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Constitutional Political Economy

Viktor J. Vanberg
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zur Ordnungsökonomik

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on Constitutional Economics

Instituts für allgemeine Wirtschaftsforschung
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Albert-Ludwigs-Universität Freiburg

Constitutional Political Economy

Viktor J. Vanberg

Introduction

“Constitutional political economy is a research program that directs inquiry to the working properties of rules and institutions within which individuals interact, and the processes through which these rules and institutions are chosen or come into being.” This is how James M. Buchanan (1999 [1990]: 377) defined, in the inaugural issue of the journal *Constitutional Political Economy*, the subject of the sub-discipline in economics which owes its main inspiration to Buchanan’s work.

Constitutional political economy or *constitutional economics* emerged, as Buchanan (ibid.) puts it, “as an integral, but distinguishable, part of the sub-discipline of public choice,” a research field, which also counts Buchanan (1919-2013) among its principal founders. *The Calculus of Consent: Logical Foundations of Constitutional Democracy*, co-authored by James Buchanan and Gordon Tullock (1962), is not only one of the classic texts of public choice theory but also a foundational treatise of constitutional economics.

The term *constitutional political economy* (henceforth *CPE*) was coined in the early 1980s,¹ the first dictionary entry on *Constitutional Economics* appeared in 1987,² and the journal *Constitutional Political Economy*, which serves as its principal outlet, started, as noted above, in 1990. In substance, though, the foundations for this research program Buchanan had already laid in one of his earliest publications, his 1949 paper on “The Pure Theory of Government Finance: A Suggested Approach.”³ There he challenged, as he put it in retrospect, “the still-dominant orthodoxy in public finance and welfare economics” (Buchanan 1999 [1986b]: 456) by advocating an “individualistic theory” for which the “state has no ends other than those of its individual members” and state decisions are “the collective decisions of individuals” (Buchanan 1999 [1949]: 122f.). As he has often acknowledged, Buchanan owes the principal inspiration as well as encouragement for his unorthodox endeavor in particular to two sources. These were, firstly, Frank Knight, with whom he studied at the University of

¹ R.B. McKenzie (ed.), *Constitutional Economics: Containing the Economic Powers of Government*, Lexington, Mass.: D.C. Heath 1984. Constitutional economics is defined there as “a theory of the rules by which political and economic processes will be allowed to operate through time” (ibid.: 1).

² In *The New Palgrave, A Dictionary of Economics*, vol. 1, London: Macmillan 1987, 585-88.

³ *Journal of Political Economy* 57, 1949, 496-505.

Chicago,⁴ and, secondly, Knut Wicksell, whose German dissertation *Finanztheoretische Untersuchungen* (Wicksell 1896),⁵ he serendipitously discovered in 1948 and a part of which he translated into English (Wicksell 1958 [1896]).⁶

In his writings over the following decades, Buchanan systematically developed and consistently expanded the line of inquiry that he had embarked on in his early work. The research program that Buchanan thus created is the subject of the sections that follow.

Constitutional Political Economy and the “Science of a Legislator”

Constitutional political economy (henceforth *CPE*) is part of a broader set of theoretical approaches in modern economics that includes public choice, the new institutional economics, the economics of property rights, law and economics, and others. They all aim at rectifying the institutional deficit of orthodox neoclassical economics by focusing attention on how socio-economic-political processes are shaped by the rules and institutions within which they unfold. *CPE*’s distinguishing feature is the particular attention it pays to the *choice of rules* as a means to make such processes better serve the preferences of the individuals involved. It is because of its emphasis on the *choice of rules* as a means for improving the human condition that, so Buchanan (1999 [1990]: 387) argues, *CPE* “is best interpreted as a re-emphasis, a revival, a re-discovery of ... classical political economy ..., represented especially in the works of Adam Smith.”⁷

⁴ Buchanan (1999 [1986a]: 15): “Frank Knight was *the* intellectual influence during my years at the University of Chicago.” – Buchanan (2001d [1990]: 8): “An important element in Knight’s economics was his emphasis on the organizational structure of markets ... Once attention is drawn to a structure, to process, and away from resources, goods, and services, as such, many of the technical trappings of orthodox economic theory fall away. Here Knight’s approach became institutional, in the proper meaning of this term. ... Frank Knight’s career shared a temporal dimensionality with the seminal American institutionalists: Clarence Ayres, John R. Commons, Thorstein Veblen. He treated their technical economics with derision, but he shared with them an interest in the structure of social and economic interaction.”

⁵ Buchanan (1999 [1986a]: 16): “Visitors to my office know that photographs of only two economists grace the walls, Frank Knight and Knut Wicksell.” – Buchanan (2001d [1992a]: 24): “Wicksell’s was perhaps the most significant influence, but without Knight’s teaching ... Wicksell’s message might not have been so compelling to me.”

⁶ About the part he translated, “Ueber ein neues Prinzip der gerechten Besteuerung” (*A New Principle of Just Taxation*), Buchanan (1999 [1986b]: 456) has said in retrospect: “Wicksell’s new principle of justice in taxation gave me a tremendous surge of self-confidence. Wicksell, who was an established figure in the history of economic ideas, challenged the orthodoxy of public finance theory along lines that were congenial with my own developing stream of critical consciousness. ... Stripped to its essentials, Wicksell’s message was clear, elementary, and self-evident. Economists should cease proffering policy advice as if they were employed by a benevolent despot, and they should look at the structure within which political decisions are made.”

⁷ Buchanan (2001b [1987]: 3): “The subject matter is not new or novel, and it may be argued that ‘constitutional economics’ is more closely related to the work of Adam Smith and the classical economists than its modern ‘non-constitutional’ counterpart.”

Buchanan alludes here to Adam Smith's (1981 [1776]: 428) definition of political economy as a branch of the "science of a legislator,"⁸ a definition for which the Walrasian tradition in economics had little taste. It was Léon Walras (1954 [1874]: 52) who commented that "if political economy were simply what Adam Smith said it was ... it would certainly be a very interesting subject, but it would not be a science in the narrow sense." Thereby he brought to completion what had begun with David Ricardo, the separation of the "science" of economics from moral philosophy, the twin sister of Smith's political economy. According to Walras, the "theory of institutions" belongs to the domain of "moral science or ethics" (ibid.: 63) and cannot be part of the "pure theory of economics" as a "physico-mathematical science" (ibid.: 76) that he advocated.⁹

In developing his own research agenda Buchanan was, as he has repeatedly acknowledged, influenced and encouraged by his colleague at the University of Virginia,¹⁰ Rutledge Vining, who persistently argued that not its outcomes per se but only the rules on which an economic system is based are subject to direct political choice.¹¹ Rutledge Vining, who had also been a student of Frank Knight, explicitly placed the theory of political economy he advocated in the tradition of Adam Smith's "science of the legislator."¹² It is, as he defined it, "a theory about, or conceptualization of, the choice that is exercised by a people, acting through their legislative agents, when they decide to change some component part of the ... (economic system, V.V.) presently in operation" (Vining 1969: 202f.). By contrast to an economics that concerns itself with problems that are posed by choices among alternative

⁸ A. Smith (1981 [1776]: 468) contrasts "the science of a legislator, whose deliberations ought to be governed by general principles which are always the same," with "the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs."

⁹ In concluding his article on "Science and the Legislature: Adam Smith and After" D. Winch (1983: 520) notes: "Much of Smith's science of the legislator died with him."

¹⁰ Buchanan taught at the University of Virginia in Charlottesville from 1956 to 1968.

¹¹ Buchanan (2001d [1992b]: 52f.): "Vining had ... been greatly influenced by Frank Knight. This background made for a shared intellectual heritage that facilitated communication between us. ... Rutledge Vining deserves primary credit for initiating what was to become a centrally important component of Virginia Political Economy, the stress on *rules* as contrasted with the then universal stress on policy alternatives within rules. ... I was predisposed to accept Vining's criticism of orthodoxy in this respect because I, too, recalled Knight's discussion of rules and, perhaps, more significantly, came armed with Knut Wicksell's admonition ... that we do pay heed to the rules, to the structure of incentives faced by political agents."

¹² R. Vining (1969: 199): "It was Adam Smith who presented our subject as a 'branch of jurisprudence' and 'the science of the legislator.' Accordingly I follow in this classical line when I inquire into the nature of certain fundamental concepts that are inherent in an actual situation in which a group of persons jointly decide upon a legislative program." – See also R. Vining (1956: 14): "(T)he economic problem is posed when members of the society ... inquire into the possibility of improving the performance of the system currently in force. ... We are using the term 'economic system' to mean a system of legislative constraints upon individual action. In the sense that laws and regulations are rules, an economic system is a system of rules, and legislators are confronted always with the problem of finding a better-working system of rules. ... (O)ur conception of political economy is ... strictly classical. Adam Smith regarded political economy 'as a branch of the science of a statesman or legislator'."

means for attaining given ends, such a political economy deals with the kinds of problems that are faced by individuals who, as a group, “jointly choose the constraints and regulations which they impose upon their individual actions” (Vining 1956: 9). Acknowledging his intellectual debt to F.H. Knight,¹³ Vining says about the economist’s role as practitioner:

“In the role by which he is familiarly known in the history of the subject, he has practiced his profession as counselor to legislators in their deliberations upon how well or ill an economic system is working and upon how it might be modified to improve its performance” (Vining 1984: 3).

Insisting that politics cannot directly choose outcomes or end-results of socio-economic processes (such as income distribution, employment stability, and the like), but that “only the system of statutory and administrative rule that is subject to immediate and direct modification” (Vining 1984: 177), Vining argued for a *rule-based economic policy*.¹⁴

It is significant that F.A. Hayek also describes his own theoretical efforts as a modern-day counterpart to Adam Smith’s political economy. There are, after all, close affinities between his views on the relation between “the system of rules ... and the order or pattern of actions which result” (Hayek 2014 [1967]: 278) and Buchanan’s constitutional approach,¹⁵ even if Hayek’s emphasis is more on the evolution than on the deliberate choice of rules.¹⁶ About his treatise *Law, Legislation and Liberty*, which he subtitled “A new statement of the liberal principles of justice and political economy,” Hayek explicitly says that it is intended to revive the Smithean legacy and to argue against the narrow focus of modern-day economics. As he puts it:

“Yet, although the problem of an appropriate social order is today studied from the different angles of economics, jurisprudence, political science, sociology, and ethics, the problem is one which can be approached successfully only as a whole. ...

¹³ As the “starting place” of his approach Vining (1984: 34) points to “Adam Smith’s characterization of economics as ‘the science of the legislator’,” and to the “writings of Knight from whom I think I have come to the ideas that I am trying to develop.”

¹⁴ Buchanan (2001d [1992b]: 52f.): “Vining repeatedly emphasized that relevant political choices are not among separate allocations or distributions, but rather are among alternative sets of rules, arrangements, or constraints, which along with the behavior of utility-maximizing persons generate patterns of outcomes or results that we call allocations or distributions.”

¹⁵ About the relation between his own and Hayek’s work, Buchanan (2001d [1992d]: 121f.) notes: “I disagree with Hayek on important aspects of his work. Nonetheless, along several dimensions, I feel myself to share in the more inclusive ‘Hayekian enterprise.’ These dimensions extend from the basic understanding of what economics is all about to the concern with the philosophical foundations of a free society. ... With Hayek, I consider our role, as economists and other social scientists, to be that of the moral philosopher.”

¹⁶ As he explicitly states, with his emphasis on the evolution of rules Hayek does not mean to diminish the role of deliberate legislation: “The question which is of central importance as much for social theory as for social policy is thus what properties the rules must possess so that the separate actions of the individuals will produce an overall order. ... Our main interest will then be those rules, which, because we can deliberately alter them, become the chief instrument whereby we can affect the resulting order, namely the rules of law” (Hayek 1973: 45). – On “Hayek’s constitutional political economy” see Vanberg 1994 [1989].

Nowhere is the baneful effect of the division into specialisms more evident than in the two oldest of these disciplines, economics and law. Those eighteenth-century thinkers to whom we owe the basic conceptions of liberal constitutionalism, David Hume and Adam Smith, ... were still concerned with what some of them called the 'science of legislation'. ... One of the main themes of this book will be that the rules of just conduct which the lawyer studies serve a kind of order of the character of which the lawyer is largely ignorant; and that this order is studied chiefly by the economist who in turn is similarly ignorant of the character of the rules of conduct on which the order that he studies rests" (Hayek 1973: 4f.).¹⁷

Noteworthy are also the affinities that exist between Buchanan's constitutional economics and the research program of the ordoliberal Freiburg School, founded in the 1930s by economist Walter Eucken and jurist Franz Böhm,¹⁸ a school of thought that, in turn, Hayek felt close to. When in 1962 he left the University of Chicago to join Freiburg University's *Fakultät für Rechts- und Staatswissenschaften*, Hayek emphasized in his inaugural lecture the closeness of his own thinking to the research program that the faculty's former members, Eucken and Böhm, had created.¹⁹ Even if the Freiburg ordoliberals did not explicitly relate their research program to Adam Smith's understanding of political economy, their concept of *Ordnungspolitik* is clearly in the spirit of his "science of a legislator."²⁰ It assigns to government and legislature the task of providing and enforcing an "appropriate constitutional framework" (Eucken 1990 [1952]: 289) within which markets can properly function.²¹ *Ordnungspolitik*, or rule-based economic policy, aims at improving the resulting economic

¹⁷ In a similar spirit Buchanan (2001b [1987]: 6) notes: "Classical political economy emerged from moral philosophy, and its proponents considered their efforts to fall naturally within the limits of philosophical discourse. As a modern embodiment, Constitutional Economics is similarly located, regardless of disciplinary fragmentation. How can persons live together in liberty, peace, and prosperity? This central question of social philosophy requires continuing contributions from many specialists in inquiry, surely including those of the constitutional economist."

¹⁸ Even if there has been no direct connection between the ordoliberal and Buchanan's research program, Henry Simon's *Economic Policy for a Free Society* (1948) may provide an indirect link. Walter Eucken refers to Simon's book as a most important like-minded work in his *Grundsätze der Wirtschaftspolitik* (1990 [1952]: 255), and Buchanan (2001d [1986]: 40) speaks about Simon's strong influence on Chicago University's economics students. Simon's (1948: 160) constitutional perspective is exemplified in his statement: "The liberal creed demands the organization of our economic life largely through individual participation in a *game with definite rules*. It calls upon the state to provide a stable framework of rules within which enterprise and competition may effectively control and direct the provision and distribution of goods."

¹⁹ Hayek (2014 [1963]: 214): "Special mention is due to the personal contacts with professional colleagues which have for decades provided for me a connection with this university. ... By far the most important for me was, however, the friendship of many years' standing, based on the closest agreement on scientific as on political questions, with the unforgettable Walter Eucken. ... I shall regard it as one of my chief tasks to resume and continue the tradition which Eucken and his friends have created at Freiburg and in Germany."

²⁰ In their "ORDO Manifesto of 1936" the founders of the Freiburg School stated: "The treatment of all practical politico-legal and politico-economic questions must be keyed to the idea of the economic constitution. ... We wish to bring scientific reasoning, as displayed in jurisprudence and political economy, into effect for the ... problem of understanding and fashioning the legal instruments for an economic constitution" (F. Böhm, W. Eucken, H. Großmann-Doerth (1989: 23f.):

²¹ For a more detailed review of the Freiburg School's research program, see Vanberg 1998. – For a discussion of the affinities between Buchanan's constitutional approach and the ordoliberal tradition see Vanberg 1988 and H. Leipold 1990.

order in an *indirect* manner, by improving the framework of rules, by contrast to an economic policy that seeks to change outcomes directly by specific interventions into the economic process.²²

The Game Analogy

An analytical tool that occupies a central place in *CPE* is the *game analogy*. It serves, as Buchanan argues, to illustrate the categorical distinction between choices made *within* given rules and choices *of* rules, or stated differently, between choices *within* constraints and choices *of* constraints:²³

“On many occasions ... I have used the analogy with games since I think this allows us to present the basic distinction most clearly. Consider a poker game. Participants must initially agree on the set of rules that will define the game to be played. This agreed-on set of rules becomes the constitution of the game. Play takes place within these rules There are two quite distinct stages or levels of choice involved here, and these choices have quite different features. First, there is the choice of the rules themselves, *constitutional choice*. Second, there is the choice among the strategies of play within the rules that define the game. I call this choice of strategy *post-constitutional choice*” (Buchanan 2001b [1981]: 44).

The two levels of choice to which Buchanan refers are associated with two different lines of inquiry. At the post- or sub-constitutional level, the principal question is how a game within its given rules can be played most successfully. At the constitutional level, the principal question is whether and how changes in the rules may allow all players to play a better game. The principal focus of an applied *CPE* is on the latter question. It “concentrates on reform in the rules, as opposed to improvement in strategies of play for particular players within defined or existing rules” (Buchanan 1999 [1986b]: 462).²⁴

As Buchanan has often noted, it was due to Rutledge Vining’s persistent emphasis on the game analogy that he fully recognized its fundamental significance for constitutional

²² W. Eucken (1990 [1952]: 336). – R. Sally (1996: 8): “It is incumbent on the state to set up and maintain the institutional framework of the free economic order, but it should not intervene in the mechanisms of the competitive economic process. This is the essence of *Ordnungspolitik*.”

²³ Buchanan (1999 [1990]: 379f.): “(I)t would seem unnatural or bizarre, within the mind-set fostered by ordinary economics, to consider the prospect that an individual might deliberately choose to constrain or limit the set of available choice options. Within this mind-set, the utility of the chooser is always maximized by allowing for choices over the whole range allowed by exogenously determined constraints. ... Constitutional economics directs analytical attention to the *choice among constraints*.” – The front cover of the journal *Constitutional Political Economy* shows the image of Ulysses tied to the mast, as a metaphor for the role that self-imposed constraints can play in seeking advantages one cannot realize otherwise.

²⁴ Buchanan (1991 [1989]: 36, 40): “We evaluate the rules that describe a game by assessing how successful the rules are in allowing players to achieve those objectives that they seek in playing. ... (W)e change a game by changing the rules, which will, in turn, modify the predicted pattern of outcomes. If we diagnose the pattern of results observed to be less desired than alternative patterns deemed to be possible, it is incumbent on us, as political economists, to examine predicted results under alternative constraint structures.”

analysis,²⁵ though he, too, recalled Frank Knight using the analogy to illustrate problems of social organization. Knight liked to stress, that “it is useful to think of social life as a game” (1982 [1946]: 455), and that a main task of the political economist is to assist in the choice of rules for this game.²⁶ After all, he pointed out, the “first characteristic of play, as of all social activity, ... is that freedom is conditioned and limited by ‘law’, in several meanings of the word” (ibid.: 464). Furthermore, “(a)ll problems of social ethics are like those of play, in that they have the two components of obeying the rules, and improving the rules, in the interest of a better ‘game’” (ibid.: 466).²⁷ The “parallelism between play and political and economic life” (ibid.: 466), Knight saw in particular exemplified by the characteristic combination of commonality and conflict of interests that one finds in both, in ordinary games and in social life. As he puts it:

“(P)lay exhibits in relation to its rules or laws the ubiquitous harmony and conflict of interests. All the parties to any game have a common interest in the game itself – hence, in general obedience to the rules. But they have conflicting individual interests in winning – consequently, in law-breaking or cheating. Similar considerations apply far more acutely to the improvement of the game by changing the rules. The notion of law and its enforcement – and improvement – will be found to be the locus of virtually all social problems” (1982 [1942]: 249).

Knight alludes here to a number of motivational issues that are central to the *CPE* enterprise. There is, firstly, the motivational asymmetry, both in ordinary games and in the ‘game’ of social life, routed in the fact that playing a given game successfully is in the immediate interest of each player, while reforming the rules to make for a better game for all involved is a collective good for the group of persons involved.²⁸ Secondly, while all players share an interest in general rule-compliance, individually they are tempted to seek differential gains from rule-violations. Thirdly, while all share a common interest in rule-changes that make for a better game for all involved, each player prefers, and is tempted to lobby for, rules that promise differential advantages to him or her, at the expense of other players.

²⁵ Buchanan (1999 [1986a]: 23): “Vining took from Knight, and passed on to me, a fully sympathetic listener, the analogy with the choice of rules in ordinary games, from poker to basketball.” – Buchanan (2001c [1972]: 353): “Stimulated by Frank Knight and, more directly, by Rutledge Vining ..., I sensed the possible extensions in the explanatory descriptive power of models for ‘rules of games’.”

²⁶ Knight (1940: 28): “The social action which the study of economics has as its function to guide, or at least to illuminate, is essentially that of making ‘rules of the game,’ in the shape of law, for economic relationships.”

²⁷ Knight (1982 [1946]: 464): “In the pure ideal form of play all the ‘laws’ are taken for granted; the moment they give rise to any problem, the nature of the activity and of the association is fundamentally changed.”

²⁸ Knight (1982 [1946]: 466): “It is a vitally important fact that the capacity to play intelligently, from the standpoint of winning, is much more highly and commonly developed among human beings than is the capacity to improve or invent better games.”

Again acknowledging Frank Knight as his source of inspiration,²⁹ Rutledge Vining emphasizes the analogy between ordinary games and his concept of rule-based economic policy when he argues:

“The modifiable entity that men refer to as ‘the *economic system*’ is analogous to a game in that it consists, as does a game, of a system of constraining and prescriptive rules and definitions that condition and set limits upon the prudential and means-end choices and decisions exercised by individual members of a population” (Vining 1969: 203).

Situations of rule-reforms or constitutional choice in social-economic-political life can be usefully compared, Vining stresses time and again, to “a group of players of a game who will have stopped their play in order to consider certain proposed modifications of the rules of the game” (ibid.: 200).

In light of the affinity between Buchanan’s research program and their own constitutional perspective, it is not surprising that the Freiburg Ordoliberals³⁰ and, in particular, F.A. Hayek too use the game analogy as a conceptual tool. In a section of his *Law, Legislation and Liberty* in which he discusses the “rationale of the economic game” (Hayek 1976: 70) Hayek says about the market process:

“It is a procedure which, as Adam Smith ... understood, in all important respects (except that normally it is not pursued solely as a diversion) is wholly analogous to a game, a game partly of skill and partly of chance. ... It proceeds, like all games, according to rules guiding the actions of the individual participants whose aims, skills, and knowledge are different” (ibid.: 71).

To underscore its structural similarity to rule-based games Hayek speaks of the market system as “the game of competition” (ibid.: 71) or as “the game of catallaxy,”³¹ the game of exchange.³²

Theoretical and Applied Constitutional Economics

²⁹ Vining (1969: 203, fn.): “In trying to develop this analogy, I have been much influenced by the writings of Frank H. Knight.”

³⁰ For references, see Vanberg 1998: 173.

³¹ Hayek (1976: 115): “The best way to understand how the operation of the market system leads not only to the creation of an order, but also to a great increase of the return which men receive from their efforts, is to think of it ... as a game which we may call the game of catallaxy.”

³² Hayek (2014 [1978]: 310): “The market ... is, as Adam Smith already understood, as if we had agreed to play a game, partly of skill and partly of chance. This competitive game ... is, to use up-to-date language, not a zero-sum-game, but one through which, by playing it according to the rules, the pool to be shared is enlarged, leaving individual shares in the pool in a great measure to chance.” – Hayek’s reference is to A. Smith’s (1982 [1776]: 234) criticism of the “man of system” who ignores that “in the great ‘chess-board’ of human society, every single piece has a principle of motion of its own, altogether different from what the legislator might choose to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.”

Because of its focus on the “normative” issue of how socio-economic-political “games” may be improved to the benefit of all persons involved, Buchanan’s research program has been classified by authors like Stefan Voigt (1997) as a “normative” enterprise that needs to be supplemented by a “positive constitutional economics.” Such distinction between normative and positive *CPE* suggests, misleadingly I posit, that the “positive” branch offers refutable statements about “what is,” while Buchanan’s “normative” branch specializes in prescriptive statements about “what ought to be.” It is, I suppose, more appropriate to draw instead a distinction between *theoretical* and *applied CPE*.

Theoretical CPE studies how different rules and institutions affect the nature of the socio-economic-political processes that unfold within the constraints they impose, or, in other words, it investigates into how, as Hayek (1973: 98) calls it, the “*order of rules*” shapes “*the order of actions*” that emerges within it.³³ By contrast, *applied CPE* is concerned with how the insights of the theoretical branch can be used to provide solutions to “problems” that the agents in socio-economic-political processes face.³⁴ To classify such concern as “normative” is no more appropriate than to speak of, say, applied physics as “normative physics.” To be sure, applied *CPE* is “normative” in the sense that proposing solutions for problems necessarily presupposes value judgments. Defining something as a “problem” as well as the decision to devote attention to certain kinds of problems rather than others inevitably involve normative judgments. Yet this is true for any applied science that proposes solutions to specified problems. The normative presuppositions that are involved here are, however, located at a *meta-level*, they are not part of the proposal for how the problem at stake may be solved. They define the conditions under which the proposed problem-solutions are claimed to be valid. The proposals themselves do not have the character of value judgments but are, instead, *conditional* “ought”-statements. They say what one “ought” to do if one wants to solve a problem of a specified type. Such conditional “ought”-statements are testable in the sense that the measures they recommend may or may not in fact be capable of solving the problem in question. Furthermore, they are irrelevant if their addressees have no interest in solving the problem.³⁵

³³ Buchanan (2001b [1987]: 4): “Any positive analysis that purports to be of use in an ultimate normative judgment must reflect an informed comparison of the working properties of alternative sets of rules or constraints. This analysis is the domain of Constitutional Economics.”

³⁴ Buchanan (1999 [1959a]: 196): “Propositions advanced by political economists must always be considered as tentative hypotheses offered as solutions to social problems.”

³⁵ For a more detailed discussion of this issue, see Vanberg 2012: 383.

Buchanan too contrasts occasionally “normative and positive political economy” (2001d [1992a]: 23). Yet, a closer inspection of his arguments shows that what he refers to as “normative” are the *normative presuppositions* and not the substantive claims of his applied *CPE*. In this sense one can read, for instance, his statement:

“Critics have charged that my work has been driven by an underlying normative purpose ... I shall acknowledge that I work always within a self-imposed constraint that some may choose to call a normative one. I have no interest in structures of social interaction that are non-individualist ... The individualist element in my vision of social reality, actual or potential, has been an important element of my substantive criticism of the work of others in political economy” (ibid.).

The normative presupposition of Buchanan’s *applied CPE*, the “self-imposed constraint” of which he speaks, can be summarized as *normative individualism*, complementing the *methodological individualism* on which Buchanan’s *theoretical CPE* is based.³⁶ The principle of methodological individualism says that explanations of social phenomena should start from propositions about the behavior of individual persons. The principle of normative individualism says that the evaluations of the individuals involved, as opposed to some external criterion, should be viewed as the measuring rod against which social arrangements are assessed. In other words, it requires that constitutional issues are analyzed from the perspective of the individuals who are to live under the chosen rules. Their interests define what counts as a constitutional problem and what qualifies as a suitable solution. As Buchanan (2001b [1988]: 62) puts it:

“The ‘good society’ is that which best furthers the interests of its individual members as expressed by these members, rather than that society that best furthers some independently defined criterion for the ‘good’.”

This implies “the normative premise that individuals are the ultimate *sovereigns* in matters of social organization” (1999 [1991]: 288) and, accordingly, “that they are the addressees of all proposals and arguments concerning constitutional issues” (ibid.).

As a “self-imposed constraint,” the principle of normative individualism provides the research focus for Buchanan’s constitutional economics, the criterion that guides the choice of issues to be studied. It directs *CPE*’s research interests to the kinds of problems individuals face when they seek to organize their interaction and cooperation in ways that advance the interests of all involved. In other words, it lets *CPE* be concerned with the question of how “man can organize his own association with his fellows in such a manner that the mutual

³⁶ Buchanan 1991 [1989]: 29): “I am a methodological and normative individualist.” – Buchanan (1999 [1990]: 390): “For constitutional economics, the foundational position is summarized in methodological individualism.”

benefit from social interdependence can effectively be maximized” (Buchanan and Tullock 1962: 306).

As noted above, the solutions that an applied *CPE* proposes for social-organizational problems are comparable to the solutions that other applied sciences advance for the practical problems with which they are concerned.³⁷ Buchanan emphasizes, though, that the social problems the political economist deals with in his role as legislative advisor³⁸ are of a different nature than “scientific-technical” problems in the ordinary sense.³⁹ To insist on the significance of this difference was, Buchanan recalls, one of Frank Knight’s “crusades”.⁴⁰ About the practical problems that economics may serve to solve Knight had said:

“Its practical problems are those of social policy. And the first requisite for ‘talking sense’ about social policy is to avoid the nearly universal error of regarding the problem as in any sense closely parallel to the scientific-technological problem of using means to realize ends. The social problem ... is in no sense a scientific-technical or manipulative problem unless we consider ‘society’ under the form of a dictatorship over which the dictator is proprietor as well as sovereign, and as an enterprise which is to be managed solely in his interest. ... If society is in any sense democratic or free, its problems are problems of group decision and of group self-determination, in connection with which control is a misleading term” (1940: 27f.).⁴¹

Following up on Knight, Rutledge Vining (1984: 3) has argued in the same spirit:

“In his most characteristic role as practitioner, the economist is a specialist advisor to legislators and citizens in a legislative frame of mind. The advising of business firms and other administrative organizations or agencies with well-defined ends to attain is an altogether different activity” (1984: 3).

³⁷ Buchanan (1962: 308): “Indeed the only purpose of science is its ultimate assistance in the development of normative propositions. We seek to learn how the social world works in order to make it work ‘better,’ to ‘improve’ things: this is as true for physical science as it is for social science.” – When Buchanan speaks here of “normative propositions” he obviously refers to the ‘conditional ought-statements’ that applied sciences advance rather than genuine value judgments.

³⁸ Buchanan (1999 [1959a]: 191): “The social role of the economist remains that of securing more intelligent legislation.”

³⁹ Buchanan (2001d [1989]: 307): “There are important implications if the problem of social organization is analyzed as one of securing agreement on the constraints within which we engage with one another ... Agreement on the rules by which we shall live, one with another, domestically and internationally, is, of course, informed by scientific inquiry and understanding. But, at base, the problem is not one involving technological application of scientific discoveries, and it seems a mark of folly to treat it as such, that is, as an engineering problem.” – Buchanan (2000 [1991]: 82: “The continuing task is defined as coming to agreement on the set of rules that constrain our behavior to one another.”

⁴⁰ Buchanan (2001c [1968]: 92): “One of Knight’s many crusades has been against the view ... that science in some instrumental sense can be used to solve problems in a community of free men. Knight believes that ... the social problem is one of attaining consensus, of securing agreement.”

⁴¹ Knight (1982 [1941]: 217): “(T)he practical problem of achieving any defined conception of a ‘healthy’ (or an ‘ideal’) society is still not a scientific or a technical one in the proper, instrumental sense. To begin with, it is the very different kind of problem involved in formulating, which means rationally agreeing upon, ‘rules of the game,’ which is not a matter of means and end.” – Knight (1951: 18): “The intellectual problem involved in rule-making is different in kind from that of play itself, and neither – it is important to note – has much relation to scientific technology, or means-end rationality.”

“The individuals who jointly choose the constraints are the same individuals whose actions are constrained. ... The system must be jointly chosen by the members of the society, and the technical problem ... is that of facilitating the social-interaction and communication leading to a consensus” (1956: 17f.).⁴²

The “Gains-from-Trade” Paradigm

“What Should Economists Do?” In his 1963 Presidential Address to the Southern Economics Association Buchanan (1999 [1964]) posed this question to his colleagues, answering it by suggesting that the “mutuality of advantage that can be secured ... as a result of cooperative arrangements, be these simple or complex, is the one important truth in our discipline” (ibid.: 36). The issue of how cooperative associations can be “mutually beneficial to all parties” should therefore be, he concluded, the discipline’s central concern,⁴³ and the proper explanatory approach for economists to adopt should be, what he calls, the “*gains-from-trade paradigm*.”

Buchanan’s claim about the “one important truth” in economics is based on the argument that voluntary exchange transactions, which are at the very core of economists’ theory of the market,⁴⁴ represent the paradigm example of mutually advantageous transactions.⁴⁵ When economists speak of “the market” as a wealth-creating arrangement, Buchanan emphasizes, they do not mean just any system of decentralized interactions. They presuppose, by implication, the existence of an institutional framework that aims at securing voluntariness in transactions by preventing the use of coercion and fraud as strategies of enrichment.⁴⁶ As Buchanan (1999 [1964]: 38) puts it: “The ‘market’ or market organization is

⁴² Vining (1956: 37): “What is evaluated is the system of legislative enactments ... This is a joint evaluation representing a joint expression of preferences by all members of the society ... The joint evaluation involves the reaching of a consensus by the members of a society with respect to an ordering of sets of values.”

⁴³ Suggesting that economics might be called *catalactics* or *symbiotics*, Buchanan (1999 [1964]: 35) notes: “Symbiotics is defined as the study of the association between dissimilar organisms, and the connotation of the term is that the association is mutually beneficial to all parties. This conveys, more or less precisely, the idea that should be central to our discipline.”

⁴⁴ Buchanan (1999 [1979]: 49): “(T)his trading for mutual advantage is what economic theory is all about.” – Buchanan (1999 [1986b]: 457): “The eighteenth century discovery that, in an institutional framework that facilitates voluntary exchange among individuals, this process generates results that might be evaluated positively, produced ‘economics’ as an independent academic discipline or science.”

⁴⁵ Buchanan (2001b [1977]): “Economists ... are specialists in exchange. ... When they observe a social interaction they interpret the results in exchange terms, as possibly emergent from voluntary actions. To the extent that results can be fitted into the exchange pattern, economists can infer that all parties secure gains, as these gains are measured in terms of the participants’ preferences and not of the observer.”

⁴⁶ About the economist who looks at the market as an arena for voluntary exchange Buchanan (1991 [1989]: 37) says: “He or she does not evaluate the results of exchange teleologically against some previously defined and known scalar. Instead, he or she adjudges the exchange to have been utility enhancing for each trader to the extent that the *process* itself has embodied attributes of fairness and propriety. If there has been neither force nor

... the institutional embodiment of the voluntary exchange processes that are entered into by individuals in their several capacities.”

The *gains-from-trade paradigm* Buchanan contrasts to the “*maximization paradigm*” that, as he argues, became particularly influential since Lionel Robbins (1932: 16) famous definition of economics as “a science which studies human behavior as a relationship between ends and scarce means which have alternative uses.” Once we accept the Robbins formulation of the ‘economic problem,’ so Buchanan charges, economics “comes to be conceptualized as a varied set of exercises, all of which involve the maximization of some appropriately selected objective function subject to the appropriately defined constraints” (2001d [1976: 125]).⁴⁷ The problem with this conceptualization is, he argues, that what may be an appropriate analytical tool in studying individual human choices becomes misleading when it is extended to the social, aggregate level. Just such extension was however, in his view, invited by Robbins’ definition.⁴⁸

“Search him as you will, and you will not find an explicit statement as to *whose* ends are alternatives. His neutrality extends to the point of remaining wholly silent on the identity of the choosing agent, and few economists seem to have bothered with the difficult issue of identifying properly the entity for whom the economic problem exists. It is thus by quite natural extension that the economic problem moves from that one which is confronted by the individual person to that facing the larger family group, the business firm, the trade union, the trade association, the church, the local community, the regional or state government, the national government, and, finally, the world” (1999 [1964]: 30f.).

While acknowledging that the maximization logic of the standard rational model can be usefully applied to the choices of individual human beings, as they participate in exchange and collective action, Buchanan insists, that it is inapplicable either to the exchange process itself or to organized, collective action.⁴⁹ What should be generalized as we move from the

fraud, and if the exchange has been voluntary on the part of both traders, it is classified to have been mutually beneficial.”

⁴⁷ Buchanan (1991 [1989]: 30f.): “Scarce resources are allocated among alternative uses to secure maximum value ... Economics, as a realm for scientific inquiry, does indeed seem to be reducible to applied maximization”.

⁴⁸ In reference to Robbins, Buchanan (1999 [1964]: 32) notes: “The definition of our subject makes it all too easy to slip across the bridge between personal or individual units of decision and ‘social’ aggregates.”

⁴⁹ Buchanan (1991 [1989]: 32): “In exchange ... participants may be modeled as behaving to maximize their separately defined utilities, subject to the constraints separately faced, as defined by the rules, the endowments, and the predicted responses of other participants. The standard maximization behavior embodied in rational choice models may, of course, be accepted for this analytical exercise. But, in exchange ... neither any single player-participant nor the set of players-participants, as a group, treats the outcome of the process as a maximand. The solution to the exchange process, simple or complex, is not the solution of a maximization problem, and to model it as such is the continuing source of major intellectual confusion in the whole discipline.” – R. Vining (1984: 39) has specifically emphasized that “nothing at all is being maximized or minimized or optimized by persons genuinely participating in a joint choice of a modification of the law.”

level of individual choice to organized, collective action is, he suggests, not the rational maximization paradigm but the exchange or gains-from-trade paradigm that economists routinely apply, at least implicitly, when they look at market exchanges as value-enhancing transactions. By focusing attention on the *processes* from which social outcomes result rather than on the outcomes per se, the gains-from-trade paradigm provides economists, Buchanan posits, with an analytical tool that allows them to integrate the study of markets as well as of organized collective arrangement within one coherent theoretical framework.⁵⁰

In its generalized application of the gains-from-trade paradigm, *CPE* mainly concentrates on the organization of politics, inquiring into how the choice of rules or constraints at this level may serve to enhance the prospects of mutual gains for all participants. Yet it includes, Buchanan (1999 [1990]: 384) emphasizes, also

“the derivation, analysis of, and justificatory arguments for rules that constrain both individual and collective behavior in a wide array of membership groupings ... Clubs, trade unions, corporations, parties, universities, associations – these and many more, exist and operate under constitutions that are amenable to scientific inquiry.”⁵¹

The “exchanges” that are involved in organized, collective action are, of course, of a different nature than the two-party transactions into which market processes may be factored down.⁵² They require what Buchanan calls a “*complex exchange*,” the simultaneous participation of all parties to the collective enterprise.⁵³ The complex exchange of which Buchanan speaks can be described best as an *exchange of commitments* among all participants. Such joint commitments can take either of two principal forms (Vanberg 2005, 29). They may consist in the exchange of promises to contribute one’s share to the financing of some collective good in

⁵⁰ Buchanan (1999 [1990]: 384): “If an exchange rather than a maximizing paradigm is taken to be descriptive of the inclusive research program for the discipline, then *economics* involves inquiry into *cooperative* arrangements for human interaction, extending from the simplest of two-person, two-good trading processes through the most complex quasi-constitutional arrangements for multi-national organizations.”

⁵¹ Buchanan (1999 [1964]: 39, 41f.): “The task of the economist includes the study of all such cooperative trading arrangements which become merely extensions of markets as more restrictively defined. ... I am simply proposing that economists concentrate on the institutions, the relationships, among individuals as they participate in voluntarily organized activity, in trade or exchange, broadly considered.” – In retrospect Buchanan (1991 [1989]: 31) said about his 1963 Presidential Address: “My argument was that economics, as a social science, is or should be about trade, exchange, and the many and varied institutional forms that implement and facilitate trade, including all of the complexities of modern contracts as well as the whole realm of collective agreement on the constitutional rules of political society.”

⁵² For a more detailed discussion of the *CPE* approach to organizations see Vanberg 1994 [1992]. – Frank Knight (1982 [1946]: 449) implies the concept of organizations as constitutional systems when he states: “Free association also allows for the organization of groups to act as units in production or trade, in the interest of still greater efficiency. These, again, may have any form of internal constitution on which the parties can agree.”

⁵³ Buchanan (1991 [1989]: 39): “If we then generalize the trading interaction and extend its application over large numbers of actors, we may begin to explain, derive, and analyze social or political interdependence as complex exchange, as a relationship that embodies political voluntary agreement as an appropriate criterion of legitimation.”

the consumption of which all participants in the joint enterprise share. Alternatively, they may involve the exchange of promises to jointly submit to the rules that impose binding constraints on all contracting parties. To the former type Buchanan (1999 [1986b]: 461) refers when he states:

“In the market, individuals exchange apples for oranges; in politics, individuals exchange agreed-on shares in contributions toward the costs of that which is commonly desired, from the services of the local fire station to that of the judge.”

On the latter he comments when he notes that

“individuals choose to impose constraints or limits on their own behavior primarily, even if not exclusively, as a part of an *exchange* in which the restrictions on their own actions are sacrificed in return for the benefits that are anticipated from reciprocally extended restrictions on the actions of others with whom they interact” (1999 [1990]: 380).

Mutual Gains and Agreement

In 1986 Buchanan was awarded the Alfred Nobel Memorial Prize in Economic Science “for his development of the contractual and constitutional bases for the theory of economic and political decision-making.” His acceptance speech he used in particular to acknowledge the influence on his own work of “that great Swede, Knut Wicksell,” describing his “1948 discovery of Knut Wicksell’s unknown and untranslated dissertation, *Finanztheoretische Untersuchungen*” as “as one of the most exciting moments of his career” 1999 [1986b]: 455f.). What had impressed Buchanan most in Wicksell’s dissertation was the part on “A New Principle of Just Taxation” (Wicksell 1967 [1896]). In it Wicksell had argued that in a society of free and equal citizens public expenditures can be considered legitimate only if they are “intended for an activity useful to the whole of society and so recognized by all” (ibid.: 89). As for the “recognized by all,” he specified that whether the benefits of a “proposed activity to the individual citizens would be greater than its costs to them, no-one can judge this better than the individuals themselves” (ibid.: 79).

Accordingly, for Wicksell, “justice in tax distribution” required that public projects generate net benefits for each individual citizen, since, so he argued, it “would seem to be a blatant injustice if someone should be forced to contribute toward the costs of some activity which does not further his interests” (ibid.: 89). Furthermore, he concluded, only unanimous approval of a proposed activity can provide a conclusive test of whether it promises indeed net benefits for all members of the polity. After all, he added, for projects that are claimed to

be beneficial for society at large it should “always be theoretically possible, and approximately so in practice, to find a distribution of costs such that all parties regard the expenditure as beneficial and may therefore approve it unanimously” (ibid.: 89f.).⁵⁴

In Wicksell’s “principle of unanimity and voluntary consent in the approval of public expenditures and taxes” (ibid.: 116) Buchanan found a most congenial theoretical outlook that helped him, in an early stage of his academic career, to develop with more confidence the research program that he had embarked on. The Wicksellian approach he later summarized as follows:

“Wicksell’s objective was to construct a criterion for efficiency in fiscal decisions, by which he meant the satisfaction of the demands of individuals, as consumers of collectively financed goods and services, analogous to the satisfaction of consumer demands in the competitive market for private goods and services. ... By the very nature of the problem that he confronted ... Wicksell was compelled to adopt the criterion of *agreement*, interpreted as that which emerges as the end state of any voluntary exchange process. As this criterion was extended to the fiscal choice process, the ‘voluntary exchange theory’ of modern public finance was born” (Buchanan 2001d [1988]: 141).

In Wicksell insistence on the “criterion of *agreement*” Buchanan found support for his claim that theoretical consistency requires economists to apply their principal analytical tool, the exchange paradigm, as well as the corresponding criterion of efficiency, namely voluntary agreement, in their study of collective arrangements no less than in their study of the spontaneous order of the market. According to Buchanan, just as in ordinary market exchange claims of mutual gains or “efficiency” are ultimately derived from the presumption of voluntary agreement among the trading parties,⁵⁵ claims of “efficiency” or value enhancement in organized, collective action can ultimately be based on nothing other than the supposition that the parties involved voluntarily agreed to the measures taken. As Buchanan puts it:

“If only individual evaluations are to count, and if the only source of information about such evaluations is the revealed choice behavior of individuals themselves, then no change can be assessed to be ‘efficient’ until and unless some means could be worked out so as to bring all person (and groups) into agreement” (2001b [1987]: 10).⁵⁶

⁵⁴ Wicksell (1967 [1896]: 90): “In the final analysis, unanimity and fully voluntary consent in the making of decisions provide the only certain and palpable guarantee against injustice in tax distribution.”

⁵⁵ Buchanan (1991 [1989]: 37f.): “Exchange involves agreement on the part of the traders, both upon entry into trade and upon terms of trade ... Since there are no independently existing scalars, the only indication that traders have improved their position lies in their observed agreement. A positive welfare assessment must become possible because the agreement has signaled mutually preferred change.”

⁵⁶ Buchanan (1999 [1959a]: 208): “Since ‘social’ values do not exist apart from individual values in a free society, consensus or unanimity (mutuality of gain) is the only test which can insure that a change is beneficial.”

“The political analogue to decentralized trading among individuals must be that feature common over all exchanges, which is *agreement* among the individuals who participate. The unanimity rule for collective choice is the political analogue to freedom of exchange of partitionable goods in markets” (1999 [1986b]: 463).⁵⁷

In order to develop the Wicksellian unanimity criterion into a principal analytical tool of his own research program,⁵⁸ though, Buchanan needed to solve first a problem inherent in Wicksell’s argument. That the requirement of “absolute unanimity” for every single budgetary decision⁵⁹ may be impossible to implement in practice, Wicksell (1967 [1896]: 92) had acknowledged and concluded that one must be content with the “requirement of approximate unanimity of decisions.” This concession creates, however, a disturbing tension. While the unanimity principle is supposed to provide the indispensable criterion of “justice in taxation,” its practical applicability appears to be rather doubtful. It is Buchanan’s significant contribution to have shown how this tension can be resolved.

The solution Buchanan proposes amounts in effect to a distinction between, on the one side, unanimity as an indispensable criterion of *legitimacy* in social transactions and, on the other side, unanimity as a *decision rule* that may be dispensed with for reasons of practicability. The problems of practical applicability that Wicksell’s interpretation of the unanimity principle faces can be solved, so Buchanan’s argument, without giving up its role as normative criterion, namely by shifting it upwards to the *constitutional level* where the rules for in-period decisions are chosen.⁶⁰ As he puts it:

“This (Wicksell’s, V.V.) restrictive interpretation ... is very substantially reduced ..., when the unanimity criterion is shifted one stage upward, to the level of potential agreement on constitutional rules within which ordinary politics is to be allowed to operate. In this framework, an individual may rationally prefer a rule that will, on particular occasions, operate to produce results that are opposed to his own interests. The individual will do so if he predicts that, on balance over the whole sequence of

⁵⁷ Buchanan and Tullock (1962: 6f.): “Agreement among all individuals in the group becomes the only real measure of ‘improvement’.” – “The *only* test for the presence of mutual gain is agreement” (ibid.: 252).

⁵⁸ Buchanan (2001b [1987]: 10): “Wicksell needed some criterion by which the possible efficacy of a proposed change in rules could be judged. He introduced the now-familiar unanimity or consensus test, which is carried over into Constitutional Economics.”

⁵⁹ Musgrave and Peacock (1967: xv) comment on Wicksell’s approach: “While there are issues on which public policy must be determined by simple majority, Wicksell argues that most matters of budget policy are not of this type. Specific public services should be voted upon in conjunction with specific cost distributions; and their adoption should be subject to the principle of voluntary consent and unanimity.”

⁶⁰ Buchanan (2001d [1988]: 151): “By shifting ‘voluntary exchange’ upward to the constitutional level of choice among rules, the consensual or general agreement test may be applied.” – Buchanan (1999 [1990]: 465f.): “Because of his failure to shift his own analytical construction to the level of constitutional choice, Wicksell was confined to evaluation of the political process in generating current allocative decisions.” – Buchanan credits, once more, Rutledge Vining’s emphasis on rules for allowing him “to pull out from Wicksell’s more applied treatment the two-state or two-level structure of political decision making that is perhaps the *sine qua non* of constitutional economics” (2001d [1992b]: 53).

‘plays,’ his own interests will be more effectively served than by the more restrictive application of the Wicksellian requirement in-period” (1999 [1986b]: 464).

The ‘calculus of advantage’ that may lead individuals to dispense with the unanimity requirement at the level of in-period decisions is the principal subject of ” *The Calculus of Consent*, co-authored by Buchanan and Tullock (1962), a book to which I referred to earlier as a Public Choice ‘classic’ as well as a foundational treatise in constitutional economics. In-period decisions that are made by less-than unanimity rules, such as, in particular, majority rule, can, of course, no longer be claimed to be ‘efficient’ in the sense of generating gains for all participants. They qualify, however, as legitimate or ‘just’ if, and to the extent that, they are made by rules that all parties voluntarily agree to.⁶¹

The significance of shifting the unanimity requirement upward to the constitutional level lies in the fact, that at this level general agreement can be more readily achieved than at the level of particular in-period decisions, because of the increased uncertainty with which the individuals involved can predict how they will personally be affected. Buchanan (1999 [1990]: 464) points this out when he states:

“To the extent that the individual reckons that a constitutional rule will remain applicable over a long sequence of periods, with many in-period choices to be made, he is necessarily placed behind a partial ‘veil of uncertainty’ concerning the effects of any rule on his own predicted interests. Choice among rules will, therefore, tend to be based on generalizable criteria of fairness, making agreement more likely to occur than when separable interests are more easily identifiable.”⁶²

To be sure, at the constitutional level the participants must be expected to pursue their own interests no less than at the level of particularizes in-period choices, and their interests in rules being implemented that work to their own differential advantage will tend to create impediments to the reaching of agreement. This problem points to the fact that the choice of rules must itself be framed by rules, placed at a more general constitutional level, that aim at

⁶¹ Buchanan (1999 [1990]: 464): “The in-period Wicksellian criterion remains valid as a measure of the particularized efficiency of the particular decision examined. But the in-period violation of the criterion does not imply the inefficiency of the rule so long as the latter is itself selected by a constitutional rule of unanimity.” – “Individuals may generally agree upon the rules of the game within which ordinary politics takes place, and these agreed upon rules may allow for predicted net gainers and no losers in particularized political choices. The question of legitimacy or justification shifts directly to the rules, to the constitutional structure, which must remain categorically distinct from the operations of ordinary politics, which is constrained by the rules” (2001b [1988]: 63).

⁶² As Buchanan (2001d [1988]: 150) notes, the role in constitutional choice of a “sufficiently thick veil of ignorance and/or uncertainty such that no identification of prospective gainers or losers is possible” has likewise been emphasized by John Rawls (1971).

creating conditions that discourage the seeking of privileges and encourage the search for impartial rules.⁶³

Politics as Exchange

In the introduction of his pioneering 1949 paper Buchanan (1999 [1949]: 119) pointed out that a “framework for the pure theory of government finance may be erected on either of two political foundations,” an “‘organismic’ theory of the state” or an “‘individualistic theory,” the approach he advocated. To a later re-publication, he added the footnote: “This paper was written before the author was familiar with the Italian fiscal theory. The Italian literature is characterized by a much more careful consideration of the political presupposition.”⁶⁴

As he has noted in retrospect, it was his discovery of the English translation of de Viti de Marco’s *First Principles of Public Finance* (1936 [1928]) that stimulated Buchanan’s “interest in looking further into the Italian sources,”⁶⁵ a project he realized when he spent the year 1955/56 as a Fulbright fellow in Italy.⁶⁶ Contrasting the “cooperative” and the “monopolistic” state, de Viti de Marco (ibid.: 43) had supposed that “we may regard the democratic State as that which resembles the economic pattern of the co-operative.” Its “law of taxation,” he argued, “is based on the assumption of an exchange relationship: that is, the exchange of a payment to the State for the provision of public services by the State” (ibid.).

The arguments on the “cooperative state model” that he found in the Italian public finance literature, in particular in de Viti de Marco’s writings,⁶⁷ further strengthened Buchanan’s confidence in his “exchange conceptualization of politics” (1999 [1986b]: 461) as a central part of the research program that, influenced by Knight and Wicksell, he had begun

⁶³ That such conditions are present is implied when Buchanan (1962: 312) notes: “(W)e have then tried to answer the question: What set of rules should the fully rational individual, motivated primarily by his own self-interest, seek to achieve if he recognizes that the approval of such rules must embody mutual agreement among his fellows.” – R. Vining (1956: 18) indirectly refers to the issue at stake when he states: “One can never propose an alteration in an economic system on the explicit grounds that he will gain personally from the alteration – at least he can never do so with any hope that he will be listened to. The proposal must be made on the grounds that the result will be generally more satisfying ... These obligations – to reach judgments which are independent of personal interests ... - are implied in the idea of a political organization of individuals each of whom recognizes all of the others as equally free each to act as he wills.”

⁶⁴ In Buchanan (1960: 8-23). The footnote is omitted in Buchanan (1999 [1949]).

⁶⁵ Buchanan and Musgrave (1999: 17).

⁶⁶ About the year 1955/56 he spent as Fulbright fellow in Italy Buchanan (2001d [1992c]: 28) notes: “It is no exaggeration to state that the Italian year allowed me to cross the threshold into what would later come to be called the research program in ‘public choice,’ and, particularly, ... in ‘constitutional political economy.’”

⁶⁷ Buchanan (2001a [1960]: 70) refers to Luigi Einaudi as “the most distinguished follower of de Viti de Marco in this cooperative or democratic tradition.”

to develop with his early article.⁶⁸ Agreeing with Wicksell and de Viti de Marco Buchanan insists that for a free and democratic society the individualistic exchange model of politics is the only appropriate theoretical approach.⁶⁹ As he posits:

“If we adhere strictly to the individualistic benchmark, there can be no fundamental distinction between economics and politics, or more generally, between the economy and the polity. The state, as any other collective organization, is created by individuals, and the state acts on behalf of individuals. Politics, in this individualistic framework, becomes a complex exchange process, in which individuals seek to accomplish purposes collectively that they cannot accomplish non-collectively or privately in any tolerably efficient manner. The catallactic perspective on simple exchange of economic goods merges into the contractarian perspective on politics and political order” (Buchanan 2001b [1988]: 62).⁷⁰

The claim “that ‘political exchange,’ at all levels, is basically equivalent to economic exchange” (Buchanan and Tullock 1962: 250) can obviously not mean that citizens voluntarily pay their taxes and comply with the existing legal order in the same sense in which they voluntarily deal with their trading partners in the market arena. They would scarcely do so if it were not for the presence of the coercive apparatus of the state. Indeed, as Buchanan (1999 [1986b]: 461) notes, the “observed presence of coercive elements in the activity of the state seems difficult to reconcile with the model of voluntary exchange among individuals.” What the exchange model of politics claims is that, just as transactions in the market arena derive their legitimacy from voluntary agreement among the trading parties, in a society of free and equal individuals⁷¹ the coercive apparatus of the state can derive its ultimate legitimacy only from voluntary agreement among the members of the polity to submit to such coercion.

The ‘exchange’ of which the exchange model of politics speaks is an exchange of promises or commitments at the *constitutional* level.⁷² The agreement to accept an apparatus

⁶⁸ On de Viti de Marco’s “cooperative state model” Buchanan (2001a [1960]: 69) notes: It “involves the fundamental premise of democratic choice to the effect that *all* members of the social group participate conceptually in the reaching of collective decisions. ... The voluntary aspects of fiscal action are stressed, and the tax is considered as a price in the broadest philosophical sense.”

⁶⁹ In the “Introduction” to a collection of essays that included a reprint of the 1949 paper Buchanan (1960: 4) states: “I consider the ‘individualistic’ assumptions to be the only appropriate ones for democratically-organized societies.”

⁷⁰ Buchanan (1999 [1986b]: 461): “The relevant difference between markets and politics does not lie in the kinds of values/interests that persons pursue, but in the conditions under which they pursue their various interests. Politics is a structure of complex exchange among individuals, a structure within which persons seek to secure collectively their own privately defined objectives that cannot be efficiently secured through simple market exchanges.”

⁷¹ Vining (1984: 31 fn.) defines such a society as one “whose members are themselves the choosers of the laws that constrain their respective private actions.”

⁷² Buchanan (1991 [1989]: 39): “How can we even begin to explain political reality by an exchange model? ... Conflict, coercion ... do indeed characterize political institutions, as they may be observed to operate *within a set*

of coercion is a concomitant to the exchange of commitments involved when the members of a polity for prudential reasons agree on rules that promise a ‘better game’ for all involved. Where they cannot expect such rules to be self-enforcing – in other words, where common *constitutional* interests do not per se generate general *compliance* interests – the contracting parties may rationally agree on an apparatus of enforcement.⁷³ As Buchanan phrases it:

“In agreeing to be governed, explicitly or implicitly, the individual exchanges his own liberty with others who similarly give up liberty in exchange for the benefits offered by a regime characterized by behavioral limits” (1999 [1960]: 386).

“Individuals acquiesce in the coercion of the state, of politics, only if the ultimate constitutional ‘exchange’ furthers their interests. Without some model of exchange, no coercion of the individual by the state is consistent with the individualistic value norm upon which a liberal social order is grounded” (1999 [1990]: 461).

Because of its emphasis on voluntary agreement as the only conclusive test of “efficiency” and ultimate source of legitimacy in social transactions and arrangements – from ordinary market exchange to collective organizations of all kinds, private and public – constitutional economics in the Buchanan tradition is often classified as “contractarian.” In fact, Buchanan has often pointed to the close relation between his own research program and “the contractarian tradition in political philosophy” (2001b [1987]: 10),⁷⁴ and, in particular, its affinity with John Rawls’s (1971) modern contractarianism.⁷⁵

Since, from a contractarian perspective, agreement at the constitutional level is essential in providing legitimacy to non-consensual in-period decisions in collective action, private and public, the practicability of the agreement test at this level obviously becomes the central issue. Other than for private associations, this issue is particularly challenging for polities as collective organizations. In the case of private organizations with free entry and exit, somebody’s voluntarily choice to join and to remain within the organization is a relevant indicator of his agreement to its constitution. In the case of polities, the same applies to

of constitutional rules ... But if analysis and attention is shifted to the level of rules, among which choices are possible, we can use potential and actual agreement among persons on these rules as the criterion of normative legitimacy. And such agreement may well produce rules, or sets of rules, that will operate so that, in particularized sequences of ordinary politics (single plays of the game) there may be negatively valued results for some of the participants.”

⁷³ Buchanan (1999 [1959a]: 204): “State or governmental coercion enters only insofar as individuals, through collectively imposed rules, prevent themselves from acting as they would in the absence of such rules.”

⁷⁴ Buchanan (1991 [1989]: “The contractarian tradition in political philosophy offers the intellectual avenue that facilitates the shift of inquiry from simple market exchange engaged in by two traders to the intricacies of politics.”

⁷⁵ Buchanan (1999 [1990]: 465): “(T)he research program in political economy merges into that of contractarian political philosophy, both in its classical and modern variations. In particular, my own approach has affinities with the familiar construction of John Rawls.” –Buchanan (2001c [1972]: 353) notes, though, that he was more sympathetic with Rawls’ original conception of “justice as fairness” (Rawls 1958) than with Rawls’ later specification (Rawls 1971).

individuals who voluntarily acquire and maintain citizenship in a polity. Typically, though, the vast majority of citizens in most states acquired their citizen-status by birth and not by their own explicit choice. Given the fact that requiring explicit unanimous agreement would imply an obviously unrealistic standard, the search for a most meaningful interpretation and specification of the agreement test is an important challenge for constitutional inquiry.⁷⁶ As Buchanan (1999 [1986b]: 463) puts it:

“Politics as observed remains, of course, far from the idealized collective-cooperative exchange that the unanimity rule would implement. ... But barriers to realization of the ideal do not imply rejection of the benchmark definition of the ideal.”

Conclusion: Procedures vs. Outcomes

The paradigmatic significance of the shift in analytical focus that the *CPE* research program implies is most apparent in its comparison to welfare economics, the discipline’s traditional applied branch. The defining feature of welfare economics, with all its modern variations and refinements, remains the notion of some aggregate measure of ‘social welfare,’ the maximization or advancement of which is the task of politics. With its outlook at politics, Buchanan (1999 [1990]: 382) charges, welfare economics inappropriately transfers the maximization paradigm from the realm of individual rational choice “to social or collective choice on the basis of some implicit presumption that collectivities choose analogously to individuals” (1999 [1990]: 382). Within its theoretical framework, so defined, welfare economics naturally concentrates its analytical attention, firstly, on specifying the ‘social welfare function’ as the standard against which policy outcomes are to be evaluated, and, secondly, on exploring which policy measures are best suited to advance ‘social welfare.’⁷⁷ In other words, welfare economics focuses on *directly* evaluating outcomes in ‘social welfare’ terms, and aims at providing policy in the form of information about the instrumentality of alternative policy measures for producing welfare enhancing outcomes.

By contrast, *CPE*’s research focus is on *procedures* rather outcomes per se.⁷⁸ It rejects the welfare economist’s claim that policies can be directly assessed in terms of their social

⁷⁶ On this issue Vanberg (1994 [1986]: 228ff.; 2014: 26).

⁷⁷ Buchanan and Tullock (1962: 284): “This (social welfare, V.V.) function conceptually orders all possible states of society, and quite unambiguously allows for the selection of the ‘best’ or from a restricted set of available alternatives, the relatively ‘best’.”

⁷⁸ Buchanan (1999 [1959a]: 204): “Whereas the ‘social welfare function’ approach searches for a criterion independent of the choice process itself ..., the alternative approach evaluates results only in terms of the choice process itself.”

welfare effects⁷⁹ and insists that outcomes or ‘social states’ can be evaluated only *indirectly*, in terms of the choice processes from which they result.⁸⁰ As Buchanan (1999 [1986b]: 461f.) puts it:

“Improvement in the workings of politics is measured in terms of the satisfaction of that which is desired by individuals, whatever this may be, rather than in terms of moving closer to some externally defined, supra-individualistic ideal. ... There is no criterion through which policy may be directly evaluated. ... The focus of evaluative attention becomes the process itself, as contrasted with end-states or outcome patterns. ‘Improvement’ must, therefore be sought in reforms in process, in institutional change that will allow the operation of politics to mirror more accurately that set of results that are preferred by those who participate. ... (T)he *constitution* of policy rather than policy itself becomes the relevant object of reform.”

As they differ in their analytical foci, welfare economists and constitutional economists differ accordingly in how they interpret their role as advisors in politics. While constitutional economics, as noted earlier, sees itself in the tradition of Adam Smith’s “science of the legislator,” providing advice on the choice of rules, welfare economics may be described “science of the politician,” providing advice on the choice of policies. Stated, again, in Buchanan’s (2001b [1987]: 4) words:

“The constitutional economist, precisely because the subject matter is the analysis of alternative sets of rules, has nothing to offer by way of policy advice to political agents who act within defined rules. ... (T)he whole exercise is aimed at offering guidance to those who participate in the discussion of constitutional change. In other terms, constitutional economics offers a potential for normative advice to the members of the continuing constitutional convention, whereas orthodox economics offers a potential for advice to the practicing politician.”

As opposed to the welfare economist’s role as *policy advisor*, the constitutional economist’s task as *legislative advisor* is to locate potential deficiencies in existing institutional structures, deficiencies in the sense of obstacles that prevent the individuals involved from realizing

⁷⁹ Buchanan (1999 [1954]: 100f.): “A necessary condition for deriving a social welfare function is that all possible social states be ordered *outside* or *external* to the decision process itself. What is necessary, in effect, is that the one erecting the function be able to translate the individual values which are presumably revealed to him) into social building blocks. If these values consist only of individual orderings of social states (which is all that is required for either political voting or market choice) this step cannot be taken.” – As Paul Samuelson (1954: 389) has famously said in his “The Pure Theory of Public Expenditures”: “The failure of market catallactics (to determine the optimal level of collective consumption, V.V.) in no way denies the following truth: given sufficient knowledge the optimal decisions can always be found by scanning over all the attainable states of the world and selecting the one which according to the postulated ethical welfare function is best. The solution ‘exists’; the problem is how to ‘find’ it.”

⁸⁰ Buchanan (1975: 6): “That is ‘good’ which ‘tends to emerge’ from the free choices of the individuals who are involved. It is impossible for an external observer to lay down criteria for ‘goodness’ independently of the *process* through which results or outcomes are attained. The evaluation is applied to the means of attaining outcomes not to outcomes as such.”

mutual gains that under more suitable rules of the game might be attainable.⁸¹ The ultimate addressees of proposals for reform are the individual constituents of the polities or collectivities in question. They are the ultimately judges on whether or not adopting the suggested reforms will serve their interests, as they see them.

This is how Buchanan (1999 [1986b]: 467) summarizes the role of the constitutional economist:

“Positively, this role involves analysis of the working properties of alternative sets of constraining rules. ... Normatively, the task for the constitutional political economist is to assist individuals, as citizens who ultimately control their own social order, in their continuing search for those rules of the political game that will best serve their purposes, whatever these might be.”

⁸¹ Buchanan (1991 [1989]: 32f.): “Since participants are presumed able to make their own within-exchange choices, the political economist’s hypothesis that value is not being maximized must be derived from observations that there exist impediments to the trading process, whether at the simple level of buyer-seller exchange or at the level of all-inclusive complex ‘exchanges’ in public goods. The observing political economist is unable, even conceptually, to construct a ‘social welfare function’ that will allow him or her to carry out a maximization exercise.”

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