James M. Buchanan, 1963
The Collected Works of
James M. Buchanan

Volume 6
Cost and Choice
An Inquiry in Economic Theory

Liberty Fund
Indianapolis
This book is published by Liberty Fund, Inc., a foundation established to encourage study of the ideal of a society of free and responsible individuals.

The cuneiform inscription that serves as our logo and as the design motif for our endpapers is the earliest-known written appearance of the word “freedom” (\textit{amaggi}), or “liberty.” It is taken from a clay document written about 2300 b.c. in the Sumerian city-state of Lagash.

© 1999 by Liberty Fund, Inc.
All rights reserved
Printed in the United States of America

\begin{itemize}
\item 11 15 16 17 18 C 6 5 4 3 2
\item 15 16 17 18 19 P 7 6 5 4 3
\end{itemize}

\textit{Library of Congress Cataloging-in-Publication Data}
Buchanan, James M.
Cost and choice : an inquiry in economic theory / James M. Buchanan.
p. cm. — (The collected works of James M. Buchanan ; v. 6)
Includes bibliographical references and index.
4. Welfare economics. 5. Social choice. I. Title. II. Series:
HB199.B82 1999
338.5’1—dc21 98-32143

\textit{LIBERTY FUND, INC.}
8335 Allison Pointe Trail, Suite 300
Indianapolis, IN 46250-1684
I, too, sought expression. I know now that my gods grant me no more than allusion or mention.

—Jorge Luis Borges, “Prologue” to A Personal Anthology
Contents

Foreword xi
Preface xiii
Acknowledgments xvii

1. Cost in Economic Theory 3
   Classical Economics 3
   Marginal-Utility Economics 9
   The Marshallian Synthesis 12
   Frank Knight and American Neoclassical Paradigms 13

2. The Origins and Development of a London Tradition 17
   Wicksteed and the Calculus of Choice 17
   H. J. Davenport 18
   Knight on Cost as Valuation 19
   Robbins, 1934 19
   Mises, Robbins, and Hayek on Calculation in a Socialist Economy 21
   Hayek, Mises, and Subjectivist Economics 23
   The Practical Relevance of Opportunity Cost: Coase, 1938 26
   G. F. Thirlby and “The Ruler” 29
   Mises’ *Human Action* 33
   The Death of a Tradition? 34
   Appendix to Chapter 2: Shackleton on Decision 35

3. Cost and Choice 37
   The Predictive Science of Economics 37
   Cost in the Predictive Theory 40
Contents

Cost in a Theory of Choice 41
Choice-Influencing and Choice-Influenced Cost 42
Opportunity Cost and Real Cost 43
The Subjectivity of Sunk Costs 45
Cost and Equilibrium 46

4. The Cost of Public Goods 49
The Theory of Tax Incidence 50
Costs and Fiscal Decision-Making: The Democratic Model 52
Costs and Decision-Making: The Authoritarian Model 55
Costs and Decision-Making: Mixed Models 55
The Choice Among Projects 57
The Costs of Debt-Financed Public Goods 59
Ricardo’s Equivalence Theorem 61
Tax Capitalization 63

5. Private and Social Cost 65
Summary Analysis 65
A Closer Look 66
Internal Costs, Equilibrium, and Quasi-Rents 69
An Illustrative Example 70
Pigovian Economics and Christian Ethics 72
Narrow Self-Interest and Alternative-Opportunity Quasi-Rents 74
Conclusion 76

6. Cost Without Markets 77
Prices, Costs, and Market Equilibrium 77
Resource-Service Prices as Final-Product Costs 78
Market Equilibrium, Costs, and Quasi-Rents 80
The Cost of Military Manpower: An Example 81
The Cost of Crime: Another Example 84
Artificial Choice-Making 86
Socialist Calculation and Socialist Choice 87
Costs in Bureaucratic Choice 89

Author Index 93

Subject Index 95
James M. Buchanan himself speaks of “my little book, Cost and Choice.” Cost and Choice is indeed small in size, but, systematically, it holds quite a central place in Buchanan’s work. For the fundamental economic notion of “cost,” or “opportunity cost,” is intimately related to the individualist and subjectivist perspective that is so essential to the Buchanan enterprise. As a subjectivist, Buchanan insists that opportunity costs exist only in the “eye of the beholder” as envisioned “alternatives” that are never brought into existence. As a methodological individualist, Buchanan believes that opportunity costs cannot be measured in terms of a collective welfare functional aggregating utility foregone across persons.¹

Similar views in theories of cost have been developed and expressed since the 1930s at the London School of Economics by scholars such as Lionel Robbins, F. A. Hayek, Ronald Coase, and Jack Wiseman. These theories, for systematic as well as personal reasons, have quite strong links to even older theories of the so-called Austrian economists. However, though acknowledging and supporting the Austrian contribution in the socialist calculation debate with arguments based on his own concept of cost, Buchanan distances himself somewhat from the Austrians. Avoiding what he regards as the “arrogance of the eccentric,” Buchanan makes a serious effort to integrate his views into the orthodox classical and neoclassical framework. Therefore the discussion in Cost and Choice starts with Adam Smith’s famous deer-beaver example. In the particularly simple “one-factor” setting of that example, subjective opportunity costs are themselves “explained” by objective transforma-

tion rates. Because everybody can transform two deer into one beaver and vice versa, any divergence between the transformation and the exchange rate should eventually be washed out by the choices that rational decision makers make in view of the opportunity costs of their decisions. But what about more complicated settings?

*Cost and Choice* addresses this issue. When publishing the book, Buchanan clearly hoped that other scholars might follow him in his efforts to build a new research tradition in economic analysis around a thorough understanding of the opportunity-cost concept. However, despite Buchanan’s serious efforts to communicate his profound insights on the nature of “cost and choice” and to relate these insights to mainstream neoclassical economics, a look at the *Social Science Citation Index* indicates that he did not succeed in this regard. This relative neglect of the theoretical underpinnings of Buchanan’s economic worldview as presented in *Cost and Choice* is somewhat strange. After all, specific applications of his general views to problems of public economics were much better received and, in fact, enormously influential. In any event, it might be good policy for those who think highly of Buchanan’s more specific insights and arguments to consider more seriously their general foundations as laid out in *Cost and Choice*. The republication of *Cost and Choice* clearly reduces the costs of doing just this and offers ample opportunity to go back to the roots of economics.

Hartmut Kliemt

*University of Duisburg*

1998

---

2. In particular, as reprinted in *Debt and Taxes, Externalities and Public Expenditure Theory*, and *Public Principles of Public Debt*, respectively, volumes 14, 15, and 2 of the Collected Works.

3. See also some of the essays in *Economic Analysis*, volume 12 of the Collected Works.
You face a choice. You must now decide whether to read this Preface, to read something else, to think silent thoughts, or perhaps to write a bit for yourself. The value that you place on the most attractive of these several alternatives is the cost that you must pay if you choose to read this Preface now. This value is and must remain wholly speculative; it represents what you now think the other opportunity might offer. Once you have chosen to read this Preface, any chance of realizing the alternative and, hence, measuring its value, has vanished forever. Only at the moment or instant of choice is cost able to modify behavior.

If you decided a few moments ago that your valuation of the alternative exceeded that expected from reading this Preface, you will have missed this economist's pedestrian prose. But, having rejected it at the outset, you can never know what you will have missed. The benefits that you are now securing from reading the Preface are not comparable with the costs that you would have suffered on choosing the most attractive alternative. These benefits, if there are any, exist. They can be evaluated \textit{ex post}. Costs that are influential for behavior do not exist; they are never realized; they cannot be measured after the fact.

Nonetheless, when you have completed reading this Preface, there is something that will have happened, something that may be valued. You can think about what you might have done with these minutes and, if desired, you can translate these “might have beens” that never were into value terms.

An observer of your behavior, knowing the choice you face, could make an objective estimate of the minutes of resource time that reading this Preface would involve. After your decision he could look at a watch and objectively check out his estimates. If he knew your alternative earnings value, he could place some value on this resource time, a value that would be objective.
and that would be useful for many purposes of comparison. The observer could not, of course, accurately estimate the value that you might place on your own lost opportunities either before or after choice.

In ordinary discussion, we refer to both your own evaluations and to the observer’s as “costs.” The external observer of your behavior would say that reading this Preface will or has cost you X minutes which he estimates to be worth Y dollars. You would normally say that the same activity “will cost X minutes when I might sleep” or “has cost X minutes when I might have been sleeping.” The point to be noted here is that these several uses of the word “cost” are categorically different. Linguistic usage dictates the same word for several different things. It is little wonder that we find great confusion, especially among economists, about cost.

So much for a summary of this book’s main argument. The central notions are simple, and I advance no claim to analytical sophistication. My working hypothesis is that many economists rush headlong into the intricacies of analysis while overlooking certain points of elementary economic logic. Clarification at the conceptual level may be irrelevant for particular applications, and those who are anxious to get on with solving the world’s ills may scoff at my insistence on methodological purification. Their skepticism may be increased when they recognize that, in any preliminary confrontation, their own views parallel those developed here. There are few modern economists who would dispute the elementary definition of opportunity cost. Statements that are presumably well understood abound in the standard textbooks.

I suggest that there is likely to be a significant difference between such second-chapter definitions and those which are implied in the analysis that follows. Opportunity cost tends to be defined acceptably, but the logic of the concept is not normally allowed to enter into and inform the subsequent analytical applications. My aim is to utilize the theory of opportunity cost to demonstrate basic methodological distinctions that are often overlooked and to show that a consistent usage of this theory 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