

Chapter 6. Public choice

Till now, we questioned ourselves what kind of actions the government should take. In this chapter we will look at who decides what the government actually does. This chapter applies economic principles to the analysis of political decision making, a field known as **political economy**. Most economic theories assume that the government acts in the interest of society, but political economy theories assume that politicians are self-interested.

- Selfishness does not necessarily lead to inefficient outcomes. If the market for political decisions works perfect, we should see an efficient outcome.
- While the maximization assumption may not be totally accurate, it provides a good starting point for analysis.

We will examine how political decisions are being made in both a direct and a representative democracy.

Democratic societies use various different voting procedures to decide on public expenditures. Some direct democracy voting procedures:

- **Unanimity rules**

Lindahl stated that if a vote was taken on whether to provide an efficient quantity of the good, consent would be unanimous as long there was a suitable tax system to finance it. In this *Lindahl procedure*, each individual faces a personalized price per unit of public good, which depends on his or her tax share. The tax shares are referred to as **Lindahl prices**. Lindahl's procedure has two main problems:

- Free rider problem: People hide their true preferences.
- Getting everyone's consent involves enormous decision-making costs.

- **Majority voting rules**

With a majority voting rule, more than half of the voters must favor a measure to gain approval. But if there are more than 2 options to choose from, majority decision rules do not always yield such clear-cut results. Although each individual voter's preferences are consistent, the community's could be not. This is called the **voting paradox**.

It depends on the question if a voter has single-peaked or double-peaked preferences. A **peak** in an individual's preferences is a point at which all the neighboring points are lower. A voter had **single-peaked preferences** if his utility consistently falls when he moves from his favored outcome in all directions. He has **multi-peaked preferences** if, as he moves away from his favored outcome, the utility goes down, but then goes up again. If all voters' preferences are single peaked, no voting paradox occurs.

With more voting options, the ultimate outcome depends on the order in which the votes are taken. This opens the opportunity of **agenda manipulation**: organizing the order of votes to assure a favorable outcome. A related problem is that paired voting can go on forever without reaching a decision. This process of *cycling* can continue indefinitely.

The **median voter theorem** states that as long as all preferences are single peaked; the outcome of majority voting reflects the preferences of the median voter. The *median voter* is the voter whose preferences lie in the middle of all voters' preferences. Half the voters want more than the median voter wants, half want less.

- **Logrolling**

Logrolling systems allow people to trade votes and hence register how strongly they feel about various issues. The effect on general welfare is unclear. The main disadvantage is that it leads to wasteful public expenditures. Logrolling is likely to result in special-interest gains not sufficient to outweigh general losses. The main advantage is that it allows voters express the intensity of their preferences by trading votes.

Arrow's impossibility theorem

In a democratic society, a collective decision-making rule should satisfy the following ethical criteria:

- It must produce decisions, whatever the configuration of votes' preferences.
- It must be able to rank all outcomes
- It must be responsive to individuals' preferences
- It must be consistent
- It must be independent of irrelevant alternatives
- Dictatorship is ruled out

Arrow's impossibility theorem states that it is impossible to find a rule which satisfies all of these criteria. This means that democracies are inherently prone to make inconsistent decisions.

Representative democracy

Explanations of government behaviour in a representative democracy require studying the interaction of elected politicians, public employees, and special-interest groups.

- **Elected politicians**

Often, citizens elect politicians who make decisions on their behalf. The median voter theorem helps explain how these representatives set their positions. It pays candidates to place themselves as close as possible to the position of the median voter. Still several issues require careful examination:

- *Single-dimensional rankings*: it should be possible to rank political beliefs along a single spectrum.
- *Ideology*: the ideology of the politicians also plays an important role
- *Personality*: voters not only base their vote on the issues
- *Leadership*: voters' preferences can be influenced by the politicians themselves.
- *Decision to vote*: not every eligible citizen chooses to exercise his or her franchise.

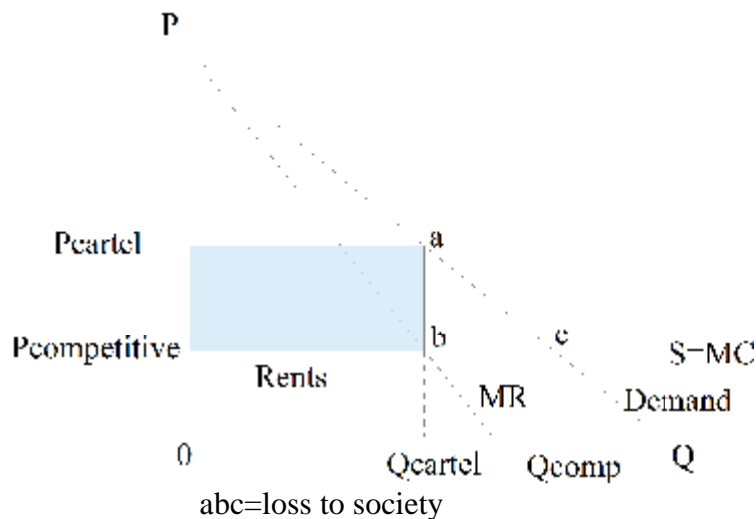
- **Public employees**

The decisions of politicians are carried out by civil servants, bureaucrats. Public employees have an important impact on the development and implementation of economic policy. The goals from the bureaucrats will sometimes differ from the public good. They often focus on reputation, power, patronage, etc.

The **Niskanen model** suggests that these goals are positively related with the size of the bureaucrat's budget. Bureaucrats attempt to maximize the size of their agencies' budgets, resulting in oversupply of the service. They have the power to influence this output decision, because of their informational advantage.

- **Special interests**

People with common interests can exercise disproportionate power by acting together. Special interest groups can form on the basis of income source(capital/labor, industry/employment), income size, region, or demographic and personal characteristics. These groups can manipulate the political system to redistribute income towards them. This is called **rent-seeking**.



There are also other groups that affect government fiscal decisions:

- Judiciary – through court decisions.
- Journalists – by bringing certain issues to public attention.
- Experts – information is potentially an important source of power.

Government growth

The concern about political economy issues has been stimulated by the growth of the government. There are different explanations for the growth of the government. The most prominent theories follow:

- **Citizen preferences:** Growth in government expenditure is an expression of the preferences of the citizenry.
- **Marxist view:** Growth in government expenditure depends to the political economic system. In the Marxist model, the private sector tends to overproduce, so the capitalist-controlled government must expand its expenditures in order to absorb this production.
- **Chance events:** External shocks to the economic and social systems require higher level of government expenditure.
- **Change in social attitudes:** Social trends encouraging personal self-assertiveness lead people to make extravagant demands on the political system.
- **Income redistribution:** Government grows because low-income individuals use the political system to redistribute income towards themselves.

Many people want to control the growth in government. Proposals include encouraging private sector competition, reforming the budget process, and constitutional amendments.