RMM Vol. 0, Perspectives in Moral Science,
ed. by M. Baurmann & B. Lahno, 2009, 151–156
http://www.rmm-journal.de/

James M. Buchanan

Economists Have No Clothes

Abstract:

Why have economists had so little meaningful to say about the 2008 crises? Where and when did the 'science' get off the track? Can anything be done to restore respectability to Economics as a useful area of inquiry? This short essay examines these questions.

1. Introduction

David Hume is Hartmut Kliemt's intellectual hero. And in the whole history of philosophy, no one has been Hume's equal in an ability and willingness to remain as the small boy who calls attention to the king's nakedness.

Economists have rarely claimed the role of kings, and, in many respects, they recognize their own limitations. Nonetheless, economists must appreciate the waste of massive intellectual energy as their best and brightest have chased intellectual puzzles that emerge from a flawed abstract understanding. It is little wonder that so much of what economists have said, and say now, is exposed as irrelevant and essentially useless.

Economists are embarrassed by their inability to offer 'scientific' explanations for the 2008–9 crises or to advance suggestions for reform. And for the few who have dared enter the political dialogue, the arguments seem to differ little, if at all, from the nostrums offered three-quarters of a century past by Keynes and his converted disciples. It seems as if, for economists, the whole post-Keynesian epoch must be judged to be a sequence of lost generations from whom no value product emerged at all.

2. Measure without Control

The Keynesian-inspired separation of macroeconomics from microeconomics that took place in midcentury seemed to embody genuine scientific advance. The attention of many economists was shifted to measure the aggregate variables that seemed adequate to describe the macroecomy. The size of the gross product, the number of unemployed, the price level—these variables, and others, seemed intrinsically worth measuring, and especially rates of change over time. The whole corpus of macroeconomic modeling that came to be dominant in the years immediately following World War II seemed to offer new vistas for economists' productive value to the general welfare.

Unfortunately, economists, generally, failed to understand that aggregate variables that may be measured with tolerable accuracy *ex post* may not be variables subject to control, directly or even indirectly. The fundamental misconception here lies in the understanding of what 'the economy' is. The 'economic problem' is not (despite Lionel Robbins) an engineering problem that may be defined simply as the allocation of scarce resources among alternative uses. The economy, in some inclusive definitional sense, is perhaps best described as an order that consists of an interlinked set of exchanges, simple and complex, from which outcomes emerge that may in some respects be meaningfully measured but that cannot be chosen, and thereby controlled, by concentrated decision takers.

The false conceptualization here is, of course, exemplified in the failure, both in theory and in practice, of the grand socialist experiments of the twentieth century. What remains missing, however, is a general recognition by economists themselves that their mind-set, when confronted with challenge, has not escaped from the engineering mentality. There has been little or no spillover from observation of events to the analysis by the putative scientists in the academies. It is not, therefore, surprising that the policy objectives and implementation are basically the same as those advanced by the Keynesians of midcentury.

Economists do not really understand what they are doing as they seem forced to make efforts to control aggregate variables that are not controllable in any direct sense. For example, the rate of employment (or unemployment) cannot readily be shifted by governmental mandate. At best, small and peripheral changes may be made while the emergent aggregate generated by the working of the large and complex economy remains stubbornly immune, or worse, to wrongly conceived reform efforts.

3. The Missing Avenue of Inquiry

If the economy is properly conceptualized as an emerging and complex dynamic order, what is the role for the economist who claims scientific status? An elementary step is the recognition of the existence of constraints, sets of rules , or, broadly considered, the constitution. Gross misperception, especially in the minds of noneconomists, often prompts the claim that 'the market' (or 'capitalism') either works or does not work without constraints, a claim that is demonstrably unsupportable, either in analytical logic or in empirical reality.

Adam Smith's whole effort can be interpreted as an argument for getting the 'laws and institutions' reformed so as to allow individualized self-interest to generate emergent outcomes that would prove beneficial to all participants, especially to the members of the working classes.

My own position has long been clear. I entitled my 1986 Nobel lecture, *The Constitution of Economic Policy*. Economists should have paid, and should now pay, attention to the constitutional structure within which actors play out the multitude of transactions that describe the market order, whether these actions be taken in roles as consumers–buyers, sellers–investors, employers–employees, individuals–firms.

How do markets work? Standing alone, this is an inappropriate and unanswerable question. It must be replaced by the question: *How do markets work under this or that set of constitutional and institutional constraints?* Economists' scientific expertise can be brought to bear on the predicted effects of alternative sets of constraints. The relevant question is not that of asking how this or that end-state or outcome may be put in place through possible collective or political action. The question becomes, instead, how can this or that set of constraints be predicted to operate so as to allow the generation of an order that meets certain criteria of desirability? The difference between the two methodological stances may appear minor, but much ill-advised effort might be avoided if economists would recognize the limits of their own discipline.

4. Ideal Worlds

In a recent lecture, I labeled myself as a 'natural pragmatist' based on my continued emphasis on the recognition that any change must commence from the here and now—from the status quo that describes current reality. But there is a feedback relationship of a sort between this position and the one encountered in the statement 'but you can't get there from here'. Realization of the dilemma here has made me change my stance to a degree. It now seems more evident that any change from the here and now, to be at all meaningful and potentially productive, must be informed by some ultimate vision of how things might be, no matter how vague and cloudy such vision must be. We must engage our thinking and analyses of worlds that might be, ideal worlds if you will, while keeping within the boundaries of the possible.

The procedure is, then, one of moving beyond the obvious limits of what might be by the construction of idealizations that remain possibly attainable, but which have not been fully examined and analyzed. Why have political economists, in particular, been apparently so willing to accept as sacrosanct the monetary framework in being? Why has not more attention been paid to alternative structures, to differing rules and institutions?

The constitutional economics of money have been almost wholly neglected for more than a half century, while professional attention shifted to idealized constructions of models remote from reality, on the one hand, to pragmatically defined within-rules alternatives, on the other. The constitutional economics of money must, in some ultimate sense, have teleological purpose. The aim is to evaluate differing sets of rules and to place these in some order of preferability. But, as noted, the end-states that may emerge under any set of rules are drawn, as it were, from a distribution as determined by the whole complex of interlinked exchanges generated by the choices made by separate choosers. It is folly to interpret the whole exercise as the search for unique or even narrowly defined results. Such conceptualization would be analogous to choosing the rules for an ordinary game with, once chosen, the rules themselves predicted to guarantee specific outcomes, while the choices of the players in the game itself being without effect.

5. Constitutional Revolution?

As noted, the strictly pragmatic route that involves efforts to shift policy parameters so as to generate outcomes that differ from those currently observed, as produced by the existing (or nonexisting) set of rules, may not accomplish what seems to be required here. A more dramatic constitutional revolution may be necessary.

But how might a genuinely alternative set of rules be, first, articulated and, finally, emplaced? As noted above, something beyond pragmatic adjustment among institutions (e.g., new and differing politicized regulations) may be necessary. The introduction of previously imagined idealization into reality may prove minimally critical.

What function must the whole financial-monetary structure perform in an ideally working market economy? This question is relatively easy to answer. The financialmonetary structure must be neutral in its allocative effects. It must be limited to the facilitation of exchanges (to the reduction of transactions costs). As recent events demonstrate, however, the structure has been far from neutral, even in some remotely defined sense. It seems that real value has been destroyed, as if genuinely new goods previously added to the economic nexus were withdrawn thus generating a reduction in the effective extent of the market.

The results of the financial collapse that occurred in 2008 were not basically distributional in effect. Real value was apparently destroyed but should not be understood as the achievement of differential gains to some groups at the expense of others. It is not at all as if only one of two traders finds, after trade, that the good received is worthless. In the 2008 setting, everyone feels to have been somehow defrauded by the deflation of what had seemed to be real values.

In the parlance of theoretical welfare economics, there occurred a Pareto-inferior shift in which all persons in the nexus were made worse off by their own utility calculus. The utility functions seemed to have all shifted inward. What happened? It is as if all participants in the inclusive economic nexus were riding along on a donkey seated quite comfortably on a saddle of inflated air, until an unanticipated rupture collapsed the cushion.

What seems noteworthy here is that the deflation of the 'hot air' in the banking-financial sector did not benefit any defined subset. The loss in utility seemed to be general over the whole and inclusive market economy. The events were such that they could have scarcely been generated by any identifiable group whose aim was to exploit others.

Critical evaluation and assessment suggests that the structure of the whole monetary economy is flawed, which points toward genuine constitutional revolution rather than either a change in participants or piecemeal adjustments in the regulatory apparatus.

6. Toward Monetary Neutrality

Care must be taken to avoid premature efforts to locate the origins of the crises in particular markets or particular monetary-financial instruments. In the Unites States, a trigger was perhaps the market in subprime mortgages that had evolved into the complex package that described the world of finance in the early years of the century. It is necessary to understand and appreciate, however, that, even if this market had never existed, some other elements would have proved to be vulnerable to unanticipated collapse. The familiar 'house of cards' metaphor surely is applicable.

Radical rethinking is required here—a rethinking that has not occurred since the Great Depression.

Individual choices to shift nominally valued assets among differentially leveraged accounts cannot be allowed to generate multiplier effects over the whole system. Some modern equivalent of one hundred percent, or full, reserve banking must finally be installed and enforced. The Glass-Stegall efforts to separate deposit and investment banking should presumably be updated and put in play. Some extension-application of the antitrust laws to the banking conglomerations seems to be in order here. And, economists, in particular, must break free from institutionally imposed biases and, instead, imagine settings in which the liberties of traders to choose among alternatives are utilized in tandem with the tools available through the wonders of modern electronic technology, while, at the same time, still achieving some close approximation of ideal money neutrality.

7. The Constitutionalization of Money

In a separate paper, I have called for the 'constitutionalization' of money. The events of 2008 demonstrated that markets will not work with money anarchy. Further, history tells us that politicization is not an effective alternative. We are left with the in-between prospect of establishing and enforcing a set of constitutional rules that will, on the one hand, limit the range and scope of disorderly anarchy, while, on the other, isolate the monetary sector from political efforts at manipulation.

Perhaps the most hopeful perspective involves an initial recognition that the objective is within the possible. There is no physical or psychological barrier that necessarily prevents the achievement of that which is commonly desired. The value of the monetary unit, the United States dollar in the setting of early twenty-first century, can, and must, be treated as a ‘relatively absolute absolute’. Along with the other required institutional changes, some of which are noted above, this value can be operative as an anchor for exchange transactions at all levels.

8. The Challenge for Economists

Economists, and perhaps those are most closely associated in their inquiries with the monetary institutions in being, have almost totally failed in their basic understanding of the constitutional elements that must be present in any viable regime. In particular, these economists are unlikely sources of inspiration for the quantum leaps in attitudes that are needed here. There is no need for some ‘beyond science’ competence. As in other aspects of modernity, return to classical understandings and their implications could be transformative. It is time that nonmonetary economists return to their elementary textbooks.

It is also praiseworthy that both nonprofessionals and professionals from other disciplines join economists in the unique opportunities now presented. Hartmut Kliemt, a philosopher, is associated with the Frankfurt School of Finance and Management. Such an affiliation can only yield productive results as all of us, both inside and outside the academies, confront the critical challenge of the century.