

James M Buchanan

The Creation of Public Choice Theory

James Buchanan stands as one of the giants of American 20th century political economy. This Nobel Prize-winning economist's prolific work has generated interest in, and new respect for, constitutional rules versus discretionary, centralized power.

Buchanan—along with Gordon Tullock and Anthony Downs—created the public choice movement. During that process, they forced their colleagues to reexamine the most fundamental assumptions regarding the nature of government and the public policies that emerge from any political process. Economists now have the powerful public choice analytical framework to use in examining the phenomenon that public choicers call government failure.

Few economists have been as influential or as productive as James Buchanan, and it is our pleasure to add his story and ideas to our Economic Insights series.

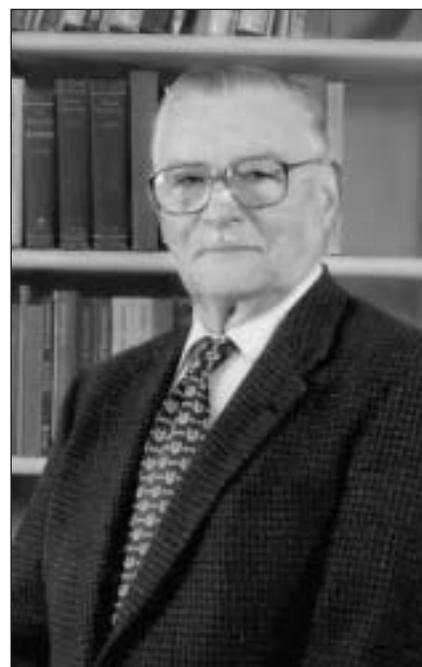
—**Bob McTeer**
President
Federal Reserve Bank of Dallas

James M. Buchanan was born in Murfreesboro, Tenn., in 1919. The son of a poor, politically populist farmer, he managed to enter Middle Tennessee State College, where he received a bachelor's degree in 1940. He obtained a master's degree the following year from the University of Tennessee and a doctorate from the University of Chicago in 1948.

While he was at Chicago, two important events changed Buchanan's life: He met Frank Knight,¹ and he found and translated an essay by the great Swedish economist Knut Wicksell.² From Knight, Buchanan says he learned "the message that there exists no god whose pronouncements deserve elevation to the sacrosanct, whether god within or without the scientific academy. Everything, everyone, anywhere, anytime—all is open to challenge and criticism."³

From Wicksell, Buchanan concluded that governments are not efficient, purely altruistic entities that effortlessly correct market imperfections. Instead, governments are aggregates of individuals pursuing private rather than the public interest through regulations and tax laws. These private interests create wasteful lobbying efforts known as rent seeking.

Buchanan's view of public finance, and hence, the appropriate size of the state, is derived from a model in which the state supplies its constituents with public goods or services, which are paid for with tax revenues. The only appropriate rule under such conditions, he has argued, would be unanimity among citizens. This is not possible in practice,



James M. Buchanan

George Mason University/Evan Cantwell

but a constitutional order that defends the rights of minorities is acceptable to Buchanan and other public choice theorists. Public choice economists support strong legal rules that constrain rent-seeking special interests from undermining an appropriate public-goods process.

After graduating from Chicago, Buchanan held a number of teaching positions, beginning as an associate professor at the University of Tennessee in 1948, making full professor there in 1950, then moving to Florida State University. He made an important move in 1956 to the University of Virginia in Charlottesville, where he taught and chaired the economics de-

Remembering His Favorite Professor and His Influence

One of Knight's many crusades has been against the view, which he associates with John Dewey, that science in some instrumental sense can be used to solve social problems in a community of free men. Knight believes that science applied instrumentally implies control, whereas the social problem is one of attaining consensus, of securing mutual agreement. The "social engineer," so prevalent in the background of modern economic models, has no place in Knight's approach to social problems.

Modern man's central problem, according to Knight, is a moral one. Historical liberalism has destroyed conventional religion and has provided no effective substitute for it; as a consequence, men have turned all too quickly to nihilism or to the deification of the state. What men need, therefore, is a common morality founded on truth, honesty, mutual respect, and "good sportsmanship," the ethics that liberalism should have produced but somehow failed to...

Surveying the history of Western civilization since the Enlightenment, Knight sees no clear indication that man can rise to the challenge presented by the liberation of his own mind. But in his later writings especially, one senses his increased willingness to leave this question open....

In his critical attitude and outlook, in his abhorrence of nonsense even in its most sophisticated forms, Frank Knight has much in common with David Hume, although Hume does not appear to have directly influenced Knight's thought. These two critics share a determination to cut through the metaphysical-linguistic fuzziness that enshrouds the human mind....

Knight has no "disciples" as such, and those who have been most influenced by his work are as likely to criticize him as others are. This is because as a teacher he has been almost uniquely willing to look for merit in all questions and because he has refused to accept any final answers. ■

—"Frank H. Knight," in *Collected Works*, vol. 19, 92–3

partment through 1961. During this period, he resided for a year in Italy, studying their tradition of public finance and political theory, an experience that further influenced his theoretical directions.

Returning from Europe, Buchanan established the Thomas Jefferson Center for Political Economy at the University of Virginia and began attracting like-minded thinkers and students to Charlottesville. Working closely with Gordon Tullock, G. Warren Nutter and Kenneth Elzinga, he oversaw the formative years of the new economic paradigm called public choice theory. Buchanan never cared for this name, but it caught on at a 1967 meeting held in Chicago under the cumbersome title of the Committee for the Study of Non-Market Decision Making. The renamed Public Choice Society was born at that meeting.⁴

After spending a year at the University of California at Los Angeles in 1968, Buchanan moved his public choice center from Charlottesville to Virginia Polytechnic Institute in Blacksburg, where he served as a university distin-

guished professor from 1969 to 1983. But the final move came in 1983 when Buchanan took a position at George Mason University in Fairfax, Va., just outside Washington, D.C., and brought the Center for Study of Public Choice with him. He remains today its advisory general director.

During his prolific career, Buchanan has authored or co-authored more than 35 books, translated two others, contributed chapters to about 300 others, and authored or co-authored hundreds of articles—an amazing publication record even if there were 10 of him. His curriculum vita is over 80 pages long and can be downloaded from www.gmu.edu. In 1986, he was awarded the Nobel Memorial Prize in Economic Sciences.

Throughout his career, Buchanan has dismissed two issues that typically dominate economists' thinking: He has never cared about public opinion of his work, and he does not care whether his work makes the world a better place.⁵ Buchanan's attitudes clearly reflect Knight's skepticism regarding human

How Can Government Debt Be Controlled?

Because of this difference in the specification and identification of liability in private and public debt, we should predict that persons will be somewhat less prudent in issuing the latter than the former. That is to say, the pressures brought to bear on governmental decision makers to constrain irresponsible borrowing may not be comparable to those that the analogous private borrower would incorporate within his own behavioral calculus. The relative absence of such public or voter constraints might lead elected politicians, those who explicitly make spending, taxing, and borrowing decisions for governments, to borrow even when the conditions for responsible debt issues are not present. It is in recognition of such proclivities that classical principles of public fiscal responsibility incorporate explicit limits on resort to borrowing as a financing alternative, and which also dictate that sinking funds or other comparable provisions be made for amortization of loans at the time of any initial spending-borrowing commitment. Without some such constraints, the classical theory embodies the prediction of a political scenario with cumulatively increasing public debt.... ■

—"The Old-Time Fiscal Religion," in *Collected Works*, vol. 8, 19–20

attempts to better society as a whole. Buchanan's opinion on why he has always been an outsider in the economics profession turns on three propositions:

First, I have been influenced by Frank Knight and F. A. Hayek in their insistence that the problem of social order is not scientific in the standard sense. Second, I was greatly influenced by Knut Wicksell's admonition that economists cease acting as if government were a benevolent despot. Third, I rejected, very early in my thinking, the orthodox economist's elevation of allocative efficiency as an independent standard of evaluation.⁶

At first glance, public choice theory seems to be nothing more than common sense: Governments are collections of individuals whose interaction is deter-



mined by the same self-interest that motivates people in the private sector. The simple view that government is a collective decisionmaking process that altruistically solves social problems has a long and, according to Buchanan, romantic tradition both in political theory and in economics. Because of his thorough, individualistic approach to government and his adherence to subjective-cost doctrine,⁷ his public finance models lie outside the neoclassical mainstream belief in the collective problem-solving model and in measurable, explicit opportunity costs. A pure subjective-cost approach denies that the actual costs of any action can ever be known, even by the decision-maker(s), because the act of choice is *itself* cost, subjectively perceived. A theorist adhering to this doctrine would not carry out any benefit–cost analysis, as costs are inherently not observable and, therefore, not measurable.

Although the economics profession has resisted Buchanan’s arguments, public choice theory has, nonetheless, found its way into public finance discussions and has had a strong influence on government policies. As many economists came to doubt the efficacy of large, state-funded programs, they saw public choice theory as a way to examine what has come to be known as government failure. For decades following Arthur Cecil Pigou’s famous book *The Economics of Welfare*, economists saw government as a disinterested agency that could correct for market failures. Buchanan and other public choice theorists altered the debate by proposing that government may not really correct problems in the marketplace because of the wealth trading, or rent seeking, that occurs during the legislative process.

Extending his view that public policy emerges from the interaction of self-interested individuals led Buchanan to a systematic study of the institutions and, in the case of the United States, the constitutional parameters within which public policy decisions are made. Buchanan’s analyses are always done

What Is Cost?

The essential element in this concept [of cost] is the direct relationship between cost and the act of choice, a relationship that does not exist in the neoclassical predictive theory. In the London–Austrian conception, by contrast, cost becomes the negative side of any decision, the obstacle that must be got over before one alternative is selected. Cost is that which the decision-taker sacrifices or gives up when he makes a choice. It consists in his own evaluation of the enjoyment or utility that he anticipates having to forgo as a result of selection among alternative courses of action.

The following specific implications emerge from this choice-bound conception of cost:

1. Most importantly, cost must be borne exclusively by the decision-maker; it is not possible for cost to be shifted to or imposed on others.
2. Cost is subjective; it exists in the mind of the decision-maker and nowhere else.
3. Cost is based on anticipations; it is necessarily a forward-looking or *ex ante* concept.
4. Cost can never be realized because of the fact of choice itself; that which is given up cannot be enjoyed.
5. Cost cannot be measured by someone other than the decision-maker because there is no way that subjective experience can be directly observed.
6. Finally, cost can be dated at the moment of decision or choice.

In a theory of choice, cost must be reckoned in a *utility dimension*. In the orthodox predictive theory, however, cost is reckoned in a *commodity dimension*...

Cost, then, is purely subjective in any theory of choice, whereas cost is objective in any theory that involves genuine prediction. ■

—“Cost and Choice,” in *Collected Works*, vol. 6, 41–2

within the framework of *political* economy rather than pure economics. Political economy deals with the understanding of collective decisionmaking and its wealth and income distribution effects on society. While some economists—notably David Ricardo and his followers—have always been concerned with income distribution, they have not approached the problem from a public choice perspective, preferring to concentrate on the distributive outcomes of market processes.

Although public choice theory seems to favor outcomes supported by society’s more conservative members, Buchanan considers himself completely apolitical:

I resist, and resist strongly, any and all efforts to pull me toward positions of advising on this or that policy or cause. I sign no petitions, join no political organizations, advise no party, serve no lobbying effort. Yet the public’s image of me, and especially as developed through the media after the Nobel Prize in 1986, is that of a right-

wing libertarian zealot who is anti-democratic, anti-egalitarian, and anti-scientific. I am, of course, none of these and am, indeed, the opposites. Properly understood, my position is both democratic and egalitarian, and I am as much a scientist as any of my peers in economics. But I am passionately individualistic, and my emphasis on individual liberty does set me apart from many of my academic colleagues whose mind-sets are mildly elitist and, hence, collectivist.⁸

Another thing that sets Buchanan apart is his view of the relationship between individuals and civilization. Influenced by what he considered the government’s overreaching in the 1960s, Buchanan believes the closer a person can come to self-sufficiency, the better off he is. That might seem a strange position for an economist, but Buchanan defies easy classification, even in how he lives his life:

I like space around me. I bought this century-old log cabin and started fix-

ing it up and added to it and so forth. I kept buying more land, more land, more land. I found out something about my utility function as I did that, because I found out that every step I took toward genuine self-subsistence really gives me a big charge. If I can build a fire in my wood stove and don't have to depend on electric heat if we have a power outage, then I'm that much happier. Or if I can go across the street to the spring and get a bucket of water as opposed to having an electric pump to the well, that gives me a charge. Or if I grow my own vegetables or pick my own berries, which I'm doing now. This year there is a good blackberry crop. I became more and more interested in having at least a backup, so self-subsistent existence really did give me a lot of utility.⁹

As this quote shows, Buchanan's theories are exemplified in his own lifestyle. ■

— Robert L. Formaini
Senior Economist

Notes

- ¹ See Formaini (vol. 7).
- ² Wicksell (1967).
- ³ Breit and Spencer (1997), 165.
- ⁴ "Interview with James Buchanan," Federal Reserve Bank of Minneapolis *The Region*, September 1995, minneapolisfed.org/pubs/region/95-09/int959.cfm.
- ⁵ Buchanan (1992).
- ⁶ Buchanan (1992), 103. Also see Formaini (vol. 4).
- ⁷ For an explanation of subjective-cost doctrine, see Buchanan (1999).
- ⁸ Buchanan (1992), 105–6.
- ⁹ "Interview with James Buchanan."

Sources and Suggested Reading

Breit, William, and Roger W. Spencer, eds. (1997), *Lives of the Laureates*, 3rd ed. (Cambridge, Mass.: MIT Press).

Buchanan, James (1968), "Frank H. Knight," *International Encyclopedia of the Social Sciences* (New York: MacMillan), 424–28.

Why We Cannot Implement Simple Keynesian Policies

The political process within which the Keynesian norms are to be applied bears little or no resemblance to that which was implicit in Keynes' basic analysis. The economy is not controlled by the sages of Harvey Road, but by politicians engaged in a continuing competition for office. The political decision structure is entirely different from that which was envisaged by Keynes himself, and it is out of this starkly different political setting that the Keynesian norms have been applied with destructive results. Political decisions in the United States are made by elected politicians, who respond to the desires of voters and the ensconced bureaucracy. There is no center of power where an enlightened few can effectively isolate themselves from constituency pressures. Furthermore, since World War II, the national economy has never been appropriately described as being in depression of the sort idealized in the elementary Keynesian models. Throughout the three decades of postwar experience, increases in aggregate demand have always been accompanied by increases in price levels, by inflation....

There are also obvious and important differences between market and political competition. Market competition is continuous; at each instance of purchase, a buyer is able to select among alternative, competing sellers. Political competition is intermittent; a decision is binding for a fixed period, usually two, four, or six years. Market competition allows several competitors to survive simultaneously; the capture by one seller of a majority of the market does not deny the ability of the minority to choose its preferred supplier. By contrast, political competition has an all-or-none feature; the capture of a majority of the market gives the entire market to a single supplier. In market competition, the buyer can be reasonably certain as to just what it is he will receive from his act of purchase. This is not true with political competition, for there the buyer is, in a sense, purchasing the services of an agent, but it is an agent whom he cannot bind in matters of specific compliance, and to whom he is forced to grant wide latitude in the use of discretionary judgment. Politicians are simply not held liable for their promises and pledges in the same manner that private sellers are. ■

— "Keynesian Economics in Democratic Politics,"
in *Collected Works*, vol. 8, 98–9

——— (1992), "From the Inside Looking Out," in *Eminent Economists: Their Life Philosophies*, ed. Michael Szenberg (Cambridge, UK: Cambridge University Press), 98–106.

——— (1999), *Cost and Choice: An Inquiry in Economic Theory* (Indianapolis, Ind.: Liberty Fund), orig. pub. 1969.

——— (2001), *The Collected Works of James M. Buchanan* (Indianapolis, Ind.: Liberty Fund).

Buchanan, James, and Gordon Tullock (1999), *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Indianapolis, Ind.: Liberty Fund), orig. pub. 1962.

Formaini, Robert L. (vol. 4), "Hayek: Social Theorist of the Century," Federal Reserve Bank of Dallas *Economic Insights*, No. 1.

——— (vol. 7), "Frank H. Knight: Origins of the Chicago School of Economics," Federal Reserve Bank of Dallas *Economic Insights*, No. 3.

Rowley, Charles K., Robert D. Tollison and Gordon Tullock, eds. (1988), *The Political Economy of Rent Seeking* (Boston: Kluwer Academic Publishers).

Wicksell, Knut (1967), *Finanztheoretische Untersuchungen* (Jena, 1896), trans. by James M. Buchanan as "A New Principle of Just Taxation," in *Classics in the Theory of Public Finance*, ed. Richard A. Musgrave and Alan T. Peacock (New York: St. Martin's Press), 72–118, orig. pub. 1958.

Economic Insights is a publication of the Federal Reserve Bank of Dallas. The views expressed are those of the authors and should not be attributed to the Federal Reserve System.

Please address all correspondence to
Economic Insights
Public Affairs Department
Federal Reserve Bank of Dallas
P.O. Box 655906
Dallas, TX 75265-5906
Visit our web site at www.dallasfed.org.