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**James M. Buchanan and the
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What Did We Learn from Him?**

by

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James M. Buchanan and the European Public Choice Movement: What Did We Learn from Him?*

By

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Abstract: In this note, three major areas of Buchanan's research are briefly described: (1) The ideas of Knut Wicksell on Buchanan's work, (2) constitutional economics and the veil of ignorance, and (3) the role of government and/or the power to tax. It is shown that these three areas had a major influence on the European public choice movement, for example, at the European constitutional group.

Keywords: Work of James Buchanan, constitutional economics, veil of ignorance, power to tax, European public choice Society, Knut Wicksell, role of government.

JEL-Codes: D63, D70, D72, D78, E02, H21, H42, H77, P16

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1. Introduction

In this short note, some remarks are made with respect to James Buchanan's influence on the European public choice scholars, including on me, as one of the founders of the European public choice Society.¹ It is obvious that James M. Buchanan and Gordon M. Tullock, two of the founders of the Public Choice Society, had a great influence on most scholars of the European public choice Society. I will address the following three major areas and focus on Buchanan's influence:

1. The influence of Knut Wicksell on James M. Buchanan
2. Constitutional economics and the veil of ignorance
3. The role of government and/or the power to tax

Chapter 2 discusses the ideas of Knut Wicksell. Chapter 3 develops some remarks about constitutional economics and the veil of ignorance. Chapter 4 discusses the role of government and the power to tax. And, chapter 5 provides some conclusions.

2. The Influence of Knut Wicksell's Taxation Principles on James Buchanan

In 1974 when I was a graduate student, I visited the Public Choice Center in Blacksburg, VA with Bruno S. Frey who had a sabbatical. While there, I met Jim Buchanan for the first time. Bruno and I presented our first political economic models in which we assumed that selfish governments decreased taxes (or increased spending) before elections and increased taxes (or decreased spending) after elections.² Quite often this "fiscal illusion" policy was successful and governments were re-elected. Buchanan was quite interested in this type of model, and he brought in Knut Wicksell's idea that public programs should be financed by those who benefit from them—that is, taxes should follow the so-called connectivity principle. By raising this point, Buchanan changed the discussion to a normative one. He used the Wicksellian argument that a strong connection should exist between what a voter/taxpayer pays and what he/she receives in public benefits. At this time, the mainstream of public finance scholars argued exactly the opposite. They analyzed governments as benevolent dictators that always knew what was good for voters and provided them with transfers without any link to the costs

¹ The following remarks are subjective and are written as I experienced them.

² Compare Frey and Schneider (1978a, 1978b).

(taxes). For the first time, I realized that our model could be used normatively and that Buchanan argued that public finance scholars should rigorously reject the benevolent dictator principle.³

3. Constitutional Economics or the Idea of the “Veil of Ignorance”

From a European perspective, James Buchanan’s most important contribution was to distinguish between two levels of public choice:

- (1) First stage (the initial level), when constitutions are chosen or “designed”
- (2) Post-constitutional level, when politicians, voters, interest groups, and bureaucrats selfishly act within a constitution but selfishly.

In the first stage, the rules of the game or constitution are chosen by using the “veil of uncertainty.” This means that no one knows their future situation, after a constitution is adopted. and the veil implies that all persons prefer a constitution that is expected to produce acceptable outcomes in both “good” and “bad” situations.⁴ In the second stage, the “game is played,” and within a given constitution politicians, voters, interest groups, and bureaucrats act selfishly.

Buchanan stressed the first stage more than the second. In discussions with me and other European public choice scholars, he emphasized that only on a constitutional level where the rules are set can a government be limited in its action and better controlled. After a constitution is in effect and all actors know their interests, it is extremely difficult, if not impossible, to undertake fundamental changes. Again it took me a while to accept this type of thinking, and it had a great influence on many European public choice scholars, especially in the 1980s. Since then, dozens of papers have been presented using constitutional economics at annual European public choice meetings.

To summarize this important point:

Crucial to understanding James Buchanan’s line of argument is the distinction between **politics** and **policy**:

- (1) Politics is about the rules of the game (set up as a constitution).
- (2) Policies are strategies that selfish players adapt within a given set of rules.

³ Compare Buchanan and Tullock (1962); Buchanan, Tollison, and Tullock (1980); Buchanan and Congleton (1998); Buchanan and Musgrave (1999); and Buchanan and Wagner (1977).

⁴ Compare here the path-breaking work of Buchanan (1975, 1976, 1987a, 1987b, and 1987c).

Questions about what are good rules of the game (e.g., a constitution) should be stressed. Buchanan came to the conclusion that it is the policy/interaction among rules (social philosophy) and the economic strategies that constitutes political economy.⁵

One remarkable example of the influence of James Buchanan on European public choice scholars was the foundation of the European Constitutional Group. About 15 European public choice scholars met several times and decided that they should do something about providing an alternative type of constitution for the European Union. To this end, the European Constitutional Group developed a paper based on Buchanan's work in constitutional economics. The recommendations important included many ideas from Buchanan's work, such as competition among governments, and federalism and direct democracy. The ideas that emerged from this European Constitutional Group, in which Peter Bernholz, Roland Vaubel, Beat Blanckart, and I have been members,⁶ spread broadly within Europe and demonstrated how Buchanan's constitutional economic ideas could be applied in a very practical way.

4. The Role of Government and the Power to Tax

Jim Buchanan had a different view about public institutions and especially about the actors (governments, bureaucracy, voters) than most other public finance scholars. In Buchanan's theory, these persons were selfish and government was by no means a "benevolent" dictator who maximized a social welfare function. Buchanan rejected any organic conception of the state as superior in wisdom and superior to citizens of a country. He was convinced that one of the main purposes of a constitution is to restrict politicians' behavior and actions and that every constitution should primarily serve future generations of citizens and protect them from exploitation by government.

He was especially concerned about and undertook an analysis on how to limit government power to tax. Buchanan wanted to limit government's power to tax and he wanted to strengthen citizen's rights. Additionally, he wanted to limit the agenda-setting power of governments and parliaments and to introduce more direct democratic elements and/or support a competitive federalist system. This analysis greatly influenced the European public choice

⁵ See Brennan and Buchanan (1977, 1980, 1985).

⁶ Compare, for example, the European Constitutional Group was formed in the Summer 1992 and the members are Peter Bernholz, Charles B. Blanckart, Francisco Cabrillo, Dietmar Döring, Lüder Gerken, Christian Kirchner, Elena Leontieva, Angelo M. Petrone, Joachim Rückert, Pascal Salin, Jiri Schwarz, Peter Stein, Roland Vaubel, Frank Vibert and Jan Winiecki. This group has written a proposal for a European constitution (1993); compare Schneider (2009) and Bernholz, Schneider, Vaubel and Vibert (2004).

movement because, especially in the 1980s and 1990s. A lot of European public choice scholars came to believe that governments in most representative democracies had gone too far and overburdened citizens with regulations and taxation.

From the late 1970s to 1990s a lot of public choice-oriented research was undertaken in on these issues. For example, Bruno S. Frey, Werner W. Pommerhene, Gebhard Kirchgässner, and I analyzed the effects of Swiss institutions on cantonal and municipal government decisions. Buchanan was highly interested in and encouraged this type of research, and welcomed our results: that the more direct democratic and federalist institutions at the cantonal or municipal level are, the lower the tax burden, *ceteris paribus*. He saw this type of result as a “proof” (or at least support) for his fundamental ideas.

Let me summarize: There are two quite important elements (federalism and direct democracy), that governments follow closer the wishes of a majority of voters’ preferences:

- The first is competition, which can be reached through a lively federalism. If taxpayers/voters realize they have an alternative—that they can move from one state within a union such as the US to another—threatening such a behavior, they might be able to force the government to act more according to a majority of voters’ preferences. Hence, federalism can be seen as a competitive element between governments (federal and state as in the United States and elsewhere) with respect to major issues such as the tax burden.
- The second element is direct democracy, in which the agenda-setting power is at least partly shifted from government to the voters. If voters have the right to vote on special issues—for example, if they have the right to force the government to hold a referendum on certain issues.

With these two elements the power of a government is limited in a good way it has stronger incentives to follow the wishes of voters.

5. Conclusions: What Did We Learn?

These three areas have been very influential for European public choice scholars. Buchanan’s first major lesson certainly is that one should be very careful when widening state or public activities without making clear how these activities are financed. If we go back to the principle that those who want state activities should primarily finance them, fewer state activities would be adopted.

Second, it is crucially important to use constitutional economics in order to limit the behavior/actions of selfish politicians, bureaucrats, and interest groups. The veil of uncertainty can be increased by requiring a considerable time span (e.g., 10 years or more) between the design of a constitution and date at which it is put into effect. A constitution or reform can then be designed to have the support of the vast majority of voters. Also, such a process of reform is less likely to be “misused” to provide voters with goods and services that they do not want or are not able to finance.

Third, and maybe most important in representative democracies, it is crucial to protect the freedom of individuals. Of course, we all want to have a state that provides for the basic needs of actual poor and disabled persons, but in most representative democracies we have gone far in providing voters/taxpayers with a lot of goods and services, when it is not clear how they were financed or whether people, if they consider their tax burden, would be willing to finance them. In Buchanan’s view, constitutions should serve to protect citizens, to guarantee their freedom and only to provide those goods and services that they want and are willing to pay for.

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