James M. Buchanan,
Citizens for a Sound Economy,
Washington, D.C., November 1986
The Collected Works of
James M. Buchanan

Volume 16
Choice, Contract, and
Constitutions

Liberty Fund
Indianapolis
This book is published by Liberty Fund, Inc., a foundation established to encourage study of the ideal of a society of free and responsible individuals.

The cuneiform inscription that serves as our logo and as the design motif for our endpapers is the earliest-known written appearance of the word "freedom" (amagi), or "liberty." It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.
## Contents

**Foreword** \(\text{xi}\)

### 1. Foundational Issues

- Constitutional Economics \(\text{3}\)
- A Contractarian Perspective on Anarchy \(\text{15}\)
- The Contractarian Logic of Classical Liberalism \(\text{28}\)
- Constitutional Restrictions on the Power of Government \(\text{42}\)
- Contractarian Political Economy and Constitutional Interpretation \(\text{60}\)
- Justification of the Compound Republic: The *Calculus* in Retrospect \(\text{68}\)

### 2. The Method of Constitutional Economics

- A Contractarian Paradigm for Applying Economic Theory \(\text{79}\)
- Boundaries on Social Contract \(\text{87}\)
- Constitutional Design and Construction: An Economic Approach \(\text{101}\)
- The Use and Abuse of Contract \(\text{111}\)

### 3. Incentives and Constitutional Choice

- Constitutional Choice, Rational Ignorance and the Limits of Reason (Viktor J. Vanberg and James M. Buchanan) \(\text{127}\)
How Can Constitutions Be Designed So That Politicians Who Seek to Serve “Public Interest” Can Survive and Prosper? 148

Interests and Theories in Constitutional Choice (Viktor Vanberg and James M. Buchanan) 155

Student Revolts, Academic Liberalism, and Constitutional Attitudes 172

A Theory of Leadership and Deference in Constitutional Construction (James M. Buchanan and Viktor Vanberg) 185

Individual Rights, Emergent Social States, and Behavioral Feasibility 201

4. Constitutional Order

Contractarianism and Democracy 215

Democracy within Constitutional Limits 225

5. Market Order

[Untitled] 237

The Minimal Politics of Market Order 253

6. Distributional Issues

Distributional Politics and Constitutional Design 267

Political Constraints on Contractual Redistribution (James M. Buchanan and Winston C. Bush) 277

Subjective Elements in Rawlsian Contractual Agreement on Distributional Rules (James M. Buchanan and Roger L. Faith) 285

7. Fiscal and Monetary Constitutions

Procedural and Quantitative Constitutional Constraints on Fiscal Authority 307
8. Reform

The Economic Constitution and the New Deal: Lessons for Late Learners 339
Sources of Opposition to Constitutional Reform 356
Achieving Economic Reform 372
Pragmatic Reform and Constitutional Revolution *(James M. Buchanan and Alberto di Pierro)* 384
Lagged Implementation as an Element in Constitutional Strategy 398
Prolegomena for a Strategy of Constitutional Revolution 417
The Structure of Progress: National Constitutionalism in a Technologically Opened World Economy 428
Notes on the Liberal Constitution 439
Dismantling the Welfare State 449

Name Index 459
Subject Index 462
Constitutional political economy is a theme that runs throughout the Collected Works of James M. Buchanan. As such, it has already been discussed considerably in other volumes, for example, in volumes 1, 3, and 10 of the series, *The Logical Foundations of Constitutional Liberty*, *The Calculus of Consent*, and *The Reason of Rules*, respectively.\(^1\) For this reason a briefer introduction to this volume of Buchanan’s more selective contributions to this topic should be sufficient to pique the reader’s interest in exploring more closely this important aspect of Buchanan’s work.

Buchanan literally founded the field of constitutional political economy. He insisted that there are two important levels of analysis in economics. Standard economic theory is about how given institutions and rules lead to predictable outcomes (for example, competitive equilibrium) in the economy. In contrast, constitutional political economy, to Buchanan, concerns the prior problem of how the given rules and institutions themselves are chosen. One might easily think of a sports analogy wherein the rules of play are selected prior to the actual playing of the game. Such choices are in many senses constitutional. They are quasi-permanent and long-lived, they are made by decision makers who may not be able to figure out how their choice of rules will ultimately affect them personally during the play of the game, and they have profound importance in terms of their impact on the subsequent productivity of the economy and society.

Buchanan’s insistence on the importance of rules was an important in-

---

novation in economics, and, over the past thirty years or so, the analytical
and empirical relevance of Buchanan’s constitutional perspective has become
apparent. The failure of socialism, the postsocialist groping of new nation-
states for social and economic orders, the keen interest of modern economists
in the impact of institutions on economic growth, and the worldwide move-
ment to devolve power away from central states are just a few examples of the
relevance of Buchanan’s research program.

A central element in Buchanan’s approach to constitutional economics is
the emphasis upon agreement as the essence of rule making. Here he draws
upon traditions in welfare economics and in contractarian political philos-
ophy. In this approach, agreement among individuals is paramount. There is
no external test for what is right or wrong or best or true: It is the agreement
of deliberating individuals that counts. These individuals may or may not
heed the advice of “experts” with respect to which rule works “best,” but ul-
timately it is their choice that matters and not the opinion of the expert.
There is no “truth” to be discovered in this process, only agreement about
how to proceed. Moreover, the “agreement” in Buchanan’s approach should
be broad-based, or Pareto-like, and one of the interesting problems of con-
stitutional economics is how to promote choice processes in which broad-
based agreement can be reached.

Buchanan’s work in constitutional political economy is but the first step.
He has established an intellectual tradition by inducing economists and other
scholars to take the constitutional problem seriously. The papers in this and
other volumes of his Collected Works suggest the nature of the problem, some
ideas and methods by which the problem can be approached, and some of
its possible applications, especially in the area of fiscal and monetary rules.
Constitutional political economy will clearly be one of Buchanan’s legacies,
and as this area increasingly attracts young economic and political theorists,
the face of modern economics will be changed.

The volume begins in part 1 with several essays that address the definition
of constitutional economics. The papers in part 2 expand upon the method
of constitutional economics and its links to contractarian traditions in po-
litical philosophy. The essays in part 3 address the issue of how individual
incentives can be made compatible with the process of constitutional deci-
sion making. The papers in parts 4 and 5 address the meaning of constitu-
tional order, as well as how the market process can be interpreted as a type
of constitutional order. The papers in part 6 consider how distributional issues can be handled in a constitutional decision-making process. The papers in part 7 apply the constitutional economics paradigm to fiscal and monetary rules. Finally, the papers in part 8 explore the prospects for genuine constitutional reform of democratic institutions.

Buchanan taught us that how we organize a society to produce is just as important as what and how the society produces. In retrospect this seems to have been a simple change of emphasis. But Monday morning quarter-backing pays low wages. It was Buchanan who saw the world through this window and figured out why and how constitutional political economy is so important.

Robert D. Tollison
University of Mississippi
1998
PART ONE

Foundational Issues
Constitutional Economics

The term *Constitutional Economics* (Constitutional Political Economy) was introduced to define and to classify a distinct strand of research inquiry and related policy discourse in the 1970s and beyond. 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. Both areas of inquiry involve positive analysis that is ultimately aimed at contributing to the discussion of policy questions. The difference lies in the level of or setting for analysis which, in turn, implies communication with different audiences.

Orthodox economic analysis, whether this be interpreted in Marshallian or Walrasian terms, attempts to explain the choices of economic agents, their interactions one with another, and the results of these interactions, within the existing legal-institutional-constitutional structure of the polity. Normative considerations enter through the efficiency criteria of theoretical welfare economics, and policy options are evaluated in terms of these criteria. The policy analyst, building on the analysis, presents his results, whether explicitly or implicitly, to the political decision-makers, who then make some ultimate determination from among the available set. In this role, the policy analyst, directly, and the theorist, indirectly, are necessarily advising governmental decision-makers, whoever these may be.

By both contrast and comparison, constitutional economic analysis

attempts to explain the working properties of alternative sets of legal-institutional-constitutional rules that constrain the choices and activities of economic and political agents, the rules that define the framework within which the ordinary choices of economic and political agents are made. In this sense, Constitutional Economics involves a “higher” level of inquiry than orthodox economics; it must incorporate the results of the latter along with many less sophisticated subdisciplines. Normative considerations enter the analysis in a much more complex manner than through the artificially straightforward efficiency criteria. Alternative sets of rules must be evaluated in some sense analogously to ranking of policy options within a specified institutional structure, but the epistemological content of the “efficiency” criteria becomes more exposed.

The constitutional economist, precisely because the subject matter is the analysis of alternate sets of rules, has nothing to offer by way of policy advice to political agents who act within defined rules. In this sense, Constitutional Economics is not appropriately included within “policy science” at all. At another level, however, the whole exercise is aimed at offering guidance to those who participate in the discussion of constitutional change. In other words, Constitutional Economics offers a potential for normative advice to the member of the continuing constitutional convention, whereas orthodox economics offers a potential for advice to the practising politician. In a real sense, Constitutional Economics examines the choice of constraints as opposed to the choice within constraints, and as this terminology suggests, the disciplinary attention of economists has almost exclusively been placed on the second of these two problems.

A preliminary illustration of the distinction may be drawn from the economics of monetary policy. The constitutional economist is not directly concerned with determining whether monetary ease or monetary restrictiveness is required for furthering stabilization objectives in a particular setting. On the other hand, he is directly concerned with evaluating the properties of alternative monetary regimes (e.g., rule-directed versus discretionary, fiat versus commodity standards). The ultimate objective of analysis is the choice among the institutions within which political agents act. The predicted behaviour of these agents is incorporated in the analysis of alternative sets of constraints.
I. Constitutional Economics and Classical Political Economy

As suggested, Constitutional Economics is related to classical political economy, and it may be considered to be an important component of a more general revival of the classical emphasis, and particularly as represented in the works of Adam Smith. (The closely related complementary components are discussed briefly in section III.) One obvious aim of the classical political economists was to offer an explanation and an understanding of how markets operate without detailed political direction. In this respect, orthodox neoclassical economics follows directly in the classical tradition. But the basic classical analysis of the working of markets was only a necessary step toward the more comprehensive purpose of the whole exercise, which was that of demonstrating that, precisely because markets function with tolerable efficiency independent of political direction, a powerful normative argument for constitutional structure exists. That is to say, Adam Smith was engaged directly in comparing alternative institutional structures, alternative sets of constraints within which economic agents make choices. In this comparative analysis, he found it essential to model the working properties of a non-politicized economy, which did not exist in reality, as well as the working properties of a highly politicized mercantilist economy, which could be directly observed.

There is no need here to enter the lists on either side of the “ideas have consequences” debate. We know that the economy of Great Britain was effectively de-politicized in the late 18th and early 19th centuries, and from the analysis of Smith and his classical fellow travellers there emerged both positive understanding of economic process and philosophical argument for a particular regime. The normative argument for laissez faire was, perhaps inevitably, intermingled with the positive analysis of interaction within a particular structure of constraints, essentially those that describe the minimal, protective, or night-watchman state. Economics, as a social science, emerged, but in the process attention was diverted from the institutional structure. Even the predicted normative reaction against the overly zealous extension of the laissez faire argument was couched in “market failure” terms, rather than in the Smithian context of institutional comparison. The early socialist critique of market order, both in its Marxist and non-Marxist variants, was almost
exclusively negative in that it elaborated putative failures of markets within an unexamined set of legal-political rules while it neglected analysis of the alternative rules that any correction of the alleged failures might require. Only with the debates on socialist calculation in the decades prior to World War II did the issues of comparative structure come to be examined.

It was only in the half-century after these debates that political economy, inclusively defined, returned, in fits and starts, to its classical tradition. Given the legal order of the protective state (the protection of property and the enforcement of contracts), we now know that under some conditions “markets fail” when evaluated against idealized criteria, whether these be “efficiency,” “justice,” or other abstract norms. We also know that “politics fails” when evaluated by the same criteria. 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.

II. Constitutional Economics and Social Philosophy

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 economists. By their focus directly on the ultimate selection of a set of constraining rules within which ordinary social interaction takes place, constitutional economists remove themselves at least one stage further from the false position of “social engineer” than their counterparts in orthodox economics. Precisely because there is no apparently simple evaluative criterion analogous to “allocative efficiency” at hand, the constitutional economist is less tempted to array alternatives as if an unexamined criterion commands universal assent. The artificial abstraction of “social utility” is likely to be less appealing to those who concentrate on choices among constraints than to those who examine choices within constraints.