

**An ‘Austrian’ Perspective  
on Public Choice**

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## An 'Austrian' Perspective on Public Choice

[F]rom the economic viewpoint, such 'goods' as family, church, love and the like are merely linguistic devices for a totality of concretely useful renditions of services. (Bohm-Bawerk 1881, 133)

It is impossible to draw a clear-cut boundary around the sphere or domain of human action to be included in economic science. (Knight 1934, 110)

The Austrian school of economics and the Virginia school of political economy have a long history of interdependence --- methodological, analytically, and ideologically. While Austrians typically focus on an analysis of market processes, Virginia Political economists analyze the dynamics of the political realm. Despite their seemingly disparate fields of interest both Austrians and members of the Virginia school share a commitment to methodological individualism and the development of a rational choice paradigm in the human sciences; a commitment to a catallactic or exchange based model of social phenomena that emphasizes the dynamic processes of adjustment by individuals within the process and not exclusively the static efficiency of equilibrium states; and a deep appreciation of the classical liberal tradition and its teachings about the necessary institutional pre-requisites for a society of free and responsible individuals.

### THE DOMAIN OF ECONOMIC EXPLANATION

Both the Austrian and Virginia schools consider the discipline of political economy a subset of the larger, more general science of human action called *praxeology* (see Buchanan and Tullock 1962, 16-30). By employing the praxeological approach, Austrians and public choice economists are able to apply the "economic way of thinking"

to a wide variety of social phenomena, including areas like politics, that for many years were considered by economists to lie outside the scope of rational choice theory. From the Austrian perspective, the purpose of economics is to understand/elucidate purposive behavior in the context of the actor's intent and to bring into relief the unintended consequences of human action. Public choice, as a discipline operating in the same praxeological framework as Austrians, has the same mission but with regard to political activity.

The praxeological approach represents the culmination of the economic way of thinking. The fullest, most consistent application of this approach belongs to the Austrian school, particularly the work of Ludwig von Mises. According to Mises, what distinguishes economics from other sciences is that it deals with *conscious* action. Unlike the unmotivated subject matter of the physical sciences, the subjects of economics' study are rational, conscious agents with certain desires and beliefs about how to achieve them. In the physical sciences, the ultimate causes of matter's "behavior" can never be known. But the science of economics is a science of human action. And its praxeological status is what allows economic scientists, who are themselves human, to thus begin with knowledge of the ultimate causes driving man's behavior. Man engages in purposeful action and his purpose, his ends are what drive him. For Mises and the rest of the Austrian school, this understanding of man's action as purposeful serves as the foundation for all of economic science. The radical philosophy of science implications of the Austrian stance are explored in various writings by Mises and Hayek (see, e.g., Hayek 1952). Because Austrians viewed themselves as working within the broader field of human action, their application of the "economic way of thinking" to political problems

came naturally, and in doing so they anticipated several of the contributions later made by public choice.

#### ‘AUSTRIAN’ CONTRIBUTIONS TO THE ECONOMICS OF POLITICS

Mises is often credited by public choice scholars as one of the first scholars to approach the problems of bureaucracy from an economic point of view (see Niskanen 1994, 3 and 7). Mises’s *Bureaucracy* contrasted economic organization on the basis of the profit-motive in the market, with the organization of public administration outside the context of the market economy. Mises argued that “Bureaucratic management is the method applied in the conduct of administrative affairs the result of which has no cash value on the market. ... Bureaucratic management is management of affairs which cannot be checked by economic calculation” (1944, 47-48). In the absence of profit and loss, bureaucratic organizations must rely on rules and monitoring of subordinates. These rules and monitoring devices impede the economic performance of these organizations and their adaptability to changing economic conditions.

Mises’ 1945 essay, “The Clash of Group Interests” provides another excellent example of how scholars in the Austrian school tradition addressed topics such as the logic of concentrated benefits and dispersed costs and special interest politics. As its title suggests, this essay constitutes an early analysis of the causes and consequences of special interest group formation in the vein of public choice. Mises begins by pointing out the growing trend of special interest group emergence and battle for political privilege. Popular opinion holds that different groups have different interests that can only be served at the expense of one another. As a result, “[o]ur age,” Mises tells us, “is

full of serious conflicts of economic group interests.” The emergence of these special interests in the first place is the result of government intervention that favors one group over another. Consequently, it should come as no surprise that these groups see each other as enemies and the struggle for survival as a zero-sum game. One of the first implications of special group formation, Mises says, is the formation of even more special interest groups. So-called “producers policy” (whereby government aims to support floundering businesses) begets group conflict as interests vie for government privilege, and group proliferation, as new interests organize to get their piece of the pie. Mises not only anticipates the growth and influence that special interest groups will increasingly have over economic policy but also traces this fact to the economic ignorance of the voting masses. He ends by correctly predicting the continuation of this trend in the future but believes one thing may have the power to thwart special interest group domination—the Constitution. In making this remark Mises foreshadows the later public choice development that stresses the importance of constitutional constraints in tying the hands of self-interested government.

Hayek’s *The Road to Serfdom* also provides an excellent example of early Austrian contributions to public choice theory. Here, Hayek is concerned with how socialism changes the demands on a democratic systems and how through this process socialism transforms the institutions of democracy into institutions of tyranny. This effect of socialism is evident in the growth of special interest groups. With the acceptance of socialist ideology, Hayek points out, comes the erosion of liberal constraints on intervention favoring particular groups. Consequently, as socialism’s popularity grew, the number of special interests pleading for privilege ballooned (Hayek

1945, 40). Like public choice theorists, Hayek understood the danger of interest groups in the context of the logic of concentrated benefits and dispersed costs. While these “innumerable interests . . . could show that particular measures would confer immediate and obvious benefits on some, the harm they caused [on others] was much more indirect and difficult to see” (Hayek 1945, 17-18). Hayek not only understood the logic of concentrated benefits and dispersed costs, but also understood the importance of rules over discretion and federalism in binding government power (Hayek 1945, 73).

Another recurrent theme in Hayek’s *The Road to Serfdom* is an analysis of the organizational logic of socialism, particularly the incentives motivating the planners and the shape they caused collective planning to take. Without market-generated information, socialism requires the exercise of political power to make it work. The best planners will therefore be the most power hungry and ruthless. The system thus selects the most unsavory characters to take its helm, who in turn have an incentive to extend their use of power as far as possible to enforce the plan and prevent others from taking their place. But power vested in the hands of the most devilish individuals is not the cause of socialism’s problems, Hayek tells us. Rather it is the necessary consequence of the incentive structure created by planning in the first place, and the type of behavior required to make the plan feasible. In order for planning to work at all, discretionary rather than rule-bound power is requisite (Hayek 1945, 56-87). In exploring the dynamics of democracy under socialism and the organizational logic of collective planning, Hayek was applying the “economic way of thinking” to political problems.

Joseph Schumpeter’s work in *Capitalism, Socialism and Democracy* represents another example of an ‘Austrian’ contribution to public choice. In this book,

Schumpeter's section on democracy not only offers an "inquiry" into the "nature of democracy," but also explodes the myths of the "Classical Doctrine of Democracy" and collective action (Schumpeter 1942, 240). The classical doctrine is somewhat akin the pre-public choice approach to politics. Via majority votes, the "will of the people" is expressed and then carried out by public-spirited, benevolent politicians. In contrast to this, Schumpeter points out that it is also "possible to frame a theory of the democratic process that takes account of all the realities of group-wise action" (Schumpeter 1942, 249). Schumpeter uses this account of the democratic process to dismantle the myths of the classical doctrine of democracy and paint a more realistic portrait of the democratic process.

Schumpeter's analysis anticipates the public choice concept of the rationally ignorant voter. He begins by pointing out that within the small sphere of his own private affairs, the individual has very specialized knowledge of circumstances and behaves quite rationally because in these areas the individual not only has a great degree of control over things but also the effects of his decisions will be felt strongly due to his closeness to the issues upon which he is deciding. However, "when we move still farther away from the private concerns of the family and the business office into those regions of national and international affairs that lack a direct and unmistakable link to those private affairs, individual volition, command of facts and method of inference" cease to exist. When it comes to politics, becoming informed is costly and the perceived benefit very small due to the individual voter's inability to affect change. As a result, Schumpeter says, the average citizen "expends less disciplined effort on mastering a political problem than he

expends on a game of bridge.” Due to this pervasive problem, Schumpeter tells us, voter “ignorance will persist” (Schumpeter 1942, 258-262).

Schumpeter also anticipated the public choice implications of such rational voter ignorance. Because obtaining and using credible information and reason to inform their decisions is too costly and yields no perceptible difference to the outcome, voters act on “irrational prejudice and impulse.” This in turn, he points out, generates opportunities for politician-special interest group interaction to exert tremendous influence over political decisions. Politicians prey on the cost/benefit circumstance facing voters by offering “personal pecuniary profit to individual voters and groups of voters” in the form of “direct payments, protective duties, silver policies and so on” and spreading the costs across the ill-informed (Schumpeter 1942, 260.) Schumpeter’s analysis gets at a central concern of public choice—the logic of concentrated benefits and dispersed costs.

Politician-special interest group dynamics, which form part of the logic of democracy, Schumpeter says, lead to the creation of *professional* politics. “[P]olitics will unavoidably be a career. This in turn spells recognition of a distinct professional interest in the individual politician and a distinct group interest in the political profession as such” (Schumpeter 1942, 285). Contrary to the classical theory of democracy, Schumpeter suggests an approach in which politicians are viewed as engaged in a “competitive struggle for the people’s vote,” and politics is viewed as a business “dealing in votes” (Schumpeter 1942, 269, 287).

THE CONSTITUTIONAL MOMENT IN POLITICAL ECONOMY

The rebirth of political economy in modern economics is largely due to the scholarly output of James Buchanan. Along with Gordon Tullock, he helped in the creation of research and teaching centers for political economy at University of Virginia, Virginia Polytechnic Institute, and George Mason University. Buchanan and Tullock's *The Calculus of Consent* (1962) is considered the *locus classicus* in constitutional political economy. Buchanan and Tullock's unique contribution to political economy was their emphasis on the 'constitutional moment'. In subsequent work, Buchanan has continually argued that one of the most important distinctions in political and economic analysis is the distinction between games *over* the rules, and games *within* the rules. In addition to his emphasis on the different levels of analysis, Buchanan has championed the use of the consistent use of the *homoeconomicus* postulate at both levels of analysis. The reason for this is rather straightforward --- by making a "worst case" move at the pre-constitutional (game over the rules) and post-constitutional level (game within the rules), Buchanan is able to provide a *robust* theory of political economy. The rules of the game determine optimal strategies players will choose within the game, but the examination of those strategies and their impact can provide feedback in our judgment on whether the chosen rules are "good" rules for social order.

Buchanan's unique research program for political economy is well-known (if not always well understood), as is his intellectual connection to his 'teacher' Frank Knight. But, it is little known that Buchanan's position is one anticipated by the Austrian economics, and in particular F. A. Hayek. Buchanan's emphasis on rules and strategies is unique to him and Knight, but the intellectual strategy for building a robust set of rules

for the economic game is not. Mises and Hayek explicitly sought to address the question of robustness in political economy.

Mid-century public interest theories assumed both benevolence and omniscience on the part of policy makers, and thus promoted a Romantic conception of the state. Ludwig Mises pointed out that whenever intellectual and moral perfection is attributed to the state the logically inescapable conclusion is that the state should be in direct control of all decision-making (Mises 1949, 692). Because of the mid-century prevailing wisdom that in the social sciences questions of incentives were questions about motivation, and because of Mises's own style of value-free, he chose to question the assumption of intellectual perfection while leaving the assumption of moral perfection in place. Even if good spirited public officials wanted to allocate resources in an effective manner, they would not have the requisite information/knowledge to make rational economic calculations about the alternative use of scarce resources. This is the crux of Mises's famous "impossibility" thesis with regard to rational economic calculation under socialism.

Public choice economics as developed in the 1950s and 1960s, took a different analytical path. Public choice theorists adopted a hard-headed economics which challenged the benevolence assumption, but left the omniscient assumption alone. Political agents (voter, bureaucrat, politician) act in their own interest with perfect information. Hence, by ignoring the structural uncertainty of the future and the diffuseness and subjectivity of knowledge, public choice analysis, one could argue, is methodologically inconsistent with Austrian economics. On the other hand, Austrian political economy, challenges the omniscience assumption, but continues to be reluctant

to relax benevolence (Kirzner 1985 and Ikeda 1997) and is therefore inconsistent with public choice. In simplest terms, a combined Austrian-public choice approach to political economy would relax both assumptions, and many contributions to the broader literature in Virginia Political Economy fit within this category. This hybrid market process and public choice paradigm for political economy analysis was, in fact, championed by Hayek, and it was argued by him that this approach was indeed a crucial aspect of the great contribution which Hume and Smith made to human knowledge in the 18<sup>th</sup> century.

As Hayek put it:

[T]he main point about which there can be little doubt is that Smith's chief concern was not so much with what man might occasionally achieve when he was at his best but that he should have as little opportunity as possible to do harm when he was at his worst. It would scarcely be too much to claim that the main merit of the individualism which he and his contemporaries advocated is that it is a system under which bad men can do least harm. It is a social system which does not depend for its functioning on our finding good men for running it, or on all men becoming better than they now are, but which makes use of men in all their given variety and complexity, sometimes good and sometimes bad, sometimes intelligent and more often stupid (1948, 11-12).

Hayek devoted his intellectual energies post-1950 to exploring the Smithian research program in political economy, and in particular the institutional design of a free society. *The Constitution of Liberty* (1960) and *Law, Legislation and Liberty* (1973-1979) sought to examine in detail the requisite institutional constraints in politics and law to maintain a free economy and a peaceful social order. Hayek, like Buchanan after him, argued that the state was both coercive and necessary for large-scale human society to emerge, but for that human society to flourish both argued that the coercive powers of the state must be severely restricted through constitutional design.

A particular concern in Hayek's writings is the consequences of the social system when one group is permitted to benefit at the expense of other groups. Special interest politics will undermine the legal and political order of a free people by diluting the 'generality' principle that underlies the rule of law. *Leges*, the Latin for the law, is to be contrasted with *privi-leges*. As we saw earlier with regard to the rule of law, Hayek was particularly concerned with the fixed features aspects of the institutional environment that a constitutionally limited government provides. As he wrote:

The conception of freedom under the law that is the chief concern of this book rest on the contention that when we obey laws, in the sense of general abstract rules laid down irrespective of their application to us, we are not subject to another man's will and are therefore free. It is because the lawgiver does not know the particular cases to which his rules will apply, and it is because the judge who applies them has no choice in drawing the conclusions of the case, that it can be said that laws and not men rule. Because the rule is laid down in ignorance of the particular case and no man's will decides the coercion used to enforce it, the law is not arbitrary. This, however, is true only if by 'law' we mean the general rules that apply equally to everybody. This generality is probably the most important aspect of that attribute of law which we have called its 'abstractness.' (1960, 153).

Hayek further argues that the chief safeguard against abuse in a constitutionally limited government is that the rules must apply equally to everybody – the government as well as the governed – and that nobody be granted exceptions from the general rule. Buchanan and Roger Congleton attempt to tease out the full implications of the generality norm for the operation of democracy in *Politics By Principle, Not Interest* (1998).

In *Law, Legislation and Liberty*, Hayek pursued his critique of special interest politics from the point of view of generality even more forcefully. Hayek acknowledged the noble and inspiring constitutional project of the American founders, but concluded that "The first attempt to secure individual liberty by constitutions has evidently failed"

(1973-1979, 1). Whereas in *The Constitution of Liberty* Hayek confined his discussion mainly to a restatement of the general principles of law in a liberal society, *Law, Legislation and Liberty* devotes considerably more time to institutional construction. Hayek tells his readers that his project can be usefully seen as an attempt to do what the founders would do if they had the benefit of the knowledge we have gained in the meantime since their time in terms of the institutional weaknesses of their own design to constrain the growth of government that threatens the preservation of individual freedom. In particular, Hayek had since the 1940s advocated various forms of federalism as a means of provided a competitive check (e.g., 1948, 255-71), but starting with *The Constitution of Liberty* (1960, 206, fn. 12) and *Law, Legislation and Liberty* (1973-1979), Hayek presented arguments for alternative institutional structures -- bi-cameralism, fixed term limits, and age requirements for legislators -- that would curtail special interest politics from undermining the constitutional order.

It is not our intent to critically examine Hayek's institutional remedies to the problems of the democratic fetish (his term) and special interest politics. Instead, for our purposes we just wanted to point out how Hayek's work in constitutional political economy touched upon themes later developed in the work of James M. Buchanan. Buchanan is clearly one of the leading thinking in constitutional political economy, but Hayek's leading role in exploring the constitutional moment in political economy must be acknowledged as well.

## CONCLUSION

We have argued that Austrian economists have made contributions to the economic analysis from politics that anticipated many of the major developments. Austrians were among the first economists that recognized that the economic way of thinking was not limited to market exchange, but was generally applicable across social settings. We have concentrated our survey on the work of Mises, Hayek and Schumpeter and pointed out how various key concepts in public choice analysis --- for example, special interest manipulation; the logic of concentrated benefits and dispersed costs in political decision making; voter ignorance; the bundled nature of political decisions; bureaucratic incentives; and the constitutional moment --- are deployed by these Austrian economists in their political economy scholarship dating from the 1940s. The Austrian economists, in short, possess deep methodological, analytical and ideological affinities with their public choice brethren – especially of the Virginia School tradition.

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