

**0610**  
**PUBLIC CHOICE, CONSTITUTIONAL  
POLITICAL ECONOMY AND LAW AND  
ECONOMICS**

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**Abstract**

The various subdisciplines within the emerging 'new institutionalism' in economics all draw special attention to the legal-political constraints within which economic and political agents choose and therefore represent a return of economics to its appropriate legal foundations. By changing the name of his research programme to constitutional political economy Buchanan distanced himself from those parts of the public choice literature that remained too close to the traditional welfare economics approach. This chapter draws lessons for law and economics from recent developments in the re-emerging field of constitutional political economy. CPE compares alternative sets of institutional arrangements, in markets and the polity, and their outcomes, using 'democratic consent' as an internal standard of comparison. The chapter discusses the methodological foundation of the CPE approach, presents Buchanan's reconstruction of the Coase theorem along subjectivist-contractarian lines and gives an overview of recent contributions to the literature.

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**A. The Manifold Legacy of Adam Smith**

**1. Introduction**

As the title of this chapter suggests, the new law and economics movement on the one hand and the now rapidly emerging field of constitutional political economy - as well as the somewhat older public choice branch of economics from which it emerged - on the other hand, are research traditions that are in some respects genuinely related. In other respects the differences between them are sufficiently important, however, to warrant a more or less detailed discussion.

Both exemplify the 'extension' of economics beyond its traditional boundaries - from market to non market behaviour - and both belong to a set of subdisciplines that draw special attention to the legal-political constraints within which economic and political agents operate. Both constitute complementary facets of the emerging 'new institutionalism' in economics.

Both may have drawn substantial inspiration from the encompassing theoretical perspective and the reformist attitude that were characteristic of Adam Smith's approach. Indeed, CPE can be considered to be an important component of a more general revival of the classical emphasis, particularly as represented in the works of Adam Smith. Among the various approaches to the new economic institutionalism, constitutional economics is probably the one that comes closest to what in Adam Smith's time was called 'moral philosophy'. It seeks to bring closer together again the economic, social, political, philosophical and legal perspectives that were once part of the study of moral philosophy, and which the process of specialization in modern academia has fragmented into separate fields. Buchanan's constitutional economics is the modern-day counterpart to what Smith called 'the science of legislation', an academic enterprise that is concerned with a comparison of the working properties of alternative sets of rules, and ultimately aims at guiding our efforts to improve the social order in which we live by improving 'the rules of the game'.

On the other hand, Coase, in his 1991 Nobel Memorial Lecture (Coase 1992, p. 713), made the claim that during the two centuries since the publication of *The Wealth of Nations*, the main activity of economists - including, by implication, a very substantial part of his own work - had been to fill the gaps in Adam Smith's system, to correct his errors, and to make his analysis vastly more exact.

The new law and economics field is usually said to have started in the early 1960s, when Guido Calabresi's first article on torts and Ronald Coase's article on social cost were published (Calabresi 1961; Coase 1960). Coase's article was without any doubt the more significant for the long-run development of the new law and economics field.

Modern public choice - or the economics of politics - is usually said to have been founded by such classics as Black (1958) - following earlier papers published in the late 1940s and early 1950s - Arrow (1951), Downs (1957) and the precursory inquiries in Schumpeter (1942) - though elements of public choice analysis can already be found in the work of Pareto (see Backhaus, 1978). The major breakthrough, however, came with Buchanan and Tullock (1962). *The Calculus of Consent* was a seminal work in several respects. The public choice perspective is usually characterized as combining two distinct elements: the extension of the economist's model of utility-maximizing behaviour to political choice and the conceptualization of

'politics as exchange'. The *Calculus* was the first book that integrated these two elements into a coherent, logical structure. Moreover, the *Calculus* differed from the precursory works in that it embodied justificatory argument. It sought to outline, at least in very general terms, the conditions that must be present for an individual to find it advantageous to enter into a political entity with constitutionally delineated ranges of activity or to acquiesce in membership in a historically existing polity. It was recognized that, if one remains within the presuppositions of methodological individualism, the state or the polity must ultimately be justified in terms of its potential for satisfying individuals' desires (see also Buchanan, 1987, p. 133).

Furthermore, *The Calculus of Consent* confronted the market failure presumption of the new welfare economics by demonstrating that the problems associated with markets were ubiquitous, indeed entered into the calculus of political consent arguably with far greater significance because of the indivisibility of collective action (Rowley, 1993, p. xiii; Goetz, 1991, p. 10). The market failure concepts were applied evenhandedly to the alternative institutional arrangements, especially those of political control, and for the first time various policy arguments could benefit from a consistent and balanced approach.

Finally, the *Calculus* contained the germs of the recent development of the research programme of constitutional political economy. It seems that Tullock's complaint about the lack of further research along the lines suggested in the *Calculus* was premature (Tullock, 1987, p. 139). The boundary between public choice, in its non-constitutional aspects of inquiry, and constitutional political economy may seem somewhat fuzzy. It is generally considered that public choice, in which attention is concentrated on analyses of alternative political choice structures and on behaviour within those structures is, through its focus on predictive models of political interactions, a preliminary but necessary stage to the more general constitutional inquiry.

On the other hand, law and economics remains somewhat closer to orthodox economic theory than either constitutional economics or public choice. The standard efficiency norm remains central to the law and economics subdiscipline, both as an explanatory benchmark and as a normative ideal.

The complex relationships between law and economics and public choice were carefully analysed in (Rowley, 1989). A masterly survey of the public choice literature is contained in Mueller (1989). Equally recommendable is Rowley's (1994) essay on 'Public choice economics' in Boettke (1994). In the present chapter we propose to draw some lessons for law and economics from recent developments in the re-emerging field of constitutional political economy.

At a time of major worldwide constitutional change, it will come as no surprise that the focus of public choice discussion is shifting away from ordinary political choices to the institutional-constitutional structure within which politics takes place.

## 2. Leading Journal

The leading journal of the sub-discipline is *Constitutional Political Economy*. Some preliminary and intuitive understanding of what CPE is all about can be gained from explaining the logic behind the logo of the journal, which is drawn from Greek mythology. CPE's logo is a representation of the familiar Homeric account of how Ulysses heard the Sirens singing, and survived (see Brennan and Kliemt, 1990). Ulysses wanted to hear the exquisite voices of the Sirens. He was passing close by and, in principle, there was nothing to prevent him from listening to them while continuing his journey. However, he recognized that the power of these voices was such that he would steer the ship ever closer to the rocks where the Sirens were located. The ship would be wrecked and he would be unable to continue his journey.

Formally, Ulysses faced a problem of time inconsistency in his optimal plan. His optimal plan was to listen to the Sirens and then continue his journey. But this was time inconsistent, because once he had embarked on the plan by listening to the Sirens he would not be able to implement the later part of the plan, the rest of his journey. By contrast, a time consistent optimal plan is one that specifies a sequence of actions ( $A_t$ ,  $A_{t+1}$ ,  $A_{t+2}$  and so on), one for each moment in time ( $T$ ,  $T+1$ ,  $T+2$  and so on), which enjoys the property that the individual will actually choose in each time period the action specified by the plan. Thus, when  $T+1$  occurs, having undertaken  $A_t$  in  $T$ , the individual will still choose  $A_{t+1}$  as the best action rather than some other, and so on.

The time-inconsistency arises because the Sirens affect Ulysses' preferences. His perception of the best action changes in the middle of the plan and this leads him to deviate from the original version. Ulysses implemented his optimal plan by denying himself freedom at the later stage of the plan. Having instructed his men to tie him to the mast and to ignore any orders to do anything other than sail past the rocks, he told them to plug their ears and row.

Thus, Ulysses established for himself a private constitution, a set of more or less binding rules that constrained his future choices. By exploiting elements of his natural and social environment, Ulysses was able to subvert certain inclinations of his future self, inclinations that he knew would be

destructive to his overall interests but which would nevertheless prove irresistible when they arose.

Though the theory of private constitution is a - small - part of the domain of constitutional political economy (Buchanan, 1990, p. 3), the principal issue for constitutional political economy is that of forming a mutually agreeable constitution for social arrangements among a community of persons. Ulysses is therefore to be seen not merely as a single actor but more particularly as representing society as a whole, and the mast and rope are to be identified as the rules by which ordered society is governed.

As Brennan and Kliemt (1990, p. 125) point out, some care must be taken in interpreting any such image. Following the individualist methodology, 'social action' must be decomposed into the actions of the individuals of whom society is made up. The exercise of social binding, specifically, must be seen as an intrinsically multilateral activity. Each agrees to a set of rules and procedures because this is the price each must pay to restrict the conduct of others. 'Weakness of the social will' will arise precisely because it is opportunistically rational for any individual to depart from the collectively agreed rules and procedures.

Moreover, in the setting with which CPE is concerned, there is no external technology available that is totally effective or not excessively costly. The tools of enforcement and maintenance must themselves be socially constructed. Human beings are not bound by nature to pursue rules: they are endowed with the capacity to deviate from rules if it is profitable to do so. Accordingly, we must search out rules which so order individuals' behaviour that it is individually profitable for most people to keep and enforce those rules most of the time. The gains from violation should not be too great. The analysis of the kind of rules and the associated institutional apparatus that exhibit these properties represents a centrepiece of constitutional political economy as an area of inquiry.

As far as dynamic choice theory in the strict sense is concerned, mention must certainly be made of the promising and in-depth analysis of the problem of dynamic consistency offered in McClennen (1990a). McClennen develops his argument in the context of a critical examination of the principles that constitute the cornerstone of the modern theory of expected utility and subjective probability: the weak ordering and the independence principles. McClennen argues for an alternative to the myopic and sophisticated approaches to the problem of dynamic consistency: the theory of resolute choice. The resolute chooser achieves dynamic consistency by regimenting ex post choice to his ex ante evaluation of plans, thus achieving a 'cooperative arrangement' between his present self and his relevant future selves that satisfies the principle of intrapersonal optimality. Technically speaking, resolute choice characterizes a commitment to dynamic

consistency (DC) and normal-form/extensive-form coincidence (NEC) at the expense of separability (SEP). Reference should also be made to McClennen (1993).

The problem of time inconsistency is addressed formally in Klein (1990).

## **B. The Theoretical Foundations of Constitutional Political Economy**

### **3. Constitutional and Sub-Constitutional Choice**

One solution to the problem of defining 'constitutional political economy' would consist of characterizing it simply as 'the economic analysis of constitutional law' (see Backhaus, 1995). The examination of real-world constitutions using the perspective of modern constitutional political economy is certainly an interesting exercise and can provide a kind of test for the usefulness of the CPE approach. In addition to Backhaus (1995), reference should be made to several case studies. Holcombe (1991) analyses the role of constitutional rules as constraints on government using three United States constitutions: the Articles of Confederation (1781), the Constitution of the United States and the Confederate Constitution. Brennan and Pardo (1991) examine the Spanish Constitution (1978). Sobel (1994) analyses the evolution of two international constitutions: the League of Nations Covenant and the United Nations Charter. However, the aforesaid definitional strategy may tend to be somewhat misleading. The use of the term 'constitutional' in the self-description of the subdiscipline is largely metaphorical.

CPE as a scientific subdiscipline is characterized by a particular kind of orientation in social analysis. Whereas orthodox economic analysis attempts to explain the choices of economic agents, their interactions with one another, and the results of these interactions, within the existing legal-institutional-constitutional structure of the polity, 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 emphasis is on the rules that define the framework within which the ordinary choices of economic and political agents are made. Thus, CPE involves a 'higher' level of inquiry than orthodox economics. CPE examines the choice of constraints as opposed to the choice within constraints.

A preliminary example can be drawn from the theory of 'market failure'. We know that under some conditions, and given the legal order of the protective state (the protection of property and the enforcement of contracts), 'markets fail' when evaluated against idealized 'efficiency' criteria. But in examining allocative institutions, the economist should ask 'As compared to what?' (Goetz, 1991, p. 10). We know today that 'politics fails' when

evaluated by the same criteria. The analysis and comparison of the working properties of underlying sets of rules or constraints constitutes the domain of constitutional economics.

A market is always a system of social interaction characterized by a specific institutional framework, that is, by a set of rules defining certain restrictions on the behaviour of the market participants. 'Market failure' arguments sometimes tend to ignore that the rules upon which a market is based may well be variable and that an adjustment in these rules is possibly a better way to deal with alleged shortcomings than to replace market forces by a political mechanism.

When it is said that the rules upon which a market is based may well be variable, this should not be misunderstood. It means that the rules can be varied at the level of constitutional choice. At the level of sub-constitutional (or post-constitutional) choice, the rules are parameters: they are items that single economic entities cannot adjust and, indeed, must adjust to. Coase's (1960) tradable property rights are not really rules as the constitutional economist defines them. Coase's tale was about *trading* defined rights, about private rearrangements of rights within a given legal structure, not about *redefining* the rights that the market participants hold. We will take a closer look at Coase's contribution in the next section.

Elementary to any constitutional analysis is therefore the explicit recognition of a notion of hierarchy. Any constitutional analysis will distinguish between at least two levels of choice - constitutional choice and sub-constitutional (or non-constitutional) choice - and correspondingly also between constitutional and sub-constitutional preferences. Constitutional choices are choices among alternative rules (constraints). Sub-constitutional choices are among alternative strategies available within rules (constraints), such as ordinary market choices.

#### **4. Methodological Individualism**

Only individuals choose and act. CPE is informed by an explicit methodological individualism (Buchanan, 1990, p. 13). Whatever phenomena at the social aggregate level we seek to explain, we ought to show how they result from the actions and interactions of individual human beings who, separately and jointly, pursue their interests as they see them, based on their own understanding of the world around them (Vanberg, 1994, p. 1). An aggregative result that is observed but which cannot, somehow, be factored down and explained by the choices of individuals, stands as a challenge to the scholar rather than as some demonstration of non-individualistic organic unity.

### **5. Homo Economicus**

Orthodox public choice models usually contain the postulate of homo economicus: they go beyond the logical presuppositions of individualism to incorporate non-tautological models of individual utility maximization. Individuals are assumed to seek their own interests, which are defined so as to retain operational content. It is increasingly recognized, however, that at least a part of the traditional public choice emphasis has been wrongly placed. Thus the emphasis is shifted away from the motivational postulates for political actors to the incentive structures of politics. In Buchanan (1993a, p. 69) it is argued that the seminal Alchian (1950) analysis of the market's analogue to evolutionary selection can be extended to politics in relatively straightforward fashion, the difference between the two evolutionary models lying in the compatibility with overall efficiency. The structure of the politics in which politicians act requires them to act contrary to public interests if they are to survive at all. For the constitutional economist the relevant question then becomes: 'How can Constitutions be Designed so that Politicians who Seek to Serve "Public Interest" can Survive and Prosper?' (Buchanan, 1993b).

### **6. Normative Individualism**

The whole exercise of CPE is ultimately aimed at offering guidance to those who participate in the discussion of constitutional change. In other words, constitutional economics is meant to offer a potential for normative advice in constitutional matters and to provide a normative framework for comparative institutional analysis. As a normative enterprise, CPE is informed by normative individualism: the presumption that the evaluations of the persons involved, their interests and values, provide the relevant criterion against which the merits of alternative sets of rules are to be judged.

### **7. Excursion: The Wicksellian Ancestry**

The distinguishing feature of the Buchanan and Tullock (1962) approach to the study of political institutions from a normative viewpoint was to treat the political process by which individuals advance their interests as one of exchange. In adding this second element - 'politics as exchange' - to the utility maximizing models for individual choice behaviour in politics, they were directly influenced by the great work of Knut Wicksell.



CPE could be characterized as 'Wicksellian' political economy. Wicksell's influence is discussed in Wagner (1988). In his basic work on fiscal theory Wicksell (1896) called attention to the significance of the rules within which choices are made by political agents, and he recognized that efforts at reform must be directed toward changes in the rules for making decisions rather than toward modifying expected results through influence on the behaviour of the actors.

In order to take these steps, Wicksell needed some criterion by which the possible efficacy of a proposed change in rules could be judged. He introduced the now-familiar (near to) unanimity or consensus test. Thus for Wicksell 'the consent of the governed' was the point of departure for the evaluation of government activities.

This 'Wicksellian' idea has had considerable influence on Buchanan's approach. According to Buchanan, politics must be understood in terms of the model of market exchange. Thus, the political process is conceptualized as one of mutually beneficial exchange. It is for this reason that he is drawn to unanimity as a collective decision rule. Since the choice among rules is more a social choice than an exchange, the form of voluntary exchange is political consent. Through the emphasis on 'consent' or 'agreement' as a normative yardstick, the research program of CPE became closely related to the contractarian tradition in political philosophy. As Buchanan sees it, contractarian political institutions typically exhibit three attributes. Central to the contractarian vision of the political process is the place of the individual. Individuals' own - and necessarily subjective - evaluations, their interests and values constitute the relevant benchmark against which the efficiency or desirability of alternative rule-regimes or institutions are to be judged. Contractarianism complies with this criterion by according each individual equal treatment at the constitutional stage. The unanimity rule serves to protect the individuals' rights and thereby ensures that those rules and institutions that become imbedded in the constitution will also treat individuals equally and impartially. Second, there is the fundamental distinction between actions taken within the constitutional rules, and changes in the rules themselves. The latter are to occur only at the constitutional stage and ideally are made using the unanimity rule. The image of political activity as a two-stage process, first developed in *The Calculus of Consent*, has recurred in many of Buchanan's later writings as a sort of normative benchmark or yardstick by which to measure the quality of a community's political institutions. Third, actions taken in the second stage of the political process should be effectively constrained by the rules written in the first, constitutional stage, and this is true not only for the individual citizen, but also for the elected representatives, and the bureaucrats and jurists who administer the system.

Recapitulating and summarizing, we can say that the two most important aspects of Buchanan's position are his emphasis on 'rules of the game' and his analysis of efficiency as involving consent. At the most fundamental level of constitutional choice, consent serves as the basis of justification. It provides the ultimate criterion of efficiency. Unlike other economists who have emphasized either the efficiency or rationality of rules, Buchanan is concerned exclusively with whether or not people consent to them.

It should be noted that Buchanan and traditional economic analysts develop the relationship between autonomy and efficiency in exactly opposite ways (Coleman, 1990, p. 141). Traditional economists believe that efficiency can be defined as a property of social states independent of the process of voluntary exchange. For example, the perfectly competitive market is efficient, but the outcome of the prisoner's dilemma is not. And given the logic of the relevant concepts - especially Pareto superiority - it follows logically that people would consent to efficient rules. Consent follows from efficiency. Buchanan puts the matter exactly the opposite way. What people consent to is efficient. Efficiency follows from consent.

In contrast with Paretian 'optimum resource allocation', a situation of 'Wicksellian efficiency' will be characterized by the fact that citizens are satisfied that the existing system of rules, institutions and policies of their society is free from improper coercion (Wiseman, 1990, p. 110).

The Wicksellian criterion of social efficiency focuses on subjective choice processes, in marked contrast to the Paretian optimality condition of neoclassical welfare economics, which permits an external observer to use individual utility as an objective measure of welfare. Social efficiency is too complex a notion to be reduced to a set of technical propositions concerning resource-use. Efficiency is not a property of social states that could be specified or defined independently of the actions of individuals and the process of voluntary exchange.

The limitations of conventional Pareto criteria in assessing efficiency are also discussed by De Alessi (1992).

However, Wicksell did not move beyond the development of criteria for evaluating policy alternatives one at a time.

Buchanan and Tullock (1962) operationalized Wicksell's (1896) insights and extended the applicability of the unanimity or consensus criterion from the level of particular proposals to the level of rules - to constitutional rather than post-constitutional or in-period choices.

For Buchanan and Tullock (1962, Chapter 6) constitutional design was a matter of determining which voting rule or choice mechanism would be specified by the constitution for each state activity. The best public decision rule for each activity was the one that minimized interdependence costs. It was specified that the representative individual perceived interdependence

costs for an activity as the sum of the anticipated external costs levied on that individual if not part of the decision set, and the anticipated decision making costs experienced by the individual if part of the decision set. External costs arise because some individuals cash in the benefits of collective decisions but shift the costs to other individuals. The group forces an individual to contribute to collective action that is not wanted by that individual (at that price). From the point of view of the individual in question, external costs are the result of wrong decisions. The higher the percentage required for a group decision, the lower the chance of wrong decisions being made, so that the corresponding curve will show a declining trend. Decision-making costs are the individual investment of time and energy in the process of negotiation, expressed in money value. The closer the requirement of unanimity comes to being met, the higher the decision costs will be because, among other reasons, strategic behaviour of individuals becomes more profitable. The corresponding curve therefore has a rising trend. The sum of both external costs and decision costs was shown to have a unique minimum somewhere between the extremes of individual rule and unanimity rule, the exact position depending on relative external and decision costs.

The shift of the Wicksellian criterion to the constitutional stage of choice has some remarkable consequences. It becomes conceivable to allow for the possibility that preferred and agreed-on decision rules might embody sizable departures from the unanimity limit, including simple majority voting in some cases and even less than majority voting in others (Buchanan, 1987, p. 135). The constitutional calculus suggests that both the costs of reaching decisions under different rules and the importance of the decisions are relevant. Since both of these elements vary, the preferred rule will not be uniform over all ranges of potential political action. The in period Wicksellian criterion may remain valid as a measure of the particularized efficiency of the single decision examined. But the in period violation of the criterion does not imply the inefficiency of the rule as long as the latter is itself selected by a constitutional rule of unanimity.

As a consequence, while it was recognized that unanimity and not majority rule is the pivot of constitutional democracy, it was equally demonstrated that 'at best, majority rule should be viewed as one among many practical expedients made necessary by the costs of securing widespread agreement on political issues when individual and group interests diverge' (Buchanan and Tullock, 1962, p. 96).

The appropriate degree of inclusiveness of the collective decision-making rule - for example qualified majority rule - as an instrument to cope with perverse forms of uncertainty about the incidence of collective decisions is discussed in Pinto Barbosa (1994).

### 8. The Rent Seeking Trap

It has become common to model the choice situation at the constitutional as well as the post-constitutional stage with potentially conflicting interests between rational persons as a classic Prisoner's Dilemma (Wagner and Gwartney 1988, p. 32; Buchanan, 1993b, p. 2). The Prisoner's Dilemma game depicts a situation in which private interests and the search for individual gain, when generalized, become the source of mutually harmful results. In other words, private interests cannot be generalized without losses. But what can be generalized (moral codes) does not obey private motivations. Conflicting interests are clearly involved, since everybody wants to be the only defector.

<i>Classic Prisoner's Dilemma</i>			
		B	
		C	D
A	C	3,3	1,4
	D	4,1	2,2

In 'generalized Prisoner's Dilemma situations', that is, social constellations under which individuals, in separate and rational pursuit of their own interests, unintentionally but systematically contribute to an overall outcome that is undesirable for all of them (or in any case less desirable than some alternative outcome that could be realized by concerted, organized action) there is a possible potential for mutual gains by collective action (collective organization).

In this way the constitution is essentially a contract intended to secure mutual gains from social cooperation and to avoid the dominant defective strategy in the Prisoner's Dilemma game which leads to a socially inefficient Nash equilibrium solution. Since the mutual gains from social cooperation constitute a public good, the maintenance of the constitutional contract gives rise to a problem that will not resolve itself naturally.

Even when it is supposed that agreement on appropriate rules can be achieved at the stage of constitutional contract formation, it should be recognized that individuals and interest groups inevitably will attempt to engage in post-contractual opportunism (problem of constitutional maintenance). Therefore the agreement, once achieved, must be enforceable. This opportunism takes several forms. First, each individual may have an incentive to defect from the cooperative agreement after it has been

concluded (compliance or unilateral defection problem). Whether or not it is rational for persons to comply with rules that they constitutionally may agree on is a matter of contingent, factual circumstances. It depends on whether or not the constraints that persons face after the agreement, that is post-constitutionally, make it rational for them to comply with previously agreed-on rules. As Vanberg has pointed out repeatedly, their constitutional interests and their compliance interests are not necessarily in congruence (Vanberg, 1994, *passim*, for example, pp. 21-23).

A second form of post-contractual opportunism consists of rent seeking and special interest plundering, which ultimately reduce the value of post-contractual cooperation and undermine the constitution itself. Groups of individuals have an incentive to seek and capture the instruments of state power and to use them as vehicles to enrich themselves in ways that are unattainable for private citizens.

Rent-seeking is a term used by economists to describe actions taken by individuals and groups to alter public policy in order to gain personal advantage at the expense of others.

The incentive to engage in rent-seeking activities is directly proportional to the ease with which the political process can be used for personal (or interest group) gain at the expense of others. In other words, distributional politics is viable and tends to become dominant to the extent that differential treatment is constitutionally permissible (Buchanan, 1993b, p. 6).

Tullock (1959) had already shown that under any voting system which requires less than unanimous approval to implement policies, majority coalitions of interest groups will seek to obtain public provision of special interest projects. A few years later Tullock (1967) independently published his innovative ideas on what came to be called rent-seeking, which he argued entailed social costs. The latter were called 'rent-seeking costs' or, by some, 'Tullock Costs'. Tullock Costs have been re-analysed recently by Spindler (1990).

The dominant strategy for any organized interest group in a majoritarian polity is to lobby for policies which provide large benefits to its members and disperse the costs over everyone else. This tendency exists even in liberal democracies. Through implicit vote-trading, a coalition of interest groups, comprising a bare majority of voters, can get all or at least most of their favoured projects approved for public provision. Under certain conditions, the total costs of these projects can exceed their total benefits, while cost spreading through the 'fisc' induces a rational ignorance of this process on the part of the disadvantaged majority. On the other hand, the asymmetric distribution of cooperative benefits leads subgroups of the collective to invest energy in the struggle for access to the government's coercive power. But the effort may turn out to cost more than it is worth and the end result will be

that the collective's loss purchases the subgroup's gain (Schmidtz, 1991, p. 91).

Buchanan and Lee (1991) demonstrate that the gains from politically generated restrictions on markets, even to organized producing interests, are more apparent than real. The analysis demonstrates that under plausibly realistic assumptions concerning coalition sizes, excess burdens, organizational costs and rent seeking outlay, a genuine utility-maximizing calculus may dictate support for constitutional prohibition of all market restrictions, by all members of the polity, including those producer interests that might be considered to be potentially identifiable beneficiaries of cartelization.

Principal-agent theory has been used to examine the rent-seeking problem (Anderson and Hill, 1986; Merville and Osborne, 1990). The principal, also the citizen, grants the agent (the government) the power of coercion. In exchange, the agent supplies the principal with public goods. Since the capitalized value of public assets is owned collectively, public-good outputs of the government are like communal resources with widely diffused benefits. It soon becomes evident to vote-maximizing agents or legislators that they can maximize their political support by significantly reducing the provision of public goods to the population at large in favor of greater transfers to interest groups. These transfers are financed by general tax collections and provide concentrated benefits to designated groups. Such collusion between agents and special interest groups will invariably lead to the development of a Leviathan state.

Merville and Osborne (1990) use agency theory to demonstrate formally that, in majority-rule political systems, coalitions of minority factions will induce politicians to systematically break the constitutional contract in order to supply special interest projects. Unlike contracts in private markets, political contracts are much more susceptible to this kind of opportunism.

Is the rent-seeking trap inescapable? A serious consideration of this question will take us a long way to the understanding of constitutional political economy.

By far the most important problem with respect to ensuring the self-enforcing character of a constitutional contract is that it must successfully constrain the power of the Leviathan state itself. Whereas Brennan and Buchanan (1980) endow Leviathan with the objective of revenue maximization, La Manna and Slomp (1994) argue that Hobbes's political construct envisages a sovereign-principal who devises rules and incentives to induce his subjects-agents to contribute to his own preservation and glory. Leviathan is a glory seeker instead of a revenue maximizer.

Generally speaking substantive constraints on government have been dismissed as ineffective precisely because of the wide latitude they allow for reinterpretation. Wagner and Gwartney (1988, pp. 44-49) make a strong

case for procedural rules designed to uphold decentralization of governmental powers and to prevent the formation of legislative coalitions. Procedural rules will provide more effective mechanisms for self-enforcement than will substantive restraints on government. In their view, the weakness of substantive restraints derives from the politicization of the Supreme Court and the ease with which legislatures can find alternative ways to implement any given policy. They propose procedural rules requiring larger legislative majorities for legislative action at higher levels of government, thereby diffusing the power of the state to regional and local governments.

Several other 'solutions' have been proposed in the literature.

### **9. Judicial Independence**

Does independence of the judiciary serve the long-term public good? The traditional view of the purpose of judicial independence has been attacked as naive by law and economics and public choice scholars. Unlike many legal contracts, it is argued, there is no third-party enforcer, external to the contract, who can ensure that defectors are caught and forced to comply with the terms of the agreement. Though many countries have a nominally independent Supreme Court whose purpose is to enforce the constitution, the Supreme Court can only do this imperfectly in most cases, because the judges themselves are not totally immune from political pressure by groups wishing to subvert the original intent of the constitution. Thus, given the unreliability of third-party enforcement, and given the strong individual incentives to defect from social cooperation, the constitutional contract should somehow be self-enforcing if it is to be maintained.

The interest group theory first advanced by Landes and Posner (1975) makes the independent judiciary an integral part of the system of rent-seeking engineered by Congress. However, the debate goes on. A very detailed criticism of the Landes-Posner theory is contained in Boudreaux and Pritchard (1994). They argue that the Landes-Posner theory is seriously deficient and conclude that the United States federal judiciary is truly independent of Congress and the President, and that this independence was designed by the Constitution's framers as a means of furthering sound government.

Blankart (1994) compares the legal rules for private clubs with the constitutions of representative governments. A nearly perfect laboratory case for a club government can be found in the example of Switzerland. The Swiss do not have a constitutional court, but have developed instead a system of popular voting rights serving as a substitute for a judicial review by a constitutional court. Though this system does not work perfectly, it has relative advantages in comparison to constitutional courts, which often tend

to become political decisionmakers thereby circumventing the control of citizens-as-principals.

Moser (1994) carefully analyses the contribution of the Swiss and the US constitutions to protect economic liberties, and compares the different strategies that both constitutions rely on to achieve this goal. It is argued that the substantial constitutional changes that did occur in both countries followed strikingly similar patterns: the constitutional protection of economic liberties was eroded in both countries, especially as far as federal legislation is concerned, due to changes in the interpretation of the constitution through the courts, or by formal amendment. Tucker (1992) looks at the impact and the judicial philosophy of the now dominating Conservative group of justices on the Supreme Court. Rowley (1992) examines the erosion of the economic liberties of US citizens with special reference to the takings-clause provisions of the Fifth Amendment. It is noticed that the Court changed direction during the late 1980s as justices appointed by Presidents Reagan and Bush gained ascendancy.

### 10. A Rule of Law in Politics

According to Buchanan (1993b) the direction of constitutional reform is obvious. If, somehow, the potential for differential treatment is reduced, so will be the inducement to rent-seeking behaviour. The off-diagonal solutions should simply be made impossible to achieve by the introduction of some rule or norm that prevents participants from acting or being acted upon differently, one from the other.

If the off-diagonal attractors are eliminated, then the players operate with the following reduced matrix:

		B	
		C	D
A	C	3,3	X
	D	X	2,2

Thus the constitutional reform measure modifies the original Prisoner's Dilemma game into a reduced setting in which each player, as a member of a political coalition, knows that any choice of an action or strategy must involve the same treatment of all players or constituencies (Buchanan, 1993b, p. 3).



If and to the extent that differential treatment is replaced with equal treatment, or with the principle of generality in politics - analogous to that present in an idealized version of the rule of law - mutual exploitation will be avoided and politicians who seek to serve the 'public interest' will survive and prosper (Buchanan, 1993b, p. 6). Therefore it seems at least conceivable that rational persons, at the stage of entering into the agreement, may recognize the 'rent-seeking trap' and engage in concerted efforts to escape.

However, in the hypothetical matrix construction above, the interaction was in fact assumed to occur in a state of nature, with each person holding equal prospects for membership in the majority and minority coalitions. This means that membership was assumed to be symmetrical among all participants. But this assumption may turn out to be too heroic with respect to real world settings.

The prospects may differ among persons and groups of persons so as to create divergences in interests which may become a source of disagreement. Thus the question remains whether it is possible to modify the constitutional choice setting so as to reconcile such possible divergences. It appears that, at least from the perspective of potentially-conflicting interests among constituencies, the general problem of constitutional efficiency and survivability does not resolve itself naturally.

### **11. Veil of Uncertainty and/or Ignorance Versus the Availability of Exit Options**

Is it possible to specify the conditions under which constitutional agreement may be facilitated in real, non-hypothetical choice situations? Is it possible to modify the constitutional choice setting so as to reconcile divergences in interests?

In this respect, two lines of reasoning have been pursued in the contractarian and neo-contractarian literature.

The first line of argument focuses attention on the need for a 'veil of uncertainty and/or ignorance' as a precondition for an efficient constitution. Buchanan and Tullock (1962) had to present a convincing positive argument that unanimous consent at the constitutional level was possible at all. How can agreement be achieved on rules among persons with potentially conflicting constitutional interests? Buchanan and Tullock's (1962) characteristic way of approaching this issue consists of emphasizing the uncertainty confronting all individuals taking part in constitutional deliberations. The existence of 'a veil of uncertainty' induces individual participants in a constitutional process to prefer rules that do not systematically favour any particular subset of citizens.

The proposed remedy involves the introduction of some means of insuring a person's inability to foresee reliably their future particularized interests, as these may be affected by different rules, thereby inducing persons to make constitutional choices on some assessment of the general working properties of alternative rules, and divorced from particularized interests. Thus, agreement is facilitated by whatever increases a person's uncertainty about the particular effects that alternative rules can be expected to have on them. In fact the assumption of a 'veil of uncertainty' was also hidden in Buchanan (1993b), discussed above.

Buchanan's approach has affinities with John Rawls's (1971) construction, who utilizes the veil of ignorance along with the fairness criterion to derive principles of justice that emerge from a conceptual agreement at a stage prior to the selection of a political constitution. Thus in Rawls's construction the prospect of agreement is secured by defining certain 'ideal' conditions under which constitutional choices are hypothetically made. The choosers are assumed to be placed behind a 'veil of ignorance', that makes it impossible for them to know anything specific about how they will be personally affected by alternative rules. Ignorant about their prospective specific interests in particular outcomes, they are induced to judge rules 'impartially'. Potential conflict in constitutional interests is not eliminated, but the veil of ignorance transforms potential interpersonal conflicts into intrapersonal ones (Vanberg, 1994, p. 170).

However, the constitutionalist notion of a veil of uncertainty is not very operational. It is not clear how genuine uncertainty could be achieved in real-world constitution formation. Moreover, in certain parts of the rent-seeking literature there is a certain tendency to suggest that conflicts of interest are no less characteristic for choices among rules at the constitutional stage than for choices within rules and that therefore the idea of some genuine constitutional agreement is a mere illusion when placed in a real-world context. This view seems to be espoused by, for example, Sutter (1995).

Therefore, it has been argued that the availability of exit options can ensure a competitive setting for participants in constitutional deliberations and can even substitute for a veil of uncertainty. This condition for efficiency can be given operational substance in processes of real-world constitution formation (Lowenberg and Yu, 1992).

In order to produce an efficient social contract or constitution, deliberations must be carried out in a competitive 'constitutional environment'. This condition is satisfied if an exit option exists for each contracting party. As will be argued later on, this conclusion is quite consistent with the Wicksell-Buchanan-Vanberg contractarian consensus test. Only in a competitive setting does unanimous agreement acquire operational substance (normative content).

The notion of exit has thus been invoked to give more operational substance to the concept of voluntary agreement. It is derived from Hirschman's (1970) classic distinction between exit and voice. Exit (and entry) is an important means by which individuals are able to express their preferences, and is precisely the method through which preferences are revealed in competitive markets for private goods.

An exit option introduces an element of market-like competition into the contracting process, which limits the ability of any party to wield power over another party. It is not even necessary that this exit option be exercised, since merely the threat of its use should be enough to restrain rent appropriation. The scope for opportunism is effectively constrained by competition, actual or potential.

Furthermore, it is argued that exit options can help to solve the constitutional maintenance problem by establishing a competitive environment for post-constitutional political and market exchange (Lowenberg and Yu, 1992).

## **12. Federalism, Once Again**

The strengthening of regional and local government relative to national government has been advocated by many scholars as an effective way to restrain the growth of legislative redistribution. The existence of separate jurisdictions with some protected powers within a constitutional federation inhibits coercive behaviour by the government. Such an arrangement facilitates migration at low cost between federal sub-regions and thereby enhances competition between these sub-regions. The resulting mobility forces competitive governmental units to supply public goods in preferred quantities and to 'price' them broadly in line with relative marginal evaluations.

The foregoing is related to the Tiebout effect (Tiebout, 1956), which says that individuals will sort themselves across communities in accordance with their preferences for the packages of taxes and public goods provided in each community. The ability of the owners of property rights to move to competing jurisdictions protects them from potential rent appropriation by a coercive government. Therefore, it is argued, a federalist constitution can effectively constrain the power of the state. In a federal system, citizens seeking political relief can vote with their feet.

The preceding paragraphs suggest that post-contractual exit opportunities might be characterized in terms of Tiebout competition between different political groupings. If the constitution permits mobility

and political plurality, it will help establish and maintain a competitive political postconstitutional environment.

The unifying theme in the preceding approach to constitution formation and maintenance is generally that of exit (or entry).

### **C. Outline of a Reconstruction of the Coase Theorem from a Subjectivist-Contractarian Perspective**

#### **13. Buchanan on the Irrelevance of Transaction Costs**

One way to interpret the Coase (1960) analysis consists of seeing it as a contribution to the externality literature, though Coase would presumably object to any use of the term 'externality'. Put in externality language, Coase was essentially arguing that all Pareto-relevant externalities would tend to be eliminated in the process of free exchange contract among affected parties (Buchanan and Stubblebine, 1962).

According to Buchanan (1984) Coase did not like the Buchanan-Stubblebine externality paper and Buchanan conjectures that Coase's objection may have stemmed from a certain 'ambiguity in perspective' (Buchanan, 1984, p. 11, footnote 6).

The 'ambiguity in perspective' Buchanan refers to is related to the fact that there are two profoundly different conceptions of competition and the competitive process. In the objectivist perspective, there is an efficient allocation of resources independently of any process through which it is generated. From this supposition, it follows that institutional arrangements can be directly evaluated in terms of their relative success or failure in attaining the desired pattern of resource use. Normative argument in support of competitive institutions emerges, in this perspective, only because such institutions tend to be relatively superior 'devices', 'instruments', or 'mechanisms' in generating independently derived results. Where competitive institutions do not seem to exist, as defined by some independently derived structural criteria (for example, the number of firms in an industry, concentration ratios, and so on), there emerges a normative argument for direct intervention with the voluntary exchange process as a means of moving results toward the externally derived allocative norm or ideal.

In the subjectivist-contractarian perspective, 'efficiency' cannot be said to exist except as determined by the process through which results are generated, and criteria for evaluating patterns of results must be applied only to processes. In this perspective, voluntary exchanges among persons, within a competitive constraints structure, generate efficient resource usage which

is determined only as the exchanges are made. Competitive institutions in this perspective are not instruments to be used to generate efficiency. They are, instead, possible structures, possible rules or sets of rules, that may emerge from generalized agreement. The role of the political order, of law or government, is to facilitate agreement on institutional arrangements, and to police rights assigned under such agreements.

In Buchanan (1984) it is argued that Coase, despite his own earlier contribution to what can be called the subjectivist theory of opportunity cost (see Buchanan, 1969, pp. 26-29; Coase, 1960) presented his argument - through a series of hypothetical and historical examples - largely in terms of presumably objectively-measurable and independently-determined harm and benefit relationships. It is suggested that Coase was, indeed, applying outcome criteria for allocative efficiency to results of the exchange process rather than limiting his attention to the process itself. Therefore the whole analysis becomes vulnerable to the critique mounted by Cooter (1982) and others who suggest that the Coase theorem fails in non-competitive settings. Small-number bargaining settings will necessarily fail to guarantee efficiency due to the presence of incentives for strategic behaviour, independently of any communication-information failures. In large-number settings, all parties may have free-rider motivations. In both of the latter cases, interpreted in terms of satisfying outcome criteria for efficiency, free exchange and contract among parties do not necessarily generate an allocation of resources to their most highly valued uses. 'Externalities' that are Pareto-relevant may remain in full trading equilibrium. Parties to potential exchanges who are rational maximizers of expected utilities may fail to reach the presumed objectifiable Pareto efficiency frontier. However, Buchanan contends that if the whole Coase analysis is interpreted in subjectivist-contractarian terms, the critique can be shown to be without substance.

Buchanan (1984) is an explicit attempt to re-interpret the Coase (1960) theorem along consistent subjectivist-contractarian (or, if preferred, Austrian-Wicksellian) lines.

If there is no objective criterion for resource use that can be applied to outcomes, as a means of indirectly testing the efficacy of the exchange process, then as long as exchange remains open and as long as force and fraud are not observed, that upon which agreement is reached is, by definition, that which can be classified to be efficient. The Coase theorem thus seems to become a tautology. How could, in this construction, inefficiency conceivably emerge? Is that which is always necessarily efficient?

Of course it is not. Already in Buchanan (1959) it was suggested that agreement is the only ultimate test for efficiency, but that the test does not need to be confined in application to the allocative results or outcomes

generated under explicitly existing or defined institutional-structural rules. The agreement test for efficiency may be elevated or moved upward to the stage of institutions or rules, as such.

The proper role for the normative political economist is that of discovering potential rules changes that might yield general benefits and then presenting these changes as hypotheses subject to the Wicksellian contractual-consensus test. If, when presented with a suggested change in rules, agreement among all potentially interacting parties is forthcoming, the hypothesis is corroborated. The previously existing rule is proven to be inefficient. Agreement on a change in the rules within which exchanges are allowed to take place is a signal that patterns of outcomes reached or predicted under the previously-existing set of rules are less preferred or valued than the patterns expected to be generated under the rule-as-changed. Hence, the new rule is deemed more efficient than the old. If disagreement emerges on the proposed rules change, the hypothesis is falsified. The existing rule is classified as Pareto-efficient. And, given this institutional setting, any outcomes attained under free and open exchange processes are to be classified as efficient.

Let us consider as an example the classic externality case from welfare economics, the setting in which ordinary economic activity within well defined legal rights imposes noncompensated damages on a sufficiently large number of persons so as to insure failure of a bargained solution due to free-rider motivation. The 'uncorrected' outcomes in this setting should still be classified as 'efficient' as long as all members of the relevant community remain free to make intervening offers and bids to those traders whose activity is alleged to generate the spillover harms. The institutional structure may not be efficient, however. The political economist may hypothesize that general agreement can be secured on some change in institutional structure and that explicit political or governmental decision rules may come to be accepted by all parties as being preferred to the decision rules of the market. Even though the outcomes reached may still be classified to be 'efficient' - *given* the assignment of rights, and *given* the institution of exchange - the institution of voluntary exchange, as ordinarily understood, may not, in this case, be efficient. This implication may sound somewhat paradoxical but for the subjectivist-contractarian it creates no difficulty since he does not acknowledge the uniqueness of the resource allocation that is properly classified to be efficient: it depends necessarily on the institutional structure within which resource utilization-valuation decisions are made.

There is a second seeming paradox. That political-governmental decision rule upon which agreement is reached may not require consent of all parties to reach particular outcomes, either explicitly or implicitly. The efficient decision rule may be such that specific outcomes need not meet the

consensus test. The analysis contained in Buchanan and Tullock (1962), which is essentially an analysis of the choice among political decision-making rules had highlighted the fact that the costs of reaching agreement increase significantly as the size of the group required to agree is expanded. However, this situation need not imply that the unanimity principle for constitutional changes is inapplicable. The members of the group may be observed to agree on changes in the rules that produce results which, when classified by the orthodox Pareto criterion, are clearly 'nonoptimal'. In other words, 'optimal rules' may generate results that may be classified as nonoptimal.

With majority rule, or any less than unanimity rule, for political-governmental decisions, the decision structure can itself be efficient while at the same time the particular outcomes attained under the structure are to be presumed inefficient, at least in some situations, for those who are directly coerced. Buchanan believes that to introduce 'transactions costs' as a barrier to the attainment of efficiency confuses rather than clarifies the complex set of issues involved. The several so-called transaction costs barriers to efficiency in resource allocation - information and communication constraints, free rider constraints, strategic behaviour ... - can be more appropriately analysed in the context of hypotheses about institutional reform (Buchanan, 1984, p. 23).

#### **D. Refinements and Applications: A Survey of Contributions**

##### **14. Foundational Explorations**

One of the major discussions in contemporary institutional economics concerns the relation between rationality and rule following. The problem is akin to what philosophers will recognize as an unresolved issue in the history of ethics. As several authors have recognized, the problem was posed at the very beginning of the history of philosophizing about the justification of moral rules, in Plato's Republic (McClennen, 1990a, p. 262). In Plato (1992, pp. 34-35, Book II, sec. 359) Glaucon challenged Socrates to prove that being just is rational even if we suppose that the material rewards of being just accrue exclusively to the unjust. The story of the ring of Gyges seems to drive a wedge between the concept of rational choice and that of choice that respects the usual kinds of moral constraints. In the language of public goods theory, the challenge is to show that when the material payoff of being just is a public good - enjoyed by everyone but its producers - there is nevertheless a hidden private benefit that makes it rational to produce this public good (Schmidtz, 1991, p. 165).

There appears to be an essential tension between the notion of rational, self interested behaviour - as postulated in economics - and the notion of a viable moral order. In the relevant literature this problem is referred to as the 'Hobbesian problem of social order' or simply the 'Hobbesian problem'.

Vanberg (1993, 1994) presents an interpretation of the rational choice and rule-following perspectives which allow their consistent integration into a common theoretical framework. Hayek had already argued that man is 'as much a rule-following animal as a purpose-seeking one' (Hayek, 1973, p. 11). Generally speaking, Vanberg's program can be characterized as a systematic and transdisciplinary integration of J.M. Buchanan's contractarian perspective with F.A. Hayek's evolutionary approach, making use of insights from a wide range of fields. The contractarian element in Hayek's thought has also been identified by Sugden (1993a). The contrast between Hayek's and Buchanan's systems of ideas is highlighted by, for example, Gray (1990).

Vanberg (1993a, p. 187) distinguishes maximizing and adaptive forms of rationality and argues that an evolutionary perspective using the concept of adaptive rationality 'may help to systematically account for observed behavioral tendencies which appear to defy explanation in standard rationality terms'. This argument is related to Hayek's notion that rule following is a response to humankind's imperfect understanding of their environment. Rules are not chosen as a result of a full rational appraisal but can best be seen as more or less reasonable adaptations to a complex world and not necessarily as optimal in their functioning.

On one occasion, Vanberg argues that rule-following behaviour, while relatively unresponsive to variations in particular situational circumstances, 'is quite compatible with choice and 'calculation' at the rule level' (Vanberg, 1994, pp. 16-17), thus suggesting that the problem can be thought of in terms of a rational maximizing choice on a metalevel. However, if maximizing itself is subject to, say, information costs, the choice of rule cannot be seen in optimizing terms. There seems to be no alternative to separating the concept of rationality from the notion of optimization. In this way Simon distinguished procedural from substantive rationality (Simon, 1976). Simon argued that the orthodox neoclassical concept of rationality as maximizing implies an unrealistic view of man's cognitive abilities, of his access to information and his computational capacities. The alternative concept of rationality which Simon proposes, namely that of bounded, procedural or adaptive rationality, is in essence a theory of behavioural learning, a theory which seeks to understand a person's current behaviour in terms of his or her past experience. Simon's theory of human decision making views an actor's choice-behaviour as based on a repertoire of behavioural patterns, routines or programmes.



An extension of the bounded rationality problem has been provided by Ronald Heiner (1983, 1990, among others). Formal economics is a theory of perfect choice that assumes agents always make best decisions based on available information. The latter may itself be inaccurate or incomplete, but no further imperfection enters into the analysis about the agents' ability to decide optimally. In a sequence of articles, Heiner has made an effort to develop a theory of imperfect choice which provides an argument for why rational, but imperfect agents may profit from following rules instead of attempting to maximize advantage on a case-by-case basis.

Heiner's argument is that there is often a gap between an agent's competence at problem solving and the difficulty of the decision problem faced. Given such a 'C-D gap', which will tend to exist in complex decision problems, agents will be subject to unpredictable errors and mistakes in selecting the most preferred alternative. The extent of these errors possibly means that an agent will do better by following a simple rule rather than by attempting to maximize in each case. Heiner's analysis implies that imperfect agents benefit from being governed by rules adapted only to recurrent situations and from ignoring relevant, even costlessly available information. The Heiner (1990, pp. 39-40) analysis also suggests a basic tradeoff between reaching initial agreement over constitutional rules and the stability of future compliance to them once they are put into practical application. There is a basic tradeoff between ignorance and uncertainty that promote consensus over *ex ante* rules (that is, before anyone has had any actual experience living under them), and the reliability of any such advance agreement in avoiding rules that turn out destabilizing *ex post* due to errors that are self-recognized through the very ongoing experience generated by following the rules.

Thus, maintaining allegiance to previously agreed social rules can be a far more difficult challenge than reaching initial agreement about which rules to begin following - especially if the initial agreement was achieved under a veil of ignorance about the practical consequences of applying rules to future conditions.

### **15. Contractarianism and Evolutionism**

In the modern research programme of Constitutional Political Economy two strands of thought are systematically interwoven: a subjectivist-contractarian strand of Austrian-Wicksellian origin, on the one hand, and an evolutionistic strand, which essentially works out the implications that follow from Popperian evolutionary epistemology for the issues of socio-economic-political organization.

For recent discussions of contractarianism, and apart from Buchanan's and Vanberg's own contributions, reference is made to Binmore (1990), Hardin (1990), Mueller (1990) and Sugden (1990). Coleman (1990) contains a valuable comparison of Buchanan's form of contractarianism with that of the philosophers John Rawls and David Gauthier. Sugden (1993a) outlines a procedural or contractarian formulation of rights. Gaus (1991) sketches an account of political authority and democracy that depicts them as responses to our moral disagreements and our inability to rationally resolve them on their merits.

The constitutional contract is often interpreted as a device to overcome the hypothetical state of anarchy (see, for example, Buchanan, 1975). How can, in a pre-constitutional setting that lacks any institutional forms, a unanimous agreement on the rules and the agency enforcing the rules be imagined to emerge? Witt (1992) conceptualizes the problem in game theoretic terms and explores the logical basis of the dilemma that turns up in this context. While the protective agency has to be endowed with sufficiently powerful coercive means to prevent anyone breaking the social contract, this concentration of power may itself induce a violation by making the protective agency usurp its power.

The implications of subjectivism are equally remarkable. Traditionally, the subjectivists par excellence within economics were the Austrians. Vanberg (1994, Chap. 13) has consistently worked out the implications of subjectivism for the theory of organized, collective action. The normative focus is shifted from endstates or outcomes, as such, to the process through which these outcomes or endstates emerge. The relevant question becomes whether the process by which outcomes and endstates are brought about can reasonably be assumed to reflect the preferences of the individuals concerned, as revealed in their actual choice behaviour. Thus the approach is incompatible with criteria that - as is true for Benthamite utilitarianism - are individualistic in the sense of measuring the goodness of social matters in terms of individual utilities, but do so without reference to individuals' choices. It can be characterized as choice-individualism, as opposed to the utility-individualism that underlies the whole tradition of the concept of a social welfare function.

Vanberg clearly recognizes that the true problem with the agreement criterion is not that it is too demanding but, instead, that it has too little normative content. A criterion needs to be specified which allows one to distinguish between constraints that are judged to render the respective individual choices involuntary, and those that do not. His analysis reaches the conclusion that a consistent normative-individualist approach needs to rely on a combined and simultaneous application of a purely procedural, rule oriented, as well as a substantive, avoidance/exit-cost criterion. The avoidance/exit cost perspective arguably provides a more operational specification of

the contractarian norm than the notion of a hypothetical contract to which Buchanan (1975, 1977) as well as Rawls (1971) appeal. The exit perspective is consistently followed by, for example, Lowenberg and Yu (1992) and Mbaku (1995).

The evolutionistic strand of thought in fact consists of a complex set of more or less interrelated theses some of which are more controversial than others. The least problematical ingredient is reflected in the idea, related to Hayek's 'limits of reason' insight, that, in the realm of rules and institutions no less than in other areas, we can never know *ex ante* what the best solutions to our problems will be, if alone - as Popper has pointed out in his critique of historicism - because we cannot know today what we will know tomorrow. In fact, we cannot know *ex ante* what our future problems will be. Therefore, we need to rely at least to some extent on the explorative potential of open ended, competitive processes and on the kind of experience that accumulates in trial and error learning. But there is no reason to expect that what survives necessarily coincides with what is desirable in the sense of being responsive to the interests and preferences of the persons involved. It would seem entirely unfounded to expect an unqualified evolutionary process generally to produce such favourable conditions. On the other hand, a recognition of 'the limits of our reason' should not imply that we cannot say something about the kinds of conditions and process-characteristics that enhance responsiveness to the interests and preferences of the persons involved. Indeed, creating and maintaining such conditions has to be the primary task for deliberate constitutional design. There is room for both evolutionary learning and constructive design, not only as compatible, but also as indispensable and complementary elements of an appropriate socio-economic-political order. This insight leads Vanberg to develop the notion of 'constitutionally-constrained evolution (or competition)', a combination of deliberate design and evolutionary learning: the design of a framework of meta rules - the idea of a meta constitution - within which efforts in constitutional construction are subject to a kind of evolutionary competition that promises to make selections in favour of rules that serve the interests of the respective constituencies. The programme culminates in a theory of institutional competition among jurisdictions viewed as a knowledge-creating discovery process (Vanberg, 1994, p. 284; Vanberg and Kerber, 1994).

Institutional competition has been analysed from a variety of perspectives. Wiseman (1990) argues that analysis of voice and exit dimensions of a fiscal constitution is a means of appraising the efficiency of social arrangements. Marlow (1992) argues that one's view toward the design of voice and exit options is affected by one's perception of the appropriate size of government. It is recognized that the design of voice and exit options in the fiscal constitution exerts a predictable influence on policy.

Sinn (1992) analyses competition among governments on the basis of a model that views countries as clubs.

Evolutionary themes are further explored in the following contributions. Parisi (1995) contains a sophisticated outline of a theory of spontaneous law. Wohlgemuth (1995) contrasts the neoclassical and the market process conceptions of economic and political competition and develops an alternative agenda for many fields of public choice. Gruner (1995) examines evolutionary stability of social norms in a formal socioeconomic equilibrium model. The institutional evolution of the Icelandic Commonwealth (930-1264 AD) is discussed in Solvason (1993).

It has almost become a commonplace to state that game-theoretic notions and approaches capture essential elements of the evolutionary paradigm. Most of the arguments can be related to repeated coordination (Warneryd, 1990), Prisoner's Dilemma (see Axelrod, 1984) or hawk dove (Sugden, 1989) games. Generally speaking, the extension of the market analogy to the constitutional level, that is, to the rules and institutions within which market coordination takes place, is not corroborated by the game-theoretic analysis of invisible-hand processes. This analysis does not warrant the conclusion that invisible-hand processes will operate to generate efficient results, except under a highly restrictive set of conditions. This point is illustrated by, for example, Warneryd (1990). Warneryd discusses the evolutionary game theoretical approach to the emergence of conventions, that is, institutions that solve recurrent coordination problems. It is argued that conventions may be said to minimize transaction costs, but that they need not be efficient.

## **16. Compliance, Renegotiation, Secession**

Constitutional preferences, like any other preferences, can be assumed to embody two conceptually distinct components, an interest-component and a theory-component. Rational actors will have reasons to be concerned, not only about the interest dimension, but also about the theory dimension in constitutional choice.

Both concerns have certain implications for the kinds of 'procedural constraints' that can be expected to facilitate actual agreement, implications that need not be in perfect accordance.

So far as the interest dimension is concerned, it has been a central tenet of constitutional political economy at least since Buchanan and Tullock (1962) that constitutional deliberations must take place behind a veil of uncertainty in order for a constitution to be efficient. The prospects for reaching constitutional agreement are enhanced by whatever tends to increase persons' uncertainty about the particular effects that alternative

rules can be expected to have on them, that is, by whatever tends to thicken the veil. The veil notion can be seen as a summary label for factors that, by increasing uncertainty, tend to alleviate potential conflicts in constitutional interests.

It should be noted that potential knowledge-based disagreement obviously requires the opposite cure. The prospects of agreement on desirable or efficient rules and the prospects for adopting such rules are enhanced, not by creating uncertainty, but, on the contrary, by raising the level of mutually-shared information and knowledge on the general working properties of alternative rules. The Buchanan-Tullock 'veil of uncertainty' and the Rawlsian 'veil of ignorance' are assumed to render persons uncertain or ignorant about their particularized interests while not inhibiting their capability accurately to anticipate the general effects of potential alternative rules. In other words, their constitutional theories are supposed to be perfect and non-controversial. Informational problems with regard to the general working properties of rules do not exist.

This section is concerned with the interest dimension, that is, with the difficulties involved in any attempt to achieve agreement on rules among persons with potentially-conflicting constitutional interests. Moreover, once agreement has been achieved, the agreement must be enforceable because each individual has a subsequent incentive to defect from the cooperative agreement.

It is recalled that in the contractarian and neo-contractarian literature two lines of reasoning have been pursued which focus central attention on the interest-component in constitutional choice with a view toward modification of the constitutional choice setting so as to reconcile potential divergences. Both are concerned with the general problem of constitutional efficiency and survivability.

The first line of argument, which is discussed in this section, focuses attention on the need for a 'veil of uncertainty' as a precondition for an efficient constitution. The second line of argument adopts an exit (entry) perspective.

Though Rawls's idea of constitutional choice 'behind the veil of ignorance' and Buchanan's notion of 'conceptual agreement' cannot be expected to provide a workable criterion upon which actual normative judgements on existing social arrangements could be based, they do serve a useful heuristic function by directing attention to the question of whether - based on our general understanding of the nature of human choice - it can be plausibly assumed that some existing set of rules could have been voluntarily agreed upon by all participants at some original stage of decision.

A notion that is typically used in this respect in contractarian theories is *fairness*. Fairness can be induced by two independent factors: (1)

uncertainty, as has been indicated already, and (2) the concern for stability, which will be discussed below.

In real-world settings persons are typically not totally ignorant about their particular constitutional interests. But they are not perfectly certain about these interests either. They typically find themselves behind a veil of uncertainty that prevents them from accurately anticipating the particular ways in which they will be affected by the prospective working properties of alternative rules.

The veil's thickness may vary, depending on certain characteristics of the actual choice situation. As the veil's thickness increases so will the prospect of achieving agreement. The variables that affect the veil's thickness can to some extent be manipulated and rational actors can take deliberate measures designed to put themselves behind a thicker veil, thereby enhancing the prospects of realizing potential gains from constitutional agreement.

In this respect the following observations are made. The degree of uncertainty is, in part, a function of the sort of rules that are under consideration. The essential dimensions here are the generality and the durability of rules. The more general rules are and the longer the period over which they are expected to be in effect, the less certainty persons can have about the particular ways in which alternative rules will affect them. They will therefore be induced to adopt a more impartial perspective and, consequently, they will be more likely to reach agreement. The veil of uncertainty works by moderating the differences among identifiable constitutional interests, thus inducing fairness or impartiality and facilitating agreement in constitutional choice.

There is an additional factor through which fairness can be induced, independent from the uncertainty factor, but working in the same direction. This factor is the concern for stability. The possibility of realizing gains by operating under constitutional constraints is not just a matter of securing some initial agreement; it is also a matter of a sufficient level of ongoing agreement, of continuing acquiescence in an ongoing co-operative arrangement. Stability refers to the viability of a constitutional arrangement over time. Rational actors can be expected to take considerations of stability into account when engaging in constitutional choice. To the extent that fairness and stability are interrelated, the concern for stability will induce a concern for fairness or impartiality even in persons who may be perfectly aware of the particular effects that alternative rules will have on them. It is not the uncertainty about one's own particular position that will induce impartiality, but the anticipation that a constitutional arrangement is unlikely to be stable if it is only designed to serve one's own particular interests.

How precisely are stability and fairness interrelated? Two aspects of the stability problem should be distinguished. They are not always sufficiently

separated in discussions on the issue: the compliance problem and the renegotiation problem.

First, in order for a constitutional arrangement to be stable over time it has to command a sufficient level of compliance. However, compliance with rules is certainly not a direct function of their fairness. The fact that rules are perceived as fair by the relevant group of persons does not, *per se*, guarantee a willingness to comply with those rules. The compliance problem results from the fact that there may be potential gains from defecting. Whether such gains exist or not is not *per se* dependent on the fairness properties of the arrangement. To the extent that such gains exist, a compliance or unilateral defection problem is present even with perfectly fair rules.

Second, constitutional arrangements should also command a sufficient level of ongoing agreement. A constitutional agreement that favours particular interests may be achievable under 'suitable' conditions, but such agreement can be expected to be less robust with regard to potential changes in circumstances than fair arrangements. Unfair arrangements may tend to give rise to the renegotiation problem. It is especially with regard to renegotiation rather than with regard to compliance that the concern for stability can be expected to induce a concern for fairness. There is a much more direct relation between the fairness issue and renegotiation than there is between fairness of rules and compliance with rules.

For further discussion on the foregoing and related issues, reference is made to the following contributions.

Several fundamental issues relating to the problem of constitutional stability are discussed in Ordeshook (1992). Twight (1992) assesses the extent to which consensuality is likely to characterize the process of constitutional revision. Theoretical and empirical grounds are provided for concluding that non-consensual constitutional revision is often the rule rather than the exception. The endogeneity of politically relevant transaction costs and their manipulation by self-interested political actors in a post-constitutional environment are central to the analysis. The theory of constitutional maintenance is equally examined in Niskanen (1990).

Constitutional renegotiation may end in impasse. Young (1994) examines the political economy of secession. Special reference is made to the case of Quebec. The author explains why secessionist movements have not been successful in industrialized welfare states, even when the structural preconditions are largely present, as in cases like Scotland and Belgium. A formal analysis of constitutional secession clauses using game theory is made in Chen and Ordeshook (1994).

### **17. The Common Law and its 'Efficiency'**

Buchanan (1977) criticized Posner (1972) for its failure to make the vital distinction between the two functional roles in which lawyers may find themselves: Posner appears to offer potential advice and counsel to future judges and legislators alike. But, recalls Buchanan, the judge should not change the basic law because by such behaviour he would be explicitly abandoning the role of jurist for that of legislator. In his role of jurist he should enforce existing law instead of enacting new legislation. Buchanan referred explicitly to Leoni's (1961) distinction between law and legislation. It follows from Buchanan's argument that there is no justification at all for a judicial introduction of the putative efficiency norm, presumably to be imposed independently of the political process. This view is implied by the adoption of the subjectivist-contractarian consensus or unanimity rule as a benchmark for efficiency. The normative economist can advance alternative sets of rules as a hypothesis to be tested in the political exchange process, but he should never be allowed to take the arrogant stance of suggesting that this or that set of institutions is or is not more efficient.

In a similar vein De Alessi and Staaf (1991) argue that the law and economics view of the common law as an efficient process that promotes the evolution of efficient rules through an auction-like mechanism is flawed because it fails to cope with the problem of aggregating preferences. They argue that the belief that the efficiency of the common law is enhanced by assigning disputed rights so as to lower transaction costs is also flawed. The common law provides a form of unanimity by allowing individuals to contract around the rule and provides order by maintaining transitivity, through the use of precedent, in the application of the rule to new situations.

Aranson (1992) highlights another problem: in the neoclassical approach to law and economics, the common law judges, in rendering decisions that maximize wealth, are placed in the position of calculators of comparative values. However, this task confronts the courts with an insoluble economic calculation problem, analogous to the problem faced by central economic planners. Therefore, courts should prefer to stay as close by as they can to a rights-based jurisprudence.

Wagner (1992) argues that social processes regarding the formation of rules should be assessed in terms of their ability to provide a framework of stable rules guaranteeing the stability of expectations and allowing people to plan their economic activities. The dichotomy between statutory and common law is overdrawn, because both derive from the same source in a setting where there are no longer polycentric sources of competing authority, since the contemporary nation-state - presumably Wagner has the United



States of America in mind - has the capacity to absorb all alternative sources of authority into itself.

More radically Benson (1992b) argues that the government-backed common law system is more likely to adopt inefficient rules than a genuine customary law system. Though he recognizes that much of common law was simply a codification of the basic norms common to Anglo-Saxon society, Benson recalls that common law was also royal law and that even during its earliest periods of development some aspects of it were legislated and imposed by authoritarian kings. Furthermore, when a government's judges make new law through precedent, it becomes enforceable law for everyone in the society whether it is a mutually beneficial law or not. Common law precedents are backed by the coercive power of the state and, therefore they take on the same authority as statute law.

Yandle (1991) develops a vision of the Common Law as an 'organic' Constitution, reflecting evolved social norms, a result that causes ordinary people to accept the authority of judges.

### **18. Studies in the History of Ideas**

There now is a fair number of review articles on Buchanan's thought. Besides those already mentioned, reference can be made to Brennan (1987, 1990), Congleton (1988) and Yeager (1990).

In Germany, institutional analysis has a long and autonomous tradition, which has not been given proper international recognition. This applies especially to the neoliberal *Ordnungstheorie*, of which Walter Eucken is generally acknowledged to be the leading representative. Leipold (1990) examines the methodological and theoretical similarities and differences between Eucken's *Ordnungstheorie* and Buchanan's Constitutional Economics. Though there is no tradition of pluralism in German history, some German thinkers developed ideas which came remarkably close to later English and American pluralists. This development, particularly as exemplified in the work of Georg Beseler, Otto Gierke and later Hugo Preuss, is dealt with in Dreyer (1993).

Aranson (1991) argues for the coherence of Calhoun's political thought, when read in the light of modern public choice theory and contrary to earlier interpretations.

Madison's constitutional political economy is carefully examined in Dorn (1991). James Madison was instrumental in the design, ratification, and implementation of the American Constitution. He also was the major force behind the Bill of Rights. It is in the light of these accomplishments that Madison has been called 'The Founding Father'. Because he focused on

the rules or principles of a liberal order rather than on the outcomes, James Madison can properly be viewed as a pioneering constitutional political economist. Drawing on the political theory of Locke and the economic theory of Smith, Madison successfully combined the two to form a coherent theory of constitutional economics. Adopting a self-interest postulate, he showed that social and economic order are best achieved by allowing open competition to prevail under a rule of law protecting private property and freedom of contract. Thus, he clearly recognized the close relation between political order and economic order, and he anticipated many of the themes in the public choice/constitutional economics literature.

One of the insights of Madison and other framers of the US constitution was that a bicameral legislature might function as a device to limit the power of legislative coalitions. The idea was that each house would be elected differently and consequently would represent different interests. The requirement of a simultaneous majority in both houses in order for legislation to be enacted would then guarantee a broad social consensus. It should be noted that the differences between the two chambers have been eroded subsequently. However, the argument for bicameral legislatures on efficiency grounds and the urge that the two houses be elected by radically different methods, was at the theoretical level revived in this century by Tullock (see Buchanan and Tullock, 1962, Chap. 16, written by Tullock; see also Tullock, 1987).

Elazar (1991) argues that the work of an early political scientist, Johannes Althusius, who developed his theory of the polity on the eve of the modern epoch at the end of the sixteenth century, offers an important starting point for building a postmodern theory of political and social organization. Althusius (1991) is a collection of excerpts from his *Politica Methodice Digesta* (1603/1614).

Sir Edward Coke's role as a constitutional entrepreneur in seventeenth-Century England is highlighted in Yandle (1993).

### **19. Variations on Hayekian Themes**

Constitutional political economy shares much of the spirit of Hayek's inquiry into the interrelation between the order of rules and the order of actions, and of his message that changes in the order of rules are the principal means by which we can hope to improve the socio-economic-political order under which we live (Vanberg, 1994, *passim*). It will come as no surprise, then, that several contributions elaborate explicitly on Hayekian themes. Buchanan's personal recollections of F.A. Hayek are set out in Buchanan (1992).

Streit (1993) brings out clearly how Hayek's approach to the social sciences, especially to economics, is rooted in his epistemological position, particularly as he set it out in Hayek (1952). Butos and Koppl (1993) outline a theory of expectations based on Hayek's cognitive theory. The central tenet of the theory, which is intended to have both policy implications and testable empirical content, is that economic expectations will serve as reliable guides to action only when certain 'filtering conditions', that is certain constitutional constraints such as the atomicity of the market process and the stability of the rules governing that process are satisfied. A failure of either condition creates a loose 'system constraint' and thus a loose link between environment and expectation, as the theory of 'big players' illustrates. Big players, of which central bankers are a prototypical example, introduce a wedge between epistemic knowledge and social reality. The theory highlights the connection between the choice of constraints and its epistemic consequences. The big player theory also suggests a possible direction for future empirical work in a Hayekian tradition. Within the adopted framework 'neoclassical' economics and 'radical Keynesianism' may be seen in a sense as limiting cases. When certain filtering conditions are in place, the results of the market process may be described by 'neoclassical' models of rational maximizing and action will seem predictable at least at some aggregate level. To the extent that these conditions fail, the market process will be influenced by animal spirits and the like and action will seem unpredictable to the observing economist. Thus the evolutionary logic of Hayekian economics provides the general theoretical foundations for special empirical theories, such as the big player theory, which may identify the precise causes and consequences of observed deviation from the neoclassical model.

It is to be regretted that the recently developing literature on, say, monetary constitutionalism has largely failed to incorporate these Hayekian insights. Recent events in the European Monetary System on the one hand, and monetary disintegration in the former Soviet Union on the other, have revived interest in the question of how to design and choose a monetary regime that ensures monetary stability for both parts of Europe. Even among economists who are otherwise considered staunch advocates of laissez-faire policy, money is still regarded as the prime and uncontroversial example of a good that has to be provided by government. Buchanan (1962), accepting the premise that money is a public good that can only be provided by government, derives its optimal properties from a constitutional perspective. In the same vein Spinelli and Masciandaro (1993) argue for a constitutionalization of the target of monetary stability in Italy.

Hefeker (1995) has argued that the objective of monetary stability can be achieved either by complete monetary union or by currency competition and that both regimes may be viable solutions depending on the circumstances.

His paper makes the case for monetary union in Western Europe, even though he recognizes that monetary union is no alternative for Eastern Europe and the former Soviet Union.

We believe that the critical examination and evaluation of the properties of alternative monetary regimes constitutes one of the most interesting and exciting lines of future research within the field of constitutional economics.

Choi (1993) offers a critical evaluation of Hayek's 'atavism of social justice' thesis, suggesting an alternative explanation for the widespread demands for social justice in contemporary society, based on the analysis of the nature of entrepreneurship and its tendency to incite envy.

Tuerck (1995) re-interprets Hayek's theory of mind in the light of contemporary philosophy of artificial intelligence.

## **20. Towards a Constitutional Economics of the Firm**

Vanberg (1992a) compares four theoretical approaches to the study of organizations that can be identified in the relevant literature: the goal paradigm, the exchange paradigm, the nexus of contracts paradigm, and the constitutional paradigm. It is argued that the latter provides the more fruitful theoretical perspective in that it reconciles an individualist methodology with an account of organizations as corporate actors, as units of collective action.

In search of a more decisive argument in the controversy concerning alternative forms of ownership of firms and allocation of capital, Pelikan (1993) complements and qualifies the standard incentive argument by an argument considering a less well explored factor: the competence with which firms are organized and managed. Alternative forms of ownership of firms are assessed according to their impact on this competence. The general conclusion is that private and tradable ownership of firms is a necessary condition for efficiency of supply. The competence argument strengthens the neoliberal defence of private ownership and market competition. It is in allocating the authority to organize supply to agents of high relevant competence, and in demoting from this authority agents of low competence, that private and tradable ownership of firms is shown to have its decisive comparative advantage.

Kiser (1994) rationalizes public enterprise by analysing the constitutional choice between private and public ownership of production arrangements. Arguing that results depend on who does the choosing, the article compares choices by self-governing citizens with choices by self-directed governmental officials. The resulting institutional theory identifies four conditions that cause citizens to favour public over private ownership: natural monopoly, output and process invisibilities, the production of consumer necessities, potential producer moral hazard. None of the

conditions refers to the standard concept of economic efficiency, which guides most economic comparisons of public and private enterprise.

Langlois (1995) argues that Hayek's theory of spontaneous order can in fact include the case of such apparently purposive and extramarket forms as the business firm. In other words, Hayek's theory of the market as a spontaneous order has implications for the theory of the firm that the mainstream Coasean approach has yet fully to absorb. Langlois picks up a number of suggestions in Hayek's evolutionary theory of social institutions and uses them to draw a picture of the firm that is somewhat different from that drawn by neoclassical transaction-cost analysis. In the Hayekian picture, firms and markets are both systems of rules of conduct. Both are systems for economizing on knowledge in the face of economic change, albeit quite different kinds of knowledge and change. Moreover, there is a sense in which the firm exists not in order to centralize control over knowledge but - like the market - precisely to decentralize the use of knowledge. In the end, it is argued that the firm is no model for political planning for one very simple reason: the firm does not plan.

Adelstein (1991) draws upon the contractarian distinction between constitutional and operational levels of personal choice and an evolutionary analysis of the growth of firms to illuminate the complex issues surrounding the emergence of large-scale economic organization in the United States in the years since 1870.

## **21. Redistribution**

There have been two recent attempts to provide a rationale for redistribution within the scope of constitutional political economy. Kliemt (1993b) argues that redistribution can be institutionalized at the constitutional level to attain a 'minimum welfare state' without violating basic principles or incurring risks beyond those that are present in the minimal state itself. Wessels (1993) describes a situation in which individuals may unanimously agree to transfer income at the constitutional stage on the grounds that redistribution provides income insurance. Both are criticized, invoking the usual arguments, by Pasour (1994).

## **22. European Integration**

Streit and Mussler (1994) analyse the changes in the economic constitution of the European Community since its foundation in 1958. It is argued that as far as the economic constitution is concerned, the Treaty of Maastricht is

dominated by traits which are characteristic of modern welfare states. The editors of *Constitutional Political Economy* took Vibert (1995) as a starting point to devote the 1996 Vol. 7 No. 4 issue of their journal to the theme *Europe: A Constitution for the Millennium*. This special issue includes articles by Blankart (1996, pp. 257-265), Buchanan (1996, pp. 253-256), Frey (1996, pp. 267-279), Holcombe (1996, pp. 281-291), Mueller (1996, pp. 293-302), Ostrom (1996, pp. 303-308), Sobel (1996, pp. 309-316) and Vaubel (1996, pp. 317-324).

### 23. Other and Related Subjects

A constitutional approach to international private law is contained in Schmidtchen and Schmidt-Trenz (1990). Constitutional issues concerning transition in Eastern Europe and the former Soviet Republics are discussed in Sunstein (1991), Apolte (1995) and Ordeshook and Shvetsova (1995). Brunetti and Weder (1994) argue that establishing strategies for the control of state discretionary power is a crucial precondition for overcoming credibility problems and generating long-term economic growth in less developed countries. Kratochwil (1992) suggests an alternative approach to the study of international politics. A critical examination of the Clean Water Act from a constitutional perspective is contained in Meiners and Yandle (1992). Pauly (1994) examines the concept that social insurance for medical care may represent a kind of constitutional choice.

Kuran (1993) argues that public opinion breeds tyranny by forcing individuals to refrain from voicing their genuine thoughts and feelings. Several devices to cope with the emergence and persistence of certain social taboos are discussed. Lipford (1992) applies constitutional economics to the constitutions and rules that govern seven of the eight largest US Christian denominations. A positive theory of economic fairness is constructed in Isaac, Mathieu and Zajac (1991). Public debt repudiation is analysed, using Jefferson's model in Gunter (1991).

### E. Conclusions

Throughout the writing of the present article we constantly had in mind the editors' aim of providing the readers of the *Encyclopedia of Law and Economics* with a well-informed overview of the existing literature. Some readers may find that our strategy of favouring 'comprehensiveness' at the expense of 'structure' has to some degree distracted from the flow of argument. However, we are reasonably confident that the unifying theme

underlying the whole will be clear. The various subdisciplines of Public Choice, Law and Economics, Constitutional Political Economy and others all represent, as opposed to the independence-isolation of economics, a return of economics to its appropriate legal foundations. But this theme only loosely connects the subparts and sections of this article. In fact the four subparts and even most of the subsections can be read largely independently. This can only add to the reader's convenience

Admittedly, and strictly from the title, the public choice element was somewhat neglected, relative to the constitutional political economy element. This bias is explained by our own priorities, but only in part. It was Buchanan himself who in the 1980s changed the name of his research program to *constitutional economics*. Early on, Buchanan had made it clear that he regarded the traditional approach to economic policy advice based on welfare economics as a scientifically flawed and politically alarming development. Welfare economics draws its conclusions from a comparison of the working properties of *real* markets with *idealized* criteria. Then, confronted with the inefficiencies of reality compared to the idealized model, the market failure approach proceeds to suggest alternative measures which consist in *real* government interventions which are *assumed* to eliminate the inefficiencies. Thus, welfare economics runs the danger of becoming a 'nirvana approach' (Demsetz, 1969), meaning that it fails to identify the relevant alternatives for drawing its conclusions. First, in judging the real economy in order to arrive at policy advice, the relevant alternative is not an idealized market but 'another' real economy, one that would emerge under a different set of constraints. This means one has to compare alternative institutional arrangements, in markets and the polity, and their outcomes. Second, such a comparison requires a criterion that is equally apt in evaluating the economic as well as the political order, that is a non-ideal, internal standard of comparison. For Buchanan, democratic consent provides this kind of criterion (Pies, 1996, p. 26).

Despite its general direction towards a comparison of alternative institutional arrangements, large parts of the public choice literature seem like an empirically oriented welfare economic analysis of the political sector and use the welfare-economic concept of normative efficiency as a benchmark, thus more or less duplicating the 'nirvana approach'. The term 'constitutional economics' clearly distanced Buchanan's paradigm from those parts of the public choice literature that make welfare economic efficiency the measure of all things. The term more adequately describes the topic of his institutional, rules-directed analyses.

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