

JAMES BUCHANAN AND THE AUSTRIANS: THE COMMON GROUND

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In June 1974 at a conference on Austrian economics in South Royalton, Vermont, Milton Friedman asserted that “There is no Austrian economics—only good economics and bad economics” (Dolan 1976, p. 4). According to Friedman, what is good about Austrian economics could, and eventually would, be incorporated into generally accepted mainstream analysis. My theme in this paper is that the economics of James Buchanan, the 1986 Nobel Laureate in economics, already incorporates much of what is good in Austrian economics. I do not claim that Buchanan consciously and purposefully adopted Austrian analysis in his own work. I merely claim that the economics of James Buchanan has much in common with modern Austrian economics, especially the work of F. A. Hayek and Israel Kirzner.

In the first two sections a broad outline of the relevant features of modern Austrian economics is presented. This broad sketch is followed by a consideration of three significant statements of Buchanan regarding Austrians and Austrian economics. Next, the influence of Knut Wicksell and Frank Knight on Buchanan is discussed. Their influence, I believe, is the source of the Austrian link. The paper then explores the alleged common ground by considering, in turn, general economics, cost, and political economy. A brief concluding section rounds out the paper.

What’s in a Name?

The adjective “Austrian,” of course, refers to the historical roots of the analysis, not to the nationality of its present adherents. Unfortu-

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nately, the label carries a strong negative affect with many mainstream economists. There are two reasons for this. First, Austrians have steadfastly refused to accept mathematics and statistics as the *sine qua non* of good economics. They have clung to the view that good methodology in the physical sciences is not necessarily good methodology in economics. To economists who wish to claim for themselves the same scientific stature as physicists, the Austrian view is anathema. (We will return to the question of methodology later.)

Second, some Austrians often appear to act as guardians of metaphysical truth. As Buchanan ([1976] 1979a, p. 84) puts it, there is a “tendency to form a priesthood, with the converted talking only to converts.” There is such a tendency among some Austrians, and I think it is due, in large measure, to the derision that has greeted Austrian attempts to discount mathematics and statistics in economics and to warn insistently of the limits of economists’ ability to write helpful public policy prescriptions. Such attempted prescriptions, Austrians assert, are likely to make things worse rather than better. Austrians are often dismissed by practitioners of neoclassical orthodoxy as free-market ideologues who cannot count. If mainstream economists will not take them seriously, the Austrians cannot be faulted for “talking only to converts.”

Friedman’s assertion that there is only good economics and bad economics does not imply that there is no such thing as Austrian economics. After all, Friedman distinguishes between “monetary economics” and, say, “environmental economics.” Austrian economics is a field of economics that can be viewed, if protagonists on both sides are sufficiently tolerant, as an analytical complement to the neoclassical, comparative static analyses found in most undergraduate and graduate microeconomics textbooks. I have often thought that Austrians need to adopt an alternative label for their analysis—a label that describes the nature of the analysis rather than its historical roots. “Market-process economics,” or “subjectivist-discovery economics” are good candidates. If some new name were adopted, attention could be focused, as it ought to be, on whether the analysis is good economics or bad economics. I think it is good economics, and, judging from the extensive common ground he shares with the Austrians, so does James Buchanan.

Distinguishing Characteristics of Austrian Economics

According to Ludwig von Mises (1969, p. 41), he and most economists used the term “Austrian School” in the 1920s only in a history-of-thought context. The significant insights of the Austrians had been,

it was thought, incorporated into contemporary mainstream analysis. It was not until the 1930s, during the height of the socialist calculation debate, that Mises and Hayek came to realize that, although mainstream economists and Austrian economists frequently used the same words in their analyses, they did not attach the same meanings to those words. For example, the mainstream understanding of such concepts as marginal utility and opportunity cost was substantially different from the Austrian understanding of the same terms.

Because of such differences of interpretation, Oskar Lange and Abba Lerner could claim that their model of market socialism refuted the Mises-Hayek claim of the impossibility of calculation under socialism. The Lange-Lerner model forced Mises and Hayek to try to clarify their use of terms in the debate. The process of clarification continued into the 1940s with the result noted by Kirzner (1988, p. 1):

[T]he Mises-Hayek position at the end of the forties was articulated in terms far different from those presented in the Misesian statements of the early twenties. Moreover, this more advanced Mises-Hayek position pointed beyond itself toward (and decisively helped generate) the more explicit Austrian statements of the seventies and the eighties.

My taxonomy of those “more explicit Austrian statements” includes thorough-going subjectivism; consistent methodological individualism; an emphasis on exchange, or catallactics, rather than on economizing and optimizing; focus on real-world market processes rather than on equilibrium states; and a view of economics as an “explanatory,” rather than an “exact,” science within which there is a severely circumscribed role for mathematics and statistics.

Subjectivism

The Marshallian synthesis claimed to have joined the marginalists’ subjectivism of tastes on the demand side with the classicists’ objectivism of real cost on the supply side to produce neoclassical price theory. However, Austrian subjectivism on the demand side is more radical than a mere subjectivism of tastes, and Austrians apply an equally extensive subjectivism to the cost side.

Austrians begin their analysis with the action axiom: People act purposefully, attempting to apply available means to the achievement of their many and varied ends. Their ends, or goals, or, to use neoclassical language, the arguments in their utility functions are both pecuniary and nonpecuniary. Altruism, prestige, power, knowledge, and wealth are recognized as common human ends. In short, the action axiom asserts that individuals attempt to do the best they

can for themselves, as they see it, within the context of the constraints and opportunities they confront.

In illustrating how Austrian subjectivism is different from neoclassical subjectivism, we need to consider the different meanings attached to the marginal utility concept by neoclassical and Austrian economists. To the former, utility is a psychology-based notion of satisfaction. Utility from successive increments of a good is simply assumed to decline. To Austrians, however, utility is an action-based notion of subjectively evaluated significance. Declining marginal utility (significance) is a logical inference of two priors: the action axiom and the empirical postulate of scarcity. The significance that person A's mind attaches to a unit of X depends on the significance that A attaches to the end to which the unit of X is serviceable. Starting with zero units of X, when A receives a gift of one unit, he will devote that unit to what he regards as the most urgent use it will serve, because he knows he will never have all the X he would like to have. When A receives a second unit of X, it *must* be less significant to him because he has already carefully applied the first unit to the most urgent use to which X is serviceable.

Austrians make no attempt to explain which ends any particular person may choose to pursue. Whatever the ends, there is a pure logic of choice and action that always applies. Moreover, Austrians are quite comfortable with the fact that ends frequently change—sometimes exogenously and sometimes endogenously.

To an Austrian, the cost that person A weighs in the decision of whether to take action X is the subjective value that person A attaches to the most highly valued alternative action that cannot be undertaken if X is undertaken. The cost is the *value* the decisionmaker attaches to the sacrificed alternative, not the sacrificed alternative itself. A money measure of a cost is only an indirect representation of the cost. If the cost of action X is \$100, that means merely that the actual cost that is weighed in the decision of whether to undertake X is the value attached to the most highly valued alternative use of the \$100. The cost is not the \$100 itself.

Cost and supply are no less subjective than wants and demand. Both ends and means are subjectively defined and evaluated by each economic actor.

Methodological Individualism

Carl Menger, the founder of the Austrian School, was the first economist to spell out the principle that Joseph Schumpeter was later to call methodological individualism (Menger [1883] 1963). Hayek ([1952] 1979, chap. 4) calls the principle the “compositive

method." Modern Austrians, along with practitioners of the Chicago/UCLA variant of neoclassical price theory, base their analyses on this principle. Only individuals think, evaluate, plan, and act. Clubs, firms, states, nations, and publics are merely groups, or collectives, of individuals. These wholes do not think, evaluate, plan, and act independently of their parts. The only way to explain and understand what a group of people do is to explain and understand what the individual members of the group do. The public interest is merely the sum of the interests of the individuals who constitute the collective called the "public." According to Hayek ([1952] 1979, pp. 124–25):

Words like *government* . . . stand not for single observable things but for structures of [interpersonal] relationships which can be described only by a schematic representation or "theory" of the persistent system of relationships between the ever-changing elements. These "wholes," in other words, do not exist for us apart from the theory by which we constitute them, apart from the mental technique by which we can reconstruct the connections between the observed elements and follow up the implications of this particular combination.

Exchange, Not Optimization

Ever since Lionel Robbins (1932) defined economics as the study of the allocation of given scarce means among given competing ends, the attention of most microeconomists has been on the identification of optimal values. Constrained maximization—the mathematics of the Lagrangian multiplier—has pride of place in most intermediate- and graduate-level price theory textbooks. Microeconomics and operations analysis have become almost indistinguishable.

Modern Austrians dissent from the Robbinsian view of economics. They ask, "To whom is the knowledge of the scarce means and the competing ends given?" Once the knowledge that is depicted in textbook budget constraints and indifference curves and in Lagrangian equations is known to a decisionmaker, the only thing that separates the decisionmaker from the correct identification of the optimum is arithmetic. Indeed, there is no human action left to examine.

To a modern Austrian, the much more interesting question is how do people acquire the knowledge that Robbins simply takes as given (Kirzner 1973, pp. 32–36). The answer to that question is that they come to discover bits and pieces of the relevant knowledge as they formulate and attempt to execute their plans to exchange with other people. Exchange with others in pursuit of broadly conceived personal gain is the quintessential economic action. It is the action on

which economic analysis should focus its attention. The study of the exchange process and its implications is called, following Archbishop Whately, “catallactics” (Mises 1949, pp. 233–57; Hayek [1968a] 1978, pp. 181–84).

To a modern Austrian, economics is the study of the logical implications of the fact that people try to do the best they can for themselves, as they see it, within the context of the constraints and institutions they confront. Economics involves an examination of both intended and unintended consequences of human action. These consequences are logically inferred from the economists’ understanding of the exchange relationship and its results, that is, its “spontaneous orders” (Hayek [1968a] 1978, pp. 181–84).

Market Process, Discovery, and Entrepreneurship

The knowledge involved in the process by which the pattern of production of goods and services becomes consistent with the pattern of individuals’ wants exists nowhere in its entirety (Hayek 1945). Each economic actor possesses only pieces of the relevant knowledge—the pieces that pertain to him or her. No one—private citizen or government functionary—possesses all the pieces. Nor is it possible, because of the subjective nature of most relevant knowledge, for the highly scattered bits of knowledge to be gathered for a central authority or collectivist decisionmaker to use. Any individual’s perceptions of the bits of knowledge pertinent to him or her may be inaccurate. *A fortiori*, any individual’s perceptions regarding the bits of knowledge pertinent to others are almost always flawed.

Only through the market process can individuals discover relevant knowledge about the intentions, plans, and actions of others, as well as knowledge of objective real-world constraints. Much of the relevant knowledge is summarized and transmitted by movements of relative prices and the profit and loss possibilities such price movements imply. During this discovery process people constantly adapt their plans and actions to newly acquired knowledge. This adaptation of plans and actions leads to more and more plan-and-action coordination. Full consistency, or coordination, of the plans and actions of relevant economic actors is what Austrians mean by equilibrium.

The concept of equilibrium is used only as a reference point. It is the result of the market process, but Austrians are more concerned with the journey itself rather than the destination. In the real world, markets are usually in disequilibrium, and the actions of economic agents are best understood and evaluated in that context. For example, in an open market a monopoly that exists at the moment is usually the result of entrepreneurial alertness to some hitherto unnoticed

profit opportunity. The economic profit earned today results in imitation of entrepreneurial success and the gradual dissolution of the monopoly as more and more people discover the relevant knowledge.

The key dynamic force in the Austrians' market-process analysis is entrepreneurship (Kirzner 1973). An entrepreneur is a person who is alert to the profit opportunities that are implicit in every disequilibrium situation. Whether through arbitrage, speculation, or innovation, an entrepreneur attempts to make economic profit by taking advantage of opportunities that others have failed to notice. The intent of the entrepreneur is to gain wealth. But successful entrepreneurship will be imitated, so the disequilibrium situations that gave rise to the profit opportunities will gradually be corrected. The desire to earn profits and to avoid losses fuels entrepreneurial alertness to disequilibrium and makes it inevitable that corrective pressures will be brought to bear in every disequilibrium situation.

That is not to say, however, that general equilibrium is ever achieved. As economic actors adapt to newly discovered knowledge in disequilibrium states, new instances of disequilibrium may emerge. Tastes may change, and new production and marketing processes may be tried as competitors try to stay ahead of each other (Lachmann 1986). In addition to these endogenous changes, there are exogenous changes in tastes, technologies, and resource availabilities that also imply that new instances of disequilibrium will emerge as old instances of disequilibrium are coordinated.

Methodology

Austrians may be considered quaint because of their focus on catallactics rather than optimization, but they are considered heretics because they insist that economics is not an exact science and that the methodology of exact sciences is not appropriate in economics. It is with regard to this issue that Milton Friedman, George Stigler, and most of the economics profession most vigorously dissent from Austrian analysis. Milton Friedman's famous 1953 essay on methodology claims that an economic theory should be judged purely on the basis of its usefulness. A theory is useful if it makes predictions that are confirmed (or at least are not falsified). Every worthwhile theory must have at least conceptually testable (falsifiable) implications. In practice the tests are most often statistical. A theory that fails the test must be discarded. A theory that passes the test is held until an alternative theory comes along that does a better job of predicting.

Austrians reject this instrumentalist view of economics because it is always possible for an economist to explain away any statistical

results he or she does not like. Every theory of human action is laden with subjective components, and subjective variables cannot be quantified. Thus, for example, if a correctly executed regression study of a demand relationship indicated a positive own price elasticity of demand, the result could be easily dismissed. All the analyst would have to do is assert that a negatively sloped demand curve has shifted due to a change of taste. The positive slope could be explained away as an identification problem. Since tastes cannot be quantified, there is no way this convenient excuse can be falsified. In brief, the *ceteris paribus* conditions needed for econometric testing of theories are unavoidably elusive.

Since econometric testing cannot separate good models from bad models, care must be taken to build economic theories on realistic assumptions. Good analysis to a modern Austrian consists of correct chains of logical inference from self-evident propositions such as the action axiom and scarcity. The term “self-evident” refers to propositions that analysts and their audiences readily accept because the propositions seem, through introspection and common personal experience, to be correct. Introspection is a legitimate tool for gaining understanding in economics because the object of inquiry in economics is what humans do, and analysts and their audiences are human. Introspection is not a legitimate tool in the physical sciences because the objects of inquiry in physical sciences are quantifiable phenomena that are external to human analysts and their audiences (Mises 1962).

A logically correct model is not always applicable to a particular real-world situation. All statistical studies are numerical descriptions of history. As such, they may be useful to illustrate principles of economics by description of past applications of such principles and to discover phenomena to be explained by economic theory, but they can never be grounds for refuting such theory.

The neoclassical mainstream is wont to express assumptions and develop models by the manipulation of mathematical equations. Austrians claim that such exercises are redundant at best and often completely misrepresent the actual character and essence of human action. First and most important, the subject matter of economics is the choices, actions, and interactions of people. Objectively observable phenomena at time t , such as labor, capital, money, and other institutions, about which equations may conceivably be written, are the results of choices, actions, and interactions of people before time t . They matter at time t only insofar as people’s subjective perceptions of them influence the choices that people then make. Human perceptions, purposes, and intentions cannot be mathematized in any

meaningful way. Interpretation and understanding (*Verstehen*) of human action, not mathematical modeling, are the essential tools of economic inquiry (Mises 1949, pp. 47–58).

Mathematical economists arbitrarily use either specific mathematical forms or empty general functional forms as representatives of real people. They then dismiss the real people as redundant to their analyses. In Pareto's words, "The individual can disappear, providing he leaves us [a] photograph of his tastes" (quoted in Littlechild 1979, p. 13). But the photograph must leave out what ought to be to economists the most important characteristics of an individual: the person's purposes, intentions, interpretations, and perceptions. On the basis of this flawed photograph, the mathematical crank is then turned to generate either well-known results that are more easily generated by the pure logic of choice and action (such as notions of marginal equivalences) or results that are more complicated but irrelevant (such as, if we assume a person spends all his income, the weighted sum of an individual's income elasticities of demand for all goods in his utility function must be one).

The modern Austrian view of econometrics and mathematics is that they may, from time to time, be useful for purposes of illustration and/or clarification, but they are not the *sine qua non* of good economics. Most of what economists should be doing does not lend itself to the use of these tools and methods. Thus economists waste a lot of time trying to master such tools, given their relatively limited usefulness in economics. The effort spent in that endeavor would be better redirected to the further understanding of market processes and institutions.

The only predictions that economics is capable of generating are what Hayek (1968a) calls pattern predictions. That is, economic analysis, correctly understood, can predict the general directions of relationships between variables and general patterns of exchange interaction, but it can never make reliable quantitative or exact numerical predictions. Economists can explain patterns, but exact quantitative measurement of those patterns is beyond their reach.

Hayek (1952) uses the term "scientism" for the application of tools that are appropriate in the physical sciences to fields of inquiry such as in economics, where they are inappropriate. He is unequivocal in his condemnation of this common practice.

Buchanan's References to Austrians

Before we get to specific consideration of the common ground between Buchanan and the Austrians, we should note that, with the

exception of the “priesthood” observation quoted above and a reference to “sin,” which we will consider later, all of Buchanan’s explicit references to Austrian economics and Austrian economists of which I am aware have been very favorable. For example, in a recent op-ed piece in the *Wall Street Journal* Buchanan (1986a), after outlining the real-world conditions that led in the 1970s to widespread disillusionment with the results of government intervention, wrote:

The ideas of Prof. Hayek, Austrian economists, Armen Alchian, and the philosopher Robert Nozick, along with those of the public choice school helped make sense of these conditions. . . . The ideas that allowed such understandings and explanations came from the very scholars whose teachings had been scorned by the academic-intellectual mainstream in the 1960s, and these scholars came to be tolerated, respected, and, occasionally, honored by their peers.

In a paper originally published in Austria and later reprinted as the introductory essay to a volume of papers on public choice theory, Buchanan ([1979c] 1984, p. 11) wrote:

Austria has a very proud and important heritage in the development of economic theory as I have here defined it, and I may say . . . that one of the most exciting and most encouraging developments within economics in the United States today is the observed resurgence of interest in “Austrian economics,” and notably as among young research scholars.

Likewise, in a lecture delivered at a conference on subjectivist economics and later published in a collection of his papers, Buchanan ([1976] 1979a, pp. 90–91) wrote:

I challenge any of you to take any issue of any economics journal and convince yourself, and me, that a randomly chosen paper will have a social productivity greater than zero. Most modern economists are simply doing what other economists are doing while living off a form of dole that will simply not stand critical scrutiny. . . . I think I know what I am doing, and I think that most of those who espouse a variant of Austrian subjectivist economics know what they are doing. And I think that our efforts are socially productive, highly so.

The Influence of Wicksell and Knight

Buchanan acknowledges Knut Wicksell and Frank Knight as the two dominant influences in the formation of his analytical perspectives on economics and the world of ideas. Two photographs—one of Knight and the other of Wicksell—are proudly placed on his office walls (Buchanan 1986b). Wicksell’s “A New Principle of Just Taxa-

tion" was the article that launched Buchanan's inquiries into the economics of politics (Buchanan 1987a). Knight was one of Buchanan's graduate school professors at the University of Chicago, the one that Buchanan calls "my professor." Knight was responsible for Buchanan's views on methodology and the primacy of subjectivism in economics (Buchanan 1969b, p. xi).

Although neither Wicksell nor Knight were Austrians, to a large extent the common ground between Buchanan and the Austrians can be traced to their influence. According to Hayek (1968b, p. 460), Wicksell's interest in, and perspectives on, the emergence and characteristics of the institutions of political economy were strongly influenced by Menger. Moreover, the views of Knight on methodology were very close to the views of modern Austrians.

In a scathing review of T. W. Hutchison's *The Significance and Basic Postulates of Economic Theory*, Knight condemns the positivist view that good methodology in economics is the same as good methodology in the physical sciences. And he does so in almost the same terms that modern Austrians use to make the same points. Knight ([1940] 1956, p. 151) wrote:

Hutchison's methodology or philosophy of economics is of a sort that is particularly irritating to this reviewer, especially because it is so common, among people who "ought to know better." The author is a positivist, i.e., one of those who always think of "science" with a capital S (if they do not always write it that way) and use it in a context which conveys instructions pronounced in the awe-inspired tone chiefly familiar in public prayer. . . . The attempt to build a social science on these foundations suggests that the human race, and especially a large proportion of its "best minds," having at long last (a very long last) found out that the objects of nature are not like human beings—are not actuated by love and hate and caprice and contrariness, and subject to persuasion, cajolery, and threats—have logically inferred that human beings must be like natural objects, and so viewed by the seeker of knowledge about them.

Knight goes on in this extensive review to emphasize the significance of the fact that humans have purposes and that natural objects—the objects of the physical sciences—do not. With explicit reference to Wieser, Knight (p. 163) endorses introspection as a valuable tool of analysis in economics. He explores the implications of the subjective nature of the knowledge that is relevant to understanding human action, and he presents human action in a subjectively perceived means-ends framework (see especially p. 173). He states that predictions in economics must be limited to pattern predictions (p. 175),

and he asserts that, unlike the natural sciences, economics requires “interpretive study (*verstehende Wissenschaft*)” (p. 177).

In an earlier methodological essay, “The Limitations of Scientific Method in Economics,” Knight (1924) examines the nature and limitations of positivist scientific method and concludes that mathematics, statistics, and other positivist scientific tools have only very limited applicability in economics and other social sciences. For Knight ([1924] 1969, p. 147)

[R]eal sociology and economics must be branches of literature as much as of science. In fact they need to be both, and commonly succeed in being neither. It is no wonder that these sciences are still in the stage of violent disagreement among their followers as to what they are and what they are about. The first step toward getting out of this slough, we suggest, is to recognize that man’s relations with his fellow man are on a totally different footing from his relations with the objects of physical nature and to give up, except within recognized and rather narrow limits, the naive project of carrying over a technique which has been successful in the one set of problems and using it to solve another set of a categorically different kind.

There are two methodological conventions associated with the Chicago School: the empiricist instrumentalism of Friedman and Stigler, and the methodological pluralism of Knight. Buchanan takes his cues from the latter.

Common Ground in General Economics

Buchanan is best known for his pioneering work in public choice: the economic analysis of politics. The Buchanan and Tullock classic, *The Calculus of Consent* (1962), set the stage for what is now known as the public choice revolution. Two types of analyses come under the rubric of public choice: constitutional economics and operational public choice analysis. The former, Buchanan’s main interest, is concerned with constitutional choice and constitutional reform. We will discuss constitutional economics in the penultimate section of this paper. The latter is concerned with political processes within existing constitutional regimes. Here the analysis, based on political entrepreneurship and focused on the anatomy of government failure, parallels Austrian market process theory.

In *The Calculus of Consent*, Buchanan and Tullock (1962, pp. 12–13) forthrightly declare their analysis to be based on methodological individualism. Along with modern Austrians they recognize that the only way to understand what any collective does is to understand the choices, plans, and actions of the individual members of the collec-

tive. To understand what governments do within a given constitutional regime, it is necessary to understand the plans and actions of the politicians and bureaucrats who wield governmental authority within that regime. And the way that understanding is pursued in public choice theory is to begin with the assumption that each person pursues broadly conceived self-interest. (Austrians would say that each person acts in accordance with the action axiom.) All people, whether employed in the government sector or the market sector, attempt to do the best they can for themselves, as they see it, within the set of constraints they confront. People who make different decisions in the government sector from those they would make in the market sector do so only because of the differences in incentives they confront in the two sectors—that is, only because institutional constraints are different in the government than in the market sector (see, for example, Buchanan 1987a, pp. 245–46).

In his presidential address to the Southern Economic Association, Buchanan ([1963] 1979a) explained why he thinks that the conventional focus of economists on constrained maximization or optimization is misplaced. The famous Robbinsian definition of economics “served to retard” progress in economic understanding (p. 20). The Robbinsian formulation pays no attention to the important task of “identifying properly the entity for whom the defined economic problem exists” (p. 21). He takes Friedman to task for his holistic characterization of economics as the “study of how a particular society solves its economic problem” (p. 21). He says he wants economists “to concentrate on exchange rather than on choice” (p. 26). If he could start all over again, Buchanan would recommend that the word “economics” be replaced with the word “catallactics” or “symbiotics” to emphasize that the proper objects of analysis are the implications of individuals seeking to further their broadly defined interests through mutually beneficial relationships with other individuals (p. 27).

In words that Mises and Hayek must have applauded and that Kirzner (1965) explicitly acclaimed, Buchanan (p. 29) called for a redirection of attention away from the comparative statics of perfect competition and monopoly and of Walrasian general equilibrium toward market process:

A market is not competitive by assumption or by construction. A market *becomes* competitive and competitive rules *come to be* established as institutions emerge to place limits on behavioral patterns. It is this *becoming* process, brought about by the continuous pressure of human behavior in exchange, that is the central part of our discipline, if we have one, not the dry rot of postulated

perfection. A solution to a general-equilibrium set of equations is not predetermined by exogenously determined rules. A general solution, if there is one, *emerges* as a result of a whole network of evolving exchanges, bargains, trades, side payments, agreements, contracts which, finally at some point, ceases to renew itself. At each stage in this evolution toward solution there are *gains* to be made, there are exchanges possible, and this being true, the direction of movement is modified.

Buchanan (pp. 30–31) clearly shares the views of Hayek on institutions, such as the market, as spontaneous orders that are the result of human action rather than human design:

The market or market organization is not a *means* toward the accomplishment of anything. It is, instead, the institutional embodiment of the voluntary exchange processes that are entered into by individuals in their several capacities. . . . It is a setting, an arena, in which we, as economists, as theorists (as onlookers), observe men attempting to accomplish their own purposes, whatever these may be. And it is about these attempts that our basic theory is exclusively concerned if we would only recognize it as such.

In “General Implications of Subjectivism in Economics,” Buchanan ([1976] 1979a, p. 84) endorses Hayek’s criticism of scientism and recognizes that Knight and Hayek share common methodological ground:

Hayek and Knight were sharply critical of any attempts to convert economics into a discipline analogous to a natural science. Economics is, or can be, scientific in a sense that is, I think, unique. The principle of spontaneous order is a scientific principle, in that it can readily be divorced from normative content. Unless we stay within the exchange paradigm, however, we lose the legitimately scientific principle, and, instead, launch off into the scientific implications that emerge from the maximization paradigm.

“Is Economics the Science of Choice?” was Buchanan’s (1969a) contribution to a Hayek *Festschrift*. It is his most systematic consideration of methodological problems. He opens the paper with a quote from Hayek’s “Economics and Knowledge” (1937), and, adopting some of Hayek’s insights in that essay, he goes on to divide economic theory into three categories: the logic of economic choice, the abstract science of economic behavior, and the predictive science of economic behavior.

The Logic of Economic Choice

The first category consists of purely a priori reasoning based on the notion that individuals attempt to pursue their broadly conceived self-interests. This category is what Mises regarded as the central

domain of economic theory. Since what is in a person's interest (the goods in his utility function) is wholly undefined, the logical inferences obtained in this category are "empirically empty." That is, the inferences are not conceptually refutable. Any observed action can be interpreted to be in the actor's interest. But Buchanan ([1969a] 1979a, pp. 41–42) tells us:

[E]mpirical emptiness should not . . . be equated with uselessness. . . . Commencing with the fact that choosers choose and that they do so under constraints which include the behavior of others, the economist can begin to make meaningful statements about the results that emerge from the interaction among several choosers. Certain "laws" can be deduced, even if conceptually refutable hypotheses cannot be derived. . . . The "law" of choice states only that the individual decision-maker will select that alternative that stands highest on his preference ordering. Defined in purely logical terms, this produces the "law of demand." In this way, trade or exchange can be explained, even in some of its most complex varieties. Characteristics of equilibrium positions can be derived, these being defined in terms of the coordination between expected and realized plans of the separate decision-makers.

In "Economics and Knowledge," Hayek (1937), too, discussed the limitations of what he called the "pure logic of choice" and explained what he considered to be the only meaningful notion of equilibrium: the interpersonal coordination of plans and actions. Actually, Hayek applied the term "pure logic of choice" to two different types of analyses: first, to the pure a priorism of Mises (Buchanan's first category) and second, to models wherein the utility function and constraints are fully specified as mathematical equations or curves in Cartesian planes. In the latter (standard neoclassical) case there is no real choice at all. With the utility function and constraints fully specified, an external observer can, with certainty, predict the outcome. All that separates the observer (and the "chooser") from the answer is mere calculation or computation.

Hayek ([1937] 1948, pp. 44–45) states that while the pure logic of choice, in the first sense, is sufficient to understand the nature of equilibrium, the question of whether there is in markets a tendency toward equilibrium is an empirical one.

To answer that question, the economist must go beyond the pure logic of choice to examine the processes by which agents acquire the knowledge they must possess for plans to be fully coordinated.

The Abstract Science of Economic Behavior

And that takes us into the realm of Buchanan's second category of economic theory: the abstract science of economic behavior. Here

the content of self-interest is specified, but the analysis remains qualitative rather than quantitative. Conceptually refutable pattern predictions can be made. As Buchanan ([1969a] 1979a, p. 45) states:

In the pure logic of choice, the arguments in the utility function are not identified: "goods" and "bads" are unknown to the external observer. In any science of economic behavior, the goods must be classified as such. But under minimally restricted utility functions, specific trade-offs among these may remain internal to the acting units. The individual chooses in the sense that his selection from among several desirable alternatives remains unpredictable to the observer. What we have here is an extremely limited "science" of behavior combined with an extensive "logic" of genuine choice. We move beyond this essentially mixed framework when the trade-offs are more fully specified. Additional "laws of behavior" can then be derived; and, more important, predictions can be made about the results of the interaction process.

Buchanan places most of his own economic theorizing in this second category. I think that Kirzner's analysis of the entrepreneurial market process also falls in this category (Kirzner 1973, 1979, 1985). The entrepreneur is the key actor in that analysis. In neoclassical language, Kirzner specifies pecuniary profit as a good and pecuniary loss as a bad in the entrepreneurs' utility functions. Because of that "restriction" on utility functions, Kirzner is able to make conceptually refutable pattern predictions, for example, the existence of a strong tendency to equilibrium in the market process. Every instance of plan discoordination based on lack of relevant knowledge is a potential profit opportunity for an entrepreneur who notices the situation and acts on it. As the entrepreneur acts, others imitate the profitable actions and thus the discoordination (disequilibrium) diminishes. To justify his confidence that the knowledge necessary for interpersonal plan coordination will be discovered by those who need to discover it, Kirzner (1979, chap. 2) relies on the propensity of entrepreneurs to notice that which is in their interest to notice.

Curiously, Kirzner (1976a, pp. 46–47) interpreted Buchanan's contribution to the Hayek *Festschrift* to be a negative appraisal of Austrian methodology:

Critics of Austrian methodology often argue that since praxeology [Mises' pure a priorism] deals with unobservables, it is inherently incapable of telling us anything scientific about observables. The latest (and perhaps the clearest and most sympathetic) statement of this argument was by James Buchanan, in his contribution to the Hayek *Festschrift* when he drew attention to the distinction between (1) the logic of choice (what he called the abstract science of economic behavior) and (2) the predictive science of human behavior.

Buchanan argued that if we treat economics as the logic of choice, it cannot in principle lead to refutable hypotheses because no particular preference ordering has been specified, and to that extent it cannot tell us anything about the real world.

In answer to Buchanan, our discussion indicates that the truth is the other way around. We are not only able to say something about the real world; we are also able to say a great deal about a large and important area of human experience about which other disciplines are necessarily silent—the realm of purpose.

I think Kirzner misunderstood Buchanan in the above. Perhaps because he was used to criticism by economists who thought that the worst thing you could say about an analysis was that it was not conceptually refutable or that it was empirically empty, he simply assumed that Buchanan had the same attitude. But, as we have seen, to Buchanan the term “empirically empty” is not a term of opprobrium, and he does recognize that useful conclusions can emerge from the pure logic of choice. Moreover, Buchanan does not equate the pure logic of choice with the abstract science of economic behavior. The latter is his second category, and he places his own work therein. I claim that much of Kirzner’s work is also in this category. Finally, in light of Buchanan’s recognition, quoted above from his 1963 presidential address, that “our basic theory is exclusively concerned” with “men attempting to accomplish their own purposes, whatever these may be,” Kirzner’s answer to Buchanan is not appropriate.

The Predictive Science of Economic Behavior

Buchanan’s third category of economic theory—the predictive science of economic behavior—is economics as an exact science that attempts to make quantitative predictions based on full specifications of objective functions and constraints and on statistical data analyses. Here, according to Buchanan ([1969a] 1979a, p. 49), the economist goes beyond conceptual refutability to actual “empirical testing against real-world observations.” But, in Buchanan’s view, actual quantitative empirical testing is next to impossible, and in the end it cannot ever refute the general laws of the first two categories.

In the concluding paragraph of this important paper Buchanan (p. 63) once again explicitly aligns himself with Hayekian methodology:

The critical methodological oversight was that which Hayek emphasized, with clarity but to little avail, in several of his fundamental papers in the late 1930s and early 1940s. The failure of economists to recognize that the sense data upon which individuals actually choose in either market or political choice structures are dimensionally distinct from any data that can be objectively called upon

by external observers led directly to the methodological chaos that currently exists. . . . Few economists are wholly free of the confusions that I have discussed. For myself, I advance no claim that my own thinking has yet fully rid itself of the paradigms of neoclassical orthodoxy.

In his foreword to Gordon Tullock's *The Politics of Bureaucracy*, Buchanan ([1965] 1979a, p. 171) indicates his agreement with the Austrians on the question of the usefulness of introspection in the sciences of human action:

[H]ypotheses about individual behavior are . . . important in Tullock's analysis, and the absence of external variables that are subject to quantification makes the refutation of positive hypotheses difficult in the extreme. For assistance here, Tullock introduces a simple, but neglected, method. He asks the reader whether or not his own experience leads him to accept or to reject the hypotheses concerning the behavior of the politician in bureaucracy.

Evidence on Buchanan's attitude toward the use of mathematics and statistics to make economics seem like an exact, predictive science can be found in several of his papers. For example, in his essay "Politics without Romance," Buchanan ([1979c] 1984, p. 11) writes:

Ecclesiastes tells us that there is nothing new under the sun, and in a genuine sense, such a claim is surely correct, and especially in the so-called social sciences. (I am reminded of this every week when I see my mathematically inclined younger colleagues in economics rediscovering almost every wheel that older economists have ever talked about.)

In "General Implications of Subjectivism in Economics," Buchanan ([1976] 1979a, p. 88) writes:

The young and aspiring economist who becomes the expert empiricist has necessarily sacrificed training time in learning more about the process to which his highly polished technical tools are to be applied. These gaps in the training of modern economists are beginning to show up in many forms, not the least of which is the deadly dullness that dominates whole departments in many universities and colleges.

In the same paper he states that there may be some legitimate uses of mathematics, such as aiding the understanding of the relationships between parts of an analysis, so long as it is kept in its proper place as a tool and is not permitted to define the scope of what is considered good economics (p. 89).

In "Retrospect and Prospect," Buchanan (1979a, p. 280) penned the following passionate condemnation of abuse of statistics and mathematics in economics:

I see a continuing erosion of the intellectual (and social) capital that was accumulated by "political economy" in its finest hours. I look at young colleagues trained to master regression routines who are totally uninterested in, and incompetent to examine, elementary economic propositions. The graduate schools attract and turn out dullards, and the exciting young minds turn increasingly to law, to philosophy, and to the commune. For those among these minds that are trapped into economics and that may, with effort, partially finesse the empiricist rage, I see them compelled to utilize their considerable mental potentials, resolving the escapist puzzles of modern mathematics.

It is not surprising, then, to note that Buchanan "makes little use of mathematics, and in none of his publications, not even one, has he undertaken statistical estimates" (Christainsen 1988, p. 11).

Buchanan's Summary Statements

Buchanan's 1979 essay "Retrospect and Prospect" consists mainly of an enumerated list of eight "cryptic statements or assertions" that Buchanan uses to restate some of the main points of the earlier essays and "to suggest possible directions that seem ripe for further inquiry" (Buchanan 1979a, p. 280). In order, his statements concern methodology, limited usefulness of equilibrium analysis, entrepreneurship, exchange over maximization as the basis of economics, institutions, economics as politics, spontaneous order, and mathematics as "excess baggage." Only the sixth statement, economics as politics, is not obviously Austrianesque. The others could have been written by a modern Austrian as forceful summary statements of much of what is distinctive about Austrian economics. What follows are brief excerpts from each of the remaining seven statements (Buchanan 1979a, pp. 280–82).

On Methodology

The problems in economics are not amenable to scientific solutions [in the sense of "physical-biological" sciences], and progress is not to be expected by pushing back the frontiers of science. The strictures of both Frank Knight and F. A. Hayek against scientism require repeated repetition.

On Equilibrium

The equilibrium constructions are useful only if their limitations are appreciated. These allow us to discuss directions of adjustment rather than states of potential attainability.

On Entrepreneurship

Increasingly, I have come to the view that the role of entrepreneurship has been the most neglected area of economic inquiry, with significant normative implications for the general understanding of how the whole economy works.

On Exchange versus Maximization

The behavioral paradigm central to economics is that of the trader whose Smithian propensity to truck and barter locates and creates opportunities for mutual gains. . . . [T]he maximization paradigm is the fatal methodological flaw in modern economics.

On Institutions

Choices are made by actors, by traders, constrained within specifically determined "laws and institutions," a central emphasis of Adam Smith and one that has been lost to modern minds. Institutions matter.

On Spontaneous Order

As a discipline or area of inquiry, economics has social value in offering an understanding of the principle of order emergent from decentralized processes, of spontaneous coordination. (The market is the classic example.) Such an understanding is necessarily prior to an informed decision on alternative forms of social order.

On Mathematics

[D]espite the attempts by modern scholars to cloak their own insecurity in complexity, the central principles of economics are elementary. We do not need the excess baggage of modern mathematics to grasp and to convey the basic wisdom that Adam Smith discovered and that his successors emphasized.

Evaluating Economic Policy

Buchanan and the Austrians also share common ground on the means by which it is legitimate for economists to come to normative conclusions regarding various governmental policies. Mises was often accused of carelessly mixing normative judgments with positive analysis. In one place Buchanan ([1969c] 1979a, p. 77) writes: "It is as much of a sin for von Mises or his followers to decry government failure on the basis of their empirically empty model as it is for Bator to neglect governmental failure in his extremely restricted model."

However, as Kirzner (1976b, p. 82) explains, Mises' negative assessments concerning governmental economic policies were based on positive conclusions of his pure logic of choice. Those conclusions, Mises taught, demonstrate that the outcomes of proposed governmental economic policies will almost always be different from the outcomes that the protagonists of the policies claim they intend. This is precisely the view adopted by Buchanan ([1977] 1979a, p. 180) for the use of public choice theory normatively to evaluate government policy:

Public-choice analysts have no business telling President Carter or Jim Schlesinger just what energy policy "ought" to be proposed. Nor do they even have any role in delineating what would be an

“ideal” policy mix. Positive public-choice analysts can tell us, however, and within broad limits, roughly the sort of energy policy that is likely to emerge from the collective decision-making institutions that we observe in operation. This is, and has been, our major contribution. And our predictions can tell us that the emergent results are unlikely to bear much relationship to those results desired, even by those who make the final normative decision as to the “ought.”

Common Ground in Cost Theory

Hayek ([1952] 1979, p. 52) wrote, “It is probably no exaggeration to say that every important advance in economic theory during the last hundred years was a further step in the consistent application of subjectivism.” That is certainly the case with cost theory. There is no notion more basic in economics than that individuals make choices on the basis of comparisons of costs and benefits. The costs that influence choice, the costs on which economists should focus, are as thoroughly subjective as the benefits that influence choice. Buchanan and the Austrians understand this better than most other economists.

In *Cost and Choice*, Buchanan (1969b, pp. 12–15) even parts company with Knight on the issue of subjectivism in costs. Knight’s conception of opportunity cost was the market value of alternative product. But, as Buchanan and the Austrians recognize, cost, thus defined, “has no connection with choice at all.”

Buchanan adopts such a thoroughly subjectivist view of cost that Leland Yeager (1987), the Ludwig von Mises Distinguished Professor of Economics at Auburn University, calls his views “exaggerations.” Before we evaluate Yeager’s objection to Buchanan’s subjectivist understanding of cost, however, we must see what Buchanan has to say about the subject.

Buchanan (1969b) identifies his subjectivist views on cost with those developed in the 1930s and 1940s by Hayek and Robbins at the London School of Economics, and extended in the mid-1940s and 1950s by G. F. Thirlby. Although he calls his views the LSE cost tradition, he writes, “Latter-day Austrians especially may suggest, with some justification, that the theory developed is properly labeled ‘Austrian’ ” (p. ix). He goes on to say, however, as Kirzner (1988) also says, that early Austrian attempts to explain cost were so unsatisfactory that they contributed to some of the misdirections and misunderstandings embodied in orthodox cost theory. In Buchanan’s view, misstatements of subjectivist cost by Mises and Hayek early in the socialist calculation debate provided Lange and Lerner with grounds for claiming that market socialism solves the calculation problem

(pp. 22–23, 26). Clarifications of the subjectivist cost theory were made by non-Austrians, such as Thirlby and Robbins, as well as Austrians, such as Mises and Hayek.

Buchanan (1969b, pp. 44–45) makes a distinction between choice-influencing and choice-influenced costs. The former are subjective and enter into the process of making choices. The latter are objectively observable accounting costs that are the result of the actions taken on the basis of choice-influencing costs. Money measures of cost of production, for example, depend on prices of labor, capital services, materials, and supplies. These prices emerge out of the market processes of production and exchange. But the actions of people in production and exchange are based on the choices those people make, and those choices are influenced by subjective evaluations attached to sacrificed alternatives.

In his development of the distinction between subjective choice-influencing costs and objectively measurable money costs, Buchanan (1969b, p. 49) adopts the Austrian views that what is important in economics is the process by which markets in disequilibrium are nudged toward equilibrium and that the special conditions that exist in equilibrium have little practical value:

If the whole economy is not operating at full competitive equilibrium, profits-losses may occur and, hence, observed outlays cannot be taken to reflect foregone opportunities of the actual decision-takers in any general setting. In full equilibrium, on the other hand, observed outlays directly represent the maximum contribution of resources in different uses. Therefore, to the extent that decision-takers behave economically, the observed outlays reflect genuine “opportunity costs,” even if somewhat indirectly. . . . [T]he whole purpose of the economic theory in which cost is relevant is to demonstrate how choices made in nonequilibrium settings will generate shifts toward equilibrium. And choices in nonequilibrium must be informed by opportunity costs that cannot, even indirectly, be represented by measured outlays.

Buchanan (1969b, p. 43) lists six implications of a choice-based conception of cost:

(1) Most importantly, cost must be borne exclusively by the decision-maker; it is not possible for cost to be shifted to or imposed on others. (2) Cost is subjective; it exists in the mind of the decision-maker and nowhere else. (3) Cost is based on anticipations; it is necessarily a forward-looking or *ex ante* concept. (4) Cost can never be realized because of the fact of choice itself: that which is given up cannot be enjoyed. (5) Cost cannot be measured by someone other than the decision-maker because there is no way that subjective experience can be directly observed. (6) Finally, cost can be dated at the moment of decision or choice.

Yeager (1987) takes strong exception to the first two implications. He says that externalities such as air pollution clearly represent an imposition of cost on others, and dirty air is not subjective. But these six implications refer to choice-influencing, not choice-influenced, cost. Externalities, by definition, do not influence the choices made by the person whose actions result in the spillovers. Externalities are choice-influenced cost. Moreover, the choice-influenced cost here is not the dirty air; it is the sufferers' subjective evaluations of the dirty air. Yeager's objection simply misses the point.

Kirzner (1973, ch. 5) uses the choice-influencing notion of cost (he does not use that language) to clarify the meaning of long-run and short-run cost and to establish that "a market process which is seen as competitive from one point of view may turn out to be monopolistic when evaluated from a different vantage point" (p. 198). In so doing, he is implicitly employing Buchanan's third and sixth implications.

Kirzner's concern is with an entrepreneurial decision to acquire all the available supply of a resource that is needed to produce a product. At the point of decision, the market process is competitive because others could attempt the same thing. After the acquisition of the resource supplies, the subsequent market process would have to be considered monopolistic because the earlier competitive decision resulted in a closed market. Were the entrepreneurial actions competitive or monopolistic? The answer depends on the perspective from which the question is examined.

Common Ground in Political Economy

Buchanan is a contractarian in constitutional choice. In *The Limits of Liberty* (1975) and with Geoffrey Brennan in the *The Reason of Rules* (1985), he spells out his views on the social contract idea of politics as exchange. The basic behavioral assumption is what Austrians would call the action axiom. The methodological perspective is individualistic. The purpose of the analysis is first of all to justify the existence of a constitutionally circumscribed state and then to discern what sort of constitutional rules could conceivably receive unanimous consent at the stage of constitutional choice. The basic tool of analysis is conjectural history—the construction of a story of how a proper constitutional order logically could have emerged. The point is not to explain how actual governments emerged in history; rather, it is to justify a particular form of state on the grounds that it could logically have emerged as a unanimously approved social contract among self-interested people.

Buchanan adopts the unanimity principle from Wicksell (1896). The importance of unanimity as a benchmark is that, because of the subjectivity of personal costs and benefits attached to each collective action, it is impossible, without unanimous consent, ever to determine whether any collective action is genuinely in the public interest. In collective decisions the counterpart to mutual consent in market exchange is unanimity. Buchanan modifies the Wicksellian principle by transferring it to the constitutional stage of collective choice.

Buchanan's contractarian approach is useful today because it provides a way of normatively evaluating proposed constitutional revisions. Clearly, in the United States in the 1980s no actual constitutional change would receive unanimous approval. There are simply too many vested interests in the status quo. Nevertheless, the political economist can use the unanimity criterion as a benchmark normatively to evaluate existing constitutional provisions and proposed constitutional changes. If a plausible argument can be made that, starting from ground zero with each person making evaluations under a "veil of uncertainty" as to his or her specific interests in an indefinite number of future applications of the constitutional rule, a proposed constitutional change would receive unanimous consent, the rule should be adopted. If it is clear that, in that artificial setting, the rule could not receive unanimous consent, the rule should not be adopted. Accordingly Buchanan (1987a, p. 248) writes:

The political economist who operates from within the Wicksellian research program, as modified, and who seeks to offer normative advice must, of necessity, concentrate on the process or structure within which political decisions are observed to be made. Existing constitutions, or structures of rules, are the subject of critical scrutiny. The conjectural question becomes: Could these rules have emerged from agreement by participants in an authentic constitutional convention?

It is crucial to see that Buchanan applies the unanimity principle at the stage of constitutional choice—the stage of choosing the rules by which the citizens of the political economy will live. The principle need not apply at the stage of postconstitutional, day-to-day operations of the government set up by the constitution. For example, at the constitutional stage people could unanimously agree that postconstitutional, annual national-defense budgets would be determined by majority voting among elected representatives. A losing minority at the postconstitutional stage could not then, according to Buchanan, legitimately claim that they were being coerced by the victorious majority.

Buchanan has not spelled out the details of what he thinks a constitution constructed on the unanimity principle would contain. His concern has been to understand and exposit the process by which such a constitution could be identified. He thinks that the postconstitutional political process in the United States has produced some disastrous results, and he thinks that it is time in America for scholars to do some serious thinking about constitutional change. Setting constitutional choice in the context of an initial zero-government state of nature with all self-interested participants making decisions under a veil of uncertainty makes unanimity conceivable. If the participants do not know their relative positions in an indefinite number of future applications of the constitutional rules, they will, Buchanan conjectures, adopt process rules that are perceived to be "fair"—ones that promote equality of opportunity (Brennan and Buchanan 1985).

The unanimity principle is applied routinely in Paretian welfare economics. The earlier Pigouvian welfare economics failed because of the incomparability of subjective costs and benefits. Individual benefits and costs cannot be measured on any objective scale that would permit interpersonal comparisons of gains and losses; hence, the formalistic application of Pigouvian marginal equivalences is an empty mind game. In Paretian welfare economics, a collective policy is said to be in the interest of the collective if the policy benefits at least one person without making anyone worse off. The evidence for such Pareto efficient changes is the consent of the individuals involved. The impossibility of a "social welfare function" (Arrow 1951) makes it impossible to make nonarbitrary collective choices from the set of Pareto optimal outcomes. In brief, because of the subjectivity of all relevant costs and benefits, welfare economics is reduced to the search for measures that receive unanimous consent.

Murray Rothbard ([1956] 1977, p. 28), an Austrian, was one of the first explicitly to call for the application of the Paretian unanimity rule to an analysis of the state itself:

Until quite recently, welfare economics has never analyzed the role of the State. Indeed, economics in general has never devoted much attention to this fundamental problem. Specific problems, such as public finance or price controls, have been investigated, but the State itself has been a shadowy figure in the economic literature. Usually, it has vaguely been considered as representing "society" or "the public" in some way. "Society," however, is not a real entity; it is only a convenient shorthand term for an array of all existing individuals. The largely unexplored area of the State and State actions, however, can be analyzed with the powerful tools of Dem-

onstrated Preference [actual choices made by people in real choice settings] and the Unanimity Rule.

Although Buchanan and Tullock did not refer to this statement by Rothbard in *The Calculus of Consent*, it could well be taken as a prologue to what later emerged as public choice theory.

But it is with Hayek that Buchanan shares the most common ground. Indeed, I think that Buchanan has strongly influenced Hayek's ideas about an ideal constitution. Buchanan frequently refers to Hayek's work. In "Public Choice and Ideology," Buchanan ([1978] 1979a, pp. 274–75) explicitly acknowledges that Hayek's political economy is consistent with, but significantly different from, his own. Hayek's views are "Panglossian" because, according to Buchanan, Hayek expresses confidence that efficient institutions inevitably emerge from the on-going process of political evolution. Thus the best thing to do is avoid interfering with the process. The institutions we have are the best we can have at the moment. Buchanan calls his own views "meliorist" because he recognizes a need to construct constitutions and rules to constrain the self-seeking propensities of man.

However, when it comes to design of constitutions, Hayek has more in common with Buchanan than the Panglossian/meliorist distinction implies. It is not true that Hayek thinks that existing governmental institutions are the best we can do. For example, in "Economic Freedom and Representative Government," Hayek ([1973] 1978, p. 107) explicitly states that majoritarian democracy has gotten out of hand and has planted "the seeds of destruction" of the market order.

While Hayek has consistently taken an anti-constructivist, evolutionary approach to nongovernmental social institutions, he has not done so when it comes to governmental institutions. His insights on the division of knowledge imply that it is impossible for one or a few persons to construct social institutions that embody the same amount of knowledge and understanding that is embodied in spontaneously formed social institutions. All relevant bits of knowledge and understanding are brought to bear in the process by which social institutions spontaneously emerge simply because all individuals, with their own fragmented, subjectively held knowledge, play a part in the process. In Hayek's words ([1937] 1948, p. 54), understanding the advantages of spontaneous orders over constructivist designs requires acknowledgment that "the combination[s] of fragments of knowledge existing in different minds bring about results which, if they were to be brought about deliberately, would require a knowledge on the part of the directing mind which no single person can possess."

But when it comes to governments, Hayek recognizes the negative sum consequences of political entrepreneurship under existing constitutional regimes. He also recognizes, on public choice grounds, that minorities can rule in a majoritarian democracy. More to the point, he proposes a constructivist constitutional solution, “demarchy,” and states that if his constructivist design were tried by any country, the resulting prosperity would create a consensus that demarchy ought to be imitated elsewhere. Approximate unanimity would be the result of successful initial trials.

Hayek (1979) lays out the details of demarchy in volume 3 of *Law, Legislation, and Liberty*. He recognizes, as does Buchanan, that there are really two levels of collective choice. There is the level of the general rules of just conduct—constitutional process rules that are intended to apply to every individual situation irrespective of the people and interests involved—and there is the level of the routine operations of government. He proposes two assemblies of representatives to handle the two different activities. The “legislative assembly” would be responsible for discovering, articulating, and applying the gradually evolving universal rules of just conduct. It would also specify limits on what the other assembly, the “governmental assembly,” may do and how it must go about its authorized tasks. The governmental assembly would be responsible for providing public goods such as national defense, roads, schools, and dams. It would decide which projects to adopt out of the permissible set and how much to spend on them. But the legislative assembly would determine the tax system. Spenders would have no power to alter the forms of taxation. Spending lobbyists could no longer shift and disguise the tax burden.

The governmental assembly could be set up as present legislatures are, but the legislative assembly would consist of men and women between 45 and 60 years old, serving 15-year terms. Although no member could run for reelection, upon completion of their 15-year terms members would be guaranteed “honorific but neutral positions as lay judges” so they would not have to return to employment in the market sector. Each year, the 45-year-old age cohort of the electorate would elect one of its own for a 15-year term. Thus each citizen would vote only once for a representative to the legislative assembly. Those running for election would be people who had already proven their leadership qualities in the market sector. People who had served in the governmental assembly would be ineligible to serve in the legislative assembly.

Good government is limited government. To keep government limited, Hayek (1979, chap. 16) attempts, in his “model constitution,”

to insulate the members of the legislative assembly from the temptations and pressures of the rent-seeking, negative-sum political entrepreneurship that characterizes present majoritarian democracies.

Buchanan does not offer a model constitution, but he and Hayek agree on the existence and nature of two separate levels of governmental activity. They agree that limited government includes more than just the protective and judicial services of the classical night watchman state. It includes what Buchanan calls the “productive state”—the provision of a limited number of genuine, but nonprotective, public goods such as schools, general-access roads, and mosquito abatement. They also agree that the provision of nonprotective public goods is a slippery slope that easily leads to excessive government. Hayek tries to avoid the hazards of the slippery slope by separating the provision of public goods from the determination of permissible government activities. Buchanan is less explicit on how to avoid the danger. Presumably constitutional revision under the conceptual unanimity principle would include such safeguards.

Conclusion

Austrian economics occupies the middle ground between the zero information cost or rational expectations view of the neoclassical orthodoxy that says markets are always at or near equilibrium and the Shackelian view that we can never know what we have to know for equilibrium, so equilibrium is impossible (Garrison 1982). Public choice occupies the middle ground between the view that government is “pure conflict” and the view that government is the embodiment of “truth and light” (Buchanan 1987b, p. 311). In my view, real solutions to real problems can be found only in such middle ground.

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