

Public choice theory

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Democracy & policy

- Why do democracies produce bad policies?
- Why do they stick with them?
- Are democracies worse in these respects than other types of political regimes?
- Why do we sometimes get good policies in democracies?

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Public choice theory

- Politics without romance
- Political actors motivated by self-interest
- Government failures common
- Democracy not a panacea
- Don't compare ideal government with real-world market

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Collective action theory

- Many groups don't form despite common interests
- Individuals often free ride – let others bear the cost of group formation
- Small groups often beat large: concentrated benefits vs diffuse costs
- Solutions: coercion, small #s, selective incentives

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Bureaucracies

- Rent-seeking – lobbying government to get privileges
- Bureaucratic capture: bureaucracy has incentive to serve businesses they regulate
- Iron triangles: bureaucracy, parliament & interest groups work together

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Iron triangle



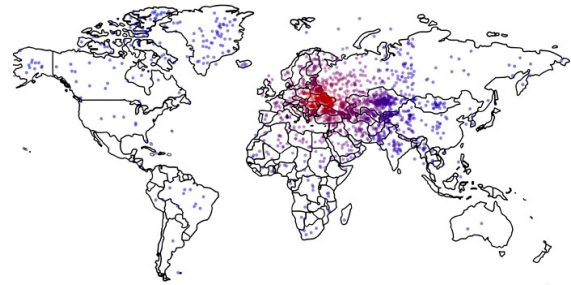
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Voter irrationality

- Rational ignorance: costs of being informed > benefits
 - Thus low levels of political knowledge
- Uninformed versus misinformed
- Systematic biases: anti-market, anti-foreign, make-work, pessimistic?

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Where is Ukraine?



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Public choice solutions

- Limited government and more markets
 - Veto points – allow actors to block change
 - Constitutional limits on taxes, spending, regulations
- Persuasion: conservative revolution, cynicism?
- Epistocracy: rule by the educated?

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How to avoid irrationality

- Are you becoming angry during political discussion?
- Do you have strong opinions about a subject before acquiring relevant evidence?
- Do your opinions NOT change as you gather evidence?
- Do you seek information only from sources you agree with?
- Do you think people who disagree with you are evil?
- <https://www.youtube.com/watch?v=4JYL5VUe5NQ>

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Discussion questions

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Public choice theory

- How controversial are the public choice axioms about studying politics, particularly the idea that political actors are maximizing personal self interest? Is this just common sense?
- How do you reconcile this view with your potential beliefs that government can make the world better? If political actors act like this, what hope do we have? Can you think of alternative assumptions?

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Motivations of politicians

- What do politicians want? Does this apply to all politicians? To the same degree?
- Does Trump fit this motivational scheme? Biden? Sanders? Clinton?
- What kind of motivations should we want from politicians? Should they be: principled & ideological or focused on winning elections?

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Collective action

- If we want policies to change, it is necessary to engage in collective or group action. But Olson says that people will always free ride, especially if groups are large & individual rewards are small.
- So what can we do? How can you organize effective collective action? Does social media help? Or hurt? How do you avoid free riding? How do you encourage others to contribute to your causes?

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Medical regulation

- There has recently been a lot of criticism of government agencies responsible for meds.
- They make it very difficult for consumers to try new medicines. The regulators argue that this prevents harms. But it also takes years for people to get access to new meds and procedures.
- How might we change our current system of medical approvals? Would a free market be a bad idea? Why?

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Bureaucrats

- How much should we reward bureaucrats? Should we pay them very high salaries and recruit “the best and the brightest”? What are the potential risks of this approach?
- Would you consider a career as a government bureaucrat? Why? What attracts you or repels you?

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Uninformed vs misinformed

- It is easy to see why many people are not well-informed about politics. People are busy; politics can be boring and complicated; and there are few rewards to being informed.
- But why are people willing to embrace misinformation (fake news)? Can we explain this in the same way?

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Economic irrationality

- Caplan claims that voters suffer from a number of biases in thinking about the economy. In particular, they are biased against foreigners, markets, & work-saving innovation.
- Do you suffer from these biases? Why? Would you agree that these are biases? If not, how would you argue against them?

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Public choice theory

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Today

- **Public choice theory**
- Collective action theory
- Bureaucracy
- Voter irrationality
- Solutions?

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Recall: Markets often suboptimal

- Public goods: non-excludable, non-rivalrous – therefore no one has an incentive to produce
- Externalities: costs not included in price of a good – therefore overproduction or overuse
- Information asymmetries: one party to transaction knows more than other – therefore markets fail

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Does this mean state is solution?

- Should state then provide public goods, regulate industry, provide insurance?
- Market failures don't mean that government will do a better job
 - Possibility of government failure
 - Government can always make things worse
 - May have to live with some market failures

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An example: Sugar subsidies in US

- Department of Agriculture sets minimum prices for sugar + import restrictions
 - Benefits small group of sugar producers in US
 - Very large political contributors
- But large side effects
 - Costs US consumers \$2 billion/year
 - Hurts manufacturers of candy and ice cream
 - Smuggling – supersweet iced tea from Canada

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Public choice theory

- Apply rational choice economic theory to the government
- Key assumption: Both voters and government officials pursue their self-interest
- Key result: Government failure as common as market failure



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Non-romantic democracy

- Democracy may produce results that are individually rational, but collectively irrational
- Often policies widely regarded as wasteful and unjust persist despite existence of better alternatives
- Need to compare real-world imperfect markets with real-world imperfect democracy
 - Not ideal democracy versus imperfect markets

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Important theories

- Collective action theory – inequalities in group formation & persistence
- Bureaucracies – rent-seeking and iron triangles
- Voter irrationality – voters may support policies that don't benefit them

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Public choice theory

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Groups are central to politics

- Individual action rarely successful
- Assumption that group formation is easy
 - If some citizens want environmental policies, then will form interest group
- But is it true?

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Why do some groups form and others don't?

- Participating in a group has benefits and costs
- Benefits if group achieves its aims
- Costs of participating in group
 - time, money, energy, risk of getting arrested
- When deciding whether to join you weigh the costs and benefits

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Problem of collective action

- My contribution alone doesn't determine success of group
- If group succeeds everyone gets benefit, not just joiners (cf., public good)
- Thus, I may decide to 'free ride' on the efforts of others
 - Not contribute but reap benefits
- Enough people may not join that group doesn't form

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Groups in U.S.

| Group | Adults | Organizations |
|------------|--------|---------------|
| Management | 7% | 71% |
| Education | 4% | 4% |
| Workers | 41% | 4% |
| At home | 19% | 2% |
| Unemployed | 4% | <1% |

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How to solve collective action problem?

- Coercion: state provision of public goods
- Size: small groups are easier to form. Why?
- Selective incentives: rewards given only to contributing members

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What does the theory explain?

- Absence of groups representing many interests
 - Where are groups for poor, unemployed, consumers, etc.?
- Power of small numbers
 - Why factory owners stronger than workers

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But may be too pessimistic

- Some people enjoy participating
 - like being part of group
 - like supporting a good cause
- Probably more important for non-economic than economic issues

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Consider sugar quotas

- Small group can organize to take advantage of most citizens
 - 60,000 employees of sugar industry can organize
 - 300 million sugar consumers cannot defend themselves
- "Exploitation of the great by the small"
- Why doesn't everybody do this?
 - Sugar is a hard business to enter
 - Doesn't work for authors or real estate agents

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Types of politics

| | Concentrated costs | Diffuse costs |
|-----------------------|---|---|
| Concentrated benefits | Interest group politics: eg, labor v. capital | Client politics: subsidies, group benefits |
| Diffuse Benefits | Entrepreneurial politics: pollution, guns | Majoritarian politics: eg, Social Security, war |

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Characteristics of each type

- Majoritarian: public opinion, ideological debate, political parties
- Interest group: changing cleavages in society, political parties, continuing struggle
- **Client politics: low visibility, little role for parties**
- Entrepreneurial politics: key role of policy entrepreneurs & media, compelling symbols

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Organizational incentives

- Should groups try to increase size and efficiency of economy?
 - A larger pie to divide among everyone
- Or should they try to take a bigger piece of the pie even if it hurts overall efficiency?
- Answer is clear
 - Hard to change entire society & smaller benefits to organization
 - Therefore better to increase own share

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Rent seeking

- Investment of resources into counterproductive activities
 - “Directly unproductive profit seeking”
- Lobbying of government in order to get privileges
 - Monopolies, trade restrictions, barriers to entry, regulations
 - Losses both from policy and from energy and resources spent on lobbying

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Incentives of bureaucracies

Serve public

- Little contact with bureaucracy
- Provides few benefits to bureaucrats
- Provides few arguments

Serve industry

- Frequent contact with bureaucracy
- Can provide favors: junkets, fact-finding trips
- Hires experts and lawyers to make their case

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Iron triangle or bureaucratic capture

- Close relationship between bureaucracy, parliamentary committees and interest groups
- Committees and bureaucracy serve interest groups
- In exchange receive support from lobbies



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Bureaucratic biases

- Food and Drug Administration approves new drugs and medical devices
- Very concerned about drugs that cause harm
 - Therefore, long testing and difficult approval
- But what about people who are harmed by these delays?
 - Consider incurable diseases
 - Consider organ transplants: illegal to pay compensation for an organ

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Bureaucratic successes

- Quality of government not a constant
- Some countries create efficient, honest, and effective bureaucracies
 - Eg, Japan, Germany
- Others not so much
- Question is how you get to this sort of bureaucracy

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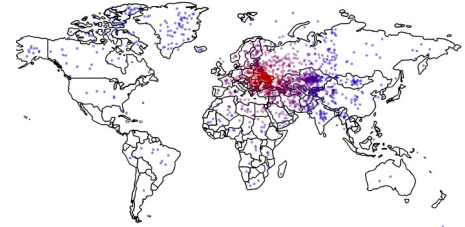
Rational ignorance

- Becoming well-informed has large costs
 - Reading newspaper, studying economics, etc.
- Benefits of being informed and voting correctly are small
 - Consequences of elections shared by all
 - Thus most citizens will know little about politics

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Where is Ukraine?

- Only 16% know correctly
- Those who don't know more likely to support war



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Research on knowledge in US

- Average American is poorly informed but not uninformed
- Levels of political knowledge relatively stable over last 50 years
- Americans slightly less informed about politics than citizens of other nations
- Average levels of knowledge mask important differences between groups
- Knowledge is tied to many aspects of good citizenship
 - Tolerance, participation

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Systematic biases

- Anti-market bias: people underestimate benefits of market
 - Profits perceived as gifts rather than incentives
- Anti-foreign bias: people underestimate benefits of interactions with foreigners
 - Trade seen as zero-sum rather than positive-sum

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Systematic biases

- Make-work bias: people underestimate benefits of conserving labor
 - Worries about downsizing and technology; but they increase productivity
 - Consider agriculture
- Pessimistic bias: people overestimate problems and underestimate future

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Consider other policies

- Occupation licensing
 - Appears to give us higher quality service, but also more expensive and limits jobs/supply
- Pollution permits
 - A price to pollute, but most efficient way to reduce pollution
- Minimum wage
 - Provides workers with better wage, but potentially fewer people get hired

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- **Solutions?**

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Public choice diagnosis

- Politicians motivated by self-interest
- Bureaucracies likely to be captured
- Group politics skewed towards certain interests
- Voters uninformed & maybe misinformed

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Public choice proposals

- Limit size of government
 - But theory implies that government will expand
- Constitutional restrictions on spending, government activity; strong property rights
- Political institutions which make government expansion difficult
 - Veto points, federalism, supermajority rules
- Persuasion? Education?

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Economic history in 70s and 80s

- OPEC raises oil prices => supply shock to economies
 - Stagflation: high inflation and slow growth
- Crisis of ungovernability
 - Strikes, public malaise, governments incapable of solving problems



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Conservative revolution

- Reagan, Thatcher and supply side economics
- Deregulation of industries
 - Trucking, airlines
- Defeat of labor unions
 - Reagan against air traffic controllers
 - Thatcher against coal miners
- Lower taxes to create better incentives
- Left-wing parties adapt – Third Way



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