Abstract

The customary Anglo-Saxon approach to public finance treats the state as exogenous to the economic process, which restricts public finance to the study of market-based reactions to exogenous fiscal impositions. In contrast, Buchanan has cultivated an approach to public finance that incorporates the state into the economic process. The domain of fiscal analysis is thus expanded in two directions. One direction, public choice, involves the study of the effect of political institutions on collective choices. The other direction, constitutional political economy, involves the emergence of and changes in political institutions.

James M. Buchanan was awarded the 1986 Nobel Memorial Prize in Economic Science for his seminal role in developing “the contractual and constitutional bases for the theory of economic and political decision-making.”

Buchanan spent his boyhood in rural Tennessee near Murfreesboro. After receiving Bachelor’s and Master’s degrees from Middle Tennessee State College and the University of Tennessee respectively, he entered the U. S. Navy in 1941. After completing his naval service in the Pacific, Buchanan enrolled at the University of Chicago in 1946, receiving his Ph. D. in 1948. He has spent the preponderance of his academic career at three Virginia universities: the University of Virginia (1956-68), Virginia Polytechnic Institute (1969-83), and
George Mason University (since 1983). Buchanan has been a truly prolific scholar throughout this period, as shown by the 20 volumes it took for Liberty Fund to publish his collected works; moreover, he has continued his scholarly work at full speed since the completion of that collection in 2001.

The Nobel citation quoted above identifies two predominant strains within Buchanan’s scholarly oeuvre. One of these is the theory of public choice, which entails the application of economic theorizing to politics. The other is constitutional political economy, which explores the relationship between constitutional rules and political outcomes. While Buchanan’s body of work also contains numerous contributions to economic theory and methodology, and which by themselves would have constituted a significant scholarly career, this short essay will focus exclusively on Buchanan’s approach to public choice and constitutional political economy.

**Precursory Influences**

While Buchanan has been creative as well as prolific, he has nonetheless been inspired by and has built upon the contributions of others. Buchanan has acknowledged these precursory influences numerous times, particularly in his autobiographical *Better than Plowing* where he identifies three sources of primary influence on his work.

The primary precursors to Buchanan’s public choice theorizing were a set of Italian scholars, among who were Antonio De Viti De Marco, Maffeo Pantaleoni, and Luigi Einaudi, who developed a unique orientation toward public
finance between the 1880s and the 1930s. Where Anglo-Saxon scholars treated
the state as outside the economy, the Italians sought to incorporate political
outcomes into the economic process. For instance, much Anglo-Saxon fiscal
scholarship sought to develop norms regarding the desirable degree of tax
progressivity, as illustrated by various sacrifice theories of taxation. By contrast,
the Italians sought to explain the actual structure of taxation independently of
normative concern, and to do so with reference to the same categories of utility
and cost as they invoked to explain market outcomes. This Italian orientation of
sober realism toward political processes was central to the later development of
public choice theorizing. For instance, in his Forward to the German translation
of Amilcare Puviani’s 1903 treatise on fiscal illusion, Teoria della illusione
finanziaria, Gunter Schmölders observed that “over the last century Italian public
finance has had an essentially political science character. . . . This work
[Puviani] is a typical product of Italian public finance . . . . Above all, it is the
science of public finance combined with fiscal politics, in many places giving a
good fit with reality.” The Italians were thoroughgoing realists and not romantic
idealists, and it was a short distance from their initial formulations to what
subsequently became known as public choice.

The sober realism of the Italians implied, in keeping with the general
equilibrium theorizing of the time, that actual fiscal outcomes were to be
explained as equilibrium outcomes. If so, it might seem as though fiscal
theorizing offered no coherent vantage point from which to pursue any program
of fiscal reform. Yet Buchanan has always sought to use fiscal knowledge as an
instrument of fiscal reform. It was Knut Wicksell who provided Buchanan the
vehicle for combining his sober realism with his interest in reform. Buchanan's
constitutional emphasis can be traced to the second of Wicksell’s three essays in
Finanztheoretische Untersuchungen, which Buchanan translated as “A New
Richard Musgrave and Alan Peacock. From Wicksell, Buchanan derived two
themes that informed his work thereafter. One theme was the treatment of
unanimous consent and not majority approval as the normative benchmark for
appraising political outcomes. The other theme was a distinction between
constitutional politics, where institutional rules are selected, and post-
constitutional politics, where particular outcomes emerge. Wicksell’s treatment of
two distinct levels of political activity led to Buchanan’s articulation of a
constitutional political economy, wherein political reform was a matter of
changing the rules that govern the game, as distinct from changing the strategies
of play within a game.

While Wicksell and the Italians cover the two themes mentioned in
Buchanan’s Nobel citation, any mention of precursory influences would be remiss
without including Frank Knight, whom Buchanan initially encountered during his
student days at the University of Chicago. Knight’s influence on Buchanan is not
so much one of particular ideas as of general attitude and orientation toward a
scholar’s life and work. From Knight, Buchanan carried forward the belief that no
doctrine or authority should be treated as sacrosanct and above challenge.
Everyone else may say that something is true, but this doesn’t mean they are
right; there may be many pretentious emperors walking around naked.

Buchanan’s work has also demonstrated the same multi-disciplinary character that was prominent in Knight’s work. For Buchanan, as for Knight, economic theorizing was not self-contained, but had points of contact throughout the humane studies, which led to a style of theorizing wherein Buchanan, as Knight, continually makes contact with such related fields of inquiry as law, ethics, history, philosophy, and politics.

**From Italian Public Finance to Public Choice**

The Italianate approach to public finance treated the state as an entity whose actions conformed to the same principles of marginal utility as the actions of other economic participants. The Italians did not seek to advance statements concerning how large the state should be in order to promote some vision of social welfare. They sought instead to offer coherent explanations about the actual size of the state. At the level of formal analysis, this meant that the state would expand until the marginal utility from state-provided services equaled the marginal utility from market-supplied services. To be sure, the Italians recognized the numerous problems of aggregation that were involved in making such statements. In response, they developed a variety of models regarding just whose utility was driving the equilibrium. Where some models treated the state as a cooperative enterprise that worked to the benefit of all, others treated the state as an entity that promoted the advantage of ruling classes. In any case, it
was a small step from the Italian fiscal theorizing to the public choice theorizing that began to take shape in the 1960s, as elaborated in Richard Wagner (2003).

Perhaps the best place to see the Italianate influence on public choice is Buchanan’s 1967 treatise *Public Finance in Democratic Process*, which was written at a time when public choice was not yet a term of scholarly identification. Buchanan starts that book by noting the narrow and limited scope of Anglo-Saxon approaches to public finance, wherein public finance is concerned only with explaining market-based reactions to exogenously imposed taxes and expenditures. On the tax side of the budget, for instance, a progressive income tax with several brackets of rising marginal rates might be replaced by a degressive tax where a single marginal rate is imposed above some initial exemption. The task of the fiscal scholar would be to explain the impact of such an exogenous tax shift on such things as the amount of labor people supply, the amount of underground economic activity they undertake, and the amount of taxable income they earn. Alternatively, on the expenditure side of the budget, an appropriation might be made to finance a highway. The task of fiscal analysis would be to analyze the market-based reactions to the highway. For instance, land rents near highway exits might rise, due to the reduction in travel time that resulted. Whatever the particular topic examined, the analytical task of Anglo-Saxon public finance has everything to do with explaining market-based reactions to exogenously imposed fiscal measures and has nothing to do with explaining state budgets and fiscal institutions.
In treating state budgets as exogenous to fiscal inquiry, the Anglo-Saxon orientation toward public finance ignored two large areas of possible inquiry, both of which Buchanan explores in *Public Finance in Democratic Process*. One ignored area is the ability of fiscal institutions to influence budgetary outcomes and not just market outcomes. This topic occupies the first part of *Public Finance in Democratic Process*, and the analyses presented there were early illustrations of public choice theorizing. The second ignored area is the choice or emergence of fiscal institutions. This topic occupies the second part of *Public Finance in Democratic Process*, and the analyses presented there were harbingers to subsequent work in constitutional political economy.

Buchanan gives several illustrations in *Public Finance in Democratic Process* of how fiscal institutions and arrangements might influence fiscal outcomes, of which I shall mention three. First, Buchanan examines the possible budgetary consequences of a choice between general-fund financing and tax earmarking. Under the former practice, tax revenues accrue to a general fund from which various appropriations are made; under the latter practice, specific taxes are earmarked to finance particular services. Buchanan suggests that general-fund financing is a form of tie-in sale that might bring about a budgetary shift in favor of services in relatively elastic demand.

Second, Buchanan examines the possible budgetary consequences of the withholding of income taxes. His analysis in this case is related to claims about fiscal illusion or perception. Buchanan argues that individual perceptions about the costliness of public output depend on the manner in which tax extractions are
made. Perhaps the most open and direct manner of paying for public output would be for people to write monthly checks to government, just as they pay their utility bills. Buchanan explores the possibility that withholding may create some tendency for individuals to perceive the costliness of government to be less than it would otherwise be, which should in turn lead to some increase in the size of government.

Third, Buchanan examines the effect of public debt on budgetary outcomes, a topic that he initially explored in *Public Principles of Public Debt* and to which he returned in *Democracy in Deficit* (co-authored with Richard Wagner). The principle of Ricardian equivalence holds that tax finance and debt finance are identical. In the aggregate, this is true as a simple matter of double-entry accounting. If $1 million of tax revenue is replaced by public borrowing, the present value of the future payments necessary to service the debt will equal the tax reduction. However, the collectivity does not act as a unit, so a statement about aggregate equivalence is irrelevant for any effort to explain fiscal conduct. What matters for collective action is the direction of individual desires as these are mediated through political and fiscal institutions. For instance, people in higher age ranges will find debt to be less costly than taxation, increasingly so with age. Compare a tax of $1,000 now with a perpetual debt that entails payments of $100 when the appropriate discount rate is ten percent. In terms of perpetuity, the debt and the tax are equivalent. For a younger person who might look forward to 50 taxpaying years, the present value of the debt is $991. For an
older person who might have but ten years of tax paying life expectancy left, the present value of the debt is but $614.

To be sure, it could be claimed that the older person has some bequest motivation toward heirs. If so, that older person would treat the debt obligation as continuing beyond his life. But not all older people have heirs. And of those that do, not all of them seem to have the types of bequest motives that generate Ricardian equivalence. This point gets to another significant feature of Buchanan's thought: his unwillingness to make statements based on aggregates without exploring the underlying structural patterns to which those aggregates pertain. After all, aggregates are not entities that act, and in Buchanan's approach collective action must be generated out of choices by discernable, acting individuals, as these choices are mediated through institutional frameworks for making collective choices.

The literature on public choice has, of course, exploded since 1967, with entrées to this literature provided by such compendia as Mueller (1997), Rowley and Schneider (2004), and Shughart and Razzolini (2001). A good deal of that literature has carried forward the effort of Buchanan and his Italian forebears to articulate the impact of political institutions on collective outcomes.

**From Wicksell to Constitutional Political Economy**

Where public choice examines the impact of political and fiscal institutions on collective outcomes, constitutional political economy examines the impact of constitutional rules on post-constitutional outcomes. The seminal statement of
constitutional political economy is the *Calculus of Consent* (co-authored with Gordon Tullock), which the authors described as simply an elaboration with economic logic of the American constitutional framework of 1789. According to that framework, government is established by the consent of the governed, which provides unanimity as the conceptual starting point, just as it did for Wicksell (Wagner (1988) explores the relationship between Wicksell and the *Calculus of Consent*). While unanimity is the conceptual starting point, any effort actually to implement unanimity will confront free riders and strategic holdouts. If everyone’s consent is required to undertake collective action, some people will be tempted to withhold their consent, not because they object to the action but because they are acting strategically to shift the fiscal terms of the action in their favor. Such strategic efforts at securing distributional gain can sabotage projects that are genuinely beneficial to all. Consequently, people may reasonably agree to be bound by something less than unanimous consent.

Buchanan and Tullock conceptualized a trade-off between decision costs and external costs, as these are viewed from the perspective of participants in collective choice. Decision costs are the costs people bear in trying to reach a collective decision. The greater the degree of consent required, the higher will be those costs due to such things as free riding and strategic bargaining. External costs are the costs that individuals bear when collective choices run contrary to their desires. These costs will fall with increases in the degree of consent required to take to collective action, and will vanish when unanimity is required. An optimal voting rule, formally speaking, will result when the sum of
those costs is minimized. With this analytical construction, Buchanan and Tullock provided a rationalization for Knut Wicksell’s support for some super-majority rule within a parliamentary assembly, as illustrated by references to three-quarters and four-fifths consent.

A voting rule is a simple scalar. Actual constitutional frameworks for collective choice contain a vector of characteristics, and to some extent those other characteristics can substitute for greater inclusivity in the degree of consent required. For instance, a representative assembly that is bicameral can achieve a greater degree of consensus with a less inclusive voting rule than would be possible within a unicameral assembly. Legislative action, moreover, can be filtered in various fashions through different parliamentary rules. There are many margins along which political and fiscal institutions can be modified, and with post-constitutional politics adapting to whatever constitutional framework is in place.

There are two levels of analysis in Buchanan’s analytical schema: constitutional and post-constitutional. Post-constitutional politics, public choice, represents the working out of interactions among political participants within the context of some particular institutional arrangement. Constitutional politics concerns the selection among possible institutional arrangements. Buchanan’s distinction between constitutional and post-constitutional politics calls forth the distinction between choosing the rules of a game and choosing strategies by which to play a game. For Buchanan, reform is a constitutional and not a post-constitutional matter.
Consider, for instance, his approach to progressive income taxation. Where the Anglo-Saxon sacrifice theorists sought to specify the degree of progressivity that some exogenous authority should impose on a society, Buchanan sought to probe the circumstances under which people might choose to employ progressivity in taxing themselves. In several places, he explores the conditions under which people might support progressive income taxation as a form of income insurance. Progressive taxation allows people to achieve some smoothing of consumption in the presence of fluctuating income, as compared with proportional taxation. The purchase of insurance, after all, is a constitutional and not a post-constitutional activity: people purchase insurance before they have had accidents and not after. To the extent such formulations have merit, what appears to be redistribution when seen from an ex post perspective might represent mutual gains from trade when viewed from an ex ante, constitutional perspective.

Alternatively, consider the treatment of broad-based taxation in Buchanan and Congleton (1998). Without a constitutional requirement of uniformity in taxation, post-constitutional politics will generate increasingly complex revenue systems as tax favors are granted or removed within the political marketplace. While the resulting narrowing of the tax base imposes excess burdens on market participants, it also warps processes of collective choice. For instance, those who are favored by the resulting fiscal discrimination will support more collective activity than they would otherwise support. With the continual churning of the tax
code that results, however, most participants may end up worse off than they would have been under a simple system of tax uniformity.

**Buchanan’s Legacy**

Until the late-1930s there was a flourishing continental orientation toward public finance that stood in contrast to the Anglo-Saxon orientation, and pretty much along the lines articulated by Buchanan in *Public Finance in Democratic Process* (this thesis is elaborated in Backhaus and Wagner (forthcoming)). Within this orientation, public finance was a multidisciplinary field of study, with a home in economics but with tentacles that reach out into such fields as politics, law, and public administration. Buchanan has carried forward the continental approach to public finance, and has given it new life through his many creative works.
Selected Works


Bibliography


Richard E. Wagner

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