Constitutional Constraints and the Market for Policy Advice

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Abstract:

There is no such thing as *the* market but rather nexus of exchange as circumscribed by certain rules. The patterns we observe as characteristics of varied markets are in turn dependant on the presence or absence of various static and dynamic rule properties. This basic insight of Constitutional Political Economy extends here to consider the market for economic theory and public policy. Traditionally interpreted, policy action rests on advice developed scientifically from economic theory. However, the possibility exists for the invocation of economic arguments and the selection of policy among alternatives offered which suit political imperatives. In turn an inquiry into whether economic science drives policy or if political imperatives select from rationalizing theories and theoretical frameworks would depend on how the market for public policy is structured.

Economic policy making is an activity like any other activity which involves producers competing to supply a market and consumers hoping to find their wants supplied. Economists may produce ideas and their ideas may be drawn upon at the official or ministerial level But what guides policy may have very little to do with the ideas that economists put forward

Sir Alec Cairncross, 1986

There is no criterion through which policy may be directly evaluated An indirect evaluation may be based on some measure of the degree to which the political process facilitates the transformation of expressed individual preferences into observed political outcomes. The focus of evaluative attention becomes the process itself as contrasted with the end-state or outcome patterns. "Improvement" must therefore be sought in reforms in process, in institutional change that will allow the operation of politics to mirror more accurately that set of results that are preferred by those who participate.

fames M. Buchanan, Nobel Lecture 1986

1. Introduction:

Policy recommendations based on economic theorizing are usually portrayed, if implicitly, as scientifically derived and impartially tendered. Neoclassical economics in particular, as based in its axiomatic foundations, lends to this interpretation. Yet, we commonly observe that individuals, organizations, and groups with diverse interests often invoke different frameworks, theories, and models to argue in favor of their positions. What then are the criteria for selection among these? Competition among

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proffered policy conclusions is ideally considered to be based on the soundness of the framework assumptions, on the logical derivation of theoretical constructs within such bounds, and, thereupon, the interpretation of policy from models. Accordingly, improving such policy advice by adopting appropriate assumptions, by developing methodology more consistently, as well as by incorporating more and better information would improve its chances of being adopted. However, it is also well possible that the selection of economic theory is influenced by the usefulness of the arguments it provides and the policy conclusions it supports to the self-interests of its direct consumers

Traditional models in economics consider as direct consumers of policy advice benign agents of government selecting from among alternatives as developed scientifically by economists and others. However, if we follow the practice in the Public Choice scholarship and relax this assumption to consider that those in public life are no less self-seeking than the rest of the population, then the possibility exists that politicians and bureaucrats may seek or select from among advocated policies those alternatives that best suit their own interests - with such interests not necessarily congruent with those of their constituents[1]. If we further consider that those who develop and interpret economic theory - the suppliers - as self-interested beings who benefit from the prestige, funding and other rewards which can come from having the ear of decision-makers, we have the basis for mutually beneficial exchange in a market for economic theory and public policy.

The characteristics of any 'market' are however dependent on the presiding framework of rules and institutions. As such, changes in the character of markets are affected by changes in the rules and constraints of such frameworks. If, as a part of a market exchange, policy is selected from among advice offered, it follows that this process of selection will be affected by how this market is structured. In turn, by restricting what the buyer can buy and on what terms, the structure of the market will affect the evolution of the sellers' output and technologies of production.

The plurality of advice offered in the policy market is anchored in the variety of frameworks and assumptions as based on contrasting world-views. Such windows on reality, to use Nietzsche's metaphor, are inevitable given the complexity of actuality and

[1] In like fashion, we can consider other consumers of policy, such as interest groups, international organizations, etc., as being composed of self-interested actors.

the limitations of human cognition. When put to judge among these vantages and corresponding normative conclusions, therefore, what standards are policy makers to rely on and within what contexts must such decisions be made? What, in short, are the constitutional constraints on the market for policy advice?

We organize the task as follows: Part 2 compares the idealized policy market, where analysis is founded on an essentialist view of the world and where competition among alternatives are conducted on the basis of ostensible scientific criteria, with the Public Choice view where policy-makers select among policy options those which best suit their own self-interest. Part 3 looks at what the characteristics of the market for policy are in light of the Austrian appreciation of market processes, and points out how it conforms to as well as differs significantly from those of other markets. Part 4 examines how the market for policy as structured, conditions the selection and survival of frameworks, theories, and models in economics. It concludes that since selection and survival are contingent on political competition among the consumers of policy, analytical attention is required on how such interactions are structured. Part 5 sets out the basis for such an inquiry.

2. **The Political Economy of Policy Advice:**

The standard civics class model for the adoption of policy posits its development by experts and its adoption by enlightened agents of government. Yet, policy advice developed by economists relies on relatively simplified perspectives of the complex social and economic realities. Since there exist a multiplicity of such world-views, there are, in turn, many models as well as many associated recommendations as to what might be done. There *is* as well a diversity of interests among those to whom such advice is proffered. Given the diversity of interests and the diversity of choices, what conditions the selection of policy advice? We examine two alternative scenarios:

2.1 *The Idealized Policy Market*

Do criteria developed from economic theory serve in selecting wisely among alternative policy options? After all, we observe governments, and other institutions and public groups citing such recommendations as guides to action. In the idealized policy market, enlightened policymakers, selflessly dedicated to improving the public's welfare, solicit advice from policy analysts as to how best serve these interests. On the other side of the exchange, economists dedicate themselves to the scientific pursuit of objective knowledge of the workings of the economy. Based on such assessments, they reach conclusions as to what should be done. In the idealized policy market, differences of opinion among policymakers as to the best course for improving public welfare is resolved by recourse to scientific consensus. As we have already noted, this consensus is approached through scientific competition, based on the soundness of framework assumptions, the logical derivation of theoretical constructions and the consistent interpretation of policy implications. Economists provide policymakers with the intellectual resources to fulfill their official obligations while policymakers provide economists with recognition and reward for their scientific achievements. As such, this model of the ideal market for policy makes assumptions not only as to the behavior of the players but also as to the epistemological foundations of economics and the role of government in diagnosing and correcting social conditions.

Niskanen (1986, 234-235) identifies five reasons why politicians (and we can add advocacy and other groups) professedly seek expertise. First, there may be a need to ascertain certain objective conditions. Second, an explanation of patterns exhibited in the gauged objective conditions may be called for. The analyst may here provide some reason for the observed pattern distribution. Third, the analyst may consider the effects of a change in some specific policy on the objective condition. Fourth, the analyst may be called to compare this proposal against alternative others. Finally, the analyst may survey other experts to see what professional consensus exists on the first four types of questions.

2.2 *A Public Choice View of the Policy Market*

Following upon the skepticism expressed by Adam Smith as to the benevolence of the butcher, the brewer, or the baker, economists are accustomed to characterizing businessmen as acting to serve their own best interests. An important contribution of the Public Choice school has been to make explicit the inconsistency between this unpropitious perception of businessmen and the sanguine representation of government officials in this regard; policymakers are after all, no less than the rest of the populace, interested in their personal welfare[2] (Buchanan and Tullock 1962; Brennan and Buchanan 1980). To this we may add, though perhaps unsettling to the professional self-image, the notion that economists too pursue self-interests.

In browsing in the policy *bazaar*, policymakers select from among the diversity of theoretical opinion and policy conclusions, those interpretations that best legitimate decisions that further their self-interest. A greater selection among such advice has become available over the past several decades, notes Niskanen (ibid. 236), with economists among the most pervasive and influential among such policy entrepreneurs. Niskanen acknowledges that while this may partly be attributable to the increased role of government in the economy over the same period, the "broader role of the economist as policy advisor may be found in the usefulness of economic skills in providing the types of information valued by the politician."[3] Niskanen (ibid. 243) goes on to note that "for the most part, politicians employ the policy advisors who serve their interests" particularly when professional opinion among economists is divided over a policy issue.

To this, Swank (1994) and Letterie and Swank (1996) add that when there exists public confusion over an issue, policy makers may exploit the Rational Ignorance of voters to adopt that view of the working of the economic system which fits in with their own preferences. Such corroboration by 'experts' of the position taken by the policy maker bolsters the legitimacy of claims made and policy proposals argued for.

Commenting on the link between policy development, its validation, and the preponderance of US trained economists in the Republic of Korea, Choi (1997, 107) notes that "Employing respected economists (Korea has over a thousand-year tradition of respecting teachers and professors), sometimes as cabinet members or key advisors (or more often giving them lucrative government-funded projects and using their "findings" to legitimize policies), was seen by some not only as an attempt to purchase legitimacy for the unpopular government [of the late President Park] but also to buy off potentially critical voices." Choi acknowledges that trying to impress and win over opinion with economic-type arguments was an improvement over the possible use of

[2] There are, of course, many political officials who are both sufficiently honest and possessing of good intentions. The point, moreover, is that incorporating the self-interest motive results in the design of more resilient institutions.
[3] It is possible that the growth of government is a byproduct of certain types of economic advice. If so, each effect - the growth of government and the usefulness of economic policy advice to agents of government - may feed into the other, leading to a snowballing of the size of government.

force towards the same end by the then military dictatorship. Still, by the establishment of economic institutes and well-paying study commissions, and by staffing of bureaucracies, the regime was at once able to quell reasoned opposition while raising the prestige of its initiatives.

In contrast to the idealized market for policy advice, the alternative sketched out here considers self-seeking and opportunistic players. Selection from among the multiplicity of policy alternatives is based on the needs of the policymaker as bound to the constituency he or she serves[4]. Indeed, in many cases, as Allen (1977, 52) notes, such opinions are made to order[5]. In this market, economists provide the self-interest-based initiatives of policymakers with scientific legitimacy, while policymakers provide economists employment, funding, and recognition.

2.3 *Idealized Assumptions and Political Decisions*

We have so far contrasted the idealized view of the policy market with one where the participants act in their self-interests. In *The Consequences of Mr. Keynes; Misuse of Economic Theory for Political Profiteering with Proposals for Constitutional Disciplines,* Buchanan and Wagner (1978) consider the fiscal repercussions when economic theories developed on idealized assumptions are realized in real-world political contexts. Buchanan and Wagner begin by noting that the Keynesian revolution replaced the conception that the spontaneous coordination of economic activities would produce economic stability, with a vision of an inherently vacillating economy that the government is obliged to stabilize through aggressive fiscal manipulation. While Keynesian theory in and of itself does not destroy the principle of a balanced budget but rather lengthens the period over which it is applied, its engagement in the political setting within which the policy is formulated and implemented has led, note Buchanan and Wagner, to the destruction of the norm of a balanced budget and the ushering of an era of chronic budget deficits.

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[4] Alesina (1987) has observed that in the American political system, the Republican Party places greater weight on inflation than unemployment while the Democratic party does the opposite, and that this leads to the presence of a partisan macroeconomic policy cycle. Indeed, theorists in macroeconomics cater to this political split - whether Monetarism versus Keynesianism or, more currently, New Classical Economics versus New Keynesianism.

[5] This is particularly the case for government economists, notes Allen (1977, 59), who quotes the former director for tax analysis of the US Department of Treasury as saying that "our job was to prepare convincing cases, in a kind of advocacy role, once we had decided what our position was going to be."

Buchanan and Wagner note that Keynes' assumptions are defective in considering that policy be developed by a priesthood of enlightened Harvey Road' economists and carried out by the ruling elite: "Keynes did not consider the application of his policy prescriptions in a contemporary democratic setting - in which government is tempted to yield to group pressure to retain or return to power" (ibid. 16). If, however, we proceed with the assumption that elected politicians respond to pressure from their constituents, special interests and the bureaucracy, then fiscal policy will be applied asymmetrically since there will be little political resistance to budget deficits and substantial resistance to budget surpluses. Thus, "the possibilities that policy precepts may unleash political biases cannot be ignored"(ibid. 17).

As illustration of such a bias, Buchanan and Wagner point out that contrary to standard treatments of macroeconomic theory, macroeconomic policies do not influence all prices equally. Rather, a policy that is intended to increase all prices proportionately will in fact influence the structure of relative prices. Yet the standard theoretical cover that accompanies such policy prescriptions serve the dictates of political survival "because it is it is only through policies designed to act on relative prices that the vote buying activities of politicians and parties can take place" (ibid. 24).

In general, therefore, if particular modes of reasoning produce policy prescriptions that enhance political survival or other factors central to the policymaker's self-interest, then, given a market for public policy, the potential exists, with the extent depending on the structure of that market, for the usefulness of such frameworks of analysis in this respect to affect its survival and popularity. Such modes of reasoning include the conceptualization of an idealized market for policy advice. To pursue this point further, let us next consider what the nature of the market for policy is and how this affects the survivability of ideas.

3. A **'market' for public policy:**

That there exists a politicized market for policy is not a new observance. Most people on both sides of the policy market are cognizant of the nature of this exchange relationship. As Cairncross (1986, 20) notes, policy makers draw from ready supply of policy enterprises drawn up by economists, especially when they provide a general theoretical justification for politically requisite initiatives.

If choice of policy in this market is guided by political exigencies, what are the institutional factors that guide its selection? To answer this, we need first to understand what a 'market' is and to learn how its character is affected by the constraints within it operates. Through this brief discussion of market process theory (sections 3.1 - 3.3), we will equip ourselves better to explore the potential for economic guidance in public policy.

3.1 *The market as a spontaneous network within a rule framework*

The characteristics that we identify with a market order arise from patterns recognized from a complex of numerous spontaneously formed interactions, each influenced by the actions of individuals engaged in exchange within certain geographical, legal, ethical, and cultural constraints. The contrast between the purposeful activities of individuals within their immediate contexts and the patterns that these activities create is reflected in Hayek's demarcation between the term *economy* and what he calls a *catallaxy*. He considers the former, in confining it to its original context, as consisting "of a complex of activities by which a given set of means is allocated in accordance with a unitary plan among the competing ends according to their relative importance" (Hayek 1976, 107). In contrast, the latter is a network of relationships that make up the market order. As such, a market network, like a network of roads, has no particular destination or end-state. Rather, the term *catallaxy* captures the idea of an "order brought about by the mutual adjustment of many individual economies in a market. [It is thus] a kind of spontaneous order produced by the market through people acting within the rules of property, tort, and contract" (ibid. 109).

If so, we may conclude that the extent and character of such a market order would depend on how such rules condition the way in which individuals may interact and form mutually beneficial relationships. The notion of *catallaxy* thus brings into focus the relevance of institutions as interconnections of abstract rules, socially considered, in variably enabling each individual to exploit his or her own knowledge of his or her own circumstances and ends v*is-a-vis* those of others and their ends. Accordingly, the chief common purpose of the members of such a means-conneaed society "is the purely instrumental one of securing the formation of an abstract order which has no specific purposes but will enhance for all the prospects of achieving their respective purposes" (ibid. 110).

3.2 *Market order and institutional constraints*

Social scientists have been aware, since at least the time of Adam Smith, of the importance of the institutional setting in securing the formation of an abstract order that enhances the prospects of each participant. Indeed, in his *Wealth of Nations,* Smith sought to harness the political order to establish those institutional settings that would condition commercial activity to prevent certain types of relations from corrupting social life. Smith held that man, in order to better his condition through specialization and trade with others, is in need of a coordinating mechanism. Individuals' activities, he noted, could only coordinate under a general framework of law that established the rules of the game, the "laws of justice" (Smith, 1982, 687). Such a legal framework, in enhancing the adaptation of market participants through competition, would limit competition by excluding the use of coercion, force, fraud, and threats. Within this century, the German Ordo-liberal school has stressed the need to design an institutional infrastructure for economic activity. As such, they distinguish between *Wettbewerbsordnung* - the rule of law or institutional framework set to maintain the 'proper' functioning of the competitive process and *Ldstungwettbewerb* - the competitive order of the market that unfolds within such rules (Vanberg 1991, 397-402).

Understanding that the characteristics of a market order are influenced by the rules that circumscribe it, leads to the insight that improvements to the market order must take into account changes in the institutional wellsprings of that order. In turn, this leads us to imagine types of rule innovations that if introduced will influence the generation of the sorts of outcome patterns we seek. Rules embodying such conditional claims specify the competitive constraints conjectured to bring about desired attributes in a market order; as per the Ordo-Liberals, rule-governed processes that restrict market competition within particular bounds may be thought to be superior to others if that order which is forecast to be generated by the process so constrained is considered desirable.

3.3 *Market Innovation and the Rules of Competition*

Harking back again to Adam Smith, we see that the characteristic behavioral element in a market order, indeed Smith's central endowment to economic thought, is that in seeking to satisfy others through producing something of marketable value, as an indirect means of producing value for oneself, participants can select from among a set of pre-existing goods and services but can also innovate, creating new goods of potential exchangeable value. Accordingly, the entrepreneur's task rests in creative activity through the exercise of imagination. Participants thus enter in competition to offer goods and services, conjectured to be of adaptational value to others, in the pursuit of improving one's own well being.

Market competition is thus a trial-and-error process in which entrepreneurs try out new products, technologies, inputs, modes of production, and advertising, based on estimations of current consumer preferences an on hypotheses of how best to slake them. In turn, consumers, through their buying decisions provide feedback on what has been successful. Those entrepreneurs who better anticipated this demand then gain a competitive advantage *vis-a-vis* their rivals. The temporary monopolistic condition that this creates produces rents that act as incentives necessary for the effort and risk-taking of the entrepreneur. The less successful competitors, by losing market share, fall under pressure to improve by innovating or by imitating those who have been more successful. As Hayek points out in *Competition as a Discovery Process* (1978), competition is manifested in the rivalry among entrepreneurs who, through trial-and-error in seeking to earn profits, learn about consumer preferences while serving the needs of the same. This then is the core of Austrian Market Process arguments.

As in any evolutionary process, there is, in a market to the extent provided by its given context, *variation* in the emergence of innovation, *selection*, through the determination of consumers in choosing those items that they perceive to better enhance their fitness or well-being, and *retention* in the imitation of strategies, technologies and products that have been perceived to be at the root of the competitor's success (Campbell 1965, 26-27). Since entrepreneurial creativity, in anticipation of consumer desires, drives competition, the 'outcome' of the evolutionary market process is open rather than predefined. However, the vitality of the competitive process and the character of the market are determined by the types of rules that govern the ability of market participants to innovate, select, and duplicate. For example, restricting such things as venues or modes of exchange may affect consumer selection among market alternatives, altering perceptions of which innovations are successful and will thus be imitated.

3.4 *The public policy market*

The policy market, that nexus of exchange for analysts and policymakers, is then an example of a complex order spontaneously brought about by the interaction of its participants - policymakers and analysts - within certain political rules and constitutional constraints. The characteristics that the policy market takes on are thus a reflection of the constituted infrastructure within which the variation, selection, and replication of policy take place. As in other competitive markets, there is in the policy market a process of innovation - trial-and-error procedures where analysts as policy entrepreneurs try out new frameworks, theories and models, woo customers through establishing reputations and developing brand names, etc.; a process of selection - where policymakers select those options that simultaneously suit political needs and are most rhetorically persuasive; and a process of duplication - where additional work is done on those areas of policy where demand is greater, putting into renewed service techniques and methodologies that have previously proved practical in this regard. The policy market however does differ from other markets in one very important respect related to the nature of the goods traded.

The policy market is unique in that what are traded here functions as part of the rule framework for exchange in broad variety market forums. Thus, the *goodness* of what is traded in the policy market cannot be judged solely on the voluntary character of this exchange or upon the mutual benefit derived by the participants. Rather, its efficiency has to be evaluated based on how well policies and rules adopted through its processes serve as the foundation that conditions exchange in such broader markets. Since what is selected in the policy market contributes significantly to the development of market exchange in broader contexts, the ability of individuals in general society to exploit more fully local knowledge and hence to enhance mutual well-being depends on how the policy market is structured. Given that the characteristics of a market order are influenced by the rules that circumscribe it, and given that many of these rules are generated through a process of policy selection, considered modifications of the market order have to take into account the processes that shape the policy market.

4. Theory, selection, and fitness of policy advice:

In examining the character of markets, we noted that the consumer's voluntary selection among proffered ware affects the scope, nature, and legitimacy of related entrepreneurial activity. It would then follow that the scope, nature, and legitimacy of entrepreneurial activity in policy development would be affected by the circumstances behind the selective process. In this respect, as we have noted, whereas in the idealized policy market, policy selection was directed by scientifically grounded analysis, in the real world, policy choice is based on self-interest. These motivations relate to the need for a rhetorically convincing argument in favor of or against a given position or, in the absence of that, clear blueprints for deliberate and ready action to address politically sensitive social or economic predicaments. Accordingly, if correspondingly rewarded, those forms of analysis which more readily provide the features of services demanded in the policy market would be sought, imitated, replicated, and developed.

To grasp how economics is influenced by the policy market, we have to understand first how its theoretical development is structured. Ostrom *et al.* (1994, 23-25) note that, in general, theoretical work in the social sciences proceeds at three levels: those of Frameworks, Theories, and Models. A particular framework organizes the overall approach to a set of questions. Such frameworks identify broad relationships and methodological foundations and provide a meta-theoretical language on which to develop theories of relevance to present problems. Within the moorings of the framework, theoreticians generate general explanations that seek to explain, predict, and evaluate general classes of events. Based on such theories, the analyst, by making more explicit assumptions about the nature of a particular situation, is able to develop positive as well as normative conclusions relating to those parameters.

How can the nature of frameworks, theories and models affect the their choice as the basis for economic argumentation and policy action? We illustrate this issue in three varied contexts:

4.1 *The selection of frameworks, theories, and models*

4.1.1 Feminist economics provides the first illustration of how a choice of framework for analysis can bear on the policy conclusions desired. Socialist-Feminist scholars have argued that gender inequality is deeply rooted in the male-dominated institutions of society. More, some who subscribe to this school of thought also see capitalistic development as exacerbating pre-capitalistic gender biases. As such, they advocate radical reform in social institutions, promoting, among other things, schemes for coercive wealth redistribution and set-asides for participation in political forums.

In terms of its rhetoric - the exploitation of women, its form of analysis - gender as a class, and its policy prescriptions - coercive redistribution and planning, this variety of feminist economics is largely inspired by Marxian economics; whereas Marxian economics sees the exploitation of labor's surplus value by capitalists, feminist economics sees the exploitation of "reproductive services[6]" by the male dominated institutions of society. As Beneria (1995, 1841), a leading feminist scholar, admits, "in particular, the Marxian focus on exploitation, inequality and the market's systemic tendency to generate social hierarchies seemed to be more conducive than the neoclassical framework to answer the questions raised by feminists." This raises the issue of whether the choice of a Marxian-style framework for analysis was influenced for the types of models and policy conclusions sought.

4.1.2 In considering next the illustration of choice among processes of inquiry, we reflect on how the construction of Rational Choice Theory has influenced its prevalence as an analytical tool. In evaluating Rational Choice Theory, we concentrate on the variant within the Chicago neoclassical tradition as a prime example. The New Chicago School, presided over by M. Friedman, Stigler, Lucas, Becker and Barro, among others, places emphasis on rigorous price theory and the use of statistical techniques. Reder (1982) identifies elements of the generating assumptions (a very strong version of homo-oeconomicus and of expected net wealth maximizing man) as well as of auxiliary assumptions as central to their program.

[6] Cagatay, Elson and Grown (1995, 1827)distinguish between the productive and the reproductive economy. Whereas the former relates to income generating activities that are largely linked to formal markets, the latter is defined to include "unpaid responsibility for care and development of people, including children, the elderly, the sick, and able-bodied adults."

In the Chicago paradigm, individuals have only economic interactions - that is, voluntary exchanges of goods and services; all other connections are ignored. Economic agents are assumed to be well-informed, rational, and self-interested wealth maximizers. The rationality assumption holds that individual decision-makers have utility functions whose arguments are defined as alternative uses of endowed resources. Each decision-maker acts as though he were solving a constrained maximization problem.

The axioms of Rational Choice Theory provide the analytical basis for studying such individual choices as are based on preferences. Actions that are known to lead to specific outcomes characterize decisions under certainty. Here, the notion that the individual, given a set of possible actions to choose from, selects one that maximizes a given index of satisfaction rests on the axioms of Completeness, Transitivity, and Continuity. Complementing decisions made under certainty are those made under risk. In this respect, von Neumann and Morgenstrern have shown that individuals make choices in uncertain situations based on expected utility. In addition, they have demonstrated a way of assigning utility numbers to available prizes. The individual is seen, therefore, to act in a way to derive the highest von Neumann-Morgenstern utility, a proxy for the utility function (Luce and Raiffa 1989, 25).

However, the axioms of Rational Choice Theory are by themselves insufficient to generate the price-quantity relationships that characterize economic models. Specific auxiliary assumptions must be cited for particular applications. These rest on the belief that there are no stable empirical relationships among prices, quantities, and disturbances outside the situation that shares the characteristics of a general equilibrium framework. A *Tïgfe Prior Equilibrium* requires, says Reder (1982,11), "that decision-makers so allocate the resources under their control that there is no alternative allocation such that any one decision-maker could have his expected utility increased or decreased without a reduction occurring in the expected utility of at least one other decision-maker." The auxiliary assumptions are then that individuals are price takers rather than price makers, that markets clear instantaneously, and that transaction and information costs remain low.

Reder notes that the emphasis on conformity to the paradigm provides a distinctive flavor to the contributions of Chicago economists, even if this involves restructuring a model to reconcile empirical anomalies (ibid. 21). The paradoxical result is that Rational Choice Theory provides economics with a disciplinary unity missing in other social sciences (Hogarth and Reder 1987,4).

General criticisms of Rational Choice Theory are well known and so a brief recitation will suffice here. As an epistemological theory, it is confined within its own deductive logic and thus not able to account for situations without prior rational grounds for doing so (Gordon 1993). In its emphasis on prediction over realism, it ignores important elements of social reality such as habits, routines, and rule following (Hausman 1992). It has been called teleological (Buchanan and Vanberg 1991)and its model of man has been noted as overstating his intellectual capacity (Hayek 1973; Simon 1984). Its axioms have also been found to conflict with observed human behavior (Tversky and Kahneman 1986).

A final criticism of Rational Choice Theory, concerning the role of auxiliary assumptions, however deserves to be drawn out here for our purposes: We have noted that the explanatory power of orthodox rationality is derived not from the maximization assumptions as such, but rather from the use of auxiliary assumptions to provide a predictive fit. As such, it is, as Herbert Simon (1987, 39) observes, "too easy within the neoclassical methodological framework to save the theory from unpleasant evidence by modifying the auxiliary assumptions and providing a new framework within which the actor 'must have been operating.'" Hence, Rational Choice, as usually applied, is an "exceedingly weak theory, as shown by the difficulty of finding sets of facts, actual or hypothetical, that cannot be rationalized and made consistent with it"(ibid.).

It is this malleability of Rational Choice Theory that makes it amenable - by selective choice of auxiliary assumptions, to generate models and implications that are consistent with particular points of view - to those who seek to exploit the seeming objectivity of its axiomatic foundations.

4.1.3 A final example of selection among economic models based on non-theoretical criteria is taken from the field of Forensic Economics. Fischer (1994, 220), in examining how economists determine compensation size in divorce settlements and in wrongful injury or death settlements, finds that they choose those valuation techniques that are most persuasive with judges and juries rather than those which are more theoretically grounded. As to the future of valuation techniques, Fischer laments that, "ideally change in forensic economics would be guided by sound research. However, if the past can be taken as a guide to the future, changes in forensic economics may be more reflective of the interplay between opposing counsels, jurors, and judges in determining the outcome in open court" (ibid.).

4.2 *From selection to the survival of ideas in economics*

Through the illustrations from Feminist, Neoclassical, and Forensic economics, we have seen those particular frameworks, theories and models may be selected that are better suited to promote specific policy agendas or outcomes. This is because they provide a convenient foundation for argumentation, because they can yield, with the appropriate assumptions, desired supporting conclusions, and because they serve as a rhetorically opportune means to some political or adjudicative end. Consumers of economic theory and public policy can and do select from those frameworks and options, ideas which best suit their needs.

A second requirement of consumers of policy as to the economic advice they receive is that it gives them concrete recommendations on immediate steps of action that can be taken to address the pressing social or economic issue on hand. Cairncross (1986, 4) notes that non-economists possess a bias towards organizational or political approaches to economic problems. Policymakers want economists to advise them as to what types of deliberate, palpable, and immediate actions can be taken to 'solve' politically sensitive problems. The dictate of political survival, particularly in democracies, is that political leaders should be seen to be responsive to the public's dissatisfaction; a 'plan of action' is to be had on hand. As such, policymakers are less interested in advice that suggests modifying institutional constraints conjectured to establish, over the long run, desirable patterns of order.

Accordingly, if there is a link between the selection of policy and reward to the analyst, we would expect those frameworks for policy analysis to survive that are compatible with developing policy options convenient to political goals, as in the first instance, or political quick-fixes, as in the second. Such a link does exist. In contrast to practitioners of the hard sciences, economists are participants in, and their methodology is subject to, the phenomena they investigate. Far from being detached and disinterested observers of social and economic phenomena, economists influence and are influenced by the society in which they live. In turn, this proposition raises issues of how ideas about the functioning of the economy evolve.

Palley (1997) distinguishes between the role of "Intellectual Appeal" and "Social Practice" in the spread of economic ideas. He notes that whereas an intellectual competition does bear upon the relative persuasiveness of ideas, survival and expansion of points of view also depend critically on the social practices adopted by practitioners. In this regard, Palley considers competition among economics departments where economists with particular shared and threatened points of view take refuge. Competition among such groups is based on the expansion of those points of view with this expansion dependant not only upon its intellectual appeal but also on its sociological organization - the ability develop managerial skills, to network, to control journals, and so on.

These social practices all depend critically on the ability of that group to develop reliable sources of funding. The ability to tap into such resources and hence improve organizational effectiveness then depends on the ability of academic groups to produce ideas that are of use to its external consumers. "Thus, ideas that are conducive to interests of business are likely to attract business funding, thereby increasing the strength of groups producing these ideas" (Palley 1997, 31). Similarly, ideas conducive to particular political interests attract like private or public funding, and so on, with corresponding consequences. As particular economics departments gain greater professional influence, they will be sought out increasingly to provide useful ideas; funding establishments with such developed reputations provide its patrons 'more bang for their funding buck.'

With their established links to policymakers and access to budgets, established research institutions will attract, in turn, new disciples. Others, wishing to replicate such success will imitate these research programs and even those who wish to innovate might rely on established frameworks of argument to lend greater credence to their proposals. In this way, we move from the selection of policy to the survivability of frameworks, theories, and models in economics.

Granted, therefore, these sociological effects selecting from among forms of economic reasoning, those frameworks and assumptions will survive and become institutionalized that best serve forms of desired argumentation and political expediency.

The outcome of competition among economic theories and corresponding contrasting policy recommendations - such as that between New Classical and New Keynesian economics - then falls upon the consequence of competition among political interests. If we reject the essentialist view of world as a basis for policy analysis and recognize the sociological realities of the market for policy, a pall is cast over the *fitness* of surviving policies and their theoretical underpinnings[7]. The analysis that brings us to this *cul-de-sac* however points out that since competition among theories operates by default at a political level, our attention should be focused on the need to constitutionally constrain this political activity to promote the desired economic results.

5. Constitutional constraints and the policy market:

The market for policy, we have seen, is distinctive in two respects: First, since that which is selected in this market serves as a framework for a variety of social and commercial intercourse, the *goodness* of what is selected cannot be judged solely on the voluntary quality of the exchange but rather more on the nature of the social and commercial activity it engenders. And second, since the selection and development of policy alternatives is related to the corresponding political interest, the competition among policies, as championed by rival groups in the polity, is by default judged and guided by the process that conditions this civic competition; we cannot infer therefore that what survives this competition is necessarily the *fittest.*

But what is the context within which policy and political competition operate? In orthodox economic analysis, the theorist, indirectly, and the policy analyst, directly, advise political decision-makers. "By both contrast and comparison, constitutional economic analysis attempts to explain the working properties of alternative sets of legal-institutional-constitutional rules that constrain the choices and activities of economic and political agents, the rules that define the framework within which the ordinary choices of economic and political agents are made" (Buchanan 1987, 585). Thus, if the rules of engagement affect the pattern of activity, considered reform of the market for policy must refer to a higher level of inquiry than that of orthodox economics. This, however,

[7] With respect to the efficiencies of institutions that have evolved, Buchanan (1977, 31) asserts that evolutionary processes "contain within their workings no guarantee that socially efficient rules will emerge over time."

first, requires a certain constitutional awareness of both the subject and tools for analysis of social science.

In the remainder of this paper, we first look at how, in the absence of this constitutional perspective, the dilemma raised by political bias in policy selection is treated. Then, following an elaboration on the constitutional perspective, we put together how this standpoint addresses the issues raised about the nature of the market for policy advice.

5.1 *Politics in the way of economics*

Even if the political bias in the market for policy is well recognized, the constitutional foundations of policy analysis are often less well appreciated. Many economists are convinced that their interpretation is true and that if only those with the power to implement proposals could adopt, by adequate sensitization, their recommendations, things would be better. Milton Friedman (1986) in his presidential address to the Western Economic Association, for example, recognizes that attempts to persuade the Federal Reserve to adopt a three percent money growth rule are futile since it is not in that institution's self-interest to give up their discretionary power. Yet, Friedman does not doubt that his own policy prescription is the correct one.

In the same vein[8], though in the context of policy implementation in developing countries, Meier (1991, 316) holds that "economists should not view the giving of economic advice as a merely technical exercise; instead they must integrate it with knowledge of the country's political process." His view thus is that economists must exhibit shrewdness and strategize in order to steer implementation of their proposals through the political system. Does recognizing political bias as an obstacle to epistemic privilege - the idea that we should defer to those who have superior knowledge of what should be done - mean that we should address the potential for failure in the policy market by finding imaginative ways of carrying the policy football past the implementation goal line? The answer would depend on how certain we are of that knowledge.

Most economists would agree that their primary professional mission is to increase the knowledge of the workings of the economic system. What, however, is the purpose of this endeavor? One rationale is to use this understanding in order to improve social welfare, just as an understanding of physics enables us to engage engineering solutions. In this Pigouvian tradition, knowledge is sought for its power in application. Yet, coming to terms with workings of our economic environment depends on our perception of it. Even if we can agree on what it is that we seek to observe, the same phenomenon, viewed from different perspectives provides different interpretations. Such differing interpretations yield divers solutions to perceived problems; there is therefore no *absolute* scientific standard for cross-evaluating alternative policy proposals[9]. The closest economists can come to such a basis is through a near unanimous professional consensus, such as on the benefits of 'free trade'.

Thus, the alternate recourse to scientific objectivity as a criteria for choice among more contested policy options, beyond standards of internal methodological consistency and data use, is limited by the ultimate reliance of derived conclusions upon the subjective or synthetic nature of its basic framework and applied assumptions. If we are unable to resolve definitively the epistemological issue of which subjective view is more equal among others, then the soundness of developing strategies to guide policy based upon knowledge so founded past the political process loses ground. Given all this then, we need instead to consider more deeply how alternative or potential ways of developing professional standards and structuring political competition can affect the generation and selection of policy and consequently the development of pattern of rules and orders they engender. In other words, instead of trying to somehow steer through the politics inherent in the choice of policy confident that we are correct, we need to step back from it all and see how we can constrain that process itself.

5.2 *The Constitutional perspective*

What then is required is an analytical apparatus, first, which directs attention to the modalities within which social choice is made, second, which recognizes the

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[8] Pun intended.

'Similarly, Boettke (1997, 46) notes that "different formal models generate different conclusions, and since each model is, in principle, equally unable to explain real-world disequilibria, there is no way to choose between them in any absolute sense. Economic arguments against interventionism based on New Classical assumptions could just as easily be false as arguments for intervention based on New Keynesian assumptions could be true. All we have is a succession of logically consistent and very elegant models that say little or nothing about the world— except that anything is possible."

inherently provisional nature of knowledge, and third, which develops normative principles within which to consider the first two issues. This challenge has been taken up by scholars in the field of Constitutional Political Economy. The Constitutional approach, rather than looking at political reality as inhibiting the development of better policy, instead considers how the rules that govern political exchange can themselves be structured, such that the way in which policy would then be selected reflects on that which is conjectured to improve welfare. As such, as Buchanan (1990, 3, emphasis in original) notes "Constitutional Economics directs analytical attention to *choice among constraints."*

This notion of choice among constraints invokes the notion of a nested structure of rule restraints, with each higher level reflecting a more fundamental and comprehensive distinction of how we wish to limit our sphere of consideration. In this account, at each level of choice, the rules that define choice are considered to be "relatively absolute absolutes," to use Buchanan's (1989) phrase. Thus, one may distinguish choices made from among constraints with those choices made within constraints, where such constraints are taken provisionally for granted. Correspondingly, and at each level, constitutional choice is more comprehensive than sub or within-constitutional choices[10].

In the case of frameworks of economic analysis, we may then consider certain world-views as provisionally given and that that these then act to circumscribe the realm within which theories and models can be consistently developed. Frameworks provide the methodological guidelines within which to develop consistently subsequent theories and models. At each level, representations containing beliefs about the world can be considered to be consulted and strengthened or modified with respect to criteria posed by other relatively fixed frames of perceptive reference. In this respect, criteria of theoretical competition include such standards as the appropriate use of logic and the relevance of invoked empirical evidence. If such orientations are judged to be misleading, then these themselves can be subject to review and reinterpretation.

In discussing the ideals on which theories and models are judged in economic analysis, we have already introduced the notion of normative standards of evaluation.

[10] A similar distinction is to be found in the Institutional Analysis and Design framework promulgated by Elinor Ostrom and colleagues.

Similarly, the Constitutional approach creates an awareness of the relatively absolute standards within which political competition is constrained. Constitutional Economics takes a normative stand in holding that the goodness of socioeconomic orders is to be judged by, or cast in terms of, the evaluation of the relevant or affected individuals themselves. Interpreted in the context of the policy market, Normative Individualism implies that since the social and economic implications of the rules that are transacted in the policy market affect the general constituency, they each are uniquely qualified to pass judgment on the efficacy of such considered policies. More, in focusing on the need for criteria for evaluating alternatives, the Constitutional approach is accordant with analyzing the various contexts within and across which individuals can express their value preferences among available or imagined policy alternatives. As such, the Constitutional approach is concerned with the responsiveness of institutional arrangements within which ideas are proposed and policies are selected to the subjective value systems of the individual members of that society.

5.3 *Structuring the market for policy advice*

In our earlier discussion of Austrian Market Process, we set out the idea that a market with its characteristic organization does not arise spontaneously but rather depends on the design and construction of a political-legal framework. This holds for both the market for policy as well as for the broader set of markets in an economy. The complementary constitutional perspective, with its notion of nested structures of rule constraints, brings into relief that the legal framework of such broader markets is developed within the market for policy. In turn, this view leads us to consider what the constraints of this market for policy are (or should be) and how they do (or might) affect the determination of policy and in turn, the character of the general economic order. As such, the constitutional perspective differs sharply from the orthodox treatment, both in the formulation of policy within an idealized market, and of its implementation—given the insufficient consideration therein for the collateral processes which the institutional aspects of such changes excite.

If we are to consider then how constitutional frameworks can foster a desirable social and market order, we require two further points of guidance. We have already spoken to the first point when, in considering Normative Individualism, we noted that evaluations of goodness must be so constructed as to facilitate the expression of those affected by policies bring adopted. There should thus be a process of feedback where these expressions serve to encourage or discourage particular areas of development in the rule framework of the market. Left to be discussed then is how policy selection can be made more attuned to public evaluations of the social or market order.

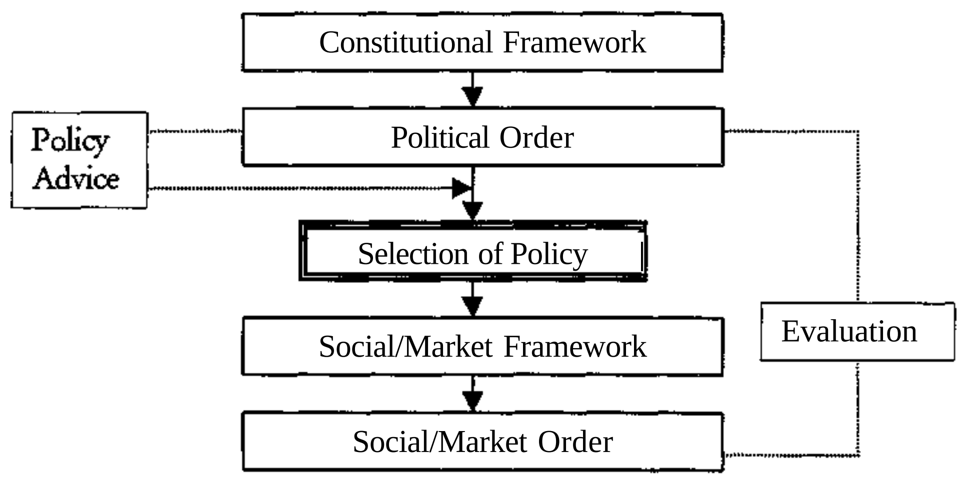

Figure 1.

The outflow of policy through the political process can be constricted either in its generation or selection. The former approach would involve imposition of restraints on the *development* of policy. In this regard, as noted earlier, requirements for logical consistency and empirical accuracy already exist and are largely self-policed through formalities of professional peer-review. These restrictions deal largely with internal methodological conformity although debates among economists and other social scientists about the relative merits of various theories and theoretical frameworks do prevail. Still, as the survival of Marxian arguments— most recently in particular strains of feminist economics as glimpsed earlier— from the assaults of Mises, Hayek and other Austrians shows, this academic competition does not always weed out the errant in the face of strong selection incentives from other quarters.

More, relying on theoretical formalism alone to constrain the dispatch of policy advice does not automatically reflect the normative conditions we have imposed.

The leaves us then with the alternative of constraining the *selection* of theory. Given that policy selection falls to policymakers, it follows that we have to consider how that choice may be structured as to incorporate our normative criterion; the nature of the competitive constraints under which the political process operates will determine the extent to which the process is expected to work to the benefits of its constituents. The literature on *Competitive Federalism* takes on significance in this respect[11].

Competitive federalism has developed from Tiebout's (1956) insight that competition among jurisdictions would allow citizens to match their preferences with the array of local public goods offered by each. It presents a forum for constitutional experimentation where alternative rule structures in effect in different jurisdictions compete with each other with choice among them expressed through the mobility of people and resources. Policymakers would find it in their self-interest to develop and maintain desirable conditions for commerce and living if their rewards are tied to attracting such people and resources. Just as the concept of *consumer sovereignty,* originally developed by Hutt (1990[1936]), holds that markets should be so structured as to make responsiveness to consumer interests the sole channel for success, so the notion of *citizen sovereignty,* as coined by Vanberg and Kerber (1994), express the notion that political entrepreneurs can be induced to be responsive to citizen interests through structuring competition where residents select from packages of institutional features proffered by alternate jurisdictions; the sole path to success in a political career is through being responsive to citizen interests. In this respect, as Dye (1990, 14) observes, "the greater number of governments to select from, and the greater variance in public policies among them, the closer each consumer-taxpayer can come to realizing his or her own preferences."

This then leads us to the concept of *Constitutional Efficiency* as the responsiveness of social arrangements to value-driven change. As such, it focuses attention on the ways and means by which individuals can more easily express their

[11] The invocation of competitive federalism here is intended to illustrate how the market for policy can be alternatively structured and does not preclude consideration of other possible constitutional arrangements.

preferences among social arrangements. It is thus accordant with developing the rule context within which individuals can express their value preferences among available or imagined alternatives. As Wiseman (1990, 121) notes, "[t]he existence of separate jurisdictions with some protected powers within a constitutional federation adds an extra dimension to the constitutional arrangements available to inhibit coercive behavior by government, so improving the power of individual Voice.' It also facilitates 'exit' at low opportunity-cost because migration between federal sub-regions is less difficult than migration between separate countries, and competition between such regions stimulated by the possibility of such migration is a potentially valuable substitute (or supplement to) the use of constitutional rules."

Competitive federalism then suggests a way of structuring the market for policy alternate to the one considered earlier where the policymaker and the analyst were parties to the exchange, to their mutual benefit. By contrast in the present alternative, policymakers innovate through implementing policies suggested by analysts as creating conditions attractive to citizens. Here, the political entrepreneur "cannot know in advance what kinds of institutional provisions are best suited to solve diagnosed problems." He or she has to act on conjectures that may or may not turn out to be of advantage. "And the process of competition among jurisdictions can be seen in analogy to market competition, as a process of experimenting, exploration and discovery in which alternate institution arrangements or social technologies are tried out in an area in which new arrangements and institutional inventions can constantly appear on stage, challenging established solutions" (Vanberg and Kerber 1994,204).

This alternative then points social scientists towards the study of appropriate constraints within which such institutional-constitutional competition can take place. It suggests that inquiry be directed into such things as how rules pertaining to competition among jurisdictions can be structured to promote constitutional efficiency, as well as pointed towards constructing rules that inhibit cartel-like ex ante coordination among governments to stifle inter-governmental competition, among others. If as argued, policy selection is contingent of political competition, then we need to reorient ourselves to consider what the terms of this competition are as founded on the evaluations by citizens of social and market order they foster.

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Workshop Colloquium - V691
Monday, March 23
12:00-1:30 pm
Presenter: Sujai Shivakumar

Workshop in Political Theory and Policy Analysis

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Dr. Sujai Shivakumar, Visiting Scholar, Workshop in Political Theory and Policy Analysis, will be the speaker for the Workshop Colloquium on Monday, March 23 1998. His presentation is entitled "Constitutional Constraints and the Market for Policy Advice." An abstract his paper is provided below.

There is no such thing as *the* market but rather nexus of exchange as circumscribed by certain rules. The patterns we observe as characteristics of varied markets are in turn dependent on the presence or absence of various static and dynamic rule properties. This basic insight of Constitutional Political Economy extends here to consider the market for economic theory and public policy. Traditionally interpreted, policy action rests on advice developed scientifically from economic theory. However, the possibility exists for the invocation of economic arguments and the selection of policy among alternatives offered which suit political imperatives. In turn, an inquiry into whether economic science drives policy or if political imperatives select from rationalizing theories and theoretical frameworks would depend on how the market for public policy is structured.

A copy of his paper is available by calling the above number. Colloquium sessions begin at 12 noon and adjourn promptly at 1:30 pm. You are welcome to bring your lunch. Coffee is provided free of charge and soft drinks are available. We hope you will be able to join us!

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