

Chapter 6

Ethics and Economics

The normative individualist whose ontology is subjectivist operates on the presumption that by their very being as individuals, members of humankind are and must be treated as responsible for their own choices.

—James M. Buchanan, “The Foundations for Normative Individualism” (1991)

Buchanan saw a close connection between economic analysis and the political philosophy of classical liberalism. The connection begins with his individualistic approach to economics. Individuals have their own goals and desires, and the purpose of economic activity is to enable them to cooperate with each other so they can further those goals. As economists depict it, individuals have “utility functions” and they make choices that enable them to maximize their utility. What this means in more common language is that individuals have their own goals, which each individual understands better than does anyone else. And the subject of economics, as Buchanan saw it, is to analyze how individuals interact for their mutual benefit in furtherance of those goals.

Individuals gain utility from accomplishing their goals, but to do so requires that they be free to pursue their goals as *they* see fit. Buchanan says that “A motivating element is, of course, the individual’s desire for liberty from the coercive power of others—an element that may be almost universally shared” (Buchanan, 2000: 117).² But he goes on to note that a requirement for individuals to have this liberty is that they must lack the ability to exert power over

2 Buchanan’s view on this matter changed in his later years. In a series of papers published during the final decade of his life, Buchanan observed, and lamented, the rise of what he called “parentalism”—which he defined as the desire to be relieved of the responsibility of making one’s own life choices (Buchanan, 2006).

others. One advantage of a market order is that it relies on voluntary exchange. Individuals can opt out of transactions if they do not see the transactions as likely to further their interests. A market order allows people to interact with each other for *mutual* gain and helps prevent some from gaining at the expense of others.

While some economists see a clear division between positive and normative analysis—between describing the facts of the world and making value judgments about those facts—Buchanan sees a close relationship between the two. While a common argument is that interjecting value judgments into economic analysis is not scientific, Buchanan argues otherwise, saying that “Indeed the only purpose of science is its ultimate assistance in the development of normative propositions. We seek to learn how the social world works in order to make it work ‘better,’ to ‘improve’ things; this is as true for physical science as it is for social science” (Buchanan, 1962/1999: 308).

Social welfare

The concept of social welfare, or the public interest, or the general will, or any similar collectivist visions of welfare depicts some concept of a common interest that stands above individual interests. But Buchanan’s individualistic approach emphasizes that there is no such thing as the welfare of a group beyond the welfare of the individuals who compose the group. To say that something improves the welfare of a group can mean nothing more than that it improves the welfare of at least some members of that group without reducing the welfare of any other members of that group. Social welfare is a faulty collectivist concept. Welfare applies to individuals, not to groups.

Value and utility are subjective concepts, as Chapter 4 noted, so there is no way to compare the well-being of some individuals against the well-being of others. It would be illegitimate to say that if some public policy benefits person A more than it harms person B, the policy is in the public interest. The utility of A cannot be compared to the utility of B, so policies that harm some for the benefit of others cannot be said to be in the public interest. This idea motivates Buchanan’s ideas on politics and constitutional rules, which are discussed further in chapters 8 and 9.

Even if comparisons of utility between individuals could be made, it would still be illegitimate to base public policy on such comparisons, because those policies restrict the liberty of some individuals to further the interests of others. To take an extreme example, if individual A would gain more utility from owning a slave than person B would lose from being a slave, this would not justify person A enslaving person B. To take a less extreme example but one that often forms the basis of public policy, if taking a dollar from A to give to B would give B more utility than A would lose, this fact alone does not justify taking the dollar from A and giving it to B.

The virtues of market exchange over political decision-making become more evident when taking this individualistic approach. Market exchanges make all participants better off, which enhances social welfare because these enhance the welfare of all parties to the exchanges. In contrast, political decision-making often imposes costs on some for the benefit of others. As the previous chapter discussed, political action carries with it a built-in externality, so there is no guarantee that it advances social welfare.

Adam Smith's system of natural liberty

Buchanan, who regarded himself as a classical liberal, drew on what Adam Smith called the “obvious and simple system of natural liberty” to explain his own ideas. In *The Wealth of Nations*, Smith said

According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain... (Smith, 1776/1937: 651)

One can see, in Smith's vision of natural liberty, the foundation for several of Buchanan's ideas. First, Buchanan's functional division of government into the protective state and the productive state (discussed in the previous chapter) echoes Smith, who limited the duties of the sovereign to protecting the society from outside invasion and from internal oppression—the protective state—and producing public works—the productive state. Smith saw the protective and productive state as being essential to a system of natural liberty. That points to the second commonality between Smith and Buchanan: the *advocacy* for a system of natural liberty.

To quote Smith again, in this system of natural liberty, "Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest in his own way, and to bring both his industry and capital into competition with those of any other man, or order of men" (Smith, 1776/1937: 651). Smith's system of natural liberty clearly encompasses free markets, and prohibits some from coercing peaceful others.

In an article titled "The Justice of Natural Liberty," Buchanan quotes this passage from Smith:

To hurt in any degree the interest of any one order of citizens for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all different orders of his subjects. (1976: 6)

Buchanan makes use of Smith's idea in two ways. The first is the clear notion that there is no such thing as social welfare beyond the welfare of the individuals who compose society. It is unjust to impose costs on some for the benefit of others. Second, Buchanan emphasizes, drawing on Smith, that markets and market exchange have an *ethical* justification that supersedes any efficiency justification. Markets are grounded ethically in the fundamental principle of justice that declares that people should deal with each other through cooperative action rather than by force.

In the twentieth century and into the twenty-first there has been an ideological divide separating advocates of free markets from advocates of central economic planning. This division has turned largely on different beliefs about which system allocates resources more efficiently. The collapse of the

Soviet Union and Eastern European economies in the early 1990s gave a clear answer to this question. The dismal performance of those centrally planned economies offers persuasive evidence that markets work better than government planning to allocate resources.

Both Buchanan and Smith envisioned a role for the productive state in cases in which collective action could further individual interests better than market transactions alone. But the productive state does not have the same ethical foundation as the market economy. One challenge Buchanan's research program addressed was how collective institutions could be designed to draw on the ethical foundations underlying market exchange.

Liberty as the fundamental value

Buchanan described an ideal of classical liberalism that “is built on the central, and simple, notion that ‘we can *all* be free’... A motivating element is, of course, the individual's desire for liberty from the coercive power of others—an element that may be almost universally shared.” Liberty is an end in itself. This desire for freedom complements the operation of the market mechanism as a way for individuals to cooperate to achieve their individual goals.

Buchanan saw the market mechanism as a spontaneous order in which individuals cooperate for the mutual gain of all who engage in voluntary exchanges. Those exchanges further the welfare of the individuals who participate in them; the evidence being that they voluntarily choose to exchange. Thus, Buchanan says, “For the scientist in the academy, understanding such principles does, or should, translate into reasoned advocacy of classical liberal policy stances” (Buchanan, 2000: 114).

Armed with an understanding of economics, Buchanan saw a *scientific* basis for promoting a classical-liberal social order. By allowing individuals the liberty to make their own choices, and by enabling them to cooperate with others to achieve their goals, individuals are best able to improve their own welfare while not infringing on the liberty of others to do likewise. The social sciences, which study how people interact with each other, treat liberty as an instrumental value—that is, as a means to a higher end. About this treatment of liberty Buchanan wrote:

Classical liberals themselves have added confusion rather than clarity to the discussion when they have advanced the claim that the idealized and extended market order produces a larger “bundle” of valued goods than any socialist alternative. To invoke the efficiency norm in so crude a fashion as this, even conceptually, is to give away the whole game. (Buchanan, 2000: 116)

Buchanan understood the strong temptation to make this efficiency argument. It is, after all, correct. But to make this argument shifts the terms of the debate to that of socialists and other critics of the market order. Yes, a market order is indeed more productive. Yet for Buchanan the *ultimate* and sufficient justification for a market order is that it is essential to protect individual liberty.

Ultimately, individuals want to make their own choices. They do not want others to tell them what to do. Fortunately, a market order allows them to make their own choices. In addition, a market is more productive than is a system in which some persons force their decisions on others. But this efficiency advantage should not distract the classical liberal from advocating liberty as a fundamental value.

Small versus large numbers

A market order works well when the cooperation of only a few individuals is needed for them to achieve their goals. The protective state is sufficient to ensure an environment in which people interact with each other voluntarily, for their mutual benefit. When a large group of individuals is required to accomplish some goals, such as producing the public works that Adam Smith mentioned, the productive state has a potential role to play at coordinating the actions of everyone in the large group.

Buchanan uses the same benchmark of mutual agreement to evaluate the role of government. Individuals should be in agreement on the government’s actions. Is it ethical for governments to coerce people into paying taxes, or to force them to obey government regulations? Buchanan argued that if government actions are truly in the public interest, people would agree to grant the government that coercive power. Taking this concept of mutually agreeable exchanges to the large-numbers case and to the coercive actions of government was a big part of Buchanan’s lifetime research program. He said, “Improvement

in the working of politics is measured in terms of the satisfaction of that which is desired by individuals, whatever this may be, rather than in terms of moving closer to some externally defined supra-individualistic idea” (Buchanan, 1986).

The Samaritan’s dilemma

An ethical problem arises for charitable individuals (“Samaritans”) wishing sincerely to use their resources to improve the well-being of less fortunate persons who cannot currently provide fully for themselves (who we will call “recipients”). If Samaritans refuse to extend charity today, they might well deny recipients the resources they need to get on their feet in order to become more productive tomorrow. Yet an extension of charity risks giving recipients incentives to remain needy and dependent. It’s a dilemma.

One way around this dilemma is for the Samaritan to attach to the receipt of any charity a clear rule establishing that the charity cease at some specific date in the future. The recipient, while receiving needed help today, nevertheless is given a strong incentive to become self-supporting before the charity runs out. If the charity runs out and the recipient is still needy, the Samaritan might feel bad—even to the extent of overriding the rule that terminates the charity. To avoid this temptation, Buchanan suggested that the Samaritan delegate the charitable activity to an agent with clear instructions on limits to the handouts.

Buchanan offers a dramatic application of the Samaritan’s dilemma: an aircraft hijacking. The plane’s captain can give in to the hijacker’s demands, thereby reducing the risk to passengers on the current flight. Yet in so doing the captain increases the likelihood of future hijackings. In contrast, a captain who refuses to give in to the hijacker’s demands, while putting his current passengers at greater risk, improves the welfare of future passengers by decreasing the prospect of future hijackings. Buchanan wrote: “Strategic courage exercised by a single captain or crew member may generate spillover benefits to all others who might face hijacking threats” (Buchanan, 1975b). Buchanan offered this example in 1975, but after the 9/11 hijackings in 2001, it is plausible that the actions taken by passengers on one flight—United Airlines #93 that crashed into the ground in Shanksville, Pennsylvania—resulted in a significant deterrent to future hijackings.

Buchanan's discussion of the Samaritan's dilemma includes a warning: "The phenomenon analyzed here takes on its most frightening aspects in its most general biological setting. A species that increasingly behaves, individually and collectively, so as to encourage more and more of its own members to live parasitically off and/or deliberately exploit its producers faces self-destruction at some point in time."

Ethics and economics

Ethics and economics, as Buchanan understood them, cannot be separated from each other, despite the efforts of some to make economics more "scientific" by removing from it any value judgments. The purpose of the social sciences, including economics, is to identify ways to improve people's well-being by gaining a better understanding of the ways that people do and might interact. Buchanan's individualistic perspective is based on two insights. The first is that individuals know their own interests better than does anyone else, so they should be responsible for making choices to further their goals. The second and more foundational insight is that liberty is a fundamental value in its own right, and so institutions should be designed to promote and preserve individual liberty.

Once again, this individualistic perspective implies that the welfare of a group can mean nothing more than the welfare of all of the individuals in the group. To further individual welfare, institutions should be designed to facilitate individual cooperation so that all individuals agree that their actions improve their well-being. Market institutions are ethical because they are based on the voluntary cooperation of individuals who engage in exchange. Buchanan judged political institutions by the same standards. Those who are subject to them should be in agreement that those institutions further their welfare.

The ethical problem that arises with governmental institutions is that, ultimately, they are based on force rather than on agreement. The threat always exists that a protective state strong enough to protect individual rights, and a productive state extensive enough to supply public goods, can expand beyond their boundaries and violate the very individual rights that it is meant to protect. If such an abusive institution emerges, it is what Buchanan called "the predatory state." An ethical government is one that citizens agree furthers their own

individual ends. Much of Buchanan's work focuses on determining when this is the case, and how governmental institutions can better conform with this norm of voluntary agreement without abusing its powers. Chapters 8 and 9 consider Buchanan's views on political institutions in more detail.

Ultimately, Buchanan says,

The justificatory foundation for a liberal social order lies, in my understanding, in the normative premise that individuals are the ultimate sovereigns in matters of social organization, that individuals are the beings who are entitled to choose the organizational-institutional structure under which they live. (Buchanan, 1999: 288)