Chapter 8

Politics as Exchange

Collective action is viewed as the action of individuals when they choose to accomplish purposes collectively, rather than individually, and the government is seen as nothing more than the set of processes, the machine, which allows such collective action to take place.

—James M. Buchanan and Gordon Tullock, "The Calculus of Consent" (1962)

Individuals engage in market exchange because it is mutually advantageous for them to do so. They voluntarily agree to trade because all parties to each exchange view it as a way for each party to further his or her own individual interest. The most familiar kind of market exchange is the simple "two-party" exchange: you give me some fish in exchange for some of my bananas. But much exchange involves many individuals, each still seeking his or her own gain, consciously organizing together to pool their resources and efforts. Thus, individuals often work together through collective organizations to carry out those mutually advantageous activities. Some organizations, such as clubs and firms, are voluntary, but other kinds of collective action are taken through government. When government is used ideally, people exchange with each other *politically* in order to accomplish ends that they could not accomplish individually or through market exchange.

Individuals who want to drive from one city to another, or who just want to drive from their homes to do local shopping, each acquire an automobile through standard market exchange. But these individuals do not acquire the roads on which they drive through standard market exchange. Individuals, as such, are not in a good position to buy their own roads. Buchanan's theory of clubs, discussed in Chapter 5, helps us to understand why the optimal number of people who share the use of a road is a number large enough to warrant collective action. Government consists of a set of institutions that, *if well-designed*, enable large numbers of individuals to engage in exchange *collectively* for their mutual benefit.

In Buchanan's division of government activities into the protective state and the productive state, it is the productive state that best embodies his idea of politics as exchange. One hopes that the activities of the protective state meet with the approval of each and every one of the state's citizens. Buchanan shared Thomas Hobbes's view that without the protective state, life would be a war of all against all. To create the protective state, individuals agree only to not violate each other's rights, with the state enlisted to enforce this agreement. The productive state does more than the protective state. As Buchanan envisioned it, the productive state arises from an agreement among citizens to pool their resources to collectively produce goods and services that would be difficult to produce individually or through standard market activity.

Ideally, the outputs of the productive state result from collective agreement in which individuals exchange their tax payments for the collectively produced outputs—outputs such as pollution abatement, roads, and municipal parks. But how can citizens determine the size and range of duties of the productive state that will be most welfare-enhancing? How can they ensure that the state does what the people wish it to do and *only* what they wish it to do? As already noted, Buchanan's answer was to limit the activities of the state to those that command agreement from all of its constituents. But this benchmark of consensus on state activities presents a challenge. In the real world, people have not agreed to the activities of the state. Under what conditions could people be depicted as being in agreement with institutions to which they have not actually agreed? This chapter discusses the conditions that Buchanan identified as ones that would enable all individuals to be legitimately described as being in agreement with government actions.

Agreeing to the exchange

Buchanan extended the market-exchange logic—one in which all parties to an exchange voluntarily agree to it—to collective activity. The activities of the state would benefit everyone if *everyone* agreed to them. It follows that the voting rule that would make political exchange fully analogous to market exchange is unanimity. Despite the widespread tendency to view the ideal of democracy as embodied in simple majority-rule voting, Buchanan understood majority rule as being just one of many possible and justifiable political decision-making rules.

Groups can agree by two-thirds majority, 75 percent majority, 90 percent agreement, whatever-percent majority. But any voting rule short of requiring unanimous consent leaves open the possibility of political "externalities"—some people imposing costs on nonconsenting others. Whether it's a simple majority imposing costs on a minority, or two-thirds of the voters imposing costs on the other third, in the absence of a requirement of unanimity some people will impose costs on others. The differences among any voting rules—again, other than one requiring unanimous consent—are just a matter of degree. Only by requiring unanimous consent can voters be assured that whatever they approve is truly in everyone's interest.

Buchanan's insistence that all political activity ultimately be grounded in unanimous consent follows from his individualistic approach. Individuals only, not groups, possess preferences. Furthermore, as Chapter 7 noted, value is subjective, so it's impossible for one person to know the mind of another. If a public policy benefits one individual but harms another, there is no way to determine if the benefit to the one person outweighs the harm suffered by the other.

The only way to be sure that any public policy is in the best interest of a group of people is if it is in the best interest of every member of the group. Therefore, the only way to determine if particular public policies are in the public interest is to have them approved unanimously.

But of course it's impractical to require that literally everyone consent to each and every proposed government action before that action is taken. With such a requirement, government would get nothing done. Yet Buchanan, convinced that people do indeed want both a protective state and a productive state, understood that people want government to be able to act. They want government to protect their persons and rights, and to supply collective consumption goods and services such as roads and wastewater treatment.

Is there a way to ensure that government truly acts with the consent of the governed without bogging it down in the difficulties of having to secure unanimous consent for every action that it takes? Addressing this question consumed much of Buchanan's time and energies. And his answer is embodied in his (re)formulation of social-contract theory.

A social contract

Social-contract theory has a long history. It dates back at least to Thomas Hobbes's 1651 tract, *Leviathan*, which provides a starting point for Buchanan's thinking on the social contract. Hobbes conjectured that without government life would be a lawless war of all against all, and that everyone therefore benefits by agreeing to obey a government committed to preventing such strife. Hobbes argued that society can be made orderly and productive only by a powerful government in possession of a great deal of discretionary authority to issue commands. In his 1975 book, *The Limits of Liberty: Between Anarchy and Leviathan*, Buchanan considered the notion of an ideal stateless society, but, agreeing with Hobbes, dismissed orderly anarchy as unworkable. For society to be orderly, Buchanan insisted that the protective state is necessary.

The social contract, as Buchanan viewed it, is the set of rules and constraints to which everyone would agree. The legitimacy of the specific terms of the social contract is defined by the benchmark of unanimity. The theory is plausible, if somewhat open-ended. For example, almost everybody would agree that we should not assault or kill each other. Even murderers recognize that they are violating this social norm that commands broad agreement.

Most people would agree that we should not steal each other's property, although some gray areas might appear because there can be legitimate disagreement over what constitutes rightful ownership. (Is a patent on an invention from 30 years ago a legitimate property right?) But the principle behind the social-contract theory of the state is that people generally agree that they have certain rights and obligations toward each other, and, in addition, that they should cooperate, through government, to ensure the production of collective goods such as roads. The unanimously agreed-upon rules according to which a government will act as it performs these tasks constitute the social contract.

In reality no such contract exists. People living under the jurisdiction of a government are subject to that government's mandates without necessarily having agreed to them. Even if in principle they would agree, they had no actual opportunity to express their agreement or disagreement. This fact leaves two big questions for the social contractarian. First, in what sense could people be said to be in agreement with a social contract when there is no actual agreement? Second, what can usefully be said about the terms of that contract?

Hypothetical agreement

In *The Limits of Liberty* Buchanan began his approach to answering these questions by imagining Hobbesian anarchy. The relevance of this hypothetical journey to anarchy is that people in that situation lose all social status. In an anarchic condition, there are no social or economic institutions that determine how people interact with one another. No one is a legislator, a corporate CEO, a Princeton alumnus, a factory worker, or a welfare recipient. To design institutions that create social order and a foundation for productive activity, people hypothetically bargain with each other in a situation of relative equality.

Buchanan imagined individuals negotiating a social contract from Hobbesian anarchy, and he imagined the likely outcome of such a negotiation. There is uncertainty about the detailed terms of an actual renegotiated social contract, but Buchanan argues that an individual hypothetically agrees with a social contract if its terms fall within the bounds of what might reasonably be expected as a result of such a negotiation from anarchy.

Buchanan built his social-contractarian framework on this foundation of hypothetical unanimous agreement reached from anarchy. He counts people as being in agreement with the social contract if they would agree under these hypothetical conditions. We could imagine, for example, that some financially secure individuals in the real world would not agree to a highly progressive tax system that would transfer a lot of their income to people with lower incomes. But in the hypothetical state of anarchy, people would be very uncertain about their income levels once a social contract was negotiated and life commenced under it. If those individuals would agree, while in a hypothetical state of anarchy, to income transfers under the social contract, then they are in agreement with such transfers in the real world, according to Buchanan's criterion.

Such mental exercises do not actually identify specific terms of the social contract. Buchanan recognized that we cannot know which particular contractual terms all individuals in hypothetical anarchy might agree to. But reasoning in this way can give some idea of the general "appropriate" scope of government. For example, because, as noted earlier, almost everyone would agree that people should not murder each other, the social contract would certainly empower government to prosecute and punish murderers. Almost as uncontroversially, most people would agree that a majority should not be empowered, absent good reasons, to appropriate the property of a minority—and so the social contract would feature restrictions on such majoritarian actions.

Chapter 9 looks at Buchanan's further application of the principle of unanimous agreement that underlies his vision of politics as exchange.

The limits of liberty

The title of Buchanan's book, *The Limits of Liberty: Between Anarchy and Leviathan*, summarizes the issue that most concerned him throughout his career. His normative goal was to preserve liberty, and he saw threats to liberty coming from two opposite directions. On one side, if government's power is too constrained, anarchy will arise and create a society that is a war of all against all, where no one's liberty is protected. On the other side, if government's power is insufficiently constrained, it will grow into a Leviathan that itself violates the liberty of its citizens. The challenge, one that Buchanan explicitly took from the American founding father James Madison, is to design a government that is sufficiently powerful to protect individual rights and to produce collective goods, but one that also is sufficiently constrained that it does not violate the individual rights that it is created to protect. The limits of liberty lie between anarchy and Leviathan.

Buchanan felt strongly that individuals should not be compelled to live under rules that are imposed on them unilaterally by others. To be legitimate, government must enjoy the consent of *everyone* under its power. The requirement of this consent lies at the foundation of the idea of politics as exchange. The practical problem, of course, is that government would get nothing done if it had to get unanimous consent for every policy change. The costs of arriving at collective decisions would prevent bargains from taking place if everyone were required to agree. Thus, Buchanan was interested in exploring institutional arrangements to which everyone would agree if decision-making costs did not stand in the way. That is the reason he suggested the types of arrangements people would agree to in a hypothetical renegotiation of the social contract from a state of anarchy.

Can individuals agree to be coerced?

The chief problem that exists with many collective activities that are potentially beneficial to all is that each individual has an incentive to free ride off of the contributions of others. This problem exists whenever it is difficult to exclude those who don't pay for some good or service from using it. Under such a circumstance, each person has the incentive not to pay for the good, hoping that others will pay for it. The result is that there will be too few contributions toward the good's financing. A good that everyone wants to consume will be underprovided.

In this situation, individuals might agree to be forced to pay toward financing the good if everyone else is also forced to pay. Everyone could hold the same opinion, saying they do not want to pay unless everyone is forced to pay, but they would all agree to a policy that forces everyone to pay. People could agree to be coerced.

The idea that people could agree to be coerced lies at the foundation of the social-contract theory of the state. Even though there is no actual contract, people would agree to give the state the authority to coerce those who violate its mandates, if everyone was bound to the same contract provisions. According to social-contract theory, because people *would* agree to be coerced for their own benefit, the exercise of such coercion violates no individual's rights.

The role of the economist

In one of his earlier papers, "Economics, Welfare, and Political Economy," published in 1959, Buchanan identified two distinct yet related roles that the economist can legitimately play. The first is that of the "economist" as such; the second is that of the "political economist."

The sole role of the economist *per se* is to improve humankind's understanding of the workings of the economy, including how economic activity is likely to be altered when changes in the economic environment occur. These might be policy changes, such as changes in tax rates or new regulations, but these might instead be changes in other factors, such as adverse weather that cuts crop yields. Economists pursue this goal through research and analyses that permit them to make predictions about the effects of such changes in the economic environment.

In contrast, when the economist steps into the role of political economist, the reason for doing so is to help citizens choose better rules under which they live. Nevertheless, like the economist, the political economist's task is not to impose his or her own values or preferences on others. It is not the job of either the economist or the political economist to recommend, much less insist upon, this policy or that. Such a role, Buchanan believed, is reserved for individuals only in their capacity as citizens.

The political economist's function is merely to propose changes in rules and institutions to which individual citizens can either agree or disagree—accept or reject. Ideally, in Buchanan's view, agreement would require unanimity, or something very close to it. If all, or nearly all, people must agree to a change in rules, then any proposed rule change that is approved by such a vote can confidently be assumed to be one that is truly socially beneficial rather than one that benefits some individuals at the expense of others. That is the essence of the idea of politics as exchange.

A rule change that is approved by such a vote would almost of necessity involve exchange among different groups. For example, a proposal to strip government of the power to levy protective tariffs might win approval only if this proposal includes also some provision to compensate parties who expect to lose as a result of the elimination of government's power to levy tariffs. The compensation need not take the form of monetary payments; it might instead take the form of some other rule change—say, a restriction on government's ability to tax corporate profits. Either way, if this (or any other) proposed rule change wins the approval of all or nearly all citizens, we can be certain that it is worthwhile as judged by the only criteria that matter: the preferences and judgment of the people subject to the rule.

Buchanan believed that economists' knowledge of economic processes makes them especially able to identify two opportunities. The first relates to rule changes that, if adopted, would increase the size of the economic pie (and, thus, in principle potentially make everyone better off). The second opportunity relates to how to structure the details of proposed rule changes in order to ensure that whatever gains arise from the changes are shared by all citizens. Once the economist, in the role of political economist, offers a menu of such rule changes, however, he or she has no more say on the matter than does any other citizen.

Buchanan's vision of politics as exchange depicts individuals deciding what they want and negotiating with each other for their mutual benefit, just as happens with market exchange. Economists and other policy "experts" can participate in the process through policy analysis, advising citizens that if policy A is adopted, they can expect B to happen as a result. But it is up to citizens themselves to decide on the desirability of various policy alternatives. Buchanan recognized that, by the very nature of government, this mutually agreeable bargaining does not always happen. Those who have political power can use the force of government to impose their will on others who do not comply. The role of the political economist is to devise institutions that constrain the power of government to prevent oppression by Leviathan government and to create governing institutions based on consent.