

James M. Buchanan's Parable: A Conjectural History of Private Property and a Perplexing Argument for Limits on the Market

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I. Introduction

The 1986 winner of the Nobel Prize for Economic Sciences was James M. Buchanan. His work has covered a wide range of areas in economics, starting with Public Finance. He helped to create the new sub-disciplines of Public Choice,⁽¹⁾ and Constitutional Political Economy, and to some extent New Institutional Economics. In this paper I want to discuss a work by Buchanan called *Property as a Guarantor of Freedom* (Buchanan 1993) which represents a sort of paradox, given the rest of his *oeuvre*. Before discussing this work, however, I need to provide some background on Buchanan's work and his foundational assumptions.

As early as the 1950s we can see the outlines of Buchanan's 'contractarian' approach to economics. He began to advocate understanding markets in a 'gains-from-trade' framework; potential gains, of course, had to be secured by enforced contracts (1959, p.129). Within a few years Buchanan was calling for economics to focus on catallactics, or exchange (1964, p.214).⁽²⁾ The next step was to take the exchange approach and apply it to politics. As politics was now viewed

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- (1) Buchanan's Public Choice contributions are part of the tradition of economics as imperialistic social science (see Duhs 2005). One major consequence of that work is to take economics further away from the two strands of the ethical tradition outlined by Sen (1987, pp. 2-7). Self-interested behaviour is now hypothesized in new areas. Bureaucrats, politicians and voters are assumed to 'utility maximize' but the results are not socially beneficial. Hence, 'government failure' is endemic.

- (2) Buchanan was following in the tradition of Whately and others. See Kirzner 1960, Ch 4.

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as another type of exchange, the polity was seen in terms of a social contract. Thus, his exchange/contract/gains-from-trade approach was foundational for his constitutional political economy programme. By 1975 Buchanan's mature view had emerged in 'A Contractarian Paradigm for Applying Economic Theory' (Buchanan 1975). He argued that the contract perspective had to be extended to cover *all* economic and political relationships.⁽³⁾ It is not surprising, therefore, that Buchanan's Nobel Prize was awarded 'for his development of the contractual and constitutional bases for the theory of economic and political decision-making.'

In my view, there are eleven foundational assumptions in Buchanan's work. In this paper I will provide a summary of that discussion. Some assumptions underpin all of his work; others are adapted to the particular context. Buchanan's foundational assumptions fall into two groups. The first six relate to the individual in isolation or in the interactions in markets. The remaining five assumptions refer to the individual in a market or social choice setting.

First, Buchanan holds strict subjectivism: that there is no distinction between the individual's utility function and his behaviour (1991, p.225). Individual choice is all that there is (1991, pp.225-6). Second, Buchanan assumes methodological individualism: only autonomous individuals choose and act; social influences are limited (1987, p.586; 1991, p.14). Third, he says 'the ultimate sources of value' originate 'exclusively in individuals' (1987, p.586). (See also assumption eight below.) Buchanan adopts a more nuanced view in his recent work on culture (see Buchanan 1994). Fourth, he puts supreme value on freedom. For Buchanan, the goal is maximal freedom within the constraints one gives oneself individually or by agreement with others (the incorporation of ethical constraints consistent with one's interests tends to be the focus of his later works). Fifth, he assumes *homo economicus* i.e. individuals 'seek their own interests' defined in a 'non-tautological' way (1987, p.587). Sixth, Buchanan

(3) Buchanan's approach (in markets and in politics) was to start from the *status quo* and look for Pareto gains.

assumes rational choice i.e. all economic agents are able to choose between alternatives in an 'orderly manner' (1991, p.15).

Seventh, cooperative behaviour can secure mutual gains (1964, p.218). Exchange, trade, and specialization are what he has in mind by 'cooperation.' Gains from trade is one of the main themes of Buchanan's economics. Eighth, Buchanan holds 'normative individualism,' which assumes that 'individuals are the ultimate sovereigns in matters of social organization' (1991, p.225, 227). Ninth, the political unit is assumed to be a manifestation of a social contract. Tenth, in social decision making, he attributes 'equal weighting' to 'individual evaluations'; Buchanan is a democrat (1991, p.16). Finally, to prevent abuses by democratic majorities, Buchanan adopts constitutional democracy (1987, p.586). In various areas, he recommends rules which are stricter than the simple majority rule (1959, pp.127-8, p.135, 137; 1991, p.47).

The remainder of this paper has two sections. Section 2 presents Buchanan's argument in *Property as a Guarantor of Freedom*. Section 3 presents a critique of that view in the light of other work in his *oeuvre*.

II. A Summary of *Property as a Guarantor of Freedom*

There are two institutional arrangements required for the specialization-market-exchange nexus to work: limited collective action and private property. Although these institutions are interdependent, my focus will be on property. Buchanan defends private property on two grounds. First, it permits efficiency gains and promotes economic growth; this is the argument of mainstream economists. Second, he argues over some sixty pages of text in *Property as a Guarantor of Freedom* that private property is a 'means of protecting the liberty of persons' (1993, p.41). This argument about property is worth developing for three reasons: it is important in its own right as an ethical argument; it shows Buchanan's focus on freedom; and in presenting his argument, Buchanan reveals to us desirable limits on the market.⁽⁴⁾

(4) Just as there are desirable limits on intrusion by *government* on individual freedom, Buchanan now tells us that there are desirable limits on intrusion by *markets*.

Buchanan presents his argument through a conjectural history of the world;⁽⁵⁾ the story unfolds through a set of historical ‘stages.’ Buchanan begins with the Hobbesian state of war, where no private property exists (1993, p.4; Hobbes 1968). In the second stage we are transported to a Lockean world, where private property and associated institutions emerge in a pre-political state; some collective agreement, however, is needed to establish property boundaries (1993, p.9; Locke 1988). Individuals achieve ‘maximal independence’ and ‘maximal efficiency in resource or capacity use’ (1993, p.10). Even so, potential ‘boundary crossings,’ necessitate an ‘enforcing authority’ with ‘powers to identify, define, and punish lawbreakers’ (1993, p.11). The state protects property; it is ‘a watchman, night or day’ (1993, p.12). This image of the state is close to Buchanan’s heart (see Buchanan 2000).

In the third stage of history, autarky is abandoned. Some specialization in production begins (production benefits from what Buchanan calls increasing returns)⁽⁶⁾ along with ‘mutually advantageous trades’; specialization requires some ‘sacrifice of independence’ but that loss is more than offset by consumption gains (1993, pp.14-5). ‘[T]he legal structure is extended to the enforcement of voluntary contracts between’ individuals and to the ‘prevention of fraud’ (1993, p.16). As specialization increases, dependence on others increases but Buchanan says that ‘there is no loss of liberty’ where this is ‘defined ... as the absence of coercion by others’; ‘entry into the specialization-exchange nexus remains *voluntary*’ (1993, p.16 emphasis added).⁽⁷⁾

Next, Buchanan elaborates on the linkages between market dependence,

(5) This account differs in fundamental respects from that developed in Buchanan 2000. He admits, however, that he is not wedded to any specific ‘conjectural history’ (Buchanan 2000, p.140).

(6) In recent writings, Buchanan has frequently adopted what he calls the assumption of increasing returns. See, for example, his writings on the work ethic (e.g. 1994). The theory of increasing (and decreasing and constant) returns is actually set in a static framework, whereas Buchanan’s concept is set in a dynamic context (see Birks 2007, p.9).

(7) Is this a sort of sophistic argument? In the new environment the choices are fundamentally different. (It is analogous to the shadow of the law.) In this new context, what does ‘liberty’ mean? and what does ‘voluntary’ mean?

justice in exchange, exploitation, and private property (some of the central concerns of ancient/medieval writers and Karl Marx). At this stage, even though 'there is no coercion, the individual's well-being' varies depending upon the actions of others (1993, p.18). He suggests that in this context, 'terms of exchange' between the parties come to be 'classified as just or unjust' (1993, p.18). Participants feel that 'potential for exploitation' exists, 'defined vaguely as some ... *unbalanced sharing of the gains that exchange makes possible*' (1993, p.18). Such a view, of course, is a long way from Aristotle and Marx. Despite his disquiet about the talk of 'exploitation' (compare Buchanan, 1977, pp.70-1), Buchanan continues to use the term throughout the discussion. Should unfavourable terms of trade result from 'the market's "blind forces,"' private property ownership of labour and land allows the owner to 'exit' from 'exploitation' (1993, p.19; see p.18). In the 'fully competitive economy,' with all the associated 'legal-institutional structure,'⁽⁸⁾ the individual secures 'the full advantages of specialization' and 'the equivalent of costless exit options' (1993, p.20). Potential for 'exploitation' decreases as the number of producers and buyers increase (1993, p.23). At the limit, where many buyers and sellers exist, each person becomes a 'price taker'; room for *genuine* negotiation is eliminated (1993, p.20). To the person confronted by 'objective' prices, behaviour is 'as if' market 'interdependence [in the act of bilateral exchange] does not exist' (1993, p.20).⁽⁹⁾ Vulnerability to sudden shifts in prices, however, is real and exit from the market remains the 'back-up,' at least where 'private property rights ... allow voluntary withdrawal' (1993, p.16, 25). Thus, private property prevents exploitation.

In the fourth stage of history, Buchanan broadens his explanation for the gains from specialization and exchange to include 'individual skills, capacities, and talents' (1993, p.25). '[L]earning by doing' plays an important role (1993,

(8) In this context, Buchanan refers to 'viable entry and exit into all value-producing activities' and a market of sufficient size that there are many buyers and sellers (1993, p.20).

(9) In other writings, Buchanan says that strategic (game-theoretic) interactions are actually the better way of viewing human interactions (1975; 1991, p.29, pp.31-2).

p.25). Buchanan's twist on this recently acknowledged cause of growth⁽¹⁰⁾ is that despite becoming more productive in their specialization, in all of the other activities required for a self-sufficient life (recall stages 1 and 2 above) 'they forget by not doing' (1993, p.26). Increased productivity in one's specialization is achieved by sacrificing all-roundedness (productivity in all other areas). On the one hand, exit becomes more and more costly in terms of loss of productivity; on the other hand, staying in the market means increasing vulnerability to the vagaries of the market's effective demand for one's specialization (1993, p.26). The limit of the former is reached where one's production knowledge is restricted to one thing and exit from the market to autarky (self-production of just one's specialization) would result in one's physical demise (1993, p.26). That limit, Buchanan says, has been reached by almost everyone 'in the complex modern economy' (1993, p.27). Hence, in advanced capitalist economies there would seem to be great potential for 'exploitation.'

Even in this setting, however, providing that markets are kept open and one has a property right over one's own body, Buchanan says that protection for people is offered by 'two complementing sets of property rights' (1993, p.29). First, possible exploitation is diminished through the potential to sell labour services to various demanders (1993, pp.28-9, 46-7, p.57). Second, the person may become an organizer of a production unit purchasing labour services from others (1993, pp.28-9, p.57). A 'supplementary condition' required 'for a competitive environment' is that the market be large enough for multiple buyers and sellers to exist (1993, p.29). Potential 'exploitation' is much more likely to occur with respect to demand for one's labour services than supply of goods for one's consumption; even the former potentiality, however, can be largely avoided when private property rights are fully available. The right to 'shift among' and 'within occupational, industrial, and locational categories' constitutes an 'enhanced right of exit' (1993, p.30). Exit from the particular exploitative market provides freedom from coercion, because one can enter

(10) This factor is now gaining acceptance in endogenous growth theory (or new growth theory) (Arrow 1962).

other markets which are not exploitative.

In both the third and the fourth stages of history, Buchanan discusses the idealized view of markets of economists and contrasts that with what actual market participants perceive to be the reality. In the competitive ideal, everyone is a price-taker, and hence 'no person exerts *arbitrary* power over another' (1993, p.32 emphasis added). This is normatively attractive but the standard analysis is incomplete, according to Buchanan. It only supports private property on the basis of incentive and efficiency considerations; it ignores the *liberty-enhancing* role of private property seen above in Buchanan's discussion of 'exploitative' terms of trade (see 1993, p.32). People prefer to own, rather than rent, houses, cars, and so on, even if the rental or leasing options are cheaper on a strict financial calculus (1993, p.33).⁽¹¹⁾ People 'place a positive value on' exit, on 'the liberty of the withdrawal from the market ... that private property makes possible' (1993, p.34; see also Buchanan's comment on his own 'utility function' in Buchanan 1995).⁽¹²⁾

Buchanan then develops another characteristic of private property. The home owner effectively 'produces' his or her 'own housing services' (similarly the motor vehicle owner provides his or her own transportation services) and, by doing so, effectively opts out of market transactions to provide them (1993, p.35). The problem of interdependence is overcome by self-production and private property permits this exit to 'self-sufficiency' (1993, p.35). Self-production of various types is very important if the individual becomes unemployed; it greatly reduces 'the vulnerability' to such market shocks (1993, p.37). Full ownership of housing and consumer durables reduces the income flow (and labour input) needed to provide for one's consumption.⁽¹³⁾

(11) In this argument, the *homo economicus* assumption (assumption 5) seems to be reduced to a tautology.

(12) Strictly, speaking, private property ownership can also reduce liberty. For example, home ownership reduces liquidity and mobility.

(13) Of course, for most people, the mortgage burden is something they live with for most of their lives. So, it really is the motor vehicle example which is generally more relevant.

Next, the argument is extended to consider private ownership of ‘assets that yield money income’ and temporal adjustments ‘in flows of income and outlay’ (1993, p.38, 41). The former reduces the necessity to provide labour to the market in order to satisfy consumption needs (1993, p.38). In the latter case, life-cycle and intergenerational savings necessitate ‘partitionable claims to value, or property’ (1993, p.41). Private property is needed even for those who don’t fear ‘exploitation’ by the market but who do plan for the future (1993, p.42).⁽¹⁴⁾

III. Conclusion

For Buchanan, markets and exchange allow self-interest to be pursued but they are also ethical. Throughout the argument he shouts that these arrangements remain ‘voluntary’; potential exit from the arrangements is the strongest proof that they provide mutual gains.⁽¹⁵⁾ Some collective action is needed to secure private property and enforcement of contracts. Nevertheless, this specialization-market-exchange-private property nexus is ethical (it is in the common good). The great threat to freedom comes from government.⁽¹⁶⁾ The conditions required for a minimal (ethical) government are discussed by him elsewhere (Buchanan, 2000).

What is interesting and perplexing about Buchanan’s account in *Property as a Guarantor of Freedom* is that at seventy-five years of age he presents

(14) This argument leads to the conclusion that there must be a ‘monetary constitution’ (part of the broader economic constitution) to prevent potential ‘exploitation by the state’ due to its ability to ‘manipulate the terms of trade between money and goods’ (1993, pp.44-5, p.56, 59). See Buchanan and Wagner 1975, pp.63-4; Buchanan and Wagner 2000, p.9, pp.182-93.

(15) Individuals make their choices within the given environment. Did they choose the environment? This is certainly not the case. Nevertheless, Buchanan seems to be of the view that the market environment is just and could have arisen behind a Rawlsian ‘veil of ignorance’ (Rawls 1971, p.12). Is that what everyone thinks?

(16) Government is supposed to secure private property, enforce contracts and provide economic freedom. It is also the great threat to these things. Hence, it is a necessity and a threat. The social contract (see assumption 9) is designed to provide citizens with the benefits of government, while minimizing the risks from it. Buchanan discusses these issues at length in Buchanan 2000.

circumstances in which people rationally choose to exit from the market: they opt out of exchange. Speaking loosely one could say that in such cases freedom is more important than exchange. More precisely, *gains from trade* in these cases are now less than *losses from trade*. Is *Property as a Guarantor of Freedom* a detour from Buchanan's lifelong commitment to gains from trade? Or is it merely stating something that Buchanan conveniently kept under wraps for so many years?

Property as a Guarantor of Freedom does not present an explicit case for tariffs and protectionism (Buchanan opposes these in other writings⁽¹⁷⁾). Nor is it implicit, providing that one avoids taking the 'organismic' view of the society or the state (Buchanan, 1949, p.496). On the other hand, many people do think in these 'organismic' terms.⁽¹⁸⁾ Buchanan's argument is likely to be misinterpreted therefore. I will develop this point shortly.

In any event, if people increasingly feel that freedom from trade exceeds the benefits of trade, Buchanan surely must accept that less international trade, and less national trade, would be a good thing. Can an individual's 'preference' for trading (at the margin) change? Is this possible within Buchanan's world-view? Yes. Can such a preference change of an individual be part of a general trend in preference changes in Buchanan's framework? Yes. There is a clear analogy here to some of Buchanan's work on the Puritan ethics. In his work on the Puritan ethics he shows that preferences are variable and that they can be shaped by 'preaching' (1994, Ch 3). Indeed, Buchanan proposes that preferences be altered by 'preaching' the Puritan ethics: hard work, hard savings, and so on.

Consider one example where 'preaching' is designed to alter preferences of many individuals. In recent years there have been active campaigns promoting

(17) In this context, see: his praise of 'spontaneous coordination'; his praise of the 'de-politicized' British economy 'in the late 18th and early 19th centuries'; and his opposition to the 'politicized mercantilist economy' (1987, pp.585-6).

(18) In Buchanan 1949 he describes two visions of the state. In the 'organismic' view, 'the state, including all individuals within it, is conceived as a single organic entity' (1949, p.496). Buchanan also discusses the 'individualistic' view, in which '[t]he state has no ends other than those of its individual members' (1949, p.498). The latter view he adopts.

the purchasing of locally-grown foods. The promotion of ‘eco-footprint’ measures and ‘food miles’ are clear signs that the sale of food in distant places will increasingly get a bad image. In addition, there are various government-led campaigns to buy locally (even though many of the same governments nominally support free trade through membership of the World Trade Organization). Efficient (and healthy)⁽¹⁹⁾ food producers (such as Australia and New Zealand) will find exporting food over long distances (e.g. to the European Union) more and more difficult in such an environment. Given these types of ‘preaching,’ preferences for internationally traded goods of people throughout the world would indeed change. Self-sufficiency would return as the ideal, just as it was for Aristotle (Aristotle 1984). In *Property as a Guarantor of Freedom*, Buchanan presented a novel argument for private property as a means to guarantee freedom. In doing so, however, he has actually made a case for self-sufficiency (or at the very least some optimal mix of trade and freedom from trade). Where does this leave Buchanan’s whole ‘contractarian paradigm’?

Further, and perhaps more importantly, Buchanan has accused various Keynesians of political naïvety in their economic theory and especially their economic policy (Buchanan and Wagner 1978, p.96; Buchanan and Wagner 2000, pp.82-3; see also Tobin 1978, p.621). Surely, Buchanan’s argument in *Property as a Guarantor of Freedom* fits nicely with a protectionist argument by nationalists, who think in ‘organismic’ terms. Is Buchanan guilty of political naïvety? For a founder of Public Choice, a sub-discipline of economics which is proud of its *realpolitik* view (or gross cynicism), no graver charge could be made. Yet that charge is exactly what Buchanan deserves, given his presentation in *Property as a Guarantor of Freedom*. His rhetorical defence of private property may prove to be a gift to those seeking a rhetorical hook for protectionism.

(19) Various concerns have been raised in recent years about the quality of food originating from the People’s Republic of China.

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<Summary>

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James M. Buchanan won the 1986 Nobel Prize for Economic Sciences 'for his development of the contractual and constitutional bases for the theory of economic and political decision-making.' He developed what he called a 'contractarian paradigm' within economics. Buchanan had eleven foundational assumptions and one of these was the pre-eminent place of freedom in the list of human values. In *Property as a Guarantor of Freedom*, Buchanan provides us with a novel argument for private property as a means to guarantee freedom. In the course of his argument, however, Buchanan relies heavily on 'exit' from the market as a means of securing freedom. In doing so, he actually makes a case for self-sufficiency and undermines his 'contractarian paradigm.' Secondly, Buchanan shows a surprising degree of political naïvety for a leader of the Public Choice sub-discipline of economics (which prides itself on its *realpolitik* view of the world). His argument for self-sufficiency can easily be used by nationalists in their call for industry protection. *Property as a Guarantor of Freedom* is a paradox given Buchanan's other work.