The Subjectivist Roots of James Buchanan's Economics

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> I have often argued that the Austrians seem ... to be more successful in conveying the central principle of economics to students than alternative schools ... or approaches.
>
> —James M. Buchanan, 1976

When James Buchanan was awarded the 1986 Nobel Prize in economics the Nobel committee cited *The Calculus of Consent*,[1] co-authored in 1962 with Gordon Tullock, as Buchanan's most important work. But Buchanan himself has stated that he considers his 1969 book, *Cost and Choice: An Inquiry in Economic Theory*,[2] to be his most important theoretical contribution.

Even though *Cost and Choice* was published seven years after *The Calculus of Consent*, it embodies important elements of Buchanan's thinking that are crucial to his contributions to *The Calculus of Consent* and to much of his other work. Of particular interest to Austrian economists is the fact that subjective cost theory lies at the heart of many of Buchanan's contributions to economic theory. Moreover, other Austrian-school insights, such as methodological individualism and an emphasis on market (and non-market) *processes*, as opposed to equilibrium conditions or end states, also figure prominently in Buchanan's work.

Buchanan's Nobel Prize is widely regarded as a salute to public choice economics. But the award also reflects well on the Austrian school, to the extent that it has influenced Buchanan's thinking.

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[1]James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962).

[2]James Buchanan, *Cost and Choice: An Inquiry in Economic Theory* (Chicago: University of Chicago Press, 1969).

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Buchanan's Principles of *Cost and Choice*

Buchanan has clearly stated that subjective cost theory is at the heart of much of his work in public choice and public policy. This methodological distinction is what separates much of his work from other economists who have written on public policy issues. The notion of opportunity cost is usually defined acceptably by most economists, according to Buchanan, but the problem is that "the logic of the concept is not normally allowed to enter into and inform the subsequent analytical applications."[3] Such applications are essential, for a consistent application of the notion of opportunity cost, writes Buchanan,

> clarifies important areas of disagreement on policy issues. In public finance alone, debates over tax incidence, tax capitalization, public debt burden, and the role of cost-benefit analysis can be partially resolved when protagonists accept common concepts of cost. The unsatisfactory state of welfare economics can at least be understood and appreciated more adequately when the incorporated cost confusions are exposed. The ... debate over the possibility of socialist calculation emerges with perhaps a different glow. Something can be said about such ... topics as the draft and crime.[4]

Buchanan's cost theory "is properly labeled Austrian,"[5] and also owes a debt to developments of the "London School Tradition" during the period of the 1930s to the 1950s.[6]

One of the essential points of *Cost and Choice* is that, to many economists, cost is divorced from the act of choice. To neoclassical economists cost is objective in that it can be estimated *ex post* by external observers, even though market values are set by the subjective evaluations of market participants. Furthermore, in "the predictive science of economics" cost is, according to Buchanan,

> the objectively-identifiable magnitude that is minimized. It is the market value of the alternate product that might be produced by rational reallocation of resource inputs to uses other than that observed. This market value is reflected in the market prices for resource units; hence, cost is measured directly by prospective money outlays.[7]

One consequence of objective cost theory is that the theory "is not a theory of choice at all. Individuals do not choose; they behave

[3]Ibid., p. ix.

[4]Ibid.

[5]Ibid.

[6]James Buchanan and G. F. Thirlby, eds., *LSE Essays on Cost* (New York: New York University Press, 1981).

[7]James Buchanan,*Cost and Choice*, p. 112.

predictably in response to objectively-measurable changes in their environment."[8] For according to the objective cost theory:

> Cost ... is faced in the strict sense only by the automaton, the pure economic man, who inhabits the scientist's model. It is the behavior-inhibiting element that is plugged into the purely mechanistic market model. The conversion of objective data reflecting prospective money outlays into the subjective evaluations made by real-world decision-makers is of no concern to the predictive theorist.[9]

Buchanan acknowledges an intellectual debt to Philip Wicksteed, who was the first to tie opportunity cost directly to choice. Wicksteed wrote, for instance, that the cost of production, "in the sense of the historical and irrevocable fact that resources have been directed to this or that special purpose, has no influence on the value of the thing produced."[10] In this respect cost of production does not affect supply. What does affect supply is *anticipated* cost "in the sense of alternatives still open which must now be relinquished in order to produce this specific article," and which "influences the craftsman in determining whether he shall produce it or not."[11]

Wicksteed's work was refined by Hayek, Mises, and other Austrians, and by some members of the London School. Buchanan summarizes the resultant "choice-bound conception of cost" as follows:

> (1) 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) Cost can be dated at the moment of decision or choice.[12]

Buchanan makes an important distinction between choice-influencing and choice-influenced cost. The former is the type of cost

[8]Ibid.

[9]Ibid.

[10]Philip Wicksteed, *The Common Sense of Political Economy* (London: MacMillan, 1910).

[11]Ibid.

[12]Buchanan, *Cost and Choice*, p. 43.

discussed by Wicksteed, whereas the latter is the type of (subjective) cost that is the consequence of economic choices. Such costs may be borne by the decisionmaker, or by others on whom costs may sometimes be shifted. This distinction is critical to much of Buchanan's work in public finance and public choice.

The Importance of Subjective Cost Theory to Public Finance and Public Choice

Buchanan gained an international reputation as a public finance scholar long before the phrase public choice was ever coined. Moreover, his subjective cost theory is what distinguishes his work from other prominent public finance theorists such as Paul Samuelson and Richard Musgrave.

Buchanan's work on tax incidence theory is a clear example of how subjectivist insights have shaped his thinking about public finance. Neoclassical public finance theory has focused on the "cost" of taxation in terms of (1) who pays the amounts of money actually sent into the Treasury, and, (2) the "excess burden" or welfare costs of taxation. Both of these costs are assumed to be objective and measurable.

Buchanan takes a very different approach to the issue of tax incidence. Specifically, he was the first modern scholar to examine the relationship between taxes *as costs of public goods* and the importance of those taxes in democratic decisionmaking. Neoclassical tax incidence theory, according to Buchanan, "examines the choice behavior of individuals and firms, but this is not the choice behavior that involves either the financing of public goods or the selection among taxing alternatives."[13] The individual or firm is assumed by the neoclassical theory "to be subjected to an imposed change in the alternatives of *private or market choice*" (emphasis in original).[14]

Neoclassical tax-incidence theory is concerned almost exclusively with the tax-induced changes in the costs of undertaking *private* production, investment, and consumption decisions, but lacks a theory of public choice. The analysis yields no information about the (subjective) cost of *public* goods.

With the neoclassical approach to tax incidence theory the economist quite naturally views his role as one of adviser to political decision makers. If the economist can identify the effects of a tax on the economy, his role is to advise the presumably benevolent political authorities as to which type of tax would raise the "desired" amount of revenue and at the same time minimize the "excess burden" on

[13]Ibid., p. 53.
[14]Ibid.

society. According to this viewpoint, the economist's role is to construct a social welfare function, even if the members of society, i.e., taxpayers, have no input into the construction of the social welfare function or to the choice of tax instruments.

Buchanan has long recognized that this approach is inherently authoritarian, for in the name of maximizing some idealized notion of "social welfare," it ignores the preferences of those who comprise the society. For example, neoclassical public finance theory holds that individuals would prefer a "lump-sum" tax to an excise tax that raised the same amount of revenue because the former causes no excess burden. But to reach this conclusion, writes Buchanan,

> the economist must assume that the taxpayer is exclusively interested in the post-tax changes in his position and that he is indifferent among tax instruments otherwise. But there are obviously many reasons why the taxpayer may not evaluate alternative tax instruments in the same way that the applied welfare economist evaluates them. The taxpayer might, in the first place, prefer to suffer the higher measurable cost imposed by the excise tax because of the wider range of personal options that this form of tax allows [i.e., to avoid an excise tax on liquor by not purchasing it]. This option feature may well outweigh the excess burden. In the second place, the taxpayer may prefer the excise tax on liquor for sumptuary reasons even though he knows that he, too, bears an excess burden. The tax-induced reduction in liquor purchases by others may be more than enough to modify the relative standing of this tax on his preference scale.[15]

Informed by subjective cost theory, Buchanan suggests an alternative approach by asking the fundamental question: "What are the 'costs' of public goods in the genuine opportunity-cost, or *choice-influencing* sense?" (emphasis in original).[16] This question ties costs directly to choice and requires one to identify the choosing agent. The choosing agents are (at least in part) the voters in a democratic decision making structure. Since there are many different types of decision-making structures, democratic and non-democratic, the focus of Buchanan's approach is on how choice-influencing costs affect these decisionmakers in alternative institutional settings. To Buchanan, it is impossible to evaluate alternative tax systems without a theory of public choice, and that theory must be based on the insights of subjective cost theory.

One of the most important distinctions between Buchanan's and the neoclassical approach to taxation theory was recently described

[15]Ibid., p. 54.
[16]Ibid., p. 55.

by one of his students, Richard E. Wagner. Wagner observed that much of the "optimal taxation" literature, which has largely ignored Buchanan's work, is labeled "individualistic," but would appear to be anything but. According to Wagner

> It is ... a curious piece of vocabulary that affixes the designation "individualistic" to an analytic construction in which people are manipulated as objects at the disposal of some type of despot, who is presumed to be benevolent by virtue of being named "Social Welfare Function." ... [In the optimal taxation literature] policy outcomes are assessed against some transcendent criterion of goodness, independent of any consideration of what the participants might or might not work out among themselves ...[17]

As an aside, it is interesting that Buchanan's suggested approach to the study of tax incidence has been met with intense hostility by some neoclassical theorists. In 1980 he published *The Power to Tax* (with Geoffrey Brennan),[18] a book that is, among other things, an exposition of Buchanan's brand of tax-incidence theory. One reviewer for the *Economic Journal* was so offended by the book that he called the authors "fascists" for merely recommending that citizens should be given a greater voice in the choice of tax instruments.

In *The Power to Tax* Buchanan and Brennan disagreed with economic orthodoxy that broad-based taxes are the most "efficient" tax structure. They argued that a system of multiple excise taxes, rather than a few broad-based taxes, would give taxpayers more control over government by permitting them to escape taxation by reducing their purchases of heavily-taxed items. Altering one's consumption patterns in this way would be a way of "protesting" against excessive government spending.

Buchanan's subjectivist cost theory has colored his views of many economic phenomena besides tax incidence. For example, in criticizing benefit/cost studies of governmental programs, Buchanan reminds us that the costs that are discussed in such studies are not choice-influencing costs. Thus, their usefulness is limited at best, and misguided at worst.

In real-world political settings, the costs that influence the choice calculus of an individual voter are his or her own personal share in the costs of government in terms of the alternatives foregone. *The distribution* of taxes certainly makes a difference in the evaluation of governmental programs, but this is ignored by benefit/cost studies.

[17]Richard E. Wagner, "Normative and Positive Foundations of Tax Reform," *Cato Journal* (Fall 1985): 386 and 388.

[18]James Buchanan and Geoffrey Brennan, *The Power to Tax* (New York: Cambridge University Press, 1980).

Subjective Cost, Public Choice, and Fiscal Institutions

Buchanan's subjectivist roots have also led him to the conclusion that "institutions matter." This may sound simplistic, but to many economists the notion that the means of making choices influence the choices themselves may imply irrational behavior. Buchanan has ignored this criticism, however, and has demonstrated throughout his career how the institutions of fiscal choice *do* matter because they influence public choices.

As Buchanan and Wagner have written, "individual choice behavior is affected by the costs and benefits of choice alternatives as these are perceived by the chooser, and not as they may exist in some objective dimension necessarily measurable by third parties."[19] Furthermore, "different tax institutions will exert differing effects on the individual's perception of his share in the costs of public services. From this, it follows that the form of tax institution, or the tax structure generally, can affect budgetary choices."[20] And, according to Buchanan and Wagner, it is *perceptions* of individuals concerning the differential effects of fiscal institutions that are relevant to public choice.

This type of thinking is at the heart of much of "the new public finance," which Buchanan has had an important role in establishing. One example of this new approach is the literature on "fiscal illusion." According to the so-called fiscal illusion hypothesis, complex and indirect payment structures create a fiscal illusion that will systematically produce higher levels of government spending than those with single-payment structures. In essence, complex and indirect tax structures weaken the cost signals upon which public choices are based.

This notion is similar to the analytical basis of the psychological literature on information processing.[21] In that literature the degree to which any message is understood varies directly with the strength of the particular signal to be received and inversely with the noise present when the signal is transmitted. It is easier, for instance, to hear what someone says in a room that is not crowded and filled with background chatter. The fiscal illusion literature espouses a similar interpretation of economic phenomena.

[19] James Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1976), p. 126.

[20] Ibid.

[21] See Richard E. Wagner, "Revenue Structure, Fiscal Illusion, and Budgetary Choice," *Public Choice* (Spring 1978); and Thomas J. DiLorenzo, "Utility Profits, Fiscal Illusion, and Local Public Expenditures," *Public Choice* (Fall 1981).

Thus, the size of governmental budgets will be directly related to the complexity and indirectness of tax systems. The *perceived* or choice-influencing costs will be lower under indirect than direct taxation, and will be lower under a multiplicity of tax sources than under a system that relies heavily on a single source. Indirect taxation, therefore, is likely to lead to greater budgetary expansion. Casual evidence supports this hypothesis, as does a body of economic research.[22]

Nevertheless, "orthodox" public finance theorists have largely neglected the theory of fiscal illusion. A reason for this neglect, according to Buchanan and Wagner, is that the orthodox theory "defines rational behavior in terms of objectifiable magnitudes and, furthermore, embodies the hypothesis that ... persons do not systematically err. The subjectively determined perceptions of persons ... have been neglected."[23] Not all economists, however, have ignored subjectively determined perceptions, such as those embodied in the fiscal illusion literature. "The ... Austrian School of economists, along with a more specialized tradition in cost theory centering on the London School of Economics in the 1930s, provide notable exceptions."[24]

The theory of fiscal illusion has led to a greater understanding of the effects of alternative tax systems. For example, one reason the inflation tax is so pernicious is because it reduces the *perceived* cost of government. Debt-financed budget deficits are also better understood once one incorporates a subjectivist view of cost. Buchanan's decades-long research on the public debt demonstrates as much as anything the importance of Austrian-school insights to his contributions to economic theory.

Buchanan and the Public Debt Controversy

Buchanan has been involved in the public debt controversy for over 30 years. He never accepted the dreamy world of Keynesian interventionism, wherein a benevolent government, faithfully obeying the academic economic sages, could "stimulate" the economy through deficit spending. Nor has he accepted the technocratic world of Robert Barro and other believers in the Ricardian "equivalence theorem," which holds that there is no fundamental difference between debt and tax finance. Buchanan has long maintained that federal deficit spending is destructive, for it crowds out private spending and imposes burdens on future generations.

[22]Ibid.

[23]Buchanan and Wager, *Democracy in Deficit*, p. 130.

[24]Ibid.

The reason why Buchanan has differed from these schools of thought, on the issue of deficit finance, is his insistence that "institutions matter," which is deduced from his subjectivist cost theory. Deficit spending allows the governmental sector to replace or crowd out private spending because,

> the replacement of current tax financing by government borrowing has the effect of reducing the "perceived price" of governmental goods and services. This "relative price" change embodies an income effect of the orthodox Hicksian sort, and this income effect will generate some attempted increase in the rate of private spending. ... To the extent that the costs of governmental goods and services are perceived to be lowered by any degree through the substitution of debt for tax finance, the "relative" price change will be present.[25]

Furthermore, the reason why deficit spending leads to governmental expansion is that in response to a reduction in the perceived price of publicly-provided goods and services, taxpayers "increase their demands for such goods and services. Preferred budget levels will be higher, and these preferences will be sensed by politicians and translated into political outcomes."[26]

Money Creation and Subjective Cost Theory

Buchanan's views of the inflation tax are also colored by subjectivist insights. Much has been written about how inflation effectively constitutes a "tax" on privately-held wealth. But inflation is not really equivalent to a tax, because "no explicit political discussion and decision takes place on either the source or the rate of tax to be imposed."[27] Consequently, "individual citizens are likely to be less informed about the probable costs of an inflation tax than they are about even the most indirect and complex [tax] levy."[28]

Once again, choice-influencing costs are altered by real-world fiscal institutions. But in this instance, the consequences are perhaps even worse than with deficit finance. The problem is that:

> the tax signal under inflation is overwhelmed by the accompanying noise which takes the form of rising prices. ... Psychologically, individuals do not sense inflation to be a tax on their money balances; they do not attribute the diminution of their real wealth to the legalized "counterfeiting" activities of government. Rather, the sense data take the form of rising prices for goods and services purchased in the private sector. The decline in real wealth is attributed to

[25]Buchanan and Wagner, *Democracy in Deficit*, p. 138.
[26]Ibid., p. 139.
[27]Ibid., p. 142.
[28]Ibid.

> failings in the market economy, not to governmental money creation. ... Inflationary finance, then, will generally produce an underestimation of the opportunity cost of public services, in addition to promoting a false attribution in the minds of citizens as to the reason for the decline in their real wealth, a false attribution that nonetheless influences the specific character of public policies.[29]

The so-called inflation tax is pernicious not only because it is a hidden tax on privately-held wealth, but also because it leads to false perceptions of the cause of the inflation. Political demagoguery adds to the confusion, as politicians are naturally inclined to lie to the public and blame the inflation on greedy capitalists, farmers, mortgage bankers, and others in the private sector. The proposed solution is typically to place even more power in the hands of the inflation-generating governmental authorities.

Methodological Individualism and the Market Process

A rigorous application of methodological individualism is perhaps what most separates the Austrian and Public Choice schools from most others. The idea that the individual should be the unit of analysis has spared public choice and Austrian economists from many of the mistakes of what might be called collectivist economics. The Austrians, for example, have exposed a great deal of macroeconomic nonsense due to the fact that Keynesian theory largely ignored aggregation problems. The Austrian conception of markets, based on the interaction among individuals and on man's inherent "propensity to truck, barter and exchange," is also more useful and informative, in my view, than the perfect competition model.

Buchanan and other public choice theorists have greatly improved our understanding of the political process by scrapping the "organic" view of collective action, which describes government, more or less, as a benevolent despot, making decisions that are assumed to be in "the public interest."

Not so long ago, in 1968, Buchanan remarked:

> Most ... economists take an approach different from my own, and one that I regard as both confused and wrong. In my vision of social order, individual persons are the basic component units, and "government" is simply that complex of institutions through which individuals make collective decisions, and through which they carry out collective as opposed to private activities. Politics is the activity of persons in the context of such institutions.[30]

[29]Ibid., p. 143.

[30]James Buchanan, "An Economists's Approach to Scientific Politics," in M. Parsons, ed., *Perspectives in the Study of Politics* (Chicago: Rand McNally, 1968), p. 78.

Of course, the economics profession has changed significantly since then, particularly in light of the public choice revolution. Methodological individualism has replaced more collectivist views in academic circles.

Nevertheless, it is far from clear that there has been a decisive "victory." Social welfare functions still clutter the economics journals. Moreover, there is no shortage of recommendations for government intervention in the name of the mythical "public interest." Proponents of methodological individualism have made great strides, but the collectivist mind set dies a slow death.

Buchanan has also long been considered a proponent of the Austrian view of the market process. In this regard he is more than just a "fellow traveller"; his work has played an important role in helping to distinguish between the theory of the market as a process and the alternative, neoclassical theory of competitive equilibrium. Thus, in addition to his seminal work on subjective cost theory, Buchanan has helped clarify the Austrian view of the market as a process.

In his 1963 presidential address to the Southern Economic Association, Buchanan explained how the economics profession was apparently being led astray by its focus on the "theory of resource allocation." He forcefully argued that the standard neoclassical definition of economics as the study of the allocation of scarce means among competing ends "has served to retard, rather than advance, scientific progress."[31] The reason for this, according to Buchanan, is that there is very little economic content in much of modern economics. What neoclassical economics, all too often involves is a computation problem, the computation of equilibrium prices, for example, which "to the subjectivist, [seems] an absurd exercise."[32]

A good example is the work of Nobel Laureate Tjalling Koopmans, who began his career by working out the optimal allocation of a set of tankers carrying oil across the Atlantic during World War II. Buchanan properly labels such work as engineering, not economics, and claims that he must have been "a confirmed subjectivist long before I realized what I was because I recall thinking in 1946, when Koopmans was lecturing ... at the University of Chicago, that there seemed to be absolutely no economic content in what he was doing ..."[33]

[31]James Buchanan, "What Should Economists Do?" *Southern Economic Journal* (January 1964): 213-22.

[32]James Buchanan, "General Implications of Subjectivism in Economics," in Geoffrey Brennan and Robert D. Tollison, eds., *What Should Economists Do?* (Indianapolis, Ind.: Liberty Press, 1979), p. 85.

[33]Ibid.

Buchanan has attempted to persuade the economics profession to abandon its fixation on allocation problems per se, for "if there is really nothing more to economics than this, we had as well turn it all over to the applied mathematicians."[34] This does appear to be the direction the profession has been heading, for "developments of note ... during the past two decades consist largely of improvements in ... computing techniques, in the mathematics of social engineering."[35]

Instead of becoming weakly-trained mathematicians (at least by the standards of professional mathematicians), Buchanan suggested replacing the theory of resource allocation with the theory of markets. This would require paying more attention to

> a particular form of human activity, and upon the various institutional arrangements that arise as a result of this form of activity. [Namely,] man's behavior in the market relationship, reflecting the propensity to truck and to barter, and the manifold variations in structure that this relationship can take.[36]

These, Buchanan has written, are the proper subjects of economics.

This approach helps us understand why, in perfect competition, there is no competition (or any trade, for that matter). It also reveals how a market is not competitive by definition, as in the neoclassical model, but that a market *becomes* competitive. "It is this becoming process, brought about by the continuous pressure of human behavior in exchange, that is the central part of our discipline, ... not the dry rot of postulated perfection."[37]

Thus, Buchanan's view of the market system may properly be labeled Austrian. Furthermore, he has urged us to apply this same notion of the economic process to the study of political institutions. This is why public choice theory is largely a study of political *processes*, with policy recommendations usually focusing on altering institutional processes, rather than political outcomes or end states.

The Importance of Austrian Economics to Public Choice

Buchanan has done seminal work in many areas of economics, but his Nobel Prize was awarded primarily for his role in establishing, with Gordon Tullock, the subdiscipline of public choice. As this paper has shown, many of the essential principles of public choice (and of "the new public finance") have subjectivist or Austrian roots. This fact doesn't seem to have been sufficiently appreciated by the economics

[34] James Buchanan, "What Should Economists Do?" p. 217.
[35] Ibid.
[36] Ibid.
[37] Buchanan, *Cost and Choice*, p. 83.

profession, however, for a number of reasons.

One possible reason, Buchanan writes in *Cost and Choice*, is that "it is not easy to question long-accepted precepts." He further confessed that he has "found it difficult to prevent the analysis [in *Cost and Choice*] from lapsing into the kind of conventional [neoclassical] methodology that I have often used in other works."[38] Moreover, many economists may balk at seriously considering the impact of subjectivist insights, writes Buchanan, because "in effect, the incorporation of the London [or Austrian] conception of opportunity cost amounts to transforming one of the foundation stones of economic theory. [However,] only when this basic modification is completed can real progress toward changing the superstructure [of economics] be attempted on a large scale."[39]

The public choice revolution provides supportive evidence for this conjecture, since many insights in public choice have subjectivist or Austrian roots. However, there are many instances where the public choice revolution has taken a step backward, in my view, because of insufficient attention paid to these roots. One should not be overly critical of public choice economists, however, for in a recent article Buchanan himself seems to have forgotten his subjectivist roots, thereby walking into a theoretical and public policy mine field.

In a paper entitled "Rent Seeking, Noncompensated Transfers, and Laws of Succession,"[40] Buchanan analyzes the supposed inefficiencies generated whenever potential heirs "compete" for an inheritance. The basic hypothesis is that the "investment of effort, time, and resources in this rent-seeking activity will be socially wasteful."[41] The behavior of children, as potential heirs, is assumed to be analytically identical to the behavior of lobbyists for protectionism, price supports, and all other sorts of government-generated monopoly rents. "To ... potential recipients [of a bequest]," writes Buchanan, "any such value becomes precisely analogous to a rental opportunity that has been artificially created. The frugal rich man whose fortune must be transferred by gifts or bequests stands ... in precisely the same relationship as Queen Elizabeth before her courtiers when she announced the possible assignment of a playing-card monopoly."[42]

[38]Ibid.

[39]Ibid.

[40]James Buchanan, "Rent Seeking, Noncompensated Transfers, and Laws of Succession," *Journal of Law and Economics* (April 1983): 71-85. For another critical look at Buchanan's work from an Austrian perspective see Peter J. Boettke, "Virginia Political Economy: A View From Vienna," *Market Process* (Fall 1987): 7-15, published by the Center for the Study of Market Processes, George Mason University, Fairfax, Va.

[41]Ibid., p. 74.

[42]Ibid., p. 83.

This logic led Buchanan to recommend governmentally-imposed restrictions on the disposition of inheritances, for "once the probable emergence of wasteful rent seeking is acknowledged ... the efficiency basis for the argument against any and all [government] restrictions on the transfer power [of individuals] vanishes."[43]

Ironically, this argument appears to have much in common with the type of reasoning that Buchanan so effectively criticized in *Cost and Choice*. Specifically, he assumes that benefits and costs are *objective* in order to conclude that "all noncompensated transfers are rents to the recipients."[44]

Gifts and bequests are labeled "noncompensated transfers" in Buchanan's analysis because there is no objectively measurable "payment" for these "transfers." But surely such gifts involve implicit, mutually-advantageous exchanges. In the case at hand, there is an exchange of tangible wealth for psychic income. Altruistic behavior toward the donor is "exchanged" for a more tangible form of wealth. Since such exchanges have persisted for millennia, it is reasonable to assume that there must be "gains from trade" to the participants.

This latter interpretation is consistent with the subjectivist principles Buchanan has advocated throughout his career. But in a bizarre repudiation of those principles—at least in this particular paper—Buchanan chooses to ignore them. "To the extent that gifts and bequests are literally payments for equal values received in exchange ... there is no net transfer of value among persons involved and there is no incentive for the emergence of rent-seeking behavior. Hence, for purposes of the analysis in this paper, fully compensated transfers of value can be neglected."[45]

By ignoring this elementary subjectivist insight for the sake of argument, Buchanan renders his case for governmental controls of inheritance untenable. His case is based on neoclassical notions of efficiency, namely, that such "rent seeking" is "socially wasteful." But as he also stated in an earlier work, since individuals base choices on data that are inherently subjective, the economist can identify waste in the actions of other people only by imposing his own standard of value.[46] And this is what Buchanan appears to be doing in this essay. Such work can only impede the public choice "revolution," however, by lending credence to public choice critics who claim that much of public choice

[43]Ibid., p. 76.
[44]Ibid., p. 71.
[45]Ibid., p. 72.
[46]James Buchanan, "Is Economics the Science of Choice?" in Brennan and Tollison, ed., *What Should Economists Do?*, p. 61.

is simply a political crusade "masquerading as science."[47]

A second example of how ignoring subjectivist or Austrian insights has impeded research in public choice is a contradiction in the work of Robert Tollison, one of Buchanan's most prolific students. Following Buchanan's advice on viewing the market as a process, rather than as an equilibrium condition, Tollison has written that:

> when competition is viewed as a dynamic, value-creating, evolutionary process, the role of economic rents in stimulating entrepreneurial decisions and in prompting an efficient allocation of resources is crucial. ... [P]rofit seeking in a competitive market order is a normal feature of economic life. The returns of resource owners will be driven to normal levels ... by competitive profit seeking as some resource owners earn positive rents which promote entry and others earn negative rents which cause exit. Profit seeking and economic rents are inherently related to the efficiency of the competitive market process. Such activities drive the competitive price system and create value (e.g., new products) in the economy.[48]

But a few pages along in the same article Tollison condemns as "wasteful rent seeking" all forms of non-price competition "in imperfectly competitive markets." The contradiction lies in the fact that if one views competition as a "dynamic, value-creating, evolutionary process," as Tollison initially suggested, then the forms of non-price competition that he labeled wasteful—advertising, R&D spending, product differentiation—are viewed as an essential ingredient of the competitive process, not as wasteful rent-seeking or monopolizing devices.[49]

There is now an emerging literature in public choice that labels almost all forms of private business behavior as "wasteful rent seeking."[50] Oddly, much of this literature recommends government regulation as a means of reducing such waste. But surely, granting even greater powers to government will lead to more, not less, rent seeking.

I have written elsewhere[51] how such bizarre reasoning has come

[47]For an elaboration of this point see Thomas J. DiLorenzo, "Property Rights, Information Costs, and the Economics of Rent Seeking," *Journal of Institutional and Theoretical Economics* (Spring 1988).

[48]Robert D. Tollison, "Rent Seeking: A Survey," *Kyklos* 35 (1982): 577.

[49]See Stephen C. Littlechild, "Misleading Calculations of the Social Costs of Monopoly Power," *Economic Journal* (June 1981): 348-63; and Thomas J. DiLorenzo, "The Domain of Rent-Seeking Behavior: Private or Public Choice?" *International Review of Law and Economics* (December 1984): 185-97.

[50]Don Boudreaux and Thomas J. DiLorenzo, "A Critique of the Economics of Raising Rivals' Costs," unpubl. ms., Department. of Economics, George Mason University.

[51]Thomas J. DiLorenzo, "Competition and Political Entrepreneurship: Austrian Insights Into Public Choice Theory," *Review of Austrian Economics* 2 (1987): 59-72.

about, at least partly, because of the failure of public choice economists to pay sufficient attention to the fundamental Austrian concepts of subjectivism, methodological individualism, and the concept of the market as a dynamic process. This is why students of public choice, above all, should more fully appreciate the subjectivist roots of James Buchanan's economics.

Finally, it is worth repeating that I have not attempted a comprehensive review of the impact of Austrian economics on the work of James Buchanan. Such an undertaking would require at least a book-length treatment. My only objective has been to point out a relatively neglected aspect of at least some of Buchanan's work, namely, its subjectivist roots.

Subjective cost theory is not at the heart of all of Buchanan's work; perhaps not even most of it. At times his writing seems strictly positivist. But a case can be made that many of his most important contributions to economics may be properly labeled "Austrian." Moreover, an equally strong case can be made that the work of Buchanan, and of other public choice scholars, is weakest when it neglects fundamental Austrian-school insights.