

## Summary of “The Constitution of Economic Policy” by James Buchanan

The article is the lecture delivered by the author in Stockholm in 1986 when he received the Nobel Prize. Throughout the lecture he makes references to “that great Swede” Knut Wicksell.

Buchanan starts the lecture by sharing a story from his life. In 1948 he discovered Wicksell’s untranslated dissertation “Finanztheoretische Untersuchungen” and he took on the determination to make Wicksell’s contribution known to a wider audience.

Wicksell’s message, in the eyes of Buchanan, was clear: Economists should stop proffering policy advice as if they were adopted by a benevolent planner; rather they should take the political structure into account. Buchanan called upon economists to develop a theory of the state.

Already in Wicksell’s dissertation, we find all three of the constitutive elements of the public choice theory. These are: methodological individualism, homo economicus [sic],<sup>1</sup> and politics-as-exchange.

### Methodological Individualism

Economists presume individuals to be able to choose and do not inquire deeply into individuals’ preferences (the arguments in the utility function). The task of economists is to offer explanation-understanding of the process through which these preferences translate into a complex outcome pattern. It has led to economics as a positive science, independent of evaluating preferences.

The individual who chooses between apples and oranges is the same individual who chooses between Candidate A and Candidate B. Both of the choosing is equally subject to the application of economic analysis.

### Homo Economicus

The same rules apply for political “goods” as for the traditional goods. If oranges get relatively cheaper, people will buy more of them. If charitable gifts are made tax deductible, people will give more, *ceteris paribus*.

The criticism of the “economic theory of politics” as net wealth maximization misrepresents the theory as the theory does not state what the “goods” for individuals really are; they can be net wealth, income, social position etc.

### Politics as Exchange

Markets are institutions of exchange and individual choosers do not take aggregate outcomes (some overall allocation or distribution) into account. Traditionally, it was viewed that in politics individuals

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<sup>1</sup> I shall note here that, as far as I know, the correct Latin spelling is “oeconomicus”. However, it seems that economists have settled with “economicus”.

search for the good, the true, and the beautiful, but Wicksell would have none of it. The difference between politics and economics does not lie in the values that persons pursue but in the conditions under which they pursue them.

In the market, individuals exchange apples for oranges; in politics, individuals exchange agreed-on shares in contributions toward the cost of that which is commonly desired.

As for coercion: Individuals acquiesce in the coercion of the state only if the ultimate constitutional “exchange” furthers their interests.

### **The Constitution of Economic Policy**

There is no criterion through which policy may be directly evaluated and therefore there are severe restrictive implications for a normative theory of economic policy. The focus becomes the process itself (the reform of the rules) instead of the end-state outcome (the strategies within the rules).

The political analogue to decentralized trading is *agreement* (unanimity), barriers to which are incorporated into a generalized “calculus of consent.” This requirement proves too strict and rigid and individuals will agree that it applies only for constitutional changes as long as they see that on aggregate this constitution furthers their interests even though there are minor results opposed to his interests.

### **Constitutionalism and Contractarianism**

The individuals thus operate behind a veil of uncertainty, something akin to the veil of ignorance, a familiar construction by John Rawls. If the veil is sufficiently thick, fiscal transfers seem clearly to be possible.

We do not observe the process of reaching agreement on constitutional rules; the purpose of the contractarian exercise is not explanatory, it is justificatory because it offers a basis for normative evaluation. If the observed rules could have emerged from agreement in constitutional contract, we have established a legitimating linkage between the individual and the state. If they could not, we have a basis for normative criticism of the existing order and a criterion for advancing proposals for constitutional reform.

What follows: It is almost impossible to construct a contractual calculus in which representatives of separate generations would agree to enjoy public consumption through the issue of public debt in the earlier generation that insures the imposition of utility losses on later generations of taxpayers. The same applies for implicit debt.