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# James M. Buchanan

## Constitutional Political Economist

Richard E. Wagner

**B**ECAUSE OF James M. Buchanan, recipient of the 1986 Nobel Memorial Prize in Economic Science, economics has become a more interesting discipline. Buchanan has expanded the analytical agenda of economics through his efforts to incorporate the state in a constructive way into the economic process. He has shown how normative concerns can once again animate economic scholarship, though in a nonromantic way that is grounded firmly in a realistic understanding of human nature. Although no single phrase can capture the contribution of a man whose publications number several hundred, *constitutional political economy* is the predominant unifying theme of his work. As the Royal Swedish Academy of Sciences recognized in awarding him the Nobel prize, Buchanan has been instrumental in the development of "the contractual and constitutional bases for the theory of economic and political decision-making."

Buchanan's work, both intellectual and

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*Richard E. Wagner is professor of economics at Florida State University.*



organizational, has been central in establishing the field of public choice. A subject of study spanning economics and political science, public choice applies economic reasoning to government policies and processes. Public choice scholars have studied a wide range of topics, including the organization of legislatures, logrolling as a form of exchange, the growth of government, and the effect of different voting rules and techniques for agenda

control. In so doing these scholars have challenged prevailing views of how government works, by explaining why government often creates or intensifies problems rather than solves them. While Buchanan has made many contributions to the positive analysis of government, his unique contribution lies in the construction of a constitutional political economy.

### Constitutional Contract

Buchanan draws a distinction between "constitutional" and "postconstitutional" levels of choice, which is critical for understanding his

construction of constitutional political economy. Constitutional choice is analogous to choosing the rules by which we are to play a game, whereas postconstitutional choice is analogous to choosing a strategy for playing the game in light of the rules already chosen. Just as the characteristics of a game are shaped by its rules, so too are the characteristic outcomes of legislative and regulatory processes. As noted by the Swedish Academy, Buchanan explains how political outcomes depend "on 'rules of the game', i.e., the constitution in a broad sense." In the Academy's words, his work emphasizes "the vital importance of the formulation of constitutional rules" based on the recognition that "it is often futile to [seek to] influence the outcome of specific issues."

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*The Calculus of Consent* (1962), written with Gordon Tullock and carrying the prescient subtitle, "Logical Foundations of Constitutional Democracy," is the locus classicus of constitutional political economy. Here originated Buchanan's conceptual distinction between constitutional and postconstitutional levels of collective choice. Particular policy outcomes are treated as more or less a natural result of people pursuing their interests through the political process, with their actions being shaped and constrained by constitutional rules; these rules in turn govern the costs and gains to legislators of alternative policy decisions. Once policy outcomes are recognized as following an economic logic, better outcomes—or "good" policies—are more a matter of institutional or constitutional reform than a matter of getting better politicians elected to Congress.

Central to Buchanan's view of constitutional political economy is the "prisoners' dilemma," a model familiar from modern game theory. It is used to illustrate both the gains to agreeing to abide by a set of constitutional rules and the difficulty of maintaining those rules. The idea behind the prisoners' dilemma, as Buchanan applies it to the public sector, is that everyone can benefit from abiding by the law, or the constitutional

contract, and yet, for each person, there is an advantage in breaking the law—in failing to respect the limits laid down in the law. Buchanan explores this theme in several places, particularly in *The Limits of Liberty* (1975), with its telling subtitle, "Between Anarchy and Leviathan," as well as in the various essays in *Freedom in Constitutional Contract* (1977).

To appreciate the gains to abiding by constitutional rules, suppose there are only two ways people can conduct their economic activities: according to rules of "exchange" or to rules of "predation." Under rules of exchange, the types of economic activity people can legitimately pursue are limited by the rules of property and contract. Someone who wants to manufacture shirts, for instance, must get the agreement of others to supply him with labor, materials, and other inputs; to receive payment for the shirts, he must get the agreement of customers to buy them.

By contrast, predation involves no such limit on economic activities. Someone who wants to manufacture and sell shirts can adhere to the rules of property and contract, but is not so limited. He may, for instance, try to take shirts from someone else; he may try to force people to work for him; he may try to prevent people from competing with him through working at home; he may try to prevent people from buying imported shirts; and he may try to get the government to buy the shirts—paid for by taxation—and distribute them as foreign aid.

In such a world of "anything goes," in which predation is an admissible economic strategy, people will, of course, invest less in exchange and more in predation—both offensive investment in predatory activities and defensive investment against being victimized by the predatory activities of others. In Buchanan's work, the constitutional contract, metaphorically speaking, offers an escape from the prisoners' dilemma. The constitutional contract defines individual rights and the constraints under which people are to operate; it provides a framework for the conduct of economic and political life.

### Postconstitutional Politics

In practice, of course, there is no inherent reason for the government to act in the manner envisioned by models of constitutional contract. Rather than curbing predation, the government may become an instrument of predation. (Con-

sider governmental restrictions on the ability of people to manufacture clothing in their homes, which are similar in their effects to an outright raid by the beneficiaries of those restrictions on the output of people who work at home.) The list of predatory activities countenanced by government is long and growing, as the rapidly expanding literature on rent seeking shows.

The bulk of public choice scholarship seeks to explain the effects of actual government institutions in the postconstitutional setting. In *The Calculus of Consent*, for example, there is a pioneering analysis of majority rule that sets forth a variety of circumstances under which collective choices will be manifestly inefficient. This results from the ability of majorities to use the political process to subsidize themselves at the expense of minorities. Subsequent work in public choice has shown how those "majorities" can

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really constitute but small shares of the population, with the losing "minorities" often comprising quite substantial majorities. This work explains that so long as representative government is organized according to majoritarian principles, its participation in economic life will contain a significant predatory component.

The analysis of postconstitutional choice bears a strong affinity with the interest group theories of regulation developed by Sam Peltzman, Richard Posner, and George Stigler, among others. Both lines of research seek to apply microeconomic reasoning to government policy and processes, with people rationally and resourcefully seeking to attain their ends within the constraints they face.

While Buchanan has made many contributions to the positive analysis of government, he has not stopped there. His strong normative interests prompt him to seek an understanding of how different types of constitutional rules can mitigate the damage caused by postconstitutional politics. A central premise of his work is that reform, if it is to be constructive, cannot be based on some fanciful hope that people will act

differently and contrary to their interests. It must be based on a presumption that people will continue to pursue their interests, but with the returns to different types of political activity altered through constitutional revision. For Buchanan, a clear understanding of postconstitutional politics is necessary for guiding constitutional reforms to achieve normative goals.

### Normative Purpose and Scientific Inquiry

According to Buchanan, his discovery in the 1940s of a little known book by Swedish economist Knut Wicksell, *Finanztheoretische Untersuchungen* (1896), was decisive in the development of his ideas. This book is concerned with the theoretical understanding of economic affairs and the practical implementation of that understanding to promote normative aims. Wicksell addressed how it might be possible for collective outcomes *truly* to reflect the consent of the governed, accepting in the process a classically liberal perspective of individual self-ownership. Armed with a rudimentary model of individual demands for collective goods and the conditions of supply, and aware that ordinary majoritarian processes would encourage choices that provide benefits to winning coalitions at the expense of others, Wicksell suggested a constitutional framework that linked the theoretical model with the normative vision. He suggested that collective decisions be made by a parliament based on proportional representation and constrained by a voting rule of approximate unanimity. Such an arrangement would sharply limit the ability of winning coalitions to enact programs only because they were able to place much of the cost of nonbeneficiaries.

A similar type of analysis is contained in *The Power to Tax* (1980), written with Geoffrey Brennan. In this book, the government is modeled as a revenue maximizer. Tax revenues are viewed as being determined not by citizens' demands for public goods but by the technology of tax extraction; government spending is viewed as rising to meet the government's ability to extract taxes. If the government exploits its tax base to the point of maximum revenue, then, as suggested by this analysis, there may be mutual gains to a constitutional rule that limits the range of things that can be taxed. A reform designed to achieve normative ends is thus based on a positive analysis of how government works.

The notion that limiting the tax base may be desirable is at odds with most normative formulations of tax principles, which hold that broad-based taxes are preferred to narrow-based taxes. The typical argument is that the tax base should be comprehensive, with all exclusions, exemptions, and deductions eliminated and the tax rate lowered. The tax revision that takes effect this year is a limited move in this direction. But if government tends to maximize the revenues it collects from whatever base it can tax, a broadening of the tax base is unlikely to be accompanied by an offsetting reduction in tax rates. More likely it will lead to an increase in tax collections. It is interesting note in this respect that there is already a considerable amount of discussion over another tax increase—even before people have determined the implications of the recent tax change.

In a similar vein, *Democracy in Deficit* (1977), written with Richard E. Wagner, argues that the government will tend to run excessive debt and suggests that there are mutual gains to a constitutional requirement for balanced budgets. The book is based on the thesis that borrowing, as compared with taxation, allows the cost of public spending to be shifted forward in time, a thesis Buchanan developed in *Public Principles of Public Debt* (1958). It accepts the premise that politicians prefer to spend than tax—spending programs enhance political support and taxes detract from that support. Deficit finance allows taxes to be shifted into the future, and thus allows today's politicians to increase their support relative to what they would have under a regime of budget balance. If unconstrained by constitutional limitations, the inevitable result is a growing public debt.

The thesis that public debt allows the cost of public spending programs to be shifted forward in time has proven difficult for many economists to accept. Consider a simple formulation of the public debt controversy: instead of taxing to finance a rail system, a government borrows. Buchanan argues that borrowing shifts the cost of the rail system into the future, while others say that the cost remains in the present, noting that the resources that went into the rail system are used up this year regardless of how it is financed. Public debt, they say, cannot be a burden on future generations because “we owe it to ourselves, [now].” Buchanan's treatment of public debt illuminates some of the central distinguishing elements in his thought.

To Buchanan the central model of economics is exchange and not rational choice, a theme he develops in the opening essay of his *What Should Economists Do?* (1979). This does not mean that Buchanan denies rationality, for he certainly does not; it means that Buchanan is centrally concerned with social relationships—with conflict and cooperation—and not with isolated individuals. If one sees the central model of economics as one of rational choice, it is tempting to extrapolate from a model of rational consumer choice to one of rational governmental choice. Just redefine a few variables in the model and you have governments maximizing social welfare instead of individuals maximizing utility. But if the primary model is exchange, one immediately recognizes that such collective entities as governments and firms are nothing but collections of individuals, rendering maximization nonsensical, save for agreement among the individual members.

It is irrelevant that “we owe it to ourselves,” for we are not many heads attached to one body. Some owe it to others, and it is irrelevant to note that the sum of the debts equals the sum of the credits. One could similarly aggregate over mortgage lenders and mortgage borrowers and say we owe it to ourselves, but it would be no more enlightening. Public debt allows present taxpayers to reduce their tax payments and obligates future taxpayers to amortize that debt, and it is here that the burden of public debt resides. True, the resources required to construct the rail system this year are furnished by bondholders, but those bondholders do not bear the burden of the debt simply because they are compensated sufficiently to make them willing lenders.

It should be clear that Buchanan never reifies “government.” When he speaks of government he is speaking of individuals doing something, with the content of their action depending on the constitutional rules that, among other things, govern the extent to which some people can escape the constraints of property and contract by acting in the name of government to restrict others' rights of property and contract.

### **The Constitutional Perspective and Regulation**

The constitutional perspective, and its implications for the evaluation and reform of regulatory policies, can be made more concrete by a simple

example. Suppose a soft drink manufacturer has a bottling machine that fills quart bottles to between 31.9 ounces and 32.1 ounces, 99 percent of the time. Just because one bottle turns out to have 32.2 or 31.8 ounces does not mean that the machine is malfunctioning and production should be halted for repairs. A “bad” or “inefficient” outcome, an under- or overfilled bottle in this case, may well be consistent with an efficiently working machine. Moreover, the range of outcomes that come off the assembly line can certainly be thought of as a “natural” consequence of the “constraints” under which the bottling machine works. And if someone decides that too many bottles are being over- or underfilled, remedy would not call for legislative or regulatory tinkering through readjusting the levels in the individual bottles. Rather, it would call for some maintenance or retooling of the bottling machine, i.e., “constitutional” reform.

Particular policy outcomes are like the individual bottles coming off the assembly line. A policy-equivalent of the underfilled bottle does not imply that there is something wrong and improvable in the process that produced that particular outcome. Mistakes are unavoidable and the performance of machines will always be subject to variation. And if someone thinks that too many of the policy-equivalents of the underfilled bottles are being enacted, remedy must focus on revising the process that produces those outcomes. Sets of regulations produced under one regime must be compared with sets of regulations produced under some alternative regime. What is subject to choice is the regime within which regulatory choices are made, and it is that regime and not individual choices made within that regime that must be evaluated.

With respect to regulation what is chosen is not any particular outcome, but a set of rules, procedures, and institutions out of which outcomes emerge. What must be evaluated, and all that is subject to choice, are these facets of the regulatory regime. Instances of regulatory failure are no more evidence that something is wrong with regulatory processes than instances of regulatory success are evidence that something is right. Buchanan’s constitutional focus distinguishes between outcomes and the processes that produce those outcomes, and concentrates on the performance characteristics of the latter.

More generally, Buchanan would place less emphasis on the development of information

about the consequences of particular regulatory measures than on the incentives that different institutional regimes present for the acquisition and use of knowledge in the first place. In this sense, there are some clear similarities between Buchanan’s work and the developing research on the efficiency of the common law, which focuses on the process by which a sequence of decisions is made rather than on any particular decision. The research on the compensation of enforcers is also relevant, for it raises the problem of incentive compatibility.

### A Final Thought

Beyond the intellectual works which have brought him his well-deserved recognition, Jim Buchanan is one of those rare people who raises the performance level of everyone around him. Tales of his industriousness are legion, as are the tales of his inspiration to students and colleagues. Students and colleagues learn to think critically and not to worry about the contrary thoughts that others might have—to do it their way as he has done it his. His inspiration, unfailing encouragement, and wise counsel are easy to admire and hard to emulate.

The Swedish Academy of Sciences has honored one of the truly admirable scholars of our age. Buchanan has expanded the domain of economics and reasserted, in new dress and with contemporary standards, the vital questions of political economy—at a time when much of economics seems to have lost its humane reference. □

### Selected Readings

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