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**The Foundations of James Buchanan's Work:
Exchange and Gains from Trade in all Aspects of
Life, including Markets and Politics**

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The Foundations of James Buchanan's Work: Exchange and Gains from Trade in all Aspects of Life, including Markets and Politics

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ABSTRACT

James Buchanan won the Nobel Prize for economic sciences in 1986. This paper sketches the foundations of his work and how it developed over time. By the 1960s he saw exchange as the key to the whole discipline of economics. Gradually he shifted the focus from 'gains from trade' in regular markets to politics. Contracts regarding goods and services were broadened to constitutional contracts. Always the approach was to start from the *status quo* and look for Pareto gains. Especially in his early work, Buchanan was a strong advocate of positivism. Over time this softened. The paper starts by listing his foundational assumptions. It then discusses Buchanan's early methodological views on how economics *should* be understood. Next, it shows his understanding of the ethics of markets, exchange, private property and the minimal state. Finally, it shows how this approach logically leads to constitutional political economy. Even though the focus was on formal rules, over the years Buchanan became increasingly aware that these rules were merely substitutes for cultural norms.

Keywords: James Buchanan; gains from trade, exchange, contract, methodology, constitutional political economy

JEL: A11, A13, B31, D02

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1. INTRODUCTION

James Buchanan¹ won the Nobel Prize for economic sciences in 1986. This paper sketches the foundations of his work and how it developed over time. Although he began as ‘a regular public finance economist’ (Buchanan 1995), he became part of the movement which sought to broaden the boundaries of economics which had narrowed after 1870. Buchanan has been a leader in new sub-disciplines, such as Public Choice,² Constitutional Political Economy, and to some extent New Institutional Economics. He is interesting because, unlike others in the economic imperialist camp (see Duhs 2005), throughout his *oeuvre* he shows a serious interest in the relationship between economics and ethics. At various times Buchanan has addressed what Sen calls ‘the ethics-related view of motivation’ (Sen 1987, p. 4). A comprehensive treatment of his work is beyond the scope of this paper.

Buchanan’s early specialization led him to think about how the state was understood. Even in the late 1940s he discussed the fundamental difference between the ‘organismic’ view of the state and the ‘individualistic’ theory of the state (Buchanan 1949, 496). In later work Buchanan developed a theory of social contract and a whole research programme called constitutional political economy. The germ of this work was evident in 1949.

Around the same time he began to advocate understanding markets in a ‘gains from trade’ framework; gains, of course, had to be secured by enforced contracts (1959, p. 129; 1975b, p. 229). By the mid 1960s Buchanan was calling for economics to focus on catallactics, or exchange (1964, p. 214).³ The gains-from-trade/contracting approach, he discovered, could be integrated into his constitutional economics programme by considering politics as a sort of exchange. In markets, and in politics, Buchanan’s approach was to start from the *status quo* and look for Pareto gains.

Much of Buchanan’s work is positive analysis. In the 1960s, he claimed that economic theory, for example public goods theory, ‘can be, and should be, wholly *wertfrei* [value free] in an explicit sense’ (1967, p. 197). Buchanan was methodologically self-aware in his writings and he tried to make clear when he ventured into normative analysis. Buchanan’s understanding of positivism may have led to a strong preference for the ‘ivory tower’ (Buchanan 1995). In any event, while Buchanan did make policy recommendations, he was content to write articles and books, staying largely clear of the ‘fury of policy argument’ (1967, p. 193). I contend that Buchanan’s positivism softened over time.

¹ Unless otherwise stated, citations in this paper are to Buchanan.

² Buchanan’s Public Choice contributions are part of the trend after World War II, of economics as imperialistic social science (see Duhs 2005). One major consequence of that work is to take economics further away from the two strands of the ethical tradition outlined by Sen (1987, pp. 2-7). Self-interested behaviour is now hypothesized in new areas. Bureaucrats, politicians and voters are assumed to ‘utility maximize’ but the results are not socially beneficial. Hence, ‘government failure’ is endemic in Public Choice.

³ Buchanan was following in the tradition of Whately and others. See Kirzner 1960, Ch 4.

Buchanan has written on many topics over a long career but the Nobel Prize was awarded ‘for his development of the contractual and constitutional bases for the theory of economic and political decision-making.’ He makes it clear in his Nobel Lecture that economic policy must be considered within the context of the political decision-making framework and that a model of the state and politics is needed *before* considering the effects of different policy choices (1987a). Somewhat surprisingly given his earlier views, Buchanan admitted frankly that in investigating the relation of the individual to the state, his goal was ‘ultimately normative’; he added that economists investigating this central topic must place their discussion within the ‘more comprehensive realm of discourse’ of political philosophy (Buchanan 1987a, p. 335; see also 1991, p. 4). By the 1990s, Buchanan went so far as to call for a closer relationship between economics and ethics (Buchanan 1994, pp. 82-3). While his particular conclusions differ greatly from Aristotle’s, the call for a thorough engagement with political philosophy and ethics is thoroughly consistent with Aristotle. At least in his mature views, Buchanan seems to be very much at odds with those who claim that anything worthwhile in ‘economics’ is value-free engineering.

The remainder of the paper comprises seven more sections. Section 2 presents Buchanan’s fundamental assumptions. Section 3 discusses some methodological themes in his early work, especially his definitions of economics and political economy. Section 4 presents Buchanan’s views of the ethics of markets and exchange. Section 5 presents six visions of the social contract presented by leading social contract theorists. Section 6 presents Buchanan’s view of the ethical minimal state. Section 7 presents his view of constitutional political economy. Section 8 provides some concluding remarks.

2. FOUNDATIONAL ASSUMPTIONS

On many questions, Buchanan says that the starting point for him in economic analysis is classical political economy and especially the work of Adam Smith (Buchanan 1964a, pp. 213-4; 1994, p. 12). While I may disagree with his interpretations of Smith (and others) I can appreciate that other interpretations are possible. In any event, Buchanan adopts several assumptions, some of which can be traced to the classical economics tradition. Some assumptions underpin all of his work; others are adapted to the particular context. The following eleven assumptions I take to be Buchanan’s fundamental assumptions.⁴ They fall into two groups. The first six relate to the individual in isolation or in the interactions in markets. The remaining five assumptions refer to the individual in a market or social choice setting.

⁴ On one occasion Buchanan said that he was ‘an individualist, a constitutionalist, a contractarian, a democrat—terms that mean essentially the same thing to me’ ([1975] 2000, p. 11). Many years later, he described himself more precisely in philosophical terms as ‘a methodological and normative individualist, a radical subjectivist, a contractarian, and a constitutionalist’ (1991, p. 29).

The first and second assumptions seem joined together in Buchanan's mind: he is 'profoundly individualistic, in an ontological-methodological sense' ([1975] 2000, p. 3). First, Buchanan's ontological view of strict subjectivism means that there is no distinction between the individual's utility function and his behaviour (1991, p. 225). Individual choice is all that there is. The notion that there is an objectively correct bundle which maximizes an individual's utility function is meaningless (1991, p. 226). Buchanan is skeptical about theological claims; he does consider human beings as a species, although it is a very thin conception.⁵ Second, Buchanan adopts methodological individualism, which assumes only autonomous 'individuals choose and act'; while he concedes that some social influence is possible, his concession does not go nearly as far as the 'communitarians' claim (1987c, p. 586; 1991, p. 14). Third, he says that a 'philosophical complement' to methodological individualism is that 'the ultimate sources of value' lies 'exclusively in individuals' (1987c, p. 586). This is important because these 'ultimate normative criteria ... inform the choices among institutions,' including rules, in constitutional economics (1987c, p. 586). (See also assumption eight below.) Buchanan adopts a more nuanced view in his recent work on culture (see 1994). Fourth, he puts supreme value on freedom, although the formulation varies. Buchanan sometimes says that the primary goal of each human is to maximize his liberty, understood in the 'negative sense' of not being coerced 'by someone else' (1984, p. 107);⁶ at other times he propounds the more subtle view that the goal is maximal freedom within the constraints one gives oneself individually or by agreement with others (the incorporation of ethical constraints consistent with one's interests tends to be the focus of some of his later works). Fifth, he assumes *homo economicus*, meaning that individuals 'seek their own interests' defined in a 'non-tautological' way (1987c, p. 587).⁷ Sixth, Buchanan assumes rational choice, by which he means that all economic agents are able to choose between alternatives in an 'orderly manner' (1991, p. 15).

Seventh, in group settings, cooperative behaviour can secure mutual gains (1964a, p. 218). What Buchanan has in mind by cooperation is trade in various forms, starting with the trade of goods between individuals. This is one of the main themes of his economics: gains from trade. Markets achieve individual goals not national goals (1964a, p. 219). Eighth, Buchanan holds 'normative individualism,' the 'normative premise that individuals are the ultimate sovereigns in matters of social organization'; while individuals can delegate, they remain the principals (1991, pp. 225, 227). Ninth, the political unit is construed as a manifestation of a social contract. This contract is analogous to other contracts. Buchanan calls himself a 'contractarian' ([1975] 2000,

⁵ Humans have 'biological necessities,' such as 'food, shelter, [and] clothing' (1993, p. 12; see also 1991, p. 17). At times, however, it is difficult to see any commitment to a species view of man in Buchanan (1964a, p. 217; see also Buchanan 1994, p. 75).

⁶ Buchanan provides a list of civil and economic liberties, including the 'liberty to secede' (1984, p. 108).

⁷ Buchanan describes himself as an economist and focuses on 'economic' phenomena. Indeed, he seems to adopt some sort of economism. 'I can remain totally indifferent as among your preference orderings over alternatives, so long as your choices among these do not affect my economic well-being' (Buchanan 1994, p. 75). Imagine someone saying that in Victorian Britain, or contemporary Iran!

p. 11). Here is another major theme in his work. Tenth, the political counterpart to the rationality and methodological individualist assumptions in social decision making is the ‘equal weighting’ to ‘individual evaluations’; Buchanan and his constitutional economics has a ‘democratic foundation’ (1991, p. 16). Finally, he does not want abuses by democratic majorities; this leads Buchanan to adopt constitutional democracy (1987c, p. 586). Particularly in public goods provision, he stresses unanimity (or, failing that, consensus or near unanimity) (1959, pp. 127-8, 135, 137; 1991, p. 47).

Some important implications follow from these assumptions. In much of the period after World War II, economic discussions, especially in Welfare Economics, were conducted in terms of utility. Not using this language may have led to being ignored. Buchanan did not want that to happen with his writings. Hence, when he wrote for the mainstream journals (as he did on various occasions), following Robbins, Buchanan made it clear that interpersonal comparison of utilities cannot be made; ‘utility’ is purely subjective (1959, p. 126). Further, he opposes all utilitarian projects which attempt to construct social aggregates by adding up utilities. No “social” aggregates have meaning, properly speaking (1964a, p. 215). This whole aggregative approach Buchanan says assumes an organic understanding of the state and he opposes that to his own individualistic approach (1949). The distinction between these two paradigms shows up frequently in his work over the next fifty years.

Aspects of Welfare Economics, such as the Social Welfare Function of various types (the simple version aggregates utility functions of individuals) are ruled out by Buchanan’s individualist approach.⁸ Even worse than constructing such a social welfare function is attempting to use it. Social ‘maximization’ he says is absurd (1975b, p. 226).⁹ Time and time again Buchanan says that ‘better’ or ‘worse’ must be measured in terms of ‘the individuals’ own preferences’; ‘better off’ is equated with observed voluntary choice or revealed preference (1994, p. 1; 1959, p. 125). Obviously, this constrains Welfare Economic analysis to the very narrow boundaries marked out by Robbins.¹⁰ His alternative to social ‘maximization’ is Pareto improvement (using their own evaluation at least one person is made better off and no one is made worse off). While Buchanan admits that Pareto improvement is an ‘ethical proposition,’ it is a ‘relatively neutral ethics’ and ‘it is one which requires a minimum of premises and one which should command wide assent’ (1959, pp. 125, 129). Given this standard, to consider implementing any economic policy which

⁸ Buchanan rejects the Bergson, Samuelson, and Graff approaches. Indeed, he objects to the Bergson-Samuelson approach because it ‘deliberately introduces ethical evaluations’ in its construction of the ‘social welfare function’ (1959, p. 133). Buchanan’s approach, however, asserts ‘that no “social” values exist apart from individual values’ (1959, p. 134). See also 1964a, pp. 215-6.

⁹ As we will see below, his alternative to social maximization is game theory, where no unique solution results from human interaction.

¹⁰ Nevertheless, from time to time, Buchanan does use the language of Welfare Economics in order to participate in contemporary discussions.

harms anyone (which is frequently the case), ‘full compensation’ must not only be feasible but *actually* paid (1959, p. 128; see pp. 129, 136).¹¹

Buchanan thought that Keynesian economics was a disaster for many reasons. One important reason was that it focused on aggregates rather than individuals. Secondly, Keynesians seemed to think in organic terms that the economy had a ‘purpose.’ In Buchanan’s view, the economy, being an aggregate of individual decisions, is ‘purposeless.’ The whole field of macroeconomics was a huge waste of time as far as Buchanan was concerned (1991, pp. 29, 33-4). It suffered from the same aggregation flaw as much of Welfare Economics.

3. METHODOLOGY IN BUCHANAN’S EARLY WORK, ESPECIALLY THE DEFINITION OF ECONOMICS AND POLITICAL ECONOMY

On various occasions starting in the late 1950s, Buchanan defines economics and distinguishes it from political economy. He also explains what economists do and what they *should* do. Buchanan also contrasts his vision of economics with that of the mainstream. Given the length of time over which these views were presented, it is not surprising that his discussions are not perfectly consistent. Over the next thirty-five years he shifted considerably away from that view. Indeed, by 1994 he was calling for a reintegration of economics and ethics (1994, pp. 82-3). In this section I will discuss Buchanan’s methodology in his early work, especially his definitions of economics and political economy.

In the late 1950s Buchanan distinguished economics from political economy, apparently on the basis that the former deals with theory and the latter with policy (Buchanan 1959). The former is positivistic and the latter can be made so, to a very large degree. His goal was consistent with the ‘positivist revolution’ (1959, p. 124).

Buchanan declared that the subject matter of economics is exchange. Economists, Buchanan suggests, must try to be scientific and hence positive economics is a core element of what economists do. In addition, there are normative areas of economic policy and here he argues that ‘political economists’ can play a role (1959, pp. 127-8). That role is severely constrained, however, by the fundamental assumptions that Buchanan makes (see above). Indeed, especially in his early work, Buchanan’s goal seems to have been to make that role as narrow and positivistic as possible (1959, pp. 127, 138).

By the mid 1960s Buchanan clearly saw exchange as the key to the whole discipline of economics. The subject matter for the economist Buchanan traces back to Adam Smith. Buchanan says that the starting point is Smith’s view that the ‘propensity to truck, barter and

¹¹ For Buchanan, compensation does not mean some ‘objectively measurable quantity’ but ‘that set of payments required to secure the agreement of all parties to the proposed change’ (1959, p. 128 n.6). His compensation demand goes further than the famous compensation test of Kaldor and Hicks requires.

exchange one thing for another' causes the division of labour and, in turn, opulence (Buchanan 1964a, p. 213 quoting Smith [1776] 1976, p. 25).

Economists 'should' concentrate their attention on a particular form of human activity, and upon the various institutional arrangements that arise as a result of this form of activity. Man's behaviour in the market relationship, reflecting the propensity to truck and to barter, and the manifold variations in structure that this relationship can take; these are the proper subjects for the economist's study (Buchanan 1964a, pp. 213-4).

Following Robbins, mainstream economists focused on efficient allocation of scarce resources. This approach shows how competition yields a certain 'unique "optimum" or "equilibrium"' (1964a, p. 218). According to Buchanan this approach is misguided. The focus should be exchange, and the markets as means of delivering Pareto gains. Over the years, Buchanan construed exchange very widely, even to the point where the relationship between citizens and the state was viewed as contractual.¹²

Is there any ethics here? Exchange requires agreement and agreement in Buchanan's view means that the parties to the exchange are improved or not made worse off. Exchange for him means Pareto improvement. All allegations about exploitation which have been raised in the past are silently dismissed. This exchange-Pareto improvement model is the paradigm for much of Buchanan's work.

Now let us shift to political economy (the study of economic policy and ultimate recommendation of policy choices). The political economist must remain 'ethically neutral' (1959, p. 127); his role is very limited. He or she first invents 'tentative hypotheses' about areas where Pareto gains are possible (1959, p. 128; see 1975b, p. 227). Second, the economist proposes these hypotheses for consideration in the political decision-making process in order to test if 'consensus' exists as to their beneficial (or non-harmful) effects (1959, p. 128). In order to realize Pareto gains, the group may need collective action by the government. Buchanan admits that an 'implicit' theory of the state is assumed (the state is based on a social contract) and that he assumed the group is composed of 'reasonable men' (1959, 134). The assumption that everyone is reasonable may be violated in reality and hence Buchanan is prepared to allow that some slightly lower standard; this consensus he calls 'relative unanimity' (1959, p. 135). Agreement of the participants in the collective decision-making process is the only measure of success (1959, p. 128).

By 1975 Buchanan's mature view had emerged. In 'A Contractarian Paradigm for Applying Economic Theory' he reiterated his old methodological themes: gains from trade, social changes that are Pareto improvements, and opposition to the Social Welfare Function (1975b). The third point was summarized in this statement "The economy" does not maximize, and we may

¹² Even these widened boundaries of economics Buchanan crossed eventually. He admitted on occasion that he did transgress into other disciplines (Buchanan [1975] 2000, p. xvi). Buchanan also considered gift relationships in his later works (1994, Ch 3).

substitute “the polity” here without change in my emphasis’ (1975b, p. 225). Now some new points emerged due to the welcome arrival of game theory. Buchanan says that the preferred type of mathematics is game theory rather than maximization or minimization (1975b, p. 229). It is preferred for two reasons: the external observer in a game-theory exercise focuses on *rules* rather than imposing particular outcomes; and there is no unique solution in games (1975b, pp. 226-7). Finally, Buchanan says that collective or group decision must also be seen in ‘contractarian’ framework (1975b, p. 228). To the extent that ‘collective-governmental institutions’ are needed, these institutions or ‘rules’ must be ‘preselected at some constitutional stage of “trade”’ (1975b, p. 227). Clearly, the ‘contractarian paradigm’ is extended from goods in regular markets to political institutions, such as those that provide public goods (1975b, p. 228).

The stage was set by 1975 for the emergence of several features in his work: the working out of a full-scale theory of social contract (see Section 6); and the start of his research programme called constitutional political economy (see Section 7). The Nobel Prize was awarded to him on the basis of the latter (plus his work on Public Choice more generally). The development of constitutional political economy seems to represent a blurring of the distinction between economics (facts) and political economy (values) discussed in his 1959 article. By necessity, his early enthusiastic embrace of positivism must have waned by the mid-1970s.

4. THE ETHICS OF MARKETS AND EXCHANGE

Buchanan’s understanding of the definition of economics and the role of the economist, is closely related to his understanding of the economy. Exchange is fundamental. So is contract. Buchanan’s main interest is in a *mature* economy where exchange and contracts occur regularly, but as we will see in Section 6, he is prepared to discuss the origins of these from a state of nature. In a mature economy, markets are an important institution; they link together buyers and sellers and provide the framework for bargaining and contracting. Even the exchange-contract-market framework is insufficient. Private property is needed. Once this sets of linkages is created, specialization can occur. Also the state must enter somewhere along the way. Contracts must be enforced by the state, private property boundaries must be clarified, and so on. How does this specialization-market-exchange-private property chain relate to the ethics of economics?

Recall assumption 7. The ‘mutuality of advantage that may be secured by different organisms as a result of cooperative arrangements ... is the one important truth’ in economics (1964a, p. 218). This simple truth was expanded into a spontaneous order theory by the classical economists, who are Buchanan’s inspiration. ‘Classical political economy contains the important principle of spontaneous coordination, the great discovery of the 18th century. This principle states that, within the legal umbrella of the minimal state and given certain conditions, the market “works”’ (1987c, p. 586).

Markets are not a ‘morally free zone’; on the contrary, ‘the market relationship offers the exemplar of rational morality’ (1991, p. 209). ‘The market takes persons as they are, differences and all, and allows mutual gains to be secured’; indeed, ‘the market process itself insures mutuality of gain’ (1977, p. 70). While ‘bargaining power and ... bargaining skills’ vary, the surplus ‘that trade makes possible is shared among all traders, and certainly no trader finds himself made worse off in absolute terms in his post-trade position than in his pre-trade position’ (1977, pp. 70-1). Buchanan repeatedly refers to ‘gains from trade’ made possible by specialization, and exchange in the market (see 1964a, p. 218; 1975b, p. 229; 1991, pp. 109-23). These arrangements provide Pareto gains and are in the common good.

Buchanan’s market-friendly approach is largely consistent with mainstream economics. Nevertheless, unlike the mainstream approach, Buchanan’s ‘gains from trade’ approach focuses on *process* rather than outcomes (1991, pp. 109-23).

For Buchanan, markets, exchange and private property can deliver gains from trade; they are ‘good.’ This ‘goodness’ is extended by him to the political contract and I will elaborate later on his ‘contractarian’ approach to politics in Sections 6 and 7. In addition to the minimal state mentioned above, private property must enter the ‘gains from trade’ picture. In Section 6, I will turn to Buchanan’s response to the great social contract theorists, including his view on how private property emerges historically in the state of nature *before* the social contract occurs. A little background on some of the social contract theorists is presented next.

5. SIX VISIONS OF CONSTITUTIONAL CONTRACT

Buchanan’s Nobel citation referred to his contribution to the ‘contractual and constitutional bases for ... decision-making.’ Several accounts have been given as to the origin of the state and the conditions under which one can describe the state as legitimate. I will consider six social contract theorists. These writers advanced a theory of the state based on compact or contract. The original agreement provides the ethical framework within which the state operates over time.

First, in *Leviathan*, Thomas Hobbes described a conjectural history of the world in order to justify the power of the state. The pre-political state of nature is a state of war; there is no morality and no property (Hobbes 1968, pp. 183-8). It is from this unpleasant anarchy that people seek to flee. They compact with a sovereign for security; no *mutual* contract exists (Hobbes 1968, pp. 190-201).¹³ This Leviathan must be all-powerful to provide security. Once that security is provided, the state should permit scope for autonomous action (including commerce) providing that this liberty does not undermine the state (1968, pp. 294-302). Buchanan is fascinated by Hobbes *and at times presents himself as a Hobbesian* ([1975] 2000, pp. 32, 87; 1979; see 1991, p. 234).

¹³ On this point Buchanan differs from Hobbes (see assumption 8): he refers to the ‘Hobbesian slave contract between men and a sovereign master’ ([1975] 2000, p. 187; see also pp. 66, 165).

Second, John Locke in the *Two Treatises of Government* provides an alternative conjectural history to Hobbes and uses this to justify both (limited) state power and revolution. He provides a genuine social contract theory. Private property exists in the state of nature (one mixes one's labour with that which is common to privatize it) but it is somewhat insecure; a state of war is never far away (1988, pp. 285-99, 350, 352). Individuals enter into a contract with the sovereign to protect their property and provide security to permit further acquisition (1988, pp. 276-7, 301, 324, 331, 329, 350-2, 381, 412). Failure to provide these things leads to the illegitimacy of the state and the right to revolution can be exercised (1988, pp. 406-12). Buchanan accepts aspects of Locke's approach (see also [1975] 2000, pp. 80, 107; see also pp. 79, 121n., 187).

Third, in the *Second Discourse* Jean-Jacques Rousseau sets out to correct certain details in the conjectural histories of Hobbes and Locke (Rousseau 1964, pp. 76-248). In *The Social Contract* Rousseau sets out his own social-contract framework (Rousseau 1978). In this work he developed his doctrine of the general will, among other things. It is the general will which wills the social contract. This is more than the sum of individual narrow self-interest (particular wills). Clearly, Rousseau imposed a highly restrictive set of conditions for legitimacy to be granted to a regime.¹⁴ Buchanan says that he adopts aspects of Rousseau's approach to law (Buchanan [1975] 2000, p. 140n.; see also pp. 16 n., 86 n., 119 n., cf. p. 34).

Fourth, in the union of a number of works, primarily the *Groundwork for the Metaphysics of Morals* and the *Metaphysics of Morals*, Immanuel Kant¹⁵ developed a social compact theory of the state. The compact is a hypothetical rational defence of state power, where the state provides freedom, equality and independence¹⁶ of the individual; it cannot impose a view of happiness on the citizenry (1996, pp. 290-1). Stress is placed on maximizing freedom, understood as freedom from constraint by others (1996, p. 393). The social compact is a construct of reason, where the rules are those that *could* have arisen from universal consent (1996, pp. 296-7). Legitimate laws must be universally applicable (1996, p. 387). Buchanan frequently refers to Kant's universalization or generalization principle, and recently co-wrote a book, *Politics by Principle, Not Interest*, devoted to working out applications of the Kantian 'generality norm' of personal ethics and 'its institutional embodiment in the idealized rule of law' (Buchanan and Congleton 1998, p. xix; see 1962, p. 22; [1975] 2000, pp. 150, 155).

¹⁴ The French regime then extant was clearly illegitimate according to Rousseau's *Social Contract*. Inspired by his idealism, revolutionaries began the French Revolution in the name of Rousseau. The reality was, however, that, in the *Social Contract*, Rousseau was so strict in conferring legitimacy that no actual regime could pass the test. Hence, the revolutionaries may have begun the revolution unaware that their hero was not sanguine about the realizability of the ideal.

¹⁵ Kant's work has been very influential, especially for those seeking an alternative to utilitarianism.

¹⁶ Kant considers independence in a formal way: following Rousseau, he holds that individuals must be part of the general will that wills the social contract. The individual remains independent because he is both creator of the law and subject to it.

In the 1970s, a revival of social contract theory began. Two major contributors were John Rawls and Buchanan himself; these two round out my survey of the social contract theorists. Rawls's very influential book, called *A Theory of Justice* (Rawls 1971), was developed on Kantian foundations. Rawls considers a pre-contract environment, the method of creating a social contract consistent with Kant's universality principle, and the possible content of the final contract. The 'original position' is Rawls's equivalent of the state of nature (1971, pp. 17-22). Rawls uses a device called the 'veil of ignorance' to derive two general rules for the social contract: maximal equal liberty and the difference principle (1971, pp. 60-5, 136-42). The later is an egalitarian principle of distributive justice and this aspect drew a great deal of attention to the book. Rawls's book is discussed, sometimes at length, by Buchanan.

Buchanan's own social contract theory (see assumption 9) developed in *The Limits of Liberty*, was a defence of the minimal state and is discussed at length in the next section. His book was not widely accepted.¹⁷ Nevertheless, Buchanan never abandoned the substance of the work. Over the years, due to the wide acceptance of Rawls's theory of social contract, Buchanan increasingly used aspects of Rawls's book in his own contributions. The 'veil of ignorance' approach is used by Buchanan to consider situations when issue of public debt might be agreed to and this conclusion is integrated as one element in what is now called 'the economic constitution' (1987d). Buchanan also uses the 'veil of ignorance' approach in a range of other contexts. In addition, he uses the first Rawlsian Principle (maximal equal liberty) to establish the ethical limits of taxation; when the 'liberty of session' is recognized within the Rawlsian framework of liberty, clear limits to taxation emerge (Buchanan 1984). In the next section, we will see one example of how Buchanan builds on the work of the social contract theorists (another example can be found in Buchanan 1993).

6. BUCHANAN'S ETHICAL (MINIMAL) STATE

The state is the final link in the specialization-market-exchange-private property chain. For the whole ethical chain to hold together, there must be an ethical state. Buchanan's most philosophical work is *The Limits of Liberty*, which discusses the origins of the state and private property, and much more (Buchanan [1975] 2000).¹⁸ Here, he provides a brief conjectural history of the origins of private property but he is not wedded to any specific 'conjectural history' (p. 140).¹⁹ It is in *The Limits of Liberty* that Buchanan gives his deepest response to the

¹⁷ Four reasons occur to me. First, his anarchistic ideal (see Section 6) was out of tune with the times. The next two reasons arise from Buchanan's particular focus on process: his failure to adopt a distributive principle equivalent to Rawls's difference principle ([1975] 2000, pp. 67-8, 111); and his relativistic depiction of what is possible by way of reform from the present condition (pp. 3, 98, 112, 208). The fourth reason is that he gives a strange account of slavery that appears to justify it, at least in the state of nature (pp. 77-8; see also 1991, pp. 203-4, 229).

¹⁸ Unless otherwise stated, citations in this section refer to this work.

¹⁹ The account of property given in Chapters 1-4 of *The Limits of Liberty* (see below), is fundamentally different from that presented in Buchanan 1993.

great social contract theorists, especially Hobbes; he specifically compares his work to Rawls's *A Theory of Justice* (see Buchanan [1975] 2000, pp. 10n., 221-2). It is because of the grandness of the project that, throughout the book, the reader is constantly looking for Buchanan's hints as to what constitutes a 'good society' and a legitimate state (further hints are provided in some of Buchanan's other writings).²⁰ The general impression that Buchanan gives is that *The Limits of Liberty* is 'relativistic' (p. 112).²¹ A careful reading of his book, however, shows that this is not the case. Somewhat like Aristotle,²² Buchanan holds that there are three levels of what can be called 'best': an unattainable ideal; an ideal that was achieved once (but is almost impossible to achieve); and an ideal that is attainable by most. What is important to note is that Buchanan has retained throughout his life an unchanged understanding of the first two ideals but he has shifted his ground on the third (what is currently attainable). A full discussion of his subtle and multi-layered work in *The Limits of Liberty* is impossible here but some insights into his view of these ethical states is needed.

'Individual freedom' is given the dominant role in the book because of Buchanan's 'individualist-democratic methodology' (see assumptions 2, 4, and 10)(p. 5). Due to his emphasis on freedom, it is not surprising that Buchanan is attracted to anarchy. 'Anarchy works' in many areas, providing 'mutual tolerance' is observed, namely, that 'no one man or group of men coerces another' (pp. 7, 117). In anarchy, the only criterion of goodness is process; Buchanan likes that and he says that this criterion 'also applies when nonanarchistic principles of order are considered' (p. 9). Anarchy is 'the ideal or utopian world' (p. 5; see pp. 7, 117).²³

In the end, however, 'anarchy remains tolerable only to the extent that it' produces 'an acceptable degree of order'; order is a 'necessity' (p. 8; see p. xv). In the real world, where some human beings want to 'constrain others' freedom,' and where there are busybodies, 'any equilibrium attainable under anarchy is, at best fragile' (pp. 6, 8). Anarchy is actually a 'mirage'; it is 'ideal for ideal men' (pp. xv, 5). In reality, it breaks down into a Hobbesian 'war of each against all' (p. 8; see p. 165). So that leads Buchanan to concede the need for *both* anarchy and order, but restrictions on anarchy must be kept to the minimum;²⁴ this combination

²⁰ Buchanan finally delivers a sketch of the possibilities in a paper published in 1988 and republished as Chapter 20 in Buchanan 1991.

²¹ Buchanan opens the book with this statement: 'Those who seek descriptions of the "good society" will not find them here' (p. 3). 'A "good society" defined independent of the choices of its members, *all* members, is contradictory with a social order derived from individual values' (pp. 207-8). See also pp. 20-1, 45, 98.

²² See Aristotle 1984, pp. 119, 133, 203. Of course, Aristotle's three ideals were vastly different from those in *The Limits of Liberty*.

²³ By the end of his life Buchanan declared that there was actually 'no ideal order ... there is no external standard' of restraints (1991, p. 240). Nevertheless, he does mention some 'ultimate objectives' which have received general agreement: liberty, prosperity and peace (1991, p. 243).

²⁴ For one argument along these lines, see pp. 130-1.

he calls ‘ordered anarchy’ (p. xvi). At this point, the first of many ambiguities emerges in this work.

“‘Ordered anarchy’ ...[is] the objective,’ meaning the second-best, but the term actually covers a wide range of possibilities (p. xvi; see p. 45). Buchanan mentions ‘ordinary conversation,’ a ‘walk along city pavements’ where pedestrians must interact, ‘queues in supermarkets, in banks, and in airports,’ ‘economic interchange’ in markets, and the system of ‘laissez-faire’ established in nineteenth-century Britain (pp. 7, 8, 23-4, 214-5; see also pp. 149, 228; 1991, p. 234). These usages of the term are confusing and they lead to the impression of relativism.

Although earlier periods of ordered anarchy may have occurred, the first episode that Buchanan mentions occurred in nineteenth-century Britain. As far as I can tell, the period of ‘minimal government,’ of *laissez faire*, in Britain was Buchanan’s second-best regime (p. 215). It came into being because of the work of Adam Smith and his followers. According to Buchanan, it was because Adam Smith attacked mercantilism in ‘a comprehensive and constitutional sense,’ and Smith and his followers were persuasive with the general public and politicians, that a ‘*genuine constitutional revolution* in Britain’ occurred; the new principle of social order following the revolution was ‘ordered anarchy’ (pp. 214-5 emphasis added). In the context of the 1970s in the US, he also called for a ‘genuine revolution’ (p. xvi; see p. 20). We will return to this revolutionary call later.

Was ordered anarchy in nineteenth-century Britain a unique experience? No. It can occur again in other places and at other times. Certain conditions are needed (see below). The thing that made nineteenth-century Britain unique was that ordered anarchy was achieved with such a *small state*. The *quantity of freedom* remaining in nineteenth-century Britain was extremely large. The various states that can be classified as ‘ordered anarchy’ ultimately will be judged (according to Buchanan’s framework) by how much freedom remains after order is achieved.

So let us return to what is needed for ‘ordered anarchy.’ It requires mutual acceptance of 1) ‘ethical constraints’ (or ‘informal precepts’), or 2) ‘formal laws’ or ‘formal rules’ that are enforced, or 3) some combination of these (p. 150). Buchanan’s focus is on law because he is interested in the large-number social context.²⁵ In that context, the individual ‘who limits his own freedom of choice because of built-in ethical standards, who acts in accordance with something like a Kantian generalization principle,’ is in a similar position to ‘the potential free rider²⁶ in public-goods theory’ (p. 150). Once some ‘critically large minority of persons, are observed to violate’ previously accepted ‘ethical precepts,’ and ‘act on self-interest grounds,’ the non-violators ‘find themselves subjected to what may seem to be exploitation’ (p. 151). Thereafter, there may be rapid erosion of ethical standards (p. 151). Buchanan often discusses similar ethics-related problems (usually within game-theoretic models); the moral is that while

²⁵ This argument was developed in Buchanan 1965 and extended in Buchanan 1978.

²⁶ The free rider refers to someone who benefits from a ‘jointly consumed good or service without participation, fully in the sharing of its cost’ (p. 49).

ethical norms can be sustained in small groups, self-interest tends to dominate in large-number ethical contexts (pp. 85, 153-5; see also Buchanan 1965 and 1978). Hence, law, properly enforced, must be relied upon. This is where the social contract and other sorts of post-constitutional contracting enters (see below).

What about the condition in which Buchanan found himself? It was bad. He refers to ‘sickness,’ ‘sociopolitical malaise,’ ‘constitutional anarchy,’ and so on ([1975] 2000, pp. 10, 11, 21). Buchanan spends considerable space in his book deploring the condition of the times: excesses of the executive, legislative and judicial branches of government; the breakdown of law-abidingness, and so on (pp. 7-8, 10, 19-21, 26, 108, 116-7, 126-7, 134-5, 152 n., 156, 205, 207-8, 210, 212-4, 217-8, 223). Can the US (in the mid 1970s) turn itself into a *laissez-faire* regime like nineteenth-century Britain? No (pp. 116-35, 162, 220, 227). There are several reasons and these will be discussed below. There is a certain melancholy in Buchanan’s work.

If one cannot go back to *laissez-faire* Britain, is there *any* hope of improvement to some third-best situation? Yes. What Buchanan offers is a set of processes for improvement but no vision of the shape of a third-best regime achievable from where he was, in the US in the mid-1970s. Buchanan believed, and still believes, that improvement can be made from almost any *status quo* position by adopting certain *processes*. ‘Politics is a process’; it is a ‘means through which group differences are reconciled’ (p. 3). He puts particular emphasis on starting from the *status quo* and looking for Pareto gains.

When Buchanan wrote *The Limits of Liberty*, however, he thought that some sort of dramatic shift was needed in the US. Once again there is an ambiguity. When Buchanan calls for a ‘genuine revolution in constitutional structure, through generalized rewriting of [the] social contract’, he admits that he seems ‘quasi-utopian’ or ‘visionary’ (p. xvi; see also 1978, pp. 367-8). The reality is that the shift to some new ‘ordered anarchy’ may be a very long way from nineteenth-century Britain, with the total quantity of freedom greatly reduced. Any achievable third-best position seemed to require a big (i.e. revolutionary) shift from where he stood.

Against this background sketch of Buchanan’s ‘ideal’ states, let us go back in order to make a few additional points about the book. Chapters 1 to 4 essentially spell out his response to Hobbes; they show how ‘social order might emerge contractually’ from individuals acting on utility maximization ([1975] 2000, p. 96). Buchanan accepts that there will be ‘perpetual Hobbesian conflict’ until rights are defined (p. 13).²⁷ In *The Limits of Liberty* his conjectural history is as follows. After initial chaos, a sort of equilibrium is reached, called the ‘natural distribution,’ which permits something ‘akin to “property”’ to emerge (pp. 75-6). Next, a disarmament agreement is mutually agreed to, which permits the emergence of “law” of a sort’ (p. 77). This is followed by the constitutional contract in which genuine property rights are established; the state is established to provide order and enforce rights (pp. xv, xvii, 86-8; see p.

²⁷ He also calls this an ‘anarchistic jungle,’ a ‘Hobbesian jungle’ and ‘Hobbesian anarchy’ (p. 77; 1991, pp. 35, 203, 250).

165). '[S]ome "redistribution" of goods or endowments' may be needed in order to establish the initial constitutional agreement over property rights (p. 83; see pp. 78-83). This constitutional stage is fundamentally distinct from the 'postconstitutional contract' which permits 1) exchanging of rights through markets and 2) the creation of non-market contracts which provide public goods as the need arises (pp. xv, 23-4, 36-41, 43-4, 46-68, 88-90).²⁸ Once 'well defined and nonarbitrary' rights are established and these are 'recognized and accepted by participants,' the conditions are established for 'economic interchange'; market exchange is actually 'the archetype of ordered anarchy' (p. 23). Contracting over public goods is complex and we cannot discuss the details here.²⁹ Overall, Buchanan thinks that there are two stages in the social/political contracting process and a categorical distinction must be made between them: the social contract and the postconstitutional contract.

Let me now return to the reasons why one cannot go back to *laissez faire*. Buchanan presents three arguments. First, pragmatism rules the day (p. 220). It was hard to see anything but very minor adjustments from the *status quo* before the Thatcher and Reagan eras. Second, the public does not understand 'the simple principle of *laissez-faire*'; the results from *laissez-faire* are usually better than what is achieved by 'political interference' (p. 117). The 'loss of [economic] wisdom' relative to the 'eighteenth century levels' is profound (p. 117). 'Modern economics must stand condemned in its failure to' keep that wisdom alive (p. 117). There has been a massive forgetting and a need for relearning. Third, the core argument is presented in Chapter 6. He argues that the state has two roles: enforcer of rights and provider of public goods. Buchanan calls the former the 'protective state' and the latter the 'productive state' (pp. 88-9). The former is 'ideally' viewed as 'external' to the 'individuals ... whose rights are involved' and decisions should be based on 'truth judgments' as to whether rights have been breached or not; the latter is 'internal to the community' and choices are based on the values of the citizens, participation, and compromise (pp. 121-3; see p. 90). Buchanan says that the productive state tends to overexpand, especially under unconstrained majority rule (as the logic of Public Choice theory shows) (pp. 128-9, 206).³⁰ As the productive state grows, it requires the protective state to enforce its expansion, including extraction of additional taxation to fund it (even if not fully) (pp. 130-1). The expansion of the state (both functions) tends to undermine the whole social contract (p. 133). (Winding back government is full of difficulties.) Buchanan admits that '[i]n practice' some overlap between the two roles of the state is inevitable but that overlap must be 'minimized' (p. 134). Further, this doctrine of 'separation' of the two roles of the state (p. 134) needs to be supplemented by his view that severe limits *must* be placed on supplying additional public goods through postconstitutional contracting.

²⁸ Two points should be made here. First, public goods are provided under unanimity rules (or near unanimity rules), as seen in assumption 11. Second, Buchanan admits that there is an ambiguity here because law, which is established by the social contract, is also a public good (pp. xv-xvi, 11, 138, 140).

²⁹ Buchanan discusses them in various places, including [1975] 2000, Chapter 3.

³⁰ This Public Choice argument, that majority rule leads to the expansion of the size of the government, was developed by various people and Buchanan seems to have adopted it (see [1975] 2000, pp. 128-9, 206).

There is a fascinating discussion in Chapter 7, 'Laws as Public Capital.' Legally imposed norms are a substitute for ethical norms (pp. 149-50). In the large-number context, however, ethical norms tend to break down (pp. 153-5). Law and law-abiding behaviour are like capital that must be maintained over time. Departures from 'traditionally honoured limits for behaviour' is like 'eating up' capital (p. 160; see pp. 21, 159). This discussion foreshadows much more substantial investigations of ethical norms that he was to undertake a decade or so later (see 1994).

Throughout the book Buchanan has reminded us that the state helps to end disorder but it is also a threat to freedom; this theme reaches a peak in Chapter 9, 'The Threat of Leviathan.' Drawing on conclusions from Public Choice theory, he says that 'budgetary excess will emerge from democratic process' ([1975] 2000, p. 206). Buchanan is concerned with the tendency of the government sector (especially under democratic rule) to expand, thus crowding out space for anarchy. His book ends, as I stated, in Chapter 10 with a call for a 'renegotiated social contract' that puts 'the Leviathan that threatens ... within new [tighter] limits' (p. 228). Both Public Choice and Buchanan's Constitutional Political Economy (see Section 7) are insistent on the need to roll back the state.

Also spread throughout the book is Buchanan's stress on process rather than outcomes. A defining example of this is his view of distributive justice. Unlike Aristotle, Rawls, and many others, Buchanan rejects the notion of distributive justice, where this is defined as some sort of predetermined outcome that differs from what the original endowments, assigned rights (including property rights), and exchange delivered through market processes. For Buchanan, the whole notion of distributive justice represents a confusion between the constitutional and the postconstitutional contract (pp. 67-8, 101, 111).

In *The Limits of Liberty* Buchanan writes in a range of voices: quasi-utopian, melancholic and reformist. Nevertheless, he retains throughout his long life his melancholic view of nineteenth-century Britain as the golden age. Buchanan also retains his 'constructivist' desire to engineer some improvement (1991, pp. 100, 231-6; Buchanan and Wagner 1978, p. 634; cf. Hayek 1973, 1976, 1981). He held that some sort of third-best but ethical state can be constructed through rewriting the social contract.

7. CONSTITUTIONAL POLITICAL ECONOMY

As stated earlier, *The Limits of Liberty* failed to gather much support. Nevertheless, Buchanan built on that foundation. He developed a related research programme called constitutional political economy.³¹ This approach to economics focuses on evaluating the rules of the game, the constitutional rules, in which regular politics and markets operate. It is, in Buchanan's view,

³¹ In one place Buchanan says that the fundamental assumptions of constitutional economics are assumptions 2, 3, 5 and the unanimity test in assumption 11 (1987c, pp. 586-7). Elsewhere, he says that the key assumptions are assumptions 2, 6, and 10 (1991, pp. 15-6).

a restoration of the interest in the comparison of institutional constraints evident in Adam Smith, and more recently in the socialist calculation debates ‘in the decades before World War II’ (1987c, pp. 585). In some works Buchanan presents what he takes to be the broadly held positions within the field that he created and at other times he states his own (idiosyncratic) view. This is confusing. Let me start by commenting on what the field is and why rules matter.

Buchanan says that rules are the product of chance, social evolution and deliberate choice or constructivism (1991, pp. 4-5). Buchanan’s constructivism is focused on the ‘choice among constraints,’ or the ‘selection of rules, or institutions, that will, in turn, limit the behaviour of persons who operate within them’ (1991, pp. 5, 8). This seems to be the general view of those in the field. He thinks that ‘institutions of both the economy and the polity’ belong ‘to an inclusive constitutional order’ (1991, p. 40). Buchanan’s focus on institutions is consistent with his long established preference for focusing on processes (recall discussion in Section 6). It is here where Buchanan may differ from some others in his own field. Buchanan sees the economy as a potential type of ordered anarchy; his view of ‘the economy as an order of interaction constrained within a set of rules or constraints leads more or less directly to a normatively preferred minimal intervention with the results of such interaction’ (1991, p. 36). Once the constitutional order is seen in this way, focusing on processes (on means), there appears to be complete indifference to outcomes.

Undesirable outcomes, however, can lead to examination of different rules and ‘constitutional-institutional change’ (1991, p. 40). The choice of institutions must allow individuals ‘to live in social order without conflict while at the same time achieving tolerably acceptable levels of well-being’ (1991, p. 231). Similarly, in presenting a case for constitutional reform, Buchanan argued that he is an institutionalist to a degree because he thinks that ‘arrangements or rules do affect outcomes’; irreparable damage due to government budget deficits can be prevented if action is undertaken soon (Buchanan and Wagner 1978, p. 636). Thus, outcomes do matter but changes in the rules (designed to improve outcomes) must be rare (otherwise the rationale for rules collapses). I will return to the economic constitution shortly but now let me turn to *how* we choose.

Buchanan says that we can only choose by agreement. ‘[T]here is no external standard’ from where we are now; there is no set of constraints that is “objectively” best’ i.e. in the third-best world (1991, p. 240). One approach to promoting agreement that Buchanan advocates is Rawls’s: one must choose behind the Rawlsian ‘veil of ignorance.’ Recall that one general rule that Rawls derived from the ‘veil of ignorance’ approach was maximal equal liberty.

Next, I will turn to some results from Buchanan’s work on the choice of rules, starting with his evaluation of four grand institutional types --socialism, mercantilism, minimal government (close to *laissez-faire*), and the modern welfare state. Like many ‘classical’ liberals after World War II, Buchanan spent some time analyzing and critiquing state socialism. Recall Buchanan’s view that constitutional political economy leads to a preference for minimal intervention once processes are selected. State socialism rejects the whole focus on ordered anarchy, minimal intervention, constitutional processes, and so on. In a relatively recent work, Buchanan defended

private property as a means of securing freedom (Buchanan 1993). Toward the end of that work, Buchanan explicitly considers socialism. By denying legitimacy to private property, socialism undermined freedom. ‘There is no exit option’ from ‘exploitation by collectivized authority’ (1993, p. 47). The encroachments of socialism exhaust freedom. Hence, it is morally bad.

Buchanan also provides some insights into his evaluation of commercial/capitalist systems in historical perspective. It is well known that Adam Smith described the system of regulation evident in his time as ‘mercantilist.’ Buchanan calls mercantilism a ‘highly politicized’ economy, by which he means that it was a highly regulated system where considerable ‘rent seeking’ occurred (1987c, p. 585).³² Buchanan says that, ‘in the late 18th and early 19th centuries,’ the British economy ‘was effectively depoliticized,’ meaning that a period of limited government, or *laissez-faire*, began. As stated above, this is a sort of golden age in Buchanan’s view. Then ‘from the mid-19th through the mid-20th century, control over economic decision making was transferred to the public sector without an understanding of how politics works’; ‘politicization proceeded apace’ for a century (1987e, pp. 1, 6). Finally, in the period after World War II, in various capitalist countries, the welfare state emerged. This type of system, of course, Buchanan discusses at length. He regards it as a sort of reincarnation of the mercantilism of Smith’s day (see 1976, pp. 277-9; 1991, p. 35 n.9). This cycle of varieties of commercial/capitalist societies is also an ethical cycle.

Although constitutional economics does discuss these grand institutional types, the focus is on contemporary capitalism (especially the US type). In his entry in *The New Palgrave*, Buchanan mentions a range of applications of constitutional political economy, the most relevant of which can be grouped together under the heading ‘the economic constitution’ (1987c, pp. 587-8). Such a constitution must include a monetary rule (ensuring stability in the purchasing power of money), limits on welfare payments and on government spending above its revenue (Buchanan and Wagner [1977] 2000, pp. 9, 182-93; Buchanan and Wagner 1978, pp. 634-5; Buchanan 1986, pp. 193-4; 1987c, pp. 587-8; 1993, pp. 44-5, 56, 59).³³

In the remainder of the section I will focus on the balanced-budget provision because it was probably the primary policy goal of his life (see 1995). A full discussion of Buchanan’s views on debt-financed deficits requires perhaps eight steps.³⁴ In what follows I will state three

³² Rent is a return above the opportunity cost. Profit-seeking in the private sector may yield temporary rents but these will be competed away, provided that there is no impediment to competition. By the term ‘rent seeking,’ Buchanan has in mind activity to achieve special privilege through various aspects of politics; rent-seeking is related to ‘the size of the public sector’ (see Buchanan 1980, pp. 3, 9).

³³ Buchanan mentions three other applications of constitutional economics: the choice of taxation base; regulatory constitutions; and the organization of public enterprises (1987c, p. 588).

³⁴ I am in broad agreement with the analysis of Tempelman 2007, who lists seven propositions that emerge from Buchanan’s work on public debt. I have split Tempelman’s fourth proposition on Keynesian macroeconomics into two. Apart from the four propositions discussed in the text, there are four others: Victorian Britain had an effective fiscal norm that held budget deficits to be immoral; Keynesianism undermined this norm; public debt will be permanent without a replacement for the Victorian norm; and public debt financing is immoral because it places a

preliminary propositions and then jump to the final one. The middle of the argument will have to wait for another occasion.

The first proposition, deriving from positive analysis, is that *future* rather than current taxpayers bear the burden of today's public debt (1958, pp. 31-47, 114-22; 1964b, pp. 486-7; 1964c, p. 49; 1964d, pp. 60-2; Buchanan and Wagner 1978, p. 629; Buchanan 1987b, p. 182; 1987d, p. 372; see Tempelman 2007, pp. 436-40). The second positive proposition is that, given that most of the public expenditure since World War II has been used for consumption rather than for infrastructure (and other capital), public debt has a negative effect on capital accumulation and on the net wealth (1986, pp. 180-5, 192-3; [1986] 2000, p. 447; see Tempelman 2007, pp. 438-9). Debt is 'equivalent to "eating up" of capital' (1987b, p. 182; see 1986, p. 180). The third proposition is that people suffer from 'fiscal illusion' and prefer debt to taxation (1964e, p. 161; Buchanan and Wagner 1978, p. 629; see Tempelman 2007, p. 440).³⁵

Given these propositions, and the Public Choice conclusion that democratic politicians are biased towards public deficits (1986, pp. 179; Buchanan and Wagner [1977] 2000, pp. 4, 26, 95-6), restraints must be imposed on the actions of politicians. Buchanan believes that the prohibition on deficits is another of those rules of the game that people would support behind a Rawlsian 'veil of ignorance.' As he stated in his Nobel Prize address, '[i]t is almost impossible to construct a contractual calculus in which representatives of separate generations would agree to allow majorities in a single generation to finance currently-enjoyed public consumption through the issue of public debt that insures ... utility losses on later generations of taxpayers' (1987a, p. 343; see 1987d, pp. 368-9, 372).³⁶

As he develops his constitutional research programme, Buchanan builds on the observations made in *The Limits of Liberty* that legal approaches to problems are really only substitutes for unwritten, cultural norms. This 'turn' in his work to cultural norms begins in 1986.³⁷ While Buchanan's work continued on constitutional legal rules, his focus gradually shifted to culture (although some work contained both elements).

burden on later generations, even though they could not participate in the deliberations leading up to the imposition of the burden (see Tempelman 2007). I hope to discuss the ethics of public debt on another occasion.

³⁵ According to Buchanan, people lack clear-sighted expectations of the future (rational expectations); in this instance Buchanan is clearly out of step with modern macroeconomics (but in tune with contemporary psychology). In one place (Buchanan 1964c), he argues that there is a 'burden,' even without fiscal illusion.

³⁶ Buchanan makes the same claim about the modern welfare state: its transfer programs amount to an implicit debt obligation (1987a, p. 343).

³⁷ Buchanan says that 1986 was the year that marked the 'full development of [his] interest in the economics of ethical norms' (1994, p. 91).

8. CONCLUSION

Buchanan sees everything in term of exchange and potential gains from trade. It is *the* paradigm within which he thinks. Buchanan recognizes at least five types of economists: socialists, Keynesians, regular neoclassicals and two types of classical liberals (allocationists and gains from trade types). His approach to economics is to focus on processes (gains from trade). Buchanan says that many of his opponents focus on outcomes (efficient resource allocation, maximizing utility, etc). Buchanan denies that there can be any such thing as what Sen calls ‘social achievement’ which is based on outcomes (Sen 1987, p. 4).

At times, exchange (and ‘gains from trade’) becomes a sort of fetish in Buchanan’s work. Contracts, private property, and an enforcing agency are three of the means needed to secure the gains from trade. While Buchanan’s vision of the market seems to be just a different emphasis from mainstream economists, it is clear that he does not accept that there are any social aggregates to maximize. This difference becomes clearer when Buchanan applies his frame of reference to politics. Buchanan’s focus on exchange in politics inevitably leads to constitutional contract.

The contract must provide benefits to the principals, the citizens. The constitutional rules are designed to ensure benefits are delivered by the state and costs of running the state are minimized (limits on the power of the state must be set). Constitutional political economy is the embodiment of Buchanan’s work. The focus is on written, formal constraints on behaviour, such as the balanced-budget constitutional proposal. This was the one policy on which he actively campaigned during his career. His one entry into the ‘fury’ of policy debate has been a failure. Formal, written rules are alternatives to customs and other informal constraints. These also are addressed by Buchanan in his later work. I hope to addresses these ethical norms more fully soon.

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