Public Choice: The Virginia School

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Abstract
Public Choice, broadly defined, is the economic analysis of nonmarket decision-making. My primary focus in this chapter will be on the central importance of the “Virginia School” of Public Choice, specifically in two aspects. First, Public Choice was central to countering the presumption of market failure among economists, beginning in the 1950s and 1960s. Second, yet less emphasized, is the role in which Public Choice played in analyzing the economics of anarchy, beginning in the 1970s. Although seemingly disconnected, both aspects of the Virginia School are linked by the fundamental question of political economy: Under what institutional conditions can social order emerge unintendedly from the self-interest of individuals? Therefore, in both respects, the Virginia School has been central to the rearticulation of 19th political economy during the twentieth and twenty-first centuries.

Introduction
Public Choice, broadly defined, is the economic analysis of nonmarket decision-making. More specifically, James Buchanan, who cofounded the field of Public Choice with Gordon Tullock, referred to Public Choice as “politics without romance” (Buchanan 1979). Public Choice first emerged as a discipline within the broader tradition of political economy at the Thomas Jefferson Center for Studies in Political Economy at the University of Virginia (UVA), which Buchanan co-founded in 1957 together with G. Warren Nutter. Since then, several other branches of Public Choice have emerged. These include the “Bloomington School” of Vincent and Elinor Ostrom; the “Chicago School” developed by Gary Becker, Sam Peltzman, and George Stigler; and the “Rochester School” of William Riker. To compare and contrast each of these branches of Public Choice, let along provide a comprehensive survey of the entire field, goes beyond the scope of this entry (see Mitchell 1988 and Mueller 1976).

My primary focus in this chapter will be on the central importance of the “Virginia School” of Public Choice, specifically in two aspects. First, more than any other branch of public choice, its explicit motivation “is the rejection of all of the
pillars of the Samuelsonian revolution” (Boettke and Marciano 2015: 54), which had begun to emphasize the tendency for markets to be a suboptimal mechanism of resource allocation. By applying the logic of economic decision-making to political settings, Public Choice economists countered the Samuelsonian presumption of market failure by pointing out that governments may also be suboptimal in their attempt to address market failures. Second, yet less emphasized, is the role in which Public Choice played in analyzing the economics of anarchy. Beginning in the 1970s, the Virginia School began to analyze the mechanisms by which institutions can emerge to define and enforce property rights and contractual arrangements without government. This has led to a flowering of theoretical and historical case studies providing evidence of social cooperation without government.

At first glance, these two aspects of the Virginia School seem to be disconnected. However, both the study of government failure and anarchy are flips sides of the same question grounding political economy: Under what institutional conditions can social order emerge unintentionally from the self-interest of individuals? Therefore, in both respects, the Virginia School has been central to the rearticulation of 19th political economy during the twentieth and twenty-first centuries. In both the study of government failure and anarchy, the uniqueness of the Virginia School has been its ability to “marry the property-rights, law-and-economics, public-choice, Austrian subjectivist approaches” of economics (Buchanan 2015: 260). For the remainder of this chapter, I will trace out the origins and contributions of the Virginia School to the broader tradition of political economy.

A Brief Overview of the Virginia School

The origins of Public Choice can be traced back to Adam Smith and the classical political economists of the nineteenth century. What all branches of Public Choice, in particular the Virginia School, shared with classical political economy is their comparative analysis of alternative processes of decision-making and their respective results under alternative institutional arrangements, particularly between market and nonmarket institutional settings. Public Choice, and the Virginia School in particular, bases its analysis of political decision-making on three basic assumptions: (1) rational choice; (2) methodological individualism; and (3) politics as an exchange process.

To say that individuals choose rationally implies simply the following: When an individual faces a set of alternatives, he or she will choose the alternative they expect to give them the greatest satisfaction. In other words, the pursuit of one’s rational self-interest implies simply that individuals choose more rather than less of whatever they prefer, or that the individual strives to maximize utility. Moreover, Public Choice assumes behavioral symmetry, meaning that individuals are utility maximizers in both market and political settings; the only difference between market and political actors is the manner in which utility-maximizing behavior manifests itself. For example, in the marketplace, firm owners strive to maximize monetary profit, but in nonprofit setting, such as politics, there are four groups of decision-makers, each of which are maximizing utility as well. They include voters and interest groups, who want goods and services from elected officials, politicians (i.e., elected officials), who strive to maximize votes and financial support from interest groups and voters, and bureaucrats, who wish to maximize their budgets from elected officials (Simmons 2011: 52).

Unlike in the market place, where individuals express their preference by “voting” with their dollars for different goods sold simultaneously by competing firms, the same individual in politics must vote on a single, bundled policy, which constitutes many different goods, “sold” to them by political officials they’ve elected. Given the bundled nature of public policy, and its implementation, voters will be rationally ignorant, given the high costs of gathering information about the different “goods” in a policy bundle, which may include defense, health care, import tariffs, etc. Moreover, the bundle nature of public policy also implies that individuals will prefer different “goods” within the bundle with different
intensities. For example, given the concentrated benefit from implementing tariffs on imported sugar, domestic sugar producers will no doubt express greater preference for such a policy, in the form of votes as well as campaign contributions to elected officials, unlike the common voter, who will tend to remain relatively ignorant of such a policy. Therefore, the logic of political decision-making will be for vote-maximizing politicians to concentrate benefits on well-organized and well-informed interest groups, which include budget-maximizing bureaucracies, and disperse costs on unorganized and ill-informed voters. Such a political outcome is rational, once we’ve traced such an outcome back to the choices made by utility-maximizing individuals under a nonmarket setting, where individuals do not bear the full costs and benefits of their decision-making. This brings us to methodological individualism.

By rejecting an organic holistic vision of the state, Public Choice employs methodological individualism, meaning that the outcomes of collective action are traced back to the choices and interactions of rational, utility maximizers. This does not imply that individual preferences can be aggregated into a social welfare function, which the state maximizes on behalf of the electorate. Rather, collective action under a methodologically individualist view will take place if two or more individuals find it mutually beneficial to accomplish certain common purposes jointly with others, rather than separately through bilateral market interactions, an example being the drainage of a mosquito-infested swamp (Buchanan 1964: 219–220). This example reveals that, in the Virginia School, social phenomena are not simply the result of individuals passively responding to constraints.

Unlike in a constrained maximization problem, defined by fixed constraints, Public Choice theorists of the Virginia School direct their analytic attention to choice among constraints, where politics is the artifact of an exchange process, whereby individuals strive to agree to mutually beneficial rules that constrain their behavior in a Pareto-optimal manner. The Virginia School political economists therefore take a constitutional perspective, which focuses on analyzing “the rules of game” that governs political interaction. Relevant political choices, according to the study Constitutional Political Economy, are not choices among alternative distributions or allocations of resources within a set of political rules. Rather, it postulates that relevant political choices are among an alternative set of political rules that generate different patterns of distribution and allocation of resources. Constitutional Political Economy is tied to Public Choice, broadly speaking, in two respects. Assuming rational self-interest on the part of political officials, alternative decision-making rules, such as majority rule or unanimity, will generate different policy outcomes within those sets of rules. For example, requiring more than majority rule for road repair will tend to reduce public expenditure on roads, since more people will have to be included in the political exchange. Increasing the number of individuals as a decision-making rule will consequently increase the cost to the beneficiaries of road repair, and, therefore, low costs will be spilled over and dispersed to parties not agreeing with the exchange. Second, political reform cannot occur by changing the “players” within the political game, but only by changing the rules by which the game is played. It is no accident that the study of Public Choice, and the Virginia School, in particular, emerged when the rule level of analysis began to recede to the background of political and economic analysis.

The birth of the Virginia School cannot be understood outside the historical context it inherited. The Samuelsonian revolution changed the tacit presupposition of economists with regard to the government’s role in a market economy, from a “laissez-faire presumption” to a “market failure presumption” (Boettke and Lesson 2015: xiii–xviii). This presumption can best be understood as epistemological, rather than political or ideological. Under the laissez-faire presumption, the analytical description of the market economy was complemented by a default presumption to limit government’s role in the marketplace, generally speaking, to the protection of private property and contract enforcement. However, under the market failure presumption, economists assume that the presence of macroeconomic instability, monopoly power, externalities, and public goods will merit, by default, government
correction of the market’s allocative process. The distinction here is not simply a presumption of “more government” or “less government,” but fundamentally a presumption of what knowledge government officials possess to correct market failures. Buchanan best states this distinction as follows:

The classical (Smithian) argument for control (or depoliticization) and the welfare economists’ argument for control (for politicization) are on all fours only if we presume the existence of the same underlying evaluative standard in the two cases. To suggest, with the welfare economists, that market failure supports politicization, there must be not only departures from the necessary conditions for efficiency, but also some presumption that political action is informed by a knowledge of what the allocatively efficient solution is, quite apart from the operation of politics itself. By contrast, to suggest, with Adam Smith, that regulatory failure supports market liberalization does not require any presumptive knowledge about what particular outcome is likely to produce maximal value. There is a categorical epistemological difference between the two comparative exercises, a difference that many modern economists still do not understand. (emphasis added, Buchanan 1996 [2001]: 292)

Central to this “market failure presumption” and the Samuelsonian paradigm was the presumed existence of an objective social welfare function, which government officials would maximize by delivering an optimal amount of public goods, eliminating monopoly power and externalities, and establishing macroeconomic stability in the economy through aggregate demand management. From this context, Buchanan, Tullock, and the Virginia School established Public Choice, based on the notion of homo economicus and politics as an exchange process.

**Public Choice and Government Failure**

Beginning in the late 1940s and early 1950s, Public Choice began to counter the presumption of market failure by challenging the existence of an objective social welfare function. In his 1949 article, “The Pure Theory of Government Finance: A Suggested Approach,” Buchanan contrasted between an “organismic” theory of the state and an “individualistic” theory of the state. The basis of this contrast would not only define Buchanan’s intellectual trajectory (Wagner 2017), but also that of Public Choice as well. According to the organismic theory, the state is considered as a single decision-making unit, or “a fiscal brain” as Buchanan puts it, which acts for society as a whole by seeking to maximize “general welfare” or “social utility” (1949: 497). In the individualistic theory of the state, the state embodies no ends other than those of individuals in society, who find it in their self-interest to pursue a certain portion of their wants collectively. The individualistic theory typifies the nature of interaction between individuals and the state as an “exchange” of government services paid out of the economic resources of individuals. The basis of the individualistic theory of the state, and the Public Choice perspective, is an extension of two related aspects from economic theory: (1) based on the incentive structure of an institutional setting, individuals will act according to their own self-interest (i.e., homo economicus); and (2) individuals pursue their self-interest by engaging in mutually beneficial exchange. By applying the behavioral postulate of homo economicus and the principle of mutually beneficial exchange to political decision-making, Public Choice challenges the main pillars of the Samuelsonian paradigm by arguing threefold: (1) there is no objective welfare function that a benevolent despot maximizes; (2) even if such a social welfare function existed, only individuals choose, not “society” or “the state”; and (3) individuals acting in a market setting or a political setting will pursue their self-interest based on their subjective assessment of costs and benefits (Boettke 2012: 249).

In countering the paradigm of Samuelsonian economics, Public Choice emerged “as a ‘theory of government failure’ that offsets ‘the theory of market failure’ that emerged from theoretical welfare economics” (Buchanan 1983 [2000]: 113). Under market failure theory, perfect competition became the normative benchmark from which the inefficiencies of real-world market outcomes were compared. Any deviations from perfectly competitive equilibrium, such as the presence of public goods, externalities, monopoly power, or
asymmetric information, imply government intervention as a public policy prescription to correct for such market failures. Consistent with the evaluative standard of perfect competition, political actors are presumed to possess perfect information to address market failures. However, this was a categorical epistemological difference in understanding market processes as well as political processes, not only for the Virginia School, but also for economists prior to the mid-twentieth century. Ronald Coase, a pioneer in the field of law and economics, and one of the early faculty members of the Thomas Jefferson Center at the UVA, best articulated this presumption of government failure:

This “novel theory” (novel with Adam Smith) is, of course, that the allocation of resources should be determined by the forces of the market rather than as a result of government decisions. Quite apart from the malallocations which are the result of political pressures, an administrative agency which attempts to perform the function normally carried out by the pricing mechanism operates under two handicaps. First of all, it lacks the precise monetary measure of benefit and cost provided by the market. Second, it cannot, by the nature of things, be in possession of all the relevant information possessed by the managers of every business... to say nothing of the preferences of consumers for the various goods and services (Coase 1959: 18).

Rather than view economics in terms of states of equilibrium, the Virginia School has always regarded economics as a science of exchange and the institutions within exchange takes place. By anchoring political choices in price theory and methodological individualism, Buchanan, Tullock, and the Virginia School as a whole were able to turn the presumption of market failure on its head, namely, by marrying the best insights of the property-rights economists, law-and-economics, and Austrian subjectivism. For example, following the subjectivism of Austrian economists Carl Menger, Ludwig von Mises, and F.A. Hayek, Buchanan saw the notion of cost as inherently tied to the act of individual choice and understood a subjective assessment of trade-offs by individuals if it would have any meaning in a theory of decision-making (Buchanan 1969 [1999]; see also Buchanan and Thirby 1981). Although a seemingly elementary insight into price theory, its public policy implications for market failure theorists are devastating. For example, in the face of externalities, such as pollution, market failure economists would propose, a la Pigou, the use of taxes so that individual polluters would bring the full social costs of polluting into their decision-making. However, returning to the earlier quote by Coase, this presumes that political actors have both the incentives as well as the knowledge to address these market failures in accordance with ideal conditions of general competitive equilibrium. However, under such conditions, such a policy is either possible and redundant, or impossible to set because the institutional conditions presupposed for their establishment either eliminate their necessity or preclude the availability of the knowledge necessary to calculate the correct tax to levy.

In the field of public finance, Buchanan challenged the Samuelsonian orthodoxy in fiscal policy by questioning the incentives that political actors face in balancing budgets, namely by demonstrating the intergenerational transfer of government debt (Buchanan 1958 [1999]). In his 1948 edition of his seminal text Economics, Paul Samuelson argued that the “interest on internal debt is paid by Americans to Americans; there is no direct loss of goods and services” (Samuelson 1948: 427). In other words, government debt is not a burden because “we owe it to ourselves.” By disregarding the notion of a social welfare function, let alone its maximization, what Public Choice shows is that political actors will only assess costs as subjective trade-offs in the maximization of their own utility functions. Understood this way, politicians will only have the incentive to run ever increasing budget deficits, not to smooth government spending over the business cycle. This is because the economic logic that political officials face in their decision-making is to concentrate benefits among small and well-organized interest groups in their constituency, and disperse costs among the ill-informed masses of the population. Alternatively speaking, if we regard fiscal responsibility as a public good, political actors face a free-rider problem in the elimination of budget deficits, namely because of the cost of eliminating a spending program will be concentrated on a specific interest
group, while the benefits of eliminating fiscal irresponsibility will only be dispersed throughout the population. Given the absence of property rights in a political institutional setting, it only makes political sense that a “tragedy of the fiscal commons” will prevail (see Wagner 2012). Thus, it is the interest of political actors to shift the debt burden to future generations. This fiscal insight, however, has broader public policy implications. Given the logic of political decision-making, government attempts to address alleged market failures, not only in the form of macroeconomic instability, but also in the presence of monopoly, externalities, and public goods, are prone to rent-seeking and regulatory capture for the private benefit of special interest groups, which also include government bureaucracies who benefit from the expansion of the scale and scope of government. As we show in the next section, this general concern regarding the ever increasing size and scope of government due to government failure naturally evolved into a presumption of anarchy in the Virginia School (see Powell and Stringham 2009).

Public Choice and Anarchy

Beginning in the 1970s, Public Choice economists began to analyze the capability of individuals to engage in peaceful social cooperation without government. Although seemingly new and radical, this was an inquiry in political economy dating back to the nineteenth century. Carl Menger proposed this question in his 1883 book, *Investigations into the Method of the Social Sciences*, where he asked the following: “How can it be that institutions which serve the common welfare and are extremely significant for its development come into being without a common will directed toward establishing them?” (emphasis original, 1883 [1985]: 146). Due to the civil unrest that emerged during the Vietnam War and the Civil Rights movement, James Buchanan, Gordon Tullock, and Winston Bush undertook a radical re-examination of alternative institutional arrangements for governing society at Virginia Polytechnic Institute and State University, resulting in the publication of *Explorations in the Theory of Anarchy* (1972) and *Further Explorations in the Theory of Anarchy* (1974). As Winston Bush stated, “[i]t is not surprising that ‘anarchy’ and ‘anarchism’ have reemerged as topics for discussion in the 1960s and the 1970s, as tentacles of government progressively invade private lives and as the alleged objectives of such invasions receded yet further from attainment” (1972 [2005]: 10). However, the early investigations into the prospects of anarchy were generally more pessimistic that they would later become among scholars of the Virginia School. Given the historical context in which they were writing, Buchanan, Bush, and the other contributors regarded anarchism with skepticism. “The anarchists of the 1960s,” according to Buchanan, “were enemies of order, rather than proponents of any alternative organizational structure” (2005: 192). Anarchy, as it was understood in *Explorations in the Theory of Anarchy* and *Further Explorations in the Theory of Anarchy*, referred to a state in society characterized by the absence of law, leading to banditry, violence, and social disorder. The common assumption held by these scholars was an identification of government with governance itself.

Since the 1970s, however, Public Choice scholars have extended the original work on government failure to show in fact that anarchy operates more effectively than previously believed. Applying the same logic developed by the earlier generation of Public Choice economists to develop the theory of government failure, later these scholars simply pushed the theory to its logical conclusion, arguing that governments would not always improve upon conditions of anarchy. The work of Public Choice economist Bruce Benson illustrates this well. For example, Benson has shown historically how international commercial law, known as the Law Merchant, emerged spontaneously in Medieval Europe to facilitate international trade, and operated without government enforcement. Disputes between merchants were settled in private merchant courts, and these court decisions were accepted by winners and losers because they were backed by the discipline of repeated dealings as well as the threat of
ostracism by the merchant community at large (Benson 1989). In *The Enterprise of Law* (1990), Benson also illustrates how the centralization of law enforcement by government in England later crowded out private mechanisms of law enforcement for the purpose of using the legal system to collect revenue. The failure of anarchy to provide a private market for law enforcement can be attributed then to government failure.

Another important publication in the transition from a pessimistic presumption of anarchy to a more optimistic presumption of anarchy was *Anarchy, State and Public Choice* (2005), which was ostensibly written in response to the contributions written in *Explorations in the Theory of Anarchy* and *Further Explorations in the Theory of Anarchy*. From *Anarchy, State and Public Choice*, a burgeoning literature has further developed the economic analysis of anarchy. Whereas the earlier generation of Virginia School economists saw the gains from trade and innovation being limited by the extent to which governments secured property rights and enforced contracts, the empirical challenge of this newer generation was to show that the existence of such potential gains from trade and innovation presented an entrepreneurial profit opportunity for the endogenous formation of norms and rules.

The economic analysis of anarchy as it evolved in the 1990s and 2000s, like the economic analysis of government failure in the 1950s and 1960s, cannot be understood outside the historical context in which such scholarship emerged. Specific events, such as the collapse of communism in Eastern and Central Europe, ethnic and religious fractionalization in the Balkans and the Middle East, and the exportation of liberal democracy to failed and weak states in the developing world, have demonstrated that governance requires the endogenous formation of rules, rather than their imposition by governments exogenously (Coyne 2008). Moreover, the economic analysis of anarchy, just like the theory of government failure that preceded it, emerged to counter the policy implications of utilizing perfectly competitive equilibrium as a normative benchmark of analyzing markets in the developing world. The standard neoclassical model populated by fully informed and homogenous agents, in which property rights are well-defined and well-enforced, is unreliable to understanding the situation of failed and weak states in the developing world for two reasons. First, governments in the developing world provide poor enforcement of property rights, or are outright predatory. Second, precisely because the situation in failed and weak states is one in which individuals are heterogeneous, have imperfect information, and exhibit high discount rates, collective action problems that may exist under anarchy may prove to be even worse under a dysfunctional government. For example, the Virginia School scholars have looked at Somalia as a case study, analyzing development economic indicators before and after the collapse of the Barre regime in 1991. While it may be the case that Somalia under anarchy remains one of the poorest parts of the world, it does not automatically follow that the re-establishment of government would be an ideal solution for the provision of governance. In Somalia, data on standard indicators of economic development suggests that statelessness has improved Somali development substantially in terms of lower rates of infant mortality, higher life expectancy, and lower percentage of individuals living on less than one dollar per day (See Leeson 2007: 697). Scholars of anarchy in the Virginia School, like their predecessors analyzing government failure, have attempted to overturn the existence of a “Nirvana Fallacy” (Demsetz 1969) by comparing imperfect and real institutional alternatives in history between the existence of anarchy and the state. Such analysis can be traced back not only to the roots of Public Choice broadly defined as the economic analysis of nonmarket decision-making, but also more specifically as the study of the economic role of the state without romance. In both respects, Public Choice, particularly the Virginia School, has progressively brought the central inquiry of political economy back to the forefront of economics in the twentieth and twenty-first centuries.
Conclusion

Given the breadth and development of Public Choice since the 1950s, the author has focused on the intellectual origins and evolution of the Virginia School of Public Choice. The author has highlighted the uniqueness of the Virginia School in developing a theory of government failure to counter the presumption of market failure in economics. Moreover, in developing this presumption of government failure, the author has highlighted that the economic analysis of anarchy has followed logically from the initial skepticism among Public Choice economists to use public policy measures to address market failures. Although seemingly separate enterprises, they are both rooted in comparative institutional analysis and an understanding of the price mechanism as offering the possible approach to understanding the emergence of peaceful social cooperation without government command.

Cross-References

- Anarchy
- Constitutional Political Economy
- Gordon Tullock: A Maverick Scholar of Law and Economics
- Government Failure
- Market Failure (Analysis)
- Market Failure (History)
- Political Economy
- Public Interest

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