Chapter 9

Constitutional Economics

Constitutional political economy is a research program that directs inquiry to the working properties of rules, and institutions within which individuals interact, and the process through which those rules and institutions are chosen or come into being.

—James M. Buchanan, “The Domain of Constitutional Economics” (1990)

We cannot have everything we want, so we must choose how to allocate scarce resources to best satisfy our many needs and desires. Economics excels at shedding light on the ways that individuals make choices when subject to different sorts of “constraints” and opportunities—that is, different sorts and mixes of sticks and carrots. It is therefore no surprise that James Buchanan came to use economics to shed light on the process of choosing among rules, which by their very nature are constraints that determine the opportunities open to individuals.

Rules are constraints that we impose on ourselves, as distinct from limits on the availability of resources and other such constraints that are imposed on us by nature. The whole set of such self-imposed rules is often called “institutions.” Many of these rules arise naturally in the course of human interaction. An example is the expectation that parents will care for their young children. Other of these rules, however, are consciously designed and imposed. Most obviously here are legislation and public policies. These rules affect the opportunities that each of us has and, thus, the choices that each of us make. Either way, whether a rule arises “naturally” or is designed and imposed, it can be changed.
Buchanan observed that economic analysis, for the most part, examines the choices people make subject to given rules. Constitutional economics, in contrast, examines the choice of rules themselves. Buchanan calls decisions on what those rules should be “constitutional decisions,” while decisions that people make within some set of rules are called “post-constitutional decisions.”

Using a sports analogy, Buchanan likens constitutional rules to the rules of the game, and post-constitutional decisions to those that are made within the rules of the game. Constitutional decisions are the decisions that determine the rules under which the game is played.

Basketball, for example, is played within certain rules that constrain the choices open to players and coaches—and, importantly, to referees. Players, coaches, and referees all make a series of post-constitutional decisions within the rules. For instance, the rules define which actions are fouls. The rules also specify the penalty for each kind of foul. Sometimes players will deliberately commit fouls when they anticipate that the benefit of doing so outweighs the resulting penalty. Referees play the role of third-party enforcers of the rules, rather like government officials, and—when they, too, follow the rules—referees do their best to detect when rules have been violated and then to identify and appropriately punish the violators. Each and every one of these decisions made by coaches, players, and referees during a game is “post-constitutional.”

Yet these rules of the game can be changed, as they were, for example, in 1979 by the National Basketball Association (“NBA”). Prior to that year, all successful non-foul shots made from the floor scored two points. Then, in 1979, the NBA added a three-point line. Since that time, all shots successfully made beyond this line scored three points. This rule change altered the constraints and opportunities confronting players and coaches. Many long shots that would not have been attempted prior to 1979 became, with this rule change, attractive to attempt. A change in the rules of the game led to changes in the post-constitutional decisions that players made subject to those constitutional rules, and, hence, also to changes in the outcomes of the games.

Interestingly, the now-defunct American Basketball Association (“ABA”) introduced the three-point shot 12 years before the NBA did so. The NBA’s adoption of this rule change was therefore likely the result of competition among different rule-making regimes—that is, competing
professional-basketball leagues. Seeing the popularity of the three-point shot in the ABA, NBA rule-makers adopted it for their league. While in his work on federalism Buchanan devoted much attention to competing governmental jurisdictions, he paid surprisingly little attention to the role that competition among jurisdictions might play in crafting constitutional rules.³

**Choosing desirable rules**

Buchanan’s approach to constitutional economics had a heavy normative slant. He sought to identify the contents of desirable rules, as well as the most desirable (what we might today call the most “inclusive”) means of implementing rule changes. His criterion for identifying desirable rules is that they should be able to garner unanimous agreement by everyone who is to be governed by them. Desirable rules are ones that potentially work to the advantage of everyone, and desirable rule changes are those that are endorsed by everyone, that is, unanimously.

The logic behind the benchmark of unanimity was explained in the previous chapter. Buchanan’s ideal was for all constitutional rules to be agreed to unanimously. He understood, though, two important features of reality: First, unanimity is impractical for all policy decisions to be approved unanimously; second, individuals who are considering constitutional rules also understand the impracticality of having all policy decisions approved unanimously. Therefore, Buchanan reasoned, when choosing constitutional rules, individuals would agree unanimously to conditions under which policy choices made within these rules may be approved with less than unanimous consent.

**Majority rule and other decision-making rules**

Of course, almost no collective decisions are made unanimously. Majority rule is common, with other qualified majorities (such as two-thirds) sometimes used. These less-than-unanimous decision rules can be desirable given that reaching unanimous agreement is quite costly. A rule of unanimity, in short, entails very high decision-making costs. Government would do very little if

³ We thank an anonymous referee for alerting us to the role the ABA likely played in prompting the NBA to change an important rule of its game.
every action it proposed to take required unanimous agreement from all of its citizens, or even from all of their elected representatives.

Collective decisions involve two types of costs, and the lowering of one cost raises the other. Each cost, therefore, must be weighed against the other. To use Buchanan’s and Gordon Tullock’s terminology, “external costs” are costs that people expect to bear when collective decisions go against them, such as when the person who votes for more spending on education must accept the majority’s vote against such spending.

“Decision-making costs” are costs that people expect to bear in the process of negotiating to arrive at collective decisions. Decision-making costs are not the costs that each individual incurs to decide his or her preferences for collective action. Rather, decision-making costs are those that individuals incur as they participate with fellow citizens in the actual process of reaching collective agreement.

External costs would be zero if all decisions had to be approved unanimously. The requirement of unanimous approval gives to every member of the group veto power, so a collective decision could never be made that harms the interest of any group member. The lower the threshold for agreement—that is, the smaller the portion of voters who must agree to the policy change—the more likely it is that a decision will go against a particular group-member’s interest.

For example, if 90 percent approval was required, decisions could be made that would go against the interests of as much as 10 percent of the group. If two-thirds approval was required, up to a third of the group could find decisions going against their interests. If the only criterion in choosing a voting rule was to keep these external costs as low as possible, groups would always require that all collective decisions be approved unanimously.

The problem with a high approval threshold is that the cost of negotiating an agreement rises the larger is the portion of voters needed for approval. In other words, the greater the proportion of the group required to agree, the higher are the decision-making costs. It will be more difficult, and hence costlier, to arrive at an outcome requiring 90 percent approval than one requiring two-thirds approval, and it will be more difficult to arrive at an outcome requiring two-thirds approval than one requiring the approval of a simple majority.
Very few roads would be built, for example, if unanimous agreement were required for the approval of each and every road project. People want roads. But people also want parks and police protection. To lower decision-making costs and, thus, to facilitate worthwhile collective action, people are willing to risk bearing higher external costs (in the form of decisions that go against them) in exchange for lower decision-making costs (which facilitates the reaching of collective decisions).

**Constitutional and post-constitutional decisions**

Following this framework, the voting rule to be used for making day-to-day “post-constitutional” decisions should, Buchanan argued, be chosen at the constitutional stage. If the constitutional rule is chosen unanimously, there is unanimous agreement to bear whatever costs might arise from the post-constitutional decisions that do not require unanimous approval.

At the constitutional stage of decision making, the opportunity exists to make post-constitutional choices as easy or as onerous as constitutional decision-makers choose. For example, a common constitutional rule for facilitating approval of a government budget is that the proposed budget be approved by a majority of the legislature. Yet in the United States there is an additional constitutional constraint: The president has the option of vetoing the budget bill, although Congress then has the option of overriding such a veto with a vote of at least two-thirds of the members of each house of Congress.

The straightforward logic is that people can, at the constitutional stage, unanimously agree to have post-constitutional (“day-to-day”) decisions made by different decision-making rules, including, of course, simple majority rule. If decision-making rules for the post-constitutional stage receive unanimous agreement at the constitutional stage, then the use at the post-constitutional state of rules requiring less-than-unanimity do not infringe on anyone’s rights, because everyone agreed to these rules.

But, argued Buchanan and Tullock, at the constitutional stage people will treat government activities that threaten to impose unusually high external costs differently than they treat activities that likely will impose low external costs. For example, a collective decision to seize people’s homes is more ominous—has higher “external costs”—than does a collective decision to restrict
the number of billboards along a stretch of highway. And so people at the constitutional stage will likely require that decisions to seize residential property receive a higher percentage of votes than is required for decisions about whether or not to change the policy about highway billboards.

A real-world example is jury trials for criminal cases. Being convicted of a crime carries very serious negative consequences. Therefore, it’s unsurprising that in both Canada and the United States conviction of crimes requires jurors’ unanimous consent. It is, of course, also true that the number of jurors is quite small, so the decision-making costs of reaching unanimous decisions aren’t excessive. Yet despite the relatively low cost of having jurors reach unanimous decisions, in some civil trials in the United States—trials in which no criminal conviction or punishment is possible—jurors can reach binding decisions with less than unanimous agreement. This latter fact is an example that shows that when the external costs of decisions are lower, as they generally are in civil trials compared to criminal trials, incurring the higher costs of reaching unanimous agreement might not be worthwhile.

While these examples emphasize voting rules, they apply to public policies more generally. Constitutional rules determine how all types of collective action are undertaken and, hence, according to which particular post-constitutional decision-making rules. Constitutional rules constrain how legislators might create bureaucratic agencies, and which sorts of rules legislators may impose on the operation of these agencies.

No matter how far removed a particular day-to-day decision is from the constitutional stage, a well-designed constitution that receives unanimous approval can be interpreted as bestowing unanimous agreement to live peacefully with the procedures followed by—and with the policies pursued by—the legislature or the agency.

Buchanan was well aware that rules cannot be properly judged by how they operate in any particular circumstance. The very nature of a rule is that it is a guide to action under conditions of uncertainty.

To explain the importance of judging rules by their performance over time and in many situations (rather than in any one situation), Buchanan often used a simple but revealing example that he took from the Nobel-laureate economist Ronald Coase (1910–2013), who was for many years his colleague at
the University of Virginia. The example is of a traffic light to regulate the flow of automobile traffic at intersections.

If a driver arrives at an intersection when the light is red and there is no other traffic in the vicinity, the requirement is that the driver nevertheless remain stopped until the light turns green. In this particular instance, the driver suffers a cost with no offsetting benefit. However, “the reason of rules” (to use the title of Buchanan’s 1985 book, co-written with Geoffrey Brennan) is grounded in human ignorance. If the rule instead were to let motorists drive through red lights whenever they believed that there was no on-coming traffic, too many motorists would err. Traffic accidents and fatalities would be higher than otherwise. And so the small cost of requiring that motorists always obey traffic signals is a rule that, over the long run and over many instances, improves the welfare of all motorists.

**Status quo**

Buchanan attributed special significance to the status quo. As he said often, “We start from here.” The idea is that any proposal to change the rules necessarily is done against the background of whatever benefits and costs people are experiencing under existing rules. If the rules are to be modified in a way that makes everyone better off, everyone who votes on the proposed new rules will compare them to those currently in place.

Everyone should favour changes that make everyone better off, whereas changes that make some persons better off but others worse off will face opposition from those who stand to be harmed.

Despite Buchanan’s practical emphasis on the status quo as the starting point for constitutional change, he did recognize that it was possible for the status quo to contain injustices. Thinking back to the previous chapter—specifically, to Buchanan’s idea of a social contract being negotiated from a position of hypothetical anarchy—the status quo could convey advantages to some people that they would lose if a social contract were negotiated. If so, people would be justified in rejecting the status quo as a starting point.

If current institutions give some people unjust advantages over others, then insisting that everyone agree to changes in the status quo would perpetuate those unjust advantages. Examples might be Apartheid in South Africa,
India’s caste system, and slavery in the American South. Thus, the unanimous agreement that Buchanan advocated was a hypothetical agreement from anarchy (discussed in the previous chapter) in which no individuals have institutionally based advantages over others.

Buchanan and Tullock viewed their 1962 book, *The Calculus of Consent*, as a theoretical exploration of concepts of governance that had a practical parallel in the development of American political institutions. Along these lines, the Declaration of Independence is largely a list of grievances against the King of England, detailing many ways in which Americans’ rights had been violated, thus giving to the colonists the right to form their own independent government. When viewed through Buchanan’s constitutional-economics framing, Thomas Jefferson’s argument implied that the status quo in the American colonies in 1776 was not within the bounds of any set of rules that would have received unanimous agreement had the Americans and the British negotiated a social contract from a condition of anarchy. The importance of unanimity as the criterion for agreement appears in the Constitution of the United States, which states that it was “Done in convention by the unanimous consent of the states present...”

Desirable rules are those that meet with the unanimous approval of those who will be governed by them.

**Generality and durability**

When thinking about actually designing rules, any change from the status quo will probably benefit some people while imposing costs on others. How can rules be designed so that they will meet with the approval of everyone? Such an outcome is more likely the more *general* are the proposed rules. By “general,” we mean that the rules apply to everyone rather than only to particular kinds of people. A rule that requires that *all* income earners pay income taxes is a more general rule than one that requires that income taxes be paid only by people of Swedish and Italian descent.

An important feature of a rule that contributes to its generality is its durability. The more durable a rule is—that is, the longer it is expected to remain in force—the less will people know how that rule will affect them in
their particular circumstances as opposed to how it will affect them simply in their capacity as “citizen.”

Consider, for example, a proposal to make income tax rates more progressive. If citizens believe this proposal will last for only a year or two, nearly all of today’s high-income citizens are more likely to oppose it than if they believe this proposal will last for decades. That is because many of today’s high-income earners understand that their incomes might be lower in the future. Therefore, by supporting the proposal for increased tax progressivity, today’s high-income people are not necessarily supporting a proposal to raise their taxes forever.

Similarly, today’s low-income people are more likely to support increased income tax progressivity if they believe the proposal is temporary than if they believe it to be long-lasting. After all, many of today’s low-income people have reasonable hopes of being among tomorrow’s high-income people.

While we can’t predict whether the chances of any such proposal to be approved will rise or fall as it becomes more durable, we can say that the consideration that people will give to the rule will be less biased toward their own individual interests the greater is the rule’s durability.

The optimistic vision of Buchanan’s constitutional economics

Buchanan’s goal in his constitutional-economics research program was not just to discuss the function of constitutional rules, but to search for ways to improve them. His unanimity benchmark was a big part of this effort. At the same time, he recognized that in many cases the rules under which people are governed do not satisfy his benchmark. In The Limits of Liberty he says:

I have come to be increasingly disturbed by this basically optimistic ontology. As several of our right-wing critics have recognized, the “theory of public choice” can be used to rationalize almost any conceivable decision rule or almost any specific outcome under pre-selected rules.... Increasingly, I have found myself describing what I observe as “constitutional anarchy” rather than any institutional translation of individual values into collective outcomes.... Zero-sum and negative-sum analogues yield better explanatory results in many areas of modern politics, and I find myself, like Pareto, more and more tempted to introduce nonlogical models of individual
behavior along with nondemocratic and nonconstitutional models of public choice. (Buchanan, 1975a: 7)

Buchanan’s constitutional political economy is hopeful in its search for constitutional rules that improve everyone’s well-being, but at the same time Buchanan was realistic in admitting that, often, actual political institutions fall far short of his constitutional ideal.

**Constraining Leviathan**

Returning to the theme sounded in the title of *The Limits of Liberty: Between Anarchy and Leviathan*, Buchanan was looking for a set of rules that would enable government to protect people’s rights so they could escape a lawless war of all against all, but that also would constrain government so that a government powerful enough to protect people’s rights would not be able to use that power to violate people’s rights.

To this end, Buchanan often employed the assumption that government is a revenue-maximizing and power-maximizing Leviathan. While admitting that this assumption does not always describe reality in full, he defended the assumption by noting that government institutions must be designed to prevent opportunistic individuals from abusing government power. Institutions must be designed with the understanding that unfit people—people mad for power, people concerned more with being popular than with doing what’s right, even people who are malevolent—will sometimes gain political office. It is prudent and wise to constrain all government officials to prevent the harm that would otherwise be unleashed by the worst government officials.

One application of this idea is found in his 1980 book, *The Power to Tax: Analytical Foundations of a Fiscal Constitution*, co-authored with Geoffrey Brennan. Conventional public-finance theory suggests that tax *bases*, that is, what is taxed, should be broad so that any given amount of revenue can be raised with tax *rates* that are as low as possible. This recommendation would be valid if those who in the real world design the tax system truly wish to further the public interest. But what if those in power want to maximize the revenue collected by government? In this case, broad tax bases allow revenue maximizers to collect tax revenues well in excess of what is in the public interest. Thus, constitutional rules that limit the size of tax bases can be welfare-enhancing.
This idea takes on practical relevance, obviously, when politicians propose expanding the tax base. There has been much talk recently about supplementing income taxes by creating wealth taxes. In the United States there’s talk also of adopting a value-added tax—a species of taxation that has spread since the 1970s to most countries around the world. Was the widespread adoption around the world of value-added taxes welfare enhancing, or would a constraint prohibiting governments from taxing that tax base have been preferable? Buchanan’s arguments point to the benefits of constraining the government’s power to tax.