

## REDUCTIONIST REFLECTIONS ON THE MONETARY CONSTITUTION

*James M. Buchanan*

### The Absence of a Monetary Constitution

There exists no monetary constitution, as such, in the United States. What does exist is an institutionally established authority charged with an ill-defined responsibility to "do good," as determined by its own evaluation. We would have no difficulty in classifying an analogously directed military junta in a Latin American setting as nonconstitutional, by which we would mean, quite properly, that it operates in accordance with no predictable rules of behavior. Viewed in this perspective, it becomes difficult, if not impossible, to mount intellectually respectable defenses for continuation of the monetary institutions that are in being. Yet we observe relatively little revolutionary fervor, even among political economists, to challenge the institutionalized status quo.

A shift in regime that would put in place a genuine monetary constitution, one that would incorporate stable and predictable rules of the game, would generate an outward displacement in the value feasibility space for the economy. By reducing the uncertainty involved in each and every transaction made in nominal monetary values, each potential transactor can share in the newly available increment to value surplus. Failure to introduce a constitutional regime in money, therefore, amounts to a collective refusal to implement a technological improvement that is acknowledged to be mutually beneficial.

### Explaining the Persistence of the Status Quo

How do we explain our observed failure to exploit this opportunity to increase our well-being? *Small, and possibly influential, groups*

---

*Cato Journal*, Vol. 9, No. 2 (Fall 1989). Copyright © Cato Institute. All rights reserved.  
The author is a Nobel Laureate in Economics and General Director of the Center for Study of Public Choice at George Mason University. He is indebted to David Fand and Viktor Vanberg for their helpful comments.

do exist which secure rents because of the nonpredictability that characterizes the monetary arrangements in existence. Those persons who have invested human capital in acquiring differentially advantageous abilities to foresee and react to the behavioral shifts of those who make decisions for the monetary authorities, of course, would suffer transitional loss from any shift toward an effective monetary regime. But the “Fed-watching” industry, in total, is surely not sufficiently strong to explain the apparent invulnerability of the regime of discretionary authority. We can add in the potential influence of the entrenched bureaucracy of the monetary authority itself, including all levels in the hierarchy. And we still remain with what seems to be an intellectual puzzle in political economy. Why do we, as members of the body politic, put up with institutional arrangements that seem to keep us well within the frontier of potential value? Why do the professional economists, who are presumably competent to analyze alternative institutional structures, seem so reluctant to condemn the existing regime?

The issues here are neither so simple nor so straightforward as I have made them seem to be. Both the propositions advanced and the questions posed above depend on acceptance of a conception of “the economy” that is not shared with many of either my professional peers in economics or my fellow citizens. To put my position dramatically, many economists do not know what they are talking about, and, if economists do not know, how can they expect citizens to cut through massive intellectualized absurdity?

## Two Conceptions of the Economy

There are two categorically different conceptions of what an economy or “the economy” is. The first, and that upon which the earlier statements and questions have been based, is the conception of the economy as a *structure* or *order*, described by a set of rules, and within which separate individual actors pursue individually selected objectives, including individually defined economic value. The second conception is one of an economy as an independently existing *organic* unit, to which purpose can be assigned. Macroeconomics, in its very nature, implicitly embodies the second of these conceptions. Macroaggregation (the attempt to measure national product, income, growth, employment) leads almost directly to targeted values or, at least, directions of change in the aggregated variables. By contrast, in the first conception of an economy as an order, the aggregated values *emerge* from the interlinked choices made by individual parti-

participants; but these values are not appropriate targets for purposeful manipulation.

Analogies are helpful to illustrate the contrast and comparison between the opposing conceptions. In the first, nonteleological, vision of the economy as an order or structure, the appropriate analogy might be a municipal playground, with tennis courts, swimming pools, swings, sandboxes, basketball courts, and softball diamonds. This playground operates in accordance with rules that allow the separate individual users to pursue their own objectives as they variously utilize the available facilities. In this case, it is clear that users' interests are furthered by the presence of stable and predictable rules concerning usage of the facilities. Discretionary authority on the part of the playground manager to change opening and closing hours, eligibility requirements for using facilities, and rationing schemes for usage would tend to reduce the value of the playground for all potential users. Moreover, if in some initial setting, the manager did, indeed, have such discretion, the imposition of a set of rules would surely be a value-enhancing shift for the regime.

In the second, or teleological vision, the economy, as a unit, becomes analogous to a ship which, if left alone and rudderless, would toss about on a sometimes stormy sea. The replacement of the discretionary authority of the ship's captain by an automaton may seem foolhardy. The very survival of the ship may seem to depend on the skill of the captain and crew who will maneuver the ship safely through possibly troubled waters. Displacement of the captain's discretionary authority by a navigational automaton will, to be sure, generate greater predictability in the direction of the ship's movement, but at the possible expense of navigational disaster in an unpredictable sea.

Neither of the analogies fully captures the attitude of those who hold either the nonteleological or the teleological conceptions of the economy. Those who think of the economy as an order—a structure of rules within which persons separately pursue private purposes—allow for the possible sharing of common purposes among individuals and groups, purposes that may be achieved through collective organization. Those who think of the economy as an organic unit to which macropurpose may be assigned allow for the possible extensive pursuit of private, individually identified goals within the broad limits defined by macromanagement. There remains, nonetheless, a different conceptualization of the economy at the most basic level of comprehension. The economy-as-order is accompanied by the protective state or polity, the function of which is to maintain the rules of the order itself, rather than to steer or direct the economy,

as such. The economy-as-organic unit must be accompanied by an activist state or polity, one that is required to macromanage, steer, and direct the economy toward objectively definable goals or purposes.

### Dethroning Macroeconomics

Macromanagement through fiscal fine-tuning was the initial heritage of the Keynesian revolution in economic policy, although precursory elements of macropolicy can be located in the central banking theory of the 1920s. The subsequent fall of fiscal policy from favor was due to acknowledged operational flaws rather than to any convergence of economists' attitudes toward the inappropriateness of macromanagement. More or less by default, although aided and abetted by over-enthusiasm on the part of advocates of some variants of monetarism, macromanagement came to be shifted almost exclusively to the monetary authorities. This shift, in itself, remains surprising, especially because it was accompanied by a developing recognition of monumental operational failure in the 1930s.

The discretionary powers of the existing monetary authorities are defended by those who simply cannot conceive that the economy, if constrained appropriately within the "laws and institutions" (so well understood by Adam Smith), can operate to generate maximal value for the persons who participate in the interaction process. There is a difference in mind-set at the most basic level. Many of us see the failure to exploit the opportunity offered by the adoption of a genuine monetary constitution (of almost any description) as equivalent to the explicit refusal to take more rather than less. Therefore, we will not succeed until and unless we effectively excise economic macropurpose from the listing of tasks appropriately assigned to agents of the state. The implications for the status of macroeconomics are clear; so long as macroeconomics remains central to our discipline, we shall not secure reform in our monetary arrangements.

At the same time that we dethrone macroeconomics, with its implied macropurpose for the aggregative economy, from its place in the economists' research program, we must not commit the error of over-extension. In our playground analogy, it seems clear that the discretionary authority of the manager should be restricted by rules. This is not equivalent to saying that the playground would be a more desirable place in the total absence of all rules. A rules-structured, or constitutional, order rather than anarchy is something upon which shared agreement may be reached.

### Achieving Price-Level Predictability

Predictability in the value of the monetary unit is *not* a macropurpose of state-directed economic policy. It is, instead, an attribute of

the agreed-on rules within which individual actors contract one with another in the complex interaction of voluntary exchanges. In this sense, predictability is not basically different from the security of rights to property, although descriptively such predictability is perhaps closer to enforced standards for ordinary weights and measures. As a commonly desired attribute of the rules or structure, predictability in the value of the monetary unit is within the direct sphere of responsibility of the protective state, in a sense precisely comparable to the provision of security of private rights to property and the enforcement of voluntary contracts.

It is essential to understand the difference between the *emergent* macroproperties of a well-ordered economy and the properties of the structure that are prerequisite to the attainment of the commonly desired emergent properties. With a shift to a constitutional regime that embodies predictability in the value of the monetary unit (predictability that may be generated by any one of several institutional alternatives), all individual contractors share in the relative reduction in transactions costs, thereby releasing resources for employment in various privately valued uses.

### A Fundamental Misunderstanding of Economic Process

The macroeconomics of money is complex because the institutions in existence reflect a fundamental misunderstanding of economic process. Our didactic role must be focused on removing this misunderstanding. We waste both our intellectual and our emotional energies by engaging in scientific disputes (no matter how challenging these may be) that find their relevance only because of the flawed understanding and its institutional implications.