

What Should Economists Do— and Not Do?

Man's behavior in the market relationship, reflecting the propensity to truck and barter, and the manifold variations in structure that this relationship can take; these are the proper subjects for the economist's study.... The elementary and basic approach that I suggest places "the theory of markets" and not the "theory of resource allocation" at center stage.

—James M. Buchanan, "What Should Economists Do?" (1964)

James Buchanan devoted his presidential address to the Southern Economic Association to answering the question "What should economists do?"—also the title of his talk. To non-economists, this question probably seems silly, or at least surprising. Don't professional economists already know what they should do? And isn't the answer obvious—namely, study the economy?

Well, yes, of course. But what, exactly, *is* the economy? "The economy" is a familiar enough phrase, regularly used by economists and non-economists alike. But the very familiarity of the phrase likely inhibits those who hear it from thinking deeply about just what it refers to, and hence, about what exactly it is economists should study. Buchanan argued that economists had become seriously misled by their failure to think carefully about just what the economy is and what it does.

Economics as the study of choice

Textbook definitions of economics typically come from one that the British economist Lionel Robbins (1898-1984) offered in the 1930s: "Economics is a science which studies human behavior as a relationship between ends and

scarce means which have alternative uses” (Robbins, 1932). A few years later, the American economist Paul Samuelson (1915–2009) in his highly influential introductory textbook offered a similar definition, elaborating considerably on the nature of those choices: “Economics is the study of how men and society end up choosing, with or without the use of money, to employ scarce productive resources that could have alternative uses, to produce various commodities and distribute them for consumption, now or in the future, among various people and groups in society” (Samuelson, 1973).

These definitions portray economics as a discipline for studying how people and societies choose. Resources are scarce, and both individuals and societies can put them to many alternative uses. Thus the question: How should society allocate its limited resources to satisfy as many as possible of its desires?

Buchanan saw two problems with this approach to economics.

The first problem is that in the twentieth century economists came to assume that each individual has a set of preferences, what economists call a “utility function,” that is fixed and fully known to him or her. But, Buchanan noted, if this assumption accurately describes reality, then individuals would not truly choose. If you know with 100 percent certainty that eating the peach will give you greater satisfaction than eating the pear, “choosing” the peach over the pear is a purely mechanical act. Popular language recognizes this fact with the phrase, “It’s not much of a choice,” as in, for example, saying “It’s not much of a choice” when confronted with the “choice” to pay \$5 for a glass of beer or \$6 for that same glass of beer. For Buchanan, the act of human choice necessarily involves some uncertainty about the merits of one option over another. As he concluded: “If I know what I want, a computer can make all of my choices for me. If I do not know what I want, no possible computer can derive my utility function since it does not really exist” (Buchanan, 1964: 217).

Buchanan emphasized the open-endedness of choice even further by insisting that human preferences do not exist independently of the very choices that individuals make. In his 1979 paper “Natural and Artifactual Man,” Buchanan observed that individuals often want to become tomorrow people different in some details from who they are today. Individuals, for example, want to lose weight, to finish college, to become better spouses. And so, in a very real way, individuals often choose to change their preferences. Further,

because the person today cannot fully know what it will be like to be the “different” person tomorrow, the choices that a person makes today change his or her preferences in ways that he or she cannot fully foresee.

Nothing said above implies that the simple textbook logic of how individuals with given preferences choose among a given set of options is useless. But this logic is only the starting point of economic analysis, not its core subject-matter. At the core is, or ought to be, analysis of how individuals interact with each other to accomplish their ends, whatever those ends might be.

A second problem with the standard textbook approach to economics is more serious. It judges how well or poorly resources are being used as if society itself is a sentient creature with its own preferences. That is, economists treat society as an individual with preferences, and then they ask if society uses (“allocates”) its resources in ways that best satisfy its preferences.

But as noted earlier, Buchanan was insistent that society isn’t a creature with a mind. Society has neither preferences nor the ability to choose. Only each of the many individuals who comprise society possesses preferences, and only individuals have the ability to choose.

The aggregate way of thinking that prompted economists to lose sight of the fact that groups, as such, have no preferences became popular among economists in the mid-twentieth century, especially through the influence of John Maynard Keynes. Again, it was Keynes who introduced the notion of “aggregate demand,” which treats society as a whole as the demander of goods and services. Along the same lines, economists developed “representative agent” models in which everyone is “represented” in the model by a single decision-maker whose preferences are assumed to be those typical of the group.

In earlier chapters we saw that in his work on Ricardian equivalence and on the burden of government debt Buchanan rejected such aggregate thinking. But his larger concern was to better understand the wide variety of ways that individuals can and do engage with each other—how individuals *exchange* with each other—to achieve their goals.

Economics as the study of exchange

In the quotation at the start of this chapter, Buchanan insisted that the focus of economic analysis should be on markets, that is, on institutions of exchange,

rather than on resource allocation. Buchanan says of economists who “are wholly concerned with the allocation of scarce resources among competing ends or uses... that theirs is not legitimate activity for practitioners of economics, as I want to define the discipline” (Buchanan, 1964: 216).

The reason Buchanan insisted on this distinction—one that might strike non-economists as pointless—is that to conceive of economic activity as an exercise in resource allocation is to unwittingly assume that society is rather like a giant sentient individual with preferences all its own. Given its preferences and its income, society has only one “correct” way to “choose”—that there is one optimal allocation of resources. But, as already noted, society is not a giant sentient individual with its own preferences and brain for choosing. Society is the complex interactions of many individuals each in pursuit of his or her own goals. To understand what occurs in society requires that we understand why and how diverse individuals interact and exchange. And they do not interact with the intention of achieving “the” optimal allocation of resources in society.

An “economy,” Buchanan observed, is the name that we give to the on-going process of many *different* individuals (and other organizations, including households and firms) pursuing their own individually chosen goals but with no overarching *shared* goal such as “the goal of the national economy.” Unlike a household which has an income that it spends according to the consciously chosen plan of an individual (or of a “committee,” such as mom and dad), what we call “the economy” has no such income that is spent according to any consciously chosen plan.

Each of the economy’s members—as individual persons, and as households and firms voluntarily formed by individuals—has preferences and goals. But, Buchanan warned, it is a mistake to draw from this fact the conclusion that the economy *itself* has purposes.

What, then, *should* economists do? Buchanan’s answer is that economists should return to doing what Adam Smith first set economists on course to do. Economists should study *exchange*. According to Smith, our “propensity to truck, barter, and exchange one thing for another” separates us from all other species. And this propensity should mark off the boundaries of economists’ proper subject-matter.

Importantly, all trade is voluntary. This fact means that in each exchange *all* parties to it must gain, or, at least, to anticipate gain. Because no one can be forced to trade, each person as a trader must figure out how to help make his or her potential trading partners better off while simultaneously making himself or herself better off. Exchange, therefore, often calls forth creativity.

What kinds of exchange do people engage in? What are the limits of people's ability to exchange? What policies and institutions promote exchange and which discourage it? What patterns of cooperation, conflict, production, and consumption emerge from exchange? These and similar questions are the ones that economists should ask and attempt to answer.

And if economists focus on these questions, they'll likely avoid the error of mistaking the economy for a single decision-making unit. In an economy, resources are directed to their various uses by the countless different commercial exchanges that people carry out, but with no overarching goal to reach or plan to satisfy.

By studying the many different ways that individuals exchange, Buchanan argued, economists will no longer slip unawares into the role of social engineer. The economist will avoid thinking of himself or herself as someone who advises the government on how to best achieve the fulfillment of some national economic "plan" or "purpose"—a plan or purpose that, at least in market-oriented economies, does not exist.

Put somewhat differently, by heeding Buchanan's advice, the economist will not slip into the error of thinking of the market as a means of achieving some higher social purpose. As Buchanan himself summarized it,

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. This is all there is to it. Individuals are observed to cooperate with one another, to reach agreements, and to trade. The network of relationships that emerges out of this trading process, the institutional framework, is called "the market." 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. (Buchanan, 1964: 219)

In Buchanan's view, "there is no explicit meaning of the term *efficiency* as applied to aggregate or composite results. It is contradictory to talk of the market as achieving 'national goals,' efficiently or inefficiently" (Buchanan, 1964: 219).

So what?

The non-economist can be forgiven for asking "So what? What's the point?" Part of the answer is that the engineering perspective of the economy, the perspective that Buchanan warned against, gives the mistaken impression that the economy is serving some *particular* overall social goal. In turn, this mistaken impression naturally suggests that it is the responsibility of government to stand by and monitor the performance of the economy. To the degree that the economy falls short of serving this goal, it would appear to follow that the government's responsibility is to tinker with the economy in order to improve its operation—in order to ensure that it comes closer to achieving *the* optimal allocation of resources.

The engineering perspective that Buchanan warned against leads to individuals and firms being seen as mere cogs in a great machine, as a means for helping the economy achieve some grand outcome. As a value judgment, Buchanan, working as he did in the individualist, classical-liberal tradition, rejected this understanding of individuals.

In addition, as an objective matter of economic science, Buchanan pointed out that this engineering conception of the economy is simply incorrect. Because the economy isn't a sentient creature with purposes, *it* has no goals that can be pursued and met. The economy is nothing more than that which emerges, undesigned and unintended, when countless sentient individuals, in pursuit of their own goals, exchange with each other. And so the economist should study the many ways that individuals exchange, as well as study the unplanned order that emerges from these exchanges.

The flip side of Buchanan's advice that economists study exchange is his criticism of economists for focusing exclusively on only one kind of exchange. Economists excel at studying bilateral market exchanges—exchanges that occur in supermarkets, the trading of corporate shares on the New York Stock

Exchange, the buying and selling that comprise the market for petroleum, the exchange of labour hours for wages. These exchanges are of privately owned, highly divisible property rights—ten and a quarter of my dollars for one bottle of your wine, or twenty tons of Canadian lumber for three dozen new Japanese-made pick-up trucks. These and other familiar kinds of commercial exchanges, exchanges in which, in each case, one buyer exchanges with one seller, are of course important.

But these commonplace kinds of market exchanges do not begin to exhaust the range of exchange possibilities. Yet by coming to see exchange as consisting only of that which occurs in private-property markets, economists become blind to the ways in which humans' propensity to truck, barter, and exchange lead them to devise, or to have the possibility of devising, more complex exchange relationships. The "economic" objectives that humans have include some that cannot be solved if exchange is limited to the kinds that occur in grocery stores and in other familiar private-property markets. Fortunately, observed Buchanan, humans have the capacity to devise exchange relationships that can meet these more complex challenges.

Buchanan offered as an example a community of people near a mosquito-infested swamp. If the swamp were drained, everyone in the community would benefit. Unfortunately, no one person or family in the community has the incentive to incur the full cost of draining the swamp. And because each community member will enjoy the benefit of the drained swamp whether or not he or she helps to pay for the drainage, no community member has adequate incentives to help to pay for drainage. According to standard economics, therefore, the market fails to provide the "public good" of draining the swamp. The only possible solution—as mainstream economists see it—is for government to drain the swamp, and to pay for this service by taxing the community.

Notice how this government "solution" involves no exchange. It's an instance of social engineering. The government *somehow* determines that the social value of draining the swamp would be greater than the cost of doing so. And so government undertakes this effort.

But Buchanan identifies another possibility. According to him, humans' propensity to exchange might lead residents of the community

to search voluntarily for more inclusive trading or exchange arrangements. A more complex institution may emerge to drain the swamp. The task of the economist includes the study of all such cooperative trading arrangements which become merely extensions of markets as more restrictively defined. (Buchanan, 1964: 219).

Perhaps the community members will form a neighbourhood swamp-draining association and agree to pay dues and be bound by its rules. Or, alternatively, a private developer might offer to buy out all the residents, drain the swamp himself, and then build new houses in the community which he sells at higher prices because mosquitos are no longer a problem there.

The point is that exchange possibilities are not confined to the simple bilateral exchanges on which economists traditionally focus nearly all of their attention. When this truth is recognized, many familiar features of the real world are seen in a more revealing light. Clubs, homeowners' associations, business firms, churches, philanthropic organizations—these and other voluntary associations are arrangements in which individuals choose to interact and exchange with each other in ways more complex than simple, one-off, arm's length, bilateral exchanges.

These “complex” exchange relationships are an important reality for economists to study. But they are more than mere subject matter for research. They are also evidence that human beings who are free to creatively devise and experiment with alternative organizational and contractual arrangements have great capacity to do so. Where the conventional economist sees “market failure,” humans on the spot often see opportunities for mutually advantageous exchange. The itch to call on government to *impose* a “solution” should be resisted, although, in Buchanan's view, not altogether ignored.

Conclusion

Buchanan rejected, on scientific grounds, what by the mid-twentieth century had become economists' dominant perspective. In doing so he encouraged economists to abandon the role of social engineer and instead to study how individuals perceive the challenges they confront and how they creatively form exchange relationships to meet these challenges. Societies do not make choices;

individuals do. Given the preferences of individuals, the focus of economics should be on how individuals creatively interact to further their well-being.

Buchanan's focus on exchange rather than on choice applies to all areas of economics, but one can see that this focus offers challenges to the economist when one looks at resource allocation through collective action—through government or through voluntary collective organizations like clubs and homeowners' associations. Buchanan made some of his most significant contributions by recognizing that exchange is often central to the formation and operation of collective organizations. Rather than depicting government as an omniscient benevolent despot who maximizes social welfare, he depicted "politics as exchange," which allows individuals to accomplish collectively what they cannot accomplish individually or through simple market exchange.

He was well aware that government often falls short of his ideal. He therefore looked for ways to design institutional constraints to encourage this cooperative effort while simultaneously preventing government officials from abusing power. James Buchanan's research program in this area is rooted in the idea that economists should focus their attention on exchange rather than on resource allocation. And as we hope this introduction to his work has made clear, it is a research program that produced fundamental advances in our understanding of economics and politics.