

BOOK REVIEWS

Explorations into Constitutional Economics

James M. Buchanan

College Station: Texas A&M University Press, 1989, 437 pp.

This book collects 31 of Nobel Laureate James Buchanan's papers on a wide range of topics, but all are related by their constitutional approach to economics. The selections were compiled by Robert Tollison and Viktor Vanberg, who have chosen papers that are less well known than the contents of some earlier collections of Buchanan's work. The volume serves two purposes: It makes some of Buchanan's less-familiar work more accessible, and it illustrates both the theory and application of constitutional economics. The common theme gives the papers in this volume more impact when they are considered together than if each were read individually.

Throughout his career, Buchanan has emphasized that institutional constraints are important determinants of the actual workings of economic systems, and constitutional economics studies are the properties of alternative sets of institutional rules. The first five chapters of this volume discuss the theoretical foundations of constitutional economics. Chapter 1, coauthored with Geoffrey Brennan, deals with the application of economic models to public policy questions, and it is a good choice to begin the volume. Brennan and Buchanan discuss the assumption that individual behavior is self-interested, a point that is readily accepted in models of market processes but which is more controversial in models of political processes. It is often argued that this model of economic man is not descriptive of the actual behavior of individuals in the public sector, but Brennan and Buchanan conclude that regardless of its descriptive accuracy, the assumption that public servants are self-interested is the appropriate standard to use when evaluating the probable performance of alternative institutions. Institutions work better when they are designed to guard against the possibility that some people might try to use them for selfish reasons.

In Chapter 2, Buchanan discusses the impact of public choice theory on public policy issues. By applying the same type of analysis economists

Cato Journal, Vol. 9, No. 3 (Winter 1990). Copyright © Cato Institute. All rights reserved.

have used in evaluating market institutions to the study of political institutions, public choice has, at the very least, forced discussions of public policy options to recognize the potential shortcomings of political solutions. As in Chapter 1, Buchanan notes that public choice models are not always fully descriptive of human behavior, but again he emphasizes the relevance of this approach in designing institutions that are not overly dependent on public-spirited behavior in achieving success.

Chapter 3 deals with rational choice models frequently used in the social sciences. Extending the themes of the first two chapters, Buchanan argues that use of these models ultimately allows the development of better institutions. Chapter 4 considers the relationship between citizens and their governments, focusing on the coercive nature of government, and Chapter 5, titled "Constitutional Economics," explains Buchanan's views on the scope of constitutional economics.

The first five chapters provide a methodological foundation for analyzing institutional rules, and the remainder of the book applies this methodology to a variety of topics grouped into five major categories. Four chapters are devoted to voting, four discuss the monetary and fiscal constitution, five chapters examine public goods supply, seven address taxation and public debt, and six chapters cover property rights and externalities. Taken as a group, these chapters illustrate the application of Buchanan's constitutional approach to political economy.

Under the heading of voting, for example, Buchanan analyzes the familiar cyclical majority model from an institutional standpoint. Buchanan distinguishes between those cases where decisions are relatively permanent, such as where to locate a new facility, and those cases where decisions are more temporary, such as the election of a candidate to public office. In the second set of cases, the rotation of office holders that is produced with cyclical majorities would be desirable. This observation naturally leads into a discussion of the optimal length of the terms of elected officials. In another chapter in the voting section, Buchanan and Geoffrey Brennan conclude that voters make political choices using different criteria than those used in market decisions, and the authors explore the implications of those differences in individuals' decision-making processes.

In the monetary and fiscal constitution section, Buchanan discusses the benefits of constraining policymakers with well-defined constitutional rules rather than allowing them to use their discretion to determine policy. Rules versus discretion is an on-going debate among economists, and Buchanan applies the constitutional paradigm to support the rules side of the argument. Adherence to constitutional rules not only would insulate monetary policy from self-interested political behavior, but it also would provide a predictable monetary environment. And Buchanan emphasizes the importance of predictability. No matter how knowledgeable and public spirited monetary authorities are, the benefits of predictable policy can never be obtained as long as policymakers can implement whatever policy they think is best.

In the section on public goods, Buchanan and Francesco Forte persuasively argue that including government production in GNP at cost is inconsistent with the theory of national income accounting. Government output should be added to GNP only when it is sold on the market, and then it should be included at the price it brings. Private sector output is included in GNP at its market value, and the market value of government output that is given away is zero. The importance of their argument extends beyond the conventions of national income accounting, because they are ultimately illustrating that at the margin, much government output is worthless.

The other chapters in the public goods section address traditional public goods theory. Buchanan and Milton Kafoglis challenge the standard conclusion that privately provided public goods will have too few resources devoted to their production. Buchanan and António S. Pinto Barbosa question the convexity assumptions that are made in formal models of public goods. The last two chapters in this section were originally published as comments on the work of others, and both offer an insightful analysis of optimality conditions in the production of public goods.

The seven chapters on taxation and public debt illustrate the constitutional approach by emphasizing the institutions of taxation and public finance. Buchanan and Richard Wagner respond to critics of their 1976 book, *Democracy in Deficit*, itself is a good example of the constitutional approach. Rather than analyze public finance from the standpoint of choosing the best policy in an abstract setting, Buchanan and Wagner look at the incentives created by the institutions of public finance. They illustrate that, unless those who determine government budgets are constrained by an implicit or explicit balanced budget rule, budget deficits are inevitable.

Several chapters raise interesting issues with regard to taxation. Brennan and Buchanan develop a model that would allow the tax base to be constitutionally determined, and they demonstrate that the selection of tax bases correlated with the production of specific public goods can make government more productive. This provides a constitutional argument for earmarked taxes. Other chapters deal with progressive taxation, selective versus general taxes, and coercion in tax systems. The emphasis is always on the public choice analysis of the selection of tax rules with the political process fully integrated into the model.

The final section in the book addresses property rights and externalities and in doing so analyzes the Coase theorem, compares private with communal ownership, and considers the effects of small versus large numbers in bargaining for resource allocation. As in the earlier chapters, the constitutional approach provides the foundation for analysis. The Coase theorem demonstrates that in a world with no transactions costs, resources will be allocated to their highest valued uses. It typically is applied to a market setting that fails to include government as a part of

the institutional framework. Buchanan illustrates the insights that can be produced from Coase's theorem once the role of government is explicitly recognized. His application of the Coase theorem to majority rule voting shows how efficient outcomes can be produced in voting groups where side payments are possible. Buchanan's application of the theorem to the administrative branch of government establishes that it holds for members of the decisionmaking group, for whom the zero transaction cost assumption is approximated. An important determinant of public policy, then, is who is included in the policymaking group.

Each chapter of this volume, taken individually, yields insights into the rules that govern public sector decisionmaking. The volume taken as a whole illustrates the power of the constitutional approach both in understanding public sector institutions and in developing methods for improving them. In traditional public sector economics, suggestions for improvement tend to be primarily recommendations that existing policymakers do things differently. The constitutional approach, in contrast, recognizes that the behavior of policymakers is largely determined by the rules of the game. Thus the actions of policymakers and citizens should be constrained by the rules selected. Constitutional economics explains why an orderly society requires rules, and develops models to try to improve the constitutional rules under which societies operate.

Tollison and Vanberg have compiled a valuable set of Buchanan's papers that illustrate by example the benefits of the constitutional approach to political economy.

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