

Price Theory  
Lecture 11: Political Economy

### **I. The Economic Approach to Politics**

The "public interest" assumption: when modeling political agents (politicians, bureaucrats, etc.), assume they are attempting to serve the public interest as they perceive it.

The "symmetry" assumption: when modeling political agents, make the same motivational assumptions you would make about agents in the private sector. If you assume self-interest for private sector agents, then assume self-interest for political agents as well. If you assume altruism for political agents, assume altruism for private sector agents as well.

Public Choice Economics: the branch of economics, pioneered by James M. Buchanan and Gordon Tullock, that applies economic tools to understand the outcome of political processes. Public choice economics drops the "public interest" assumption in favor of the "symmetry" assumption.

### **II. The Choice to Vote**

How do people decide whether to vote? The same way they decide everything else: they compare the (marginal) costs and (marginal) benefits of doing so.

- What are the benefits of voting? Making it more likely that policies you favor will be adopted. But the marginal benefit of one vote is very small, because one vote is extremely unlikely to affect the outcome of an election. And even if one vote did affect the outcome, the difference between the candidates might be very small. And even if you strongly support one candidate and your vote causes him to get elected, his influence over policy outcomes will be diluted by the influence of other legislators.
- What are the costs of voting? The time and effort it takes to visit the polling booth, the risk of getting hit by a truck on the way there, etc. These costs are actually very large compared to the benefits.

Given the high marginal costs and low marginal benefits of voting, economists predict many people will engage in rational non-voting. Rational non-voting is the choice not to vote because the marginal costs exceed the marginal benefits of doing so.

### **III. The Choice to Become an Informed Voter**

What incentive do voters have to become informed about political issues? The primary benefit of becoming informed is being able to cast a vote more in line with your interests. But as just discussed, the marginal benefit of one vote is very small, so the benefit of becoming informed about how to cast the vote is just as small. Meanwhile, the marginal cost of becoming informed can be very large -- it takes time and effort to become informed. Consequently, economists predict that most voters will be rationaly ignorant:

they correctly see that the individual costs of becoming informed exceed the benefits, so they choose not to become informed.

As a corollary, we can observe that people are most likely to become informed about those things that affect them most directly. Why? Because if something affects you directly, the marginal benefit of becoming informed about it is greater. For instance, students at CSUN probably know a lot about the requirements for graduation at CSUN; they are likely to know a little about how the CSU system is funded; they are not likely to know much at all about national education policy.

#### **IV. How Do Politicians Select Policies?**

In public choice economics, we usually assume that politicians are governed by the vote motive: they are most interested in getting votes in order to stay in office. Even a public-spirited politician with non-self-interested goals must obtain votes in order to be able to achieve those goals. (This does not imply always following majority opinion, as we'll see later.)

In keeping with vote motive, politicians will pick those policies that accrue more additional votes than they lose. Which policies are most likely to yield net increases in votes? Three factors are crucial here:

- **Bundling.** Voters generally cannot vote on each issue individually; instead, they must choose among package deals represented by candidates or party platforms. (Initiatives and referenda are exceptions.)
- **Rational ignorance,** as explained above. This means that voters (a) are likely to be ill-informed about most issues, and (b) are most likely to be informed about those issues that have the largest personal impact.
- **Differential organizational costs.** When different groups of people are affected by a policy, they will typically try to organize to support their position. But some groups are more easily organized than others. In general, the smaller is the group, the less costly it is to organize its members. E.g., it's easier to organize farmers (a very small group) than it is to organize all the consumers of food (a very large group).

These factors lead to the following (possibly counterintuitive) conclusion: Politicians will tend to adopt policies with concentrated benefits and dispersed costs. That is, the benefits of a policy will tend to be focused on a small group of people, while the costs of a policy will tend to be spread out over many people. Why?

- A small group that gets great benefits is much more likely to be organized, willing to contribute funds for lobbying, and willing to vote based on a single issue.
- Meanwhile, even if the costs are large in the aggregate, they may be spread so thin among the consumers or taxpayers that (a) the people affected are unlikely to be well informed about it, and (b) they are unlikely to vote based on this one issue.

The policies adopted need not have benefits greater than their costs. In fact, the costs may be much larger than the benefits in total. The policy gets implemented because the beneficiaries are much more likely to be politically effective than those harmed.

The logic of "concentrated benefits, dispersed costs" contradicts the common belief that politicians choose the most popular policies, but it is very consistent with the well-known phenomenon of special-interest legislation.

## **V. What Policies Will Special Interests Support?**

Naturally, special interests seek policies that will enhance their own wealth. But this is rarely a simple matter of pure transfers of wealth (such as through raising taxes on everyone else). Why not? Because a policy is more likely to generate opposition if its effect is obvious. A policy that is transparent is easier to get people informed about, and hence easier to oppose through voter mobilization and fund raising. So there is an incentive to support policies that concentrate costs on the ill-informed, and the policies that do that best are more subtle.

Rent-seeking means actions taken by individuals and groups to alter public policy for personal advantage at others' expense.

The term "rent-seeking" comes from the fact that many special-interest policies have the effect of creating "monopoly rents." A monopoly rent is, simply, the transfer (relative to competition) that happens when a monopoly is created. Policies that successfully hold prices above the market price -- for example, price floors or barriers to entry -- have essentially the same impact as a monopoly. They transfer wealth while creating dead-weight losses. Examples include agricultural price supports, tariff barriers, professional licensing, etc.

Rent-seeking causes losses of wealth in two ways:

- the dead-weight losses resulting from the policies themselves, and
- the expenditures interest groups make in lobbying for, maintaining, and competing for those policies. (The resources used in this way could be used for doing productive work, rather than transferring and destroying wealth.)

## **VI. The Political Arena as a Prisoners' Dilemma**

Each of us is likely to be a member of one group or another that could benefit from some kind of special-interest legislation. This legislation reduces wealth on net, but it's good for a small group of people.

Each group, therefore, has a dominant strategy to pursue its special interest. Yet in the aggregate, when many groups succeed in getting special-interest legislation, it may be the case that each group loses more (from the burden of everyone else's policies put together) than it gains (from its own special legislation). The net result is that everyone, or nearly

everyone, may be worse off than if there were no such legislation. In short, the "rent-seeking game" turns out to be a kind of Prisoners' Dilemma.