the president, while NABR voting establishes only the allocation of expenditures. Experience suggests that elected officials do not have a “hidden bias” toward smaller government—so neither does a proposal that leaves control of the total budget in their hands.

The decision to reserve a place on the NABR ballot for a “Refund” vote without a symmetric “Addition” category is justified from another perspective as well. Each option implies an assignment of property rights, and a vote to add to the size of government would give citizens a right that they do not now possess. As owners of government, citizens have the right to limit its size if that is what they desire. But citizens do not have the right to control dollars that are owned privately, and that is what they would have if they were allowed to add on to the government at will. NABR is a plan to give citizens control over the government; it was not designed to give them control over the private economy.

7. Bolnick’s most serious charge, and the one to which he devotes the most space, is that NABR would be subject to strategic voting. The scenario he describes is a bleak one, where individuals vote in ways that conflict with their actual preferences and end up with a budget allocation that they would prefer not to be stuck with. The points are illustrated in his Tables 1 and 2.

We are troubled by this part of his discussion, and believe it to be in error. First, there seems to be some confusion about the meaning of strategic voting. When voter I (Table 1) prefers that 30 percent of the total budget be spent on defense and expects that everyone else participating in the referendum will direct 35 percent into that category, he casts zero expenditure points for defense. Bolnick calls this the “voter’s strategic allocation of expenditures”—presumably because zero points differs from the “true preference” of 30 points.

But a vote of 0 percent by voter I is not a strategic vote, given his expectation of the way others will vote. It is easy to demonstrate this by example. Suppose that a person’s situation is such that he has a preference for one automobile, and he is thinking about buying it. Before he acts, however, a notice comes in the mail informing him that he has just won first prize in a raffle: a new car exactly like the one he thought about buying. Now, if we ask how many cars the individual will buy this year he will say zero. But he is not behaving strategically. He is incorporating into his decision the fact that his automobile needs have already been satisfied. A strategic decision would be one in which a person fails to buy the car he wants in hopes that someone else will notice his lack of transportation and react by buying him the car he wanted in the first place.

Bolnick's voter is in a position comparable to the person who won a car in the raffle. Other voters will (he thinks) provide him with as much defense as he has use for—so why buy more? Bolnick's error is in assuming that a person should behave the same no matter what he expects others to do. This was a point we made in our article by saying (page 649) that "each person's vote is at least partly dependent on the quantities of government goods chosen by others . . ." Our solution was to provide voters with as much information possible about how others are likely to vote by sampling the public prior to each NABR ballot, and including information on the ballot about presidential and congressional recommendations for allocating funds. In this way each person will know approximately how much of each type of activity is likely to be undertaken without his vote, and he will have a better idea of his own marginal evaluations when it is time to cast a ballot.³

So if strategic behavior is the appropriate term to describe what Bolnick has discussed, then the point was contained in our original article rather than discovered anew. Our understanding of the subject is contrary to that presented by Bolnick, however, and rather than say NABR is plagued with strategic voting problems we would say that citizens require a small amount of information before we ask them to vote. Although this is not the place to develop the idea, we have a strong feeling that elected representatives need the same type of prior information, too, before they can be expected to vote reasonably. If this is so, then the criticism has more to do with collective decision making than with the NABR proposal.

Finally, Bolnick offers no empirical refutation of our model. We had hoped that our initial paper would encourage others to do empirical research to see if the NABR proposal was operational. We now have conducted a small-scale NABR referendum among voters in Springfield, Missouri. While the experiment was too limited to draw far-reaching conclusions, our results (in Table 1) are far different from those described by Bolnick. Voters did not elect to allocate zero amounts to the functional categories, either as individuals or as a group. Moreover, there seems to be considerable satisfaction with the current budget distribution; the spending changes implied by

³A fundamental principal of economics is that a person's marginal utility from consuming a good or service—hence, his marginal evaluation of it—depends upon the quantity available for consumption. It follows that as other voters provide units of (say) national defense, then the amount which one would be willing to purchase for himself will, *ceteris paribus*, decline. This phenomenon is not associated with a particular decision-making mechanism—it is present under prevailing political institutions as well as NABR.

TABLE I
NABR SURVEY RESULTS^a

Government Activity	NABR Vote ^b
National Defense	28.8
International Affairs	1.5
Science, Space, Technology	1.9
Energy	1.1
Nat. Resources/Environment	2.0
Agriculture	1.9
Commerce & Housing Credit	0.4
Transportation	2.8
Community & Regional Development	1.0
Educ., Training, Employment & Social Services	4.1
Health	11.5
Income Security	34.0
Veterans Benefits	3.2
Administration of Justice	1.0
General Government	0.7
General Purpose Fiscal Assistance	0.8
Refund to Taxpayers	3.5
TOTAL^c	100.2

^aSurvey taken in Springfield, Missouri, October/November 1983.

^bShares (in percent) of the total budget that those surveyed would prefer to have going into each spending category.

^cTotal does not equal 100 percent because of rounding.

our survey are only marginally different from actual policy. We encourage others to undertake similar surveys and to report their findings. (We would be happy to provide background material for those who request it.)

In conclusion, we continue to believe that representative democracy can be improved upon. Initially, we held that a national annual budget referendum process, philosophically speaking, was the way to go. Today, we believe that there are so few technical problems with the budget referendum process that it stands, more than ever, as an excellent alternative to policy making as we have come to know it. We urge those persons who seek better and more responsive government to seriously research its merits.