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Constitutional Economics

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Introduction

The economics of 'public' – as distinct from private – choice in the last 30 years, the new political economy, has subjected the activities of government to the systematic micro-economic analysis of the political behaviour of its individuals and institutions long applied to the commercial behaviour of individuals and institutions in the market.

It has produced a more penetrating and realistic understanding of democratic representative government than presented by conventional political science, especially in Britain, which largely bypassed its economics: its costs as well as benefits, its government 'failure' to contrast with market 'failure', its dispensable as well as unavoidable collective functions (the so-called 'public goods'). Public choice has produced an economics of government to place alongside the economics of the market.

Since economic activity in government as well as the market confronts the same conflict between potentially unlimited demand and severely limited supply, but in a more severe form since government dispenses widely with price and has to evolve other methods of rationing, it may seem a surprising neglect of the economists until recent decades to have failed to dissect 'public' choice in the representative institutions of government as closely and critically as they dissected private choice by individuals in the market.

The philosophers and economists of the classical tradition sensed the shortcomings of politics and often evinced little respect for politicians. David Hume's admonition was unequivocal: 'in contriving any system of government ... every man ought to be supposed a knave, and to have no other end ... than private interest'.¹ Adam Smith's more familiar dismissal of politicians spurned them as 'crafty and insidious animals'.² John Stuart Mill echoed Hume: 'the very principle of constitutional government requires it to be assumed, that political power will be abused

to promote the particular purposes of the holder'.³ And Alfred Marshall's contrast between imagined and real government was crystal-clear: 'Do you mean government all wise, all just, all powerful or government as it is now?'⁴

Even with the modern experience of the inadequacies, errors, myopia, and corruptions of government, it may be difficult for the citizen to accept that men and women freely elected or appointed into 'public' office nevertheless serve their own purposes. It seems to be a reflection on the judgement of the elector that he has elected into 'public' office people no better than himself. The instinctive hope is that they are in a class apart from other, undistinguished, men and women engaged in the daily round of earning a living. The reality would be accepted more readily if it were seen as a conflict of interest: the elected cannot be expected to put their interests below and subordinate to those of the electors; they must be expected to use power and influence for their advantage. The electors may benefit, but characteristically from activities designed to benefit the elected. Except in national emergency, when all humans become heroes, the rest is vanity.

Beyond the instinctive classical realism on political people there were seminal antecedents of public-choice analysis in the public finance and other writings of 19th- and 20th-century Swedish and Italian economists, recalled in Professor Sir Alan Peacock's 1989 Martioli Lectures, *Public Choice Analysis in Historical Perspective*. And they have infused the work of contemporary public choice economists. British public choice has developed on parallel but not identical lines. As a leading British public choice scholar, Scottish by absorption, Professor Peacock's further thinking in British public choice is reviewed in a volume of essays, *Public Choice, Public Finance and Public Policy*, by former colleagues and students. Yet the essentials are common to the USA and Britain, as well as to countries in Europe and other continents. Professor John Williamson related the lag before he turned from 'the comforting Fabian assumption . . . that governments were essentially benevolent social institutions' to the Peacock Critique that 'governments are run by politicians and bureaucrats who may be maximising a party or individual welfare function [schedule of preferences] rather than any half-respectable specification of a social welfare function [a schedule that assimilates all individual preferences into a supposed general social preference]'.

Yet in conventional political science people in 'public' life still appear to be a race apart: politicians, bureaucrats, and their acolytes called to serve the public interest with scant self-regard for their own. In contrast to the classical scepticism, conventional political science, predominantly

collectivist in sentiment, created an uncritical appraisal of the competence and potential of political people to serve the public interest that propelled the massive expansion in government of the past century.

Yet both the censorious classics and the sanguine collectivists were judgemental: the new public choice economists and other scholars are analytical. They are not disappointed: they analyse people in politics as other men and women in other human activities – neither saints nor sinners but fallible humans confronted by the necessity to make the most of scarce resources, and understandably conscious of the interests about them more than of those more distant that they are not as competent to judge.

The principles and the approach of modern public choice are generally regarded as having been systematised in the seminal work of the Americans (of Scottish ancestry), Professors J. M. Buchanan and Gordon Tullock in 1962, *The Calculus of Consent*, where Buchanan analysed politics as a process of 'exchange' between governmental rent-yielding and group interest rent-seeking (under the influence of the Swedish Wicksell's work in public finance) and Tullock (with his experience of bureaucracy in government) analysed the motivations of 'public choosers', voters, and politicians as well as bureaucrats.

Elements of modern public choice were foreshadowed by the American Anthony Downs on motives in voting and by the Scottish Duncan Black on the decisions of representative committees, and further back by the doubts about the ability of electoral processes to reflect voters' intentions elucidated by the 19th-century Oxford mathematician Charles Dodgson, also known as Lewis Carroll, and the 18th-century Frenchmen Condorcet, Borda, and Leplace.

The Buchanan-Tullock book spawned a new development of economic reasoning and research in the activities of government, democracy, bureaucracy, politics, and many offshoots mainly in the USA but also in Britain and in Switzerland and other European countries. In the USA the intellectual ferment at the Center for the Study of Public Choice, originally in Charlottesville, then at Blacksburg, now at George Mason University, has spread to other universities. The main British academics are Professors Peacock (Heriot-Watt University), Jack Wiseman (York), Charles K. Rowley (George Mason), and Martin Ricketts (Buckingham); and in Switzerland Professors Peter Bernholz and Bruno Frey, in Italy Francisco Forte, in Canada Albert Breton, and others in Norway, Spain, and elsewhere.

Men and women elected as politicians or appointed as 'public' officials are not transformed into public benefactors. They have access to vastly

more resources but, compared with people in the market, they are more likely to use them ill rather than well since they largely lack the guidance of pricing, they can avoid retribution for their harmful decisions, they are using other people's money, and they are inherently unaccountable for their errors because the costs of their decisions are usually distant and incalculable.

Public choice is concerned with the micro-economic market question of how much citizen-consumers value government services sufficiently to pay for them, rather than with the macro-economic political decision of how many citizen-voters value them enough to vote for a party or a politician.

The study of public choice, belatedly recognised after 30 years in the award of the Nobel Prize to Professor James Buchanan, was originally described as 'non-market decision-making', an inelegant but precise description of the proceedings of representatives in collectives, from committees to parliaments, making decisions for constituents. 'Public choice' is simpler but unfortunate since, unlike the market where choices are made directly 'by' the public, the collective process makes choices indirectly 'for' the public. And that is the source of the conflict between what the public would have chosen and what its representatives predominantly choose for it.

Government is no longer to be seen as the impartial referee who sets the by-laws by which the economic 'game' in the market is played, but a powerful participant in the game, much more powerful than the individuals or firms and other 'players', and liable to ignore or bend the by-laws to its advantage, always claiming that it did so in the general interest of the other players. The notion of government as the impartial chairman or referee is a myth of conventional political science that has proliferated the *étatisme* that infected all British political parties.

The study of public choice is in effect the economics of politics. And in 30 short years it has revealed why representative government, of which Abraham Lincoln held high hopes on the battlefield of Gettysburg during the American civil war, had given 'democracy' a bad name. The weaknesses of conventional political science are compounded by the journalists in the American and British press who enthuse about the return of 'democracy' to the socialist countries without analysing its imperfection: its chronic susceptibility to 'government failure'. We have yet to devise means to remove its imperfections, its obstacles to Lincoln's vision; by electoral machinery that will make it government 'of' the people, by constitutional or other controls over its mechanisms and new machinery such as electronic voting (although relevant only for public goods) that

will make it government 'by' the people, and disciplines on its reneging to make it government 'for' the people.

Professor Buchanan put the essence of his teaching into three lines in a recent essay: 'It is critically important that we recapture the 18th century wisdom... [on] checks and balance to limit government... and shed once and for all the romantically idiotic notion that as long as [political] processes are democratic all is fair game.'⁵ Professor Buchanan's strictures on superficial thinking apply no less in Britain and Europe.

The title of this collection of Professor Buchanan's six IEA contributions from 1965 to 1989, *Constitutional Economics*, is also the name given by American public choice economists to their development and refinement of the economics of politics. (The American emphasis is also shown in the title of a 1984 collection of papers edited by Richard Mackenzie on 'Containing the Economic Powers of Government'.)⁶ The IEA texts indicate some of the main elements in Professor Buchanan's thinking over much of the 30 years.

The 'key-note' *Paper* was the opening address to a seminar assembled in 1978 when it was considered that, in spite of almost 20 years of exposition, the essence of public choice had made little impact on British academic, political, or public thinking. Further papers were contributed by Professors Albert Breton of Canada, Frey, Peacock, Rowley, and Wiseman. The intention was to reinforce the earlier *Paper* in 1976 by the other founding father of public choice, Professor Tullock, to explain the essentials in *The Vote Motive*.

Professor Buchanan compressed into 5,500 words the historical evaluation of the new economics of politics and indicated the fundamental issues it was raising that were left unexplained by conventional political science: whether majority voting can elect 'representative government' that faithfully represents the public interest, whether government can provide the 'public goods' (perform the unavoidably collective functions) on which individuals differ, whether politicians can be expected to act as benevolent despots, whether public officials can be expected to act as economic eunuchs, whether rent-seeking can be resisted, and whether government that fails these and other tests can be disciplined and controlled by constitutions.

These implied strictures on conventional political science had been foreshadowed in a short *Paper* on *The Inconsistencies of the National Health Service* during a brief visit to Britain in 1965. The then early failures of the NHS, evident in the professional dissatisfaction, threatened resignations, reduced recruiting, replacement of home-trained by immi-

grant hospital staffs, overcrowding, delays in treatment, and more could be rectified not by the appointment of wiser men (still the recourse of government) but by no less than structural reform in the financing mechanism. The political cancer in the NHS was the conflict between the collective, politicised, supply of medical care in response to individual demand. It had divorced supply from demand: individuals as consumers would demand more 'free' (unpriced) medical care than they were prepared to supply and pay for as taxpaying voters.

If it was true in 1965 it is still true in 1990. But government has not learned to remove the structural conflict diagnosed by Professor Buchanan. A successful business administrator has been appointed to administer the NHS, but without the pricing that had enabled him to make a success of his business. And, despite innovations such as internal markets, family doctor budgets, and opting out by hospitals, the NHS remains a politicised artefact: supply is still controlled by the political process and its financing of 'free' services by taxation extracted from reluctant voters. The gap left by markets in public services has been filled inadequately by opinion polls based on economic theory that would fail first-year economics undergraduates, that price has no effect on demand, and that elicit the hardly significant hypothetical information that individual taxpayers want more welfare services paid for by other taxpayers. The British, in short, 25 years after Professor Buchanan wrote in 1965, are in practice still refusing to finance as taxpayers and voters the unlimited medical care they are demanding at nil prices as patients. The NHS has induced the British to tolerate less or worse medical care than they could pay for, and would pay for if they were able to pay in ways they preferred.

Two *Hobart Papers* with co-authors, *The Consequences of Mr Keynes* in 1978 and *Monopoly in Money and Inflation* in 1981, enabled Professor Buchanan to apply public choice analysis to the great issues of the day. The most damaging 'consequence' of Mr Keynes was not only in economics but also in politics. His cure of budget deficits for under-employment in a market economy was not only economically defective, as the monetary economists led by Professor Milton Friedman had shown; possibly even worse, it was politically unrealistic. It was based on the 'romantic' notion, inherited from conventional political scientists, that politicians would alternate politically popular budget deficits with politically unpopular budget surpluses.

In *The Consequences of Mr Keynes* the argument was that the instrument Keynes had fashioned could not be used in a representative democracy: Keynes had 'turned the politicians loose' to overspend, overborrow,

over-print money, and over-inflate. And in many countries they had run amok. It has taken a government sufficiently imbued with the teachings of public choice to see the irrelevance of the price-less opinion polls, and to anticipate that well-timed tax-reductions are likely to be more agreeable to the voters than tax-increases to pay for even more wasteful 'welfare' services, to resist the importunities of its Departments and bureaucrats for still higher expenditure on the welfare state.

Monopoly in Money and Inflation in 1981 was a further assault on the state monopoly for reasons of the political temptation to secure revenue by inflation, rather than by economic efficiency, such as the argument of Professor Frederick Hayek that only competing private suppliers of currencies would maintain their value, since uncontrolled increases in supply would destroy their value and precipitate inflation. The conclusion, that the solution lay in reform of the monetary régime by a new monetary constitution, was also different from that of the monetarists, who proposed reform in monetary policy. The recent proposal of the British Chancellor of the Exchequer for competing national currencies in place of the unified EEC currency is a compromise between a government monopoly and competing *private* currencies: public choice analysis suggests doubts whether national governments would play the game by the new rules rather than conspire to politicise the system by agreements on exchange rates.

Professor Buchanan's solution for both unrestrained budgetary deficits and the state monopoly of money was to discipline democracy: to erect monetary and budgetary rules and institutions that disciplined government, put into writing and made part of the constitution, to be changed only by substantial majorities of the people (but in direct referenda voting rather than in representative assemblies).

In 1986 a contribution to *The Unfinished Agenda* led Professor Buchanan to emphasise a development in modern economies that made constitutional reform urgent. The modern state had become the vehicle for 'massive transfers of wealth'. Their extended powers induced politicians to compete for votes by offering short-term social benefits, to the neglect of the adverse long-term consequences on the populace. The career politician not interested in long-term socio-political viability had largely replaced the former statesman-politician who could take a long view.

Here, at least, public choice was diagnosing a dilemma in representative democracy that only a change in the rules governing the powers of short-term politicians could treat. This dilemma in the political process, that representatives elected to take a wider and longer view than

the citizens who elected them were ironically governed by political myopia, the 'short-termism' alleged against the market, raised complex questions in the design of political institutions: the optimum period of legislatures, the power to legislate for future citizens who have no vote in the present, the enactment of 'irreversible' policies, the pre-election timing of expansionary economic impulses for party-political advantage, the very range of functions permitted to government, not least the nature of 'public goods', the obligation to repeal measures outdated by events, and more.

If democracy permits or incites temporary majorities to legislate for immediate effect, irresponsibly indifferent to the long-term consequences, it is at the mercy of the cynical politics of *après nous la déluge*. The political process then incites even good men to do lasting harm. Attlee left a deluge of bureaucratic welfare, Macmillan and Wilson a deluge of corporatism, Heath a deluge of inflation, most post-war Conservative and Labour Prime Ministers a deluge of unnecessary monopoly, superfluous bureaucracy and excessive taxes. The new political democracy in the communist countries does not solve the dilemmas of democracy. The hope was that government would resolve 'market failure'; it has emerged with the even more intractable 'failure' of representative democracy. Government is self-inflationary; it is not the dependable cure of known diseases but the unrestrained cause of new diseases.

A further contribution in 1981 was an essay with Professor Tullock in *The Emerging Consensus*, a collection to celebrate the 25th year of the IEA. It proposed a 'leap forward' from the study of markets to constitutional change. The advance was to be to 'the incentives, the rewards, and the penalties' of the politicians and their bureaucrats and the new institutions in which these inducements were more calculated to induce them to work to the general advantage. Conventional orthodox political science offered little solution. It was to be sought rather in recapturing the wisdom of the 18th century: its 'scepticism about the abilities of politics, of government, to handle detailed regulatory tasks, to go beyond the limits of the "minimal" or "protection" state'.

The Buchanan-Tullock espousal of the 'minimal' state opens for liberals the central question of the functions of government. In his eloquent *Hobart Paper* 113, Dr John Gray argued persuasively for the wider functions of the 'limited' state. The whole ground has recently been traversed by Professor Joseph Stiglitz in *The Economic Role of the State*, which favours the wider limited than the narrower minimal rôle. And Professor Israel Kirzner in his latest work, *Discovery, Capitalism and Distributive Justice*, envisages a reduced rôle for government by the

argument, which circumvents John Rawls's on a larger rôle and Robert Nozick's on a smaller, that, since new resources and products are not taken from others but are newly discovered and created by individuals, 'social justice' does not require the wide redistributive functions by government envisaged in conventional political science.

Professor Buchanan's latest IEA contribution to date was to apply public choice to the market-oriented reforms of the USA in the 1980s in *Reagonomics and After* and its implications for the rôle and structure of government, some of which may apply to the Thatcher Governments so far. He judged the Reagan presidency as 'a failed opportunity to secure the structural changes that might have been within the realms of the politically possible'.

These judgements on the Reagan 'lost opportunity' raise the most fundamental issue in the over-expansion of government in representative democracy and its containment by constitutional discipline. For Britain, as well as for the USA, the questions suggested by public choice analysis are: Can government be expected to preside over its own dissolution? Can the excesses of the political process – not least the influence of rent-seeking pressure groups – be removed by action within the political process?

The pressure groups, like the regulated who capture the regulators, must be expected to manipulate political opinion on the new constitutional constraints. The bureaucrats are adept at drafting new measures to allow them discretionary powers that frustrate the purpose of the restraints. The lawyers and solicitors must be expected to interpret the amendments in their interests. (In Britain they have not taken kindly to measures that limited their restrictive practices.) In short, the self-disciplining of over-government will itself be a highly politicised process in which political people – the politicians in power and the bureaucrats who serve them – will be judge and jury.

The solution, especially in Britain with an unwritten constitution, may have to be the creation of an overwhelming public philosophy in favour of less government. It must come to be believed that government is a wayward servant inclined to self-aggrandisement, a glutton for power, and given to hypocrisy in concealing empire-building by protestations of saintly intentions. The Fabians began in the 1880s to create in all parties a sentiment in favour of more government that eased the path of socialisation in the last century. The antidote may have to be to create an equal but opposite sentiment in favour of less government that will ease de-socialisation in the coming decades. This is the task the IEA set itself in 1957, and it has been powerfully reinforced by the teachings of

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public choice developed by Professor Buchanan in the USA and by the growing army of libertarian economists, political scientists, historians, lawyers, and philosophers in Britain and Europe.

Arthur Seldon

Notes

- 1 David Hume, 'Of the Independancy of Parliament' (1741) in *Essays Moral, Political and Literary*, Liberty Classics, 1985, p. 42.
- 2 Adam Smith, *The Wealth of Nations*, 1776.
- 3 J. S. Mill, *Considerations on Representative Government* (1861), in *Essays in Politics and Society*, University of Toronto Press, 1977, p. 505.
- 4 Alfred Marshall, in A. E. Benians (ed.), *Memorials of Alfred Marshall*, Macmillan, 1926.
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- 6 Richard Mackenzie (ed.), *Constitutional Economics*, D. C. Heath, Lexington, Mass., 1984. This American emphasis is also shown in a 1989 collection, *Public Choice and Constitutional Economics*, edited by J. D. Gwartney and R. E. Wagner, Greenwich, Conn.: JAI Press.

Post-Reagan Political Economy

1 Introduction

I propose to discuss the post-Reagan political economy of the United States, a subject that surely has some relevance for the political economy of the United Kingdom. It is possible to make some relatively secure predictions about the sort of problems that will arise. The Reagan record has been written, and we can define the 'roads not taken' during eight years with some accuracy. Any discussion of the post-Reagan political economy will necessarily involve an assessment of the Reagan presidency, one that is specifically limited here to the political economy of policy.

My theme is both simple and familiar. I assess the Reagan presidency as one of failed opportunity to secure the structural changes that might have been within the realms of the politically possible. The result is that, after Reagan, the institutions in place will remain roughly the same as those existing in 1980. And the potential for mutual and reciprocal exploitation through the political process, the behavioural domain of those persons and groups (the rent-seekers) that seek private gain through the agencies of government, will not have been substantially reduced in range and scope.

On the other hand, the shift in public attitudes that made the Reagan ascendancy possible will not be reversed by a shift in administration. There will be no return to the romantic delusion that the national government offers cures for all problems: real, imagined, evolved, or invented. After Reagan we shall live in a political economy that embodies widespread public scepticism about government's capacities, and also

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about the purity of the motivations of political agents. But, as noted, at the same time we shall have in place all of the institutional trappings that emerged during the apogee of our romantic interlude with politicisation.

The struggle between interest groups

Politics involves playing many simultaneous games with and between shifting coalitions of interests. Broadly, however, it is useful to think of politics, post-Reagan, as a struggle between the rent-seekers, who try to secure private profits or rents through the authority of government, and the constitutionalists, who seek to constrain this authority. And it is important to recognise that all of us, or almost all, are likely to play on both sides of this super game simultaneously. We behave as rent-seekers when we support expanded spending programmes or tax breaks to benefit our own industry, occupation, region, local authority, or, quite simply, our own pet version of some 'public interest'. We shall behave as constitutionalists when we recognise the overreaching of government in general.

This struggle will proceed independently of the particular electoral results of 1988. The apparent competition among and between personalities and parties will matter much less than the struggle within each of us, as citizens, between resort to politics and explicit search for limits on politics. The question is clear: Without the putative legitimacy that was provided by the romantic delusion, can the rent-seekers dominate the constitutionalists? Or will the return to some semblance of the 18th-century wisdom about the potential for abuse of political authority generate, in turn, some effective embodiment of the 18th-century limits on this authority?

A modern constitutionalism?

In one sense, we may read the Reagan era in the United States as an interlude between the romantic follies represented by Kennedy's Camelot and Johnson's Great Society, and one of the two post-Reagan options that I have suggested. The first post-Reagan scenario involves the raw struggle of interests in majoritarian politics constrained by no constitutional limits; the second post-Reagan scenario could reflect the beginnings of a return to some modern version of the dream of James Madison. And we should make no mistake that one of these two out-

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comes (or a mixture of the two) must describe post-Reagan political economy. The basic struggle was exemplified in the arguments of the 1988 presidential aspirants, both of whom seemed unwilling to challenge the rent-seekers directly while at the same time both seemed to recognise that rent-seeking demands must be constrained.

In Section 2, I explain my verdict that the Reagan leadership is one of lost opportunity. In Section 3, I shall briefly examine the Reagan fiscal policy agenda, and relate this agenda to more comprehensive issues. In Section 4, I describe the change in perception and consequent evaluation of politics and politicians that has occurred only since the 1960s. In Section 5, I discuss the supergame between the rent-seekers and the constitutionalists in more detail. And finally, in Section 6, I relate the argument to American constitutional democracy, by comparison and contrast with the parliamentary democracy of the United Kingdom.

2 Policy Within Politics versus Structural Reform

Those who are familiar with my various writings will recognise that it is necessary here to review briefly the methodological perspective of the constitutional economist. Some appreciation of this perspective is required in order to understand my assessment of the Reagan enterprise. There is a categorical distinction to be made between playing the policy game within the rules of ordinary politics and engaging in the wider exercise of considering the rules themselves, by which I mean the institutional—constitutional structure that constrains the workings of politics.

A central objective of the Reagan presidency was to reduce the politicisation of the national economy, to reverse in direction a movement that had been going on for almost a century. In political economy terms, the characteristic feature of this century has been the growth in size and scope of the public sector, along with the increasing concentration of authority in the central or federal government. This feature has not, of course, been unique to the United States. The 20th century has been characterised by the growth of government everywhere.

Fixed rules or incentive structures

There are two ways in which the Reagan objective of reduced politicisation might have been approached. The first, which I have called 'policy within politics', embodies the presumption that the rules, the institutional-constitutional structure from which political decisions emerge, are fixed. By inference, the failure of pre-Reagan politics to have advanced the cause of depoliticisation was attributed to the presence of the 'wrong' parties and the 'wrong' politicians in positions of decision-making authority. In this view, the specific task for the dominant coalition of Reagan supporters was to repeal and reverse policy steps taken by the pre-Reagan 'socialists' of all stripes.

The constitutional economist, who might have shared the stipulated objective of depoliticisation, would not have accepted this interpretation of the Reagan enterprise. His was a totally different diagnosis of the pre-Reagan political economy. The increasing politicisation of the national economy over this century was attributed, not to the preferences of ideologically driven political coalitions, but to the incentive structure embedded in the existing institutions from which political choices emerge. In this approach, it matters relatively little, if at all, which parties or which politicians succeed or fail in the overt electoral competition. The constitutional economist would have based his expectations for any permanent change only in modifications of the incentive structure.

As might have been anticipated, there were elements of both of these approaches in the early Reagan rhetoric. There was talk of the need to change the rules, as well as of great things to be expected when the 'other side' was thrown out and 'our men' put in their place. In 1980 and earlier, Ronald Reagan supported the proposal for a constitutional amendment to require the federal government to balance its budget and to impose limits on rates of growth in total spending. He also promised, in his campaign rhetoric of 1980, to eliminate the cabinet-level departments of education and energy.

It was evident, however, even before inauguration in January 1981, that the Reagan leadership was to move primarily if not exclusively along the policy-within-politics route and to relegate to secondary status any attempt to achieve genuine structural change. Early proposals to examine the structure of arrangements for monetary authority were rejected; the balanced-budget amendment was not supported during the early months; no mention was made of the promised elimination of departments. These were opportunities that were lost by the new administration from the time it took office. The Reagan administration became

itself a part of the existing structure; it could no longer succeed in generating changes in the structure itself. All it was left with was to play the standard political game.

3 Taxing, Spending, and Debt

The stipulated objective of reducing the politicisation of the national economy was widely shared by the American electorate in the 1980s. One measure of the extent of politicisation is the size and rate of increase in the federal government's budget, the total rate of expenditure. There was general support for President Reagan's argument that programme spending was, in general, grossly over-extended and that rates of tax were too high, and had been allowed to increase too rapidly during the inflation of the 1970s.

A meaningful criterion for policy designed to reduce the rate of increase in federal outlay is the present value of anticipated outlay over an indefinite period. A policy designed to reduce rates of increase in current-period outlay only at the cost of ensuring increased rates of spending in later periods would not seem defensible. Yet this short-term policy is precisely the one followed by the Reagan administration. Projected rates of increase in tax revenues were cut in 1981, but *without* correspondingly reduced rates of increase in federal spending. The increased shortfall of revenues behind the increase in outlay was residually financed by the sale of debt, that is, by incurring budget deficits.

The result was that, for the Reagan years, taxpayers had available, for private disposition, an expanded level of purchasing power, relative to that which would have been available under a scenario that matched cuts in rates of increase in taxes and in government spending. This result seems appropriate only if the objective was to give more funds to individuals during the Reagan years, in disregard of the effects in subsequent years. What will be these latter effects, given the policy history sketched out? The outlays during the Reagan years, and before, that were financed by debt must be 'paid for' during the post-Reagan years by service charges represented in interest payments. To the extent that interest charges become a necessary component in the federal budget, these charges will be matched dollar-for-dollar by reductions in funds available for private disposition. The increase in the funds available for private disposition during the Reagan years is precisely matched by the reduction in funds available for private disposition during post-Reagan

years. The deficit financing of Reagan-year spending will have accomplished nothing other than a displacement of real cost in time, which is what the classical theory of public debt emphasised.

The effect of the budget deficit

Can the Reagan fiscal policy be defended in terms of the present-value criterion suggested above? Did the residual financing of outlay by debt, with mounting deficits, exert pressures on the Congress to hold down rates of increase in spending more than would have been exerted through tax financing? This argument was, indeed, prominent in the Reagan White House. By forcing a political disequilibrium between the two financing sources, taxes and debt, through the initial 1981 marginal-rate reduction of tax, the politically supportable rates of spending might have been lower than that rate financed by an equilibrium adjustment between the two financing sources. This argument would, however, seem to fly in the face of more elementary public-choice logic which suggests that political decision-makers, like individuals in their private capacities, will tend to spend more when the borrowing option is present than when it is not. The precise weights to be given to these offsetting arguments cannot be assigned here.

Nevertheless, the legacy of the Reagan fiscal policy is not in dispute. In post-Reagan years, the funds available for private disposition by individuals must be lower than if tax increases had kept pace with increases in expenditure. The costs of spending during the Reagan years will be borne by taxpayers and/or frustrated programme beneficiaries (and holders of government debt instruments if indirect or direct default is considered an option). Rates of tax will be higher and/or rates of spending on public programmes will be lower than they would have been under the alternative financing régime. The commonly observed comment about chickens coming home to roost is appropriate.

How might this result have been avoided if a structural approach to policy had been followed? It seems clear that Reagan's early mandate was sufficient to have secured approval of a constitutional amendment to require budget balance and to impose limits on rates of increase in federal spending. This policy package, with an appropriate phase-in period before balance in the budget was to be achieved, would not have reduced rates of increase in taxes so dramatically as experienced under the Reagan presidency. Rates of outlay might have increased less than those we have observed during these years, although, as I suggested

above, this conclusion may be debated by economists using different models. But the important conclusion which cannot be rejected is that, in post-Reagan years, citizens, whether as taxpayers, programme beneficiaries, or creditors, will be worse off than they would have been under the suggested alternative for policy.

4 Politics and Politicians Post-Reagan

The fiscal legacy alone places major constraints on the flexibility of response of any political coalition in the post-Reagan years. It will prove difficult to mount support for new programmes of spending, given the size of the budget deficit and the large interest component included in it. The threat or existence of emerging deficits may or may not have constrained rates of spending, relative to those rates that would have been supported under tax financing, in the 1980s. The existence of the accumulated debt, with its accompanying interest charges, must constrain rates of spending in the 1990s. This fiscal constraint may, however, be somewhat unimportant relative to the more principled constraint embodied in the attitude of the citizenry towards politics and politicians.

We can, I think, be assured that there will be no return, post-Reagan, to the romantic illusion that characterised politics during the 1960s. The Reagan presidency represented an anti-politics mentality on the part of the citizenry (the electorate), a mentality that reflected a fundamental shift in public attitudes over the decades of the 1970s and 1980s. It may be useful here to review this dramatic shift in public opinion.

The growth of government

I noted earlier that the first two-thirds of this century were characterised by a dramatic growth in the size of the public or governmental sector of the economy, whether this growth be measured by rates of increase in public spending, taxation, regulation or some other broader standard. Such growth rates were not, or course, unique to the USA. Indeed, the UK and other nations of Western Europe experienced even more dramatic increases than the US over the same period. In the USA this politicisation of economic life occurred in several distinct stages. A potted history may be useful.

The 'progressive era' that describes the turn of the century embodied attitudes that were highly critical of the unbridled market economy and offered the arguments for later politicised interferences. The 1913 enactment of the 16th amendment to the US written constitution authorised the levying of a progressive income tax. This amendment was critically important because income tax provided a source of revenue that would grow disproportionately with the growth in national income, either real or nominal. World War I, as all other wars, expanded the central government's authority, and, although there was considerable depoliticisation in the 1920s, the instruments of authority remained in place. Franklin Roosevelt's New Deal, as a response to the economic emergency of the Great Depression, reflected widespread public support for new, expanded, and often ill-conceived, programmes of governmental activity. World War II followed and, once again, the crisis itself facilitated an increase in government's authority.¹

Eisenhower's 1950s were characterised by much less political retrenchment than the 1920s. The decade of the 1950s in the United States is best described as a holding operation. There followed the bizarre decade of the 1960s, which witnessed the apogee of public support for politicisation at least a decade later than the comparable situation in the UK. The artificial and essentially romantic ideas of Kennedy's Camelot were, however, well on the way to exposure and prospective oblivion when the 1963 assassination of Kennedy and the subsequent ascendancy of Lyndon Johnson provided the impetus required to enact left-over New Deal legislation that was three decades out of date.

The romantic delusion

In retrospect, from our vantage point in 1988, it seems amazing that this whole period of dramatic growth in the politicisation of economic life in the USA and elsewhere, occurred in the absence of any plausibly realistic theory of how politics actually works. We were everywhere trapped in the romantic delusion stemming from Hegelian idealism: the state was, somehow, a benevolent entity and those who made decisions on behalf of the state were guided by consideration of the general or public interest. Thus welfare economists considered there was a *prima facie* case for politicisation of an activity once the market was judged to have failed to meet the idealised criterion of maximal efficiency.

The set of attitudes which embodies these ideas was shifted in the 1960s and beyond. There are two identifiable reasons for the change.

First of all, in the USA, Lyndon Johnson's extensions of the welfare state failed demonstrably in many instances; these failures were directly observed by citizens as well as by research scholars and specialists. The failures were often described in terms of the 'capture' of programmes by special-interest beneficiaries whose motivation seemed to be private and personal gains.

The second identifiable reason for the shift in attitude towards politicisation was the development and promulgation of a theory of how politics actually works, along with accompanying analyses of how politicians actually behave. Public choice theory, broadly defined, came along in the 1960s, 1970s, and 1980s to offer intellectual foundations that allowed citizens to understand the political failures they were able to observe at first hand. This theory, in its simplest terms, does little more than to extend the behavioural model used by economists to choices made by persons in political rôles (as voters, politicians, bureaucrats). Once this elementary shift in vision is made, however, the critical flaw in the idealised model of politics and politicians is exposed. No longer could the romanticised model of the workings of the state be tolerated.

Identifying special interests

Politics was, for the first time in two centuries, seen as a very complex interaction process, in which many persons, in many rôles, seek a whole set of divergent objectives, which include a large measure of their own and private economic gains. Politicians in elected office seek re-election, and this dictates that they be responsive to the desires of constituents. And constituents seek to profit from politics just as they seek to profit from their private activities. Politics, as a game among competing special-interest groups, each of which is organised for the pursuit of profit through the arms and agencies of the state, takes on a wholly different colouration in the post-1960s from that which it assumed in the decades before the 1960s.

The reaction on the part of the public was that which might have been anticipated. By the mid-1970s, the rhetoric of anti-politics had entered the political debates. Both the 1976 Carter and, more emphatically, the 1980 Reagan electoral successes stemmed from this shift in public attitudes, as did the 1979 Thatcher victory in the UK. For more than a decade the electorates have viewed politics and politicians more realistically than they have done for more than a century.

I have traced out this history because it is helpful in making projections

of the post-Reagan political economy. I should emphasise that there will be no return to the romantic delusion about politics that characterised public and academic attitudes throughout most of this century. The socialist god is emotionally and intellectually dead. Despite the occasional rhetorical flourish from the old left and its political spokesmen, no political leader, post-Reagan in the United States, will have the flexibility that Roosevelt, Kennedy, or Johnson possessed. Political leadership, post-Reagan, and independently of party, must confront a citizenry that will remain sceptical of political nostrums and that will attribute special-interest motivations to any and all political agents. This public scepticism will be added on to the fiscal constraints already noted. The challenge to be faced by any prospective political leader in the post-Reagan years is immense.

5 Rent-seekers versus Constitutionalists

I suggested above (p. 2) that the post-Reagan political economy in America will be described by the struggle between the rent-seekers and the constitutionalists, and that almost all citizens will play, simultaneously, both of these rôles. If we understand modern democratic politics in these terms, we remain within realistic models and steer clear of engaging in romantic images. Each of us will seek to utilise the political process to further the privately determined and specialised interest that affects us most directly, either through providing us with desired, positively-valued activities from which we secure benefits or through preventing negatively valued actions from being carried out to our cost. In this use of the political process we are rent-seekers, and I use this term to refer to any sought-for objective that involves concentrated benefits or costs.

If I seek a special tax exemption for my industry, my profession, my region, I am rent-seeking. If I seek a special spending programme that will benefit my pet project, whether this will provide me with personal pecuniary gain or not, I am rent-seeking. I am seeking to secure *differential* gains that are not shared by the full constituency. In game theory terms, I am behaving non-co-operatively; I am engaging in politics treated as a non-co-operative game. To the extent that politics may be accurately regarded as a competitive struggle among the rent-seekers, it will, in total, be negative sum, or, at best, zero sum – that is to say, the aggregate losses will be larger than the aggregate gains.

A negative-sum game

If this is all there is to politics, if all, or almost all, members of the polity consider themselves to wind up as net losers, despite the differential gains that may be secured from favourable political action on their favoured programme, pressures will increase to change the rules. Why will rational persons continue to play in a negative-sum game and, further, negative sum over all, or almost all, participants? If this result should be characteristic of a game in which persons voluntarily participate, the game could not survive. Players would, quite simply, leave the game. In this sense, it is improper to model politics by analogy with voluntary games. Individual members of a political community cannot readily exercise an exit option, especially at the level of the national political unit. If emigration thresholds are high, individuals must change the rules as an alternative to leaving the game itself.

In taking action to change the rules of the political game, based on the recognition that the rent-seeking struggle takes place within the existing rules, the individual behaves as a constitutionalist. I have suggested that, within each of us, there is a conflict between our political behaviour as a rent-seeker and our political behaviour as a constitutionalist.

Rising above interest groups

In a paper delivered at the American Economic Association meetings in Chicago in December 1987, William Niskanen, former member of Reagan's Council of Economic Advisors, pointed to three separate political events in the United States that seem to reflect the constitutionalist element at work in the political process, the element that is basically co-operative rather than conflictual.² He pointed to the whole deregulation movement, to the tax reform legislation of 1986, and to the Gramm-Rudman-Hollings budgetary constraints, enacted first in 1985 and revised in 1987. In each of these cases, the beneficiaries seem to be the citizenry generally rather than concentrated interest groups. As Niskanen suggested, the political economist who tries to remain with a rent-seeking model of democratic politics cannot explain these events. These events can be satisfactorily understood only when it is recognised that a constitutionalist model, which directs attention towards effective changes in rules that will benefit all, or almost all, players, also explains at least some aspects of observed political reality.

As I have noted earlier, the distinguishing feature of the post-Reagan political economy will be that the struggle between the rent-seeking special interests and the constitutionalist effort to secure general benefits from changes in rules, will be carried on without the romantic delusion that political agents seek to further some general or 'public interest', or, indeed, that any such interest exists. Before the 1960s, this delusion was omnipresent in all discussions about and attitudes towards politics and politicians. And it was this delusion that enabled many special-interest programmes involving concentrated benefits to be approved unwittingly by the electorate. Because these programmes are now established, as a part of the post-Reagan *status quo*, we cannot predict wholesale dismantling, even if the error in initial politicisation comes to be widely acknowledged. We can, however, predict that, without the romance of the public interest, or of the genuinely benevolent state, special benefits to concentrated interests will be more difficult to implement through the political process. Can we expect to see more Tulsa or Tombigbee canals, both notorious examples of American 'pork-barrel' spending, in the 1990s?

Binding constraints

Let me be a bit more specific about the supergame involving the rent-seekers and the constitutionalists in particular areas of policy and politics. There is perhaps a better recognition of the negative-sum aspects of the spending-taxing-deficit process, as carried on by both the Reagan presidency and the Congress in the 1980s, than for other areas of policy. The Gramm-Rudman-Hollings legislation, although not so desirable from a constitutionalist perspective as an amendment to the United States' written constitution would be, nonetheless reflects a recognition by the Congress that its spending rules, its procedures, were out of hand and that binding constraints are required. The test for the post-Reagan years will be whether or not the discipline signalled by the Gramm-Rudman-Hollings legislation, and by the attempts to work within its discipline, will carry over beyond 1991.

The issue on which there does not seem to be adequate recognition for the necessity to operate within general rules that constrain political rent-seeking is that of trade policy. Potentially, the post-Reagan political economy seems most vulnerable to the protectionist urgings of special-interest groups which may, through a set of logrolled political exchanges, succeed in imposing major damage on the national economy. We could

find our incomes reduced in post-Reagan years if we allow legislation to be enacted that will close up our markets. This threat can be contained and offset only if the citizenry, and its political agents, recognise the self-defeating or negative-sum aspect of the protectionist argument. The constitutionalist position here is that which was taken by Cordell Hull in the 1930s; trade policy, industry-by-industry, cannot effectively be made by Congress, which necessarily allows for complex trade-offs among separate beneficiary groups to the damage of the general electorate.

6 Constitutional Democracy

Any description of the American political economy, post-Reagan, must be informed by an understanding of what the American polity is and how it differs from other national polities. The United States is a republic; there is a written constitution, a two-house legislature, an executive with veto powers, and a supreme court with authority for review. This political régime is different in many respects from the idealised parliamentary democracy, which is much closer to the majoritarian model of collective decision-making so favoured by political scientists. Majority coalitions in the USA are much more constrained in what they can do and the speed with which they can do it than are parliamentary régimes. This difference alone is, I think, sufficient to explain why the American economy came to be somewhat *less* politicised over the century when politics was viewed romantically than those other Western economies, including the United Kingdom, where majoritarian dominance was characteristic. But this difference also explains why Mrs Thatcher has been more successful than Ronald Reagan in carrying through on pledges and promises for effective depoliticisation. Parliamentary régimes depend relatively more on who is in office and relatively less on the incentive structure facing whoever is in elective office. Put very simply, a constitutional democracy is constitutional, which means that rules matter.

The President's opportunity

This difference in structure is important in understanding my overall theme for this paper. Let me return to the supergame involving rent-seeking competition on the one hand and constitutional efforts to change

the rules on the other. By the nature of the structure, special-interest coalitions tend to find their initial support in the US Congress, which is organised, deliberately, on the basis of dispersed geographical representation. Congressional dominance of the executive necessarily implies that relatively more political rent-seeking will take place with relatively less constitutional thrust. By contrast, because the President is representative of the whole electorate, there is, in the presidency, a 'natural' location for attention to genuinely constitutional approaches to policy reform. It is in this sense that I judge the Reagan presidency to have failed; it paid too little attention to structure and it seems to have been too interested in playing the policy-within-politics game, too interested in pushing its policy agenda within a relatively short time perspective.

What can we predict for post-Reagan politics? Quite independently of the electoral results, because of the constitutional structure itself we can predict reasonable stability in policy. There can be no dramatic reversals in trend. Indeed, 1933 was perhaps unique to US history in that this was a peacetime year when dramatic change was possible. A post-Reagan president can adopt a constitutionalist stance and consider proposing changes in the rules that will effectively constrain the rent-seekers. The opportunity for this position to be successful will not, however, be that faced by Ronald Reagan in 1980. Quite apart from prospects for success, there seems little likelihood that the new President will adopt even so partial a constitutionalist stance as Reagan did in 1980. If policy-within-politics ultimately came to dominate the Reagan years, we can scarcely expect the post-Reagan president to place structural change high on his attention listing.

Mutual exploitation or rule change

Hard-headed and sober predictions about the post-Reagan years suggest that we will witness relatively more negative-sum rent-seeking through the agencies of national politics. These predictions are tempered somewhat when we recognise the total absence of any supportive romantic image of governmental benevolence. Can the rent-seekers continue to engage in mutual exploitation through politics without some myth of public interest? My own romantic prediction, based largely on hope rather than analysis, is that the time will be ripe for intellectual entrepreneurs in particular to convey the constitutionalist message. This message is simple and does not urge persons to act contrary to their

interests. Changing rules can be, and is, in the interests of *all* the players, especially as they are caught up in the competitive struggle among interest groups, each of which exploits all others. Personally, I think I have a moral obligation to believe that we can move towards a restoration of the vision of James Madison.

7 Post-election Postscript

The substantial election victory of George Bush confirms my hypothesis that the romance between the American electorate and the state has faded into near-oblivion. Even if somewhat lukewarmly proffered, Governor Dukakis did call for an extension and expansion of the political domain of the federal government. The accompanying electoral successes of the Democrats in both houses of the Congress confirmed another hypothesis concerning the increasing importance of rent-seeking, special-interest politics. Members of Congress act in furtherance of the interests of defined constituencies, and one of President Bush's major problems will be to control the excesses that coalitions of special-interest groups will seek to enact.

Protectionist legislation, additional to that which is already embodied in the 1988 trade bill, will move through Congress. George Bush and James Baker seem to understand the logic of free trade, but whether their expected rhetoric will be matched by effective control of protectionist pressures is not predictable. More generally, there is no indication that George Bush thinks and acts on the basis of *constitutional principle* even to the extent that motivated Ronald Reagan.

Bush deliberately locked himself into a no-tax-increase position in his campaign commitments. He will succeed in holding off tax-rate increases if costs under Medicare can be reasonably contained, and if new spending initiatives are kept in check. The payroll tax increases enacted in 1983 are beginning to accumulate surpluses in the social security account, and these surpluses act to make the budget deficit, overall, seem less than independent accounting would suggest. The Gramm-Rudman targets for reduction in the size of the comprehensive deficit can be met under favourable economic conditions, even if the problems of funding future commitments to retirees are exacerbated.

The most severe threat to economic policy in the Bush presidency may stem from a possible financial crisis, triggered by collapse of saving and loan units, or by foreign debtors. If, in response to such crises, the Federal

Reserve authority responds with increases in liquidity, inflationary pressures will accelerate, with rapidly shifting expectations. This inflation would, in turn, prompt monetary restrictions which would generate recession. This scenario need not occur, but the fragility, and hence non-predictability, of the whole set of complex monetary arrangements, both domestic and international, ought to be emphasised.

There is little or no evidence that a Bush-Baker-Brady administration will understand or seek *constitutional* approaches to the resolution of the issues of political economy that must surely emerge in the 1989-93 years.

Notes

- 1 Robert Higgs's book, *Crisis and Leviathan*, Oxford University Press, New York, 1986, provides a good source for the material sketched out here.
- 2 William Niskanen, 'The Political Economy of Gramm-Rudman and other "Policy Accidents"', unpublished manuscript, Cato Institute, Washington DC, 1987.

2

An American Perspective: from 'Markets Work to Public Choice'

with Gordon Tullock

1 Introduction

We have been careful to entitle this paper 'An American Perspective' rather than anything more general. In the initial invitation, we were asked to discuss the Institute of Economic Affairs as viewed by American 'public-choice economists', an invitation that in itself suggested the restrictiveness of our vantage point. While we do hope to discuss the IEA in a somewhat wider context than that of 'public choice', narrowly conceived, we make no claim to represent mainstream or orthodox American attitudes, to reflect 'establishment' opinion, whether reserved for the limited group of applied economists or extended to describe the intelligentsia.

Decisions and institutions

In the first of these settings, that of applied economics (often labelled as 'public policy'), we are perhaps somewhat less sympathetic to the main thrust of the IEA's efforts over the quarter-century than those of our American counterparts who have, in their own researches, paralleled the IEA thrust more closely. In a real sense, 'public-choice' research is more 'institutional' than straightforward applied economics. 'Public choice' examines more carefully the political, or government and bureaucratic structures, rules, and procedures (the *institutions*) through which policy

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decisions are made, and less the *content* of the decisions themselves.

Having said this, however, we should hasten to add, indeed to emphasise, that it is through the IEA's efforts that public-choice research has been brought to the attention of the academic-intellectual-journalistic community in Great Britain. These efforts were expressed particularly in the IEA's 1978 and 1979 symposia on the 'economics of politics', in which both of us participated,¹ and in the publication of several of our works, along with those of others who represent public choice, broadly defined.² There is, indeed there must be, a close relationship between constructive research in applied economics (or public policy) and in public choice, the 'science' or sub-discipline that examines more directly the means through which policy programmes are chosen and implemented.

The market works

In six words or less, what has been the thrust of the IEA's research programme? 'The market alternative works'. This has been the central hypothesis of most of the IEA's efforts in positive economic analysis (of what is). The demonstration of the validity of this hypothesis, in one industry, occupation or other application after another, has, in a more or less natural progression, allowed the normative imperative (of what *should be* done – policy) often to be stated as: 'Try the market', or, even more concisely if with some apologies to the Queen's English, 'privatise'.³

Comparably, the thrust of the research programme in public choice may be somewhat sketchily put as: 'The governmental-political alternative does not work'. Research in public choice has concentrated on the way government functions. As a result it has been discovered that commonly *the government alternative is inherently inferior to the market*. There have been two positive implications, one of which is to shift much government activity to the market and the other is to change government structure so as to improve its efficiency. The central 'government fails' hypothesis, again in numerous applications in IEA papers, has been demonstrated in positive analysis of varying degrees of analytical rigour. Again, given the analytical support of the hypothesis, the conclusion for policy often becomes: 'Try the market' or 'Privatise'.

The change in policy

The two research themes seem to converge, therefore, at the level of the normative implication of what should be done. There remains a difference, however, and one that deserves some discussion. The imperative, as stated briefly, may be directed differently. The central message may be aimed at the attitudes of political leaders, in party councils or legislative chambers, and at the supporting attitudes of the general public. The implementation of the imperative involves a shift in attitudes followed by an explicit *change in policy*.

Council houses, for example, are sold; airlines are de-regulated. By comparison with this more direct approach to desired policy shifts, public choice aims its message at the institutional structure through which policy is made and changed. It aims at more comprehensive, and long range, reform as opposed to piecemeal, pragmatic change. Public choice, in its normative dress, suggests that mere shifts in policy are likely to be temporary, and that effective reform lies only in a modification of the rules that allow legislatures to enact good (or bad) policy. With a well-designed legislature the kind of error which involves detailed interference with the ordinary workings of the market should be much less likely than with current structures. Further, constitutional limitations on such intervention may be desirable, although here the possibility that the constitution can always be changed puts limits on what can be done. This structural reform involves much more than the limited claim that enlightened politicians should not enact legislation involving such detailed interference with the working of markets.

2 The Transmission of Ideas

The whole set of questions concerning the transmission of ideas, particularly those with potential political impact, is highly important. Unfortunately, we know relatively little here. The only reasonably rigorous model for idea transmission through society is a direct transcription of the theory of contagious diseases developed by medical scientists. The resemblance between a contagious disease and the spread of an idea may not be immediately obvious, although perhaps many would regard the analogy as helpful in explaining the spread of Marxism. The similarity, however, is in practice quite strong. In both, a person who has a particular germ or a particular idea contacts someone else and either does or does