

Public Choice: A Story of the Ideas

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What Motivates People?

- Traditional view – dualistic motivations in private and political markets
- Public Choice view – “People are people”
- Realistic assumptions:
 - Players in government are as “self-interested” as players in the market
 - Everyone tries to economize (i.e., achieve maximum gain at minimum cost)
 - People have limited knowledge and limited benevolence

Before Public Choice

- David Hume (1742) & Adam Smith (1776)
 - Urged to treat people in government as 'knaves'
 - Criticised relationship between business and government
- Jean-Charles de Borda (1781)
 - Nature of elections
 - Ranking the options or candidates
- Marquis de Condorcet (1785)
 - Problem of *cycling*
- Knut Wicksell (1896)
 - Just distribution of tax, *unanimous* agreement

Modern Public Choice Thinkers

- Duncan Black (1948)
 - Essays on electoral problems, *median voter theorem*
 - Arguably the founder of modern public choice
- Kenneth Arrow
 - *Arrow's impossibility theorem*
 - *Social Choice and Individual Values (1951)*
- Anthony Downs
 - *Rational choice theory* applied to politics
 - *Rational ignorance of voters* (in *An Economic Theory of Democracy*, 1957)
 - *"Parties formulate policies in order to win elections, rather than win elections in order to formulate policies."*

'Virginia School' of Public Choice

- James Buchanan & Gordon Tullock
 - The Calculus of Consent (1962)
 - *Logrolling*
 - *Constitutional stage rules vs. in-period rules*
 - *Unanimous agreement for Constitution to prevent exploitation of minority*
 - Government failure vs. Market failure
 - *Monopolies, externalities, asymmetric information (comparative study)*
 - *Nirvana fallacy*



Elements of Public Choice

- For Buchanan, constitutive elements that provide the foundations of this theory are:
 - Methodological individualism
 - Homo economicus
 - Politics-as-exchange

Modern Public Choice

- William H. Riker (1962)
 - Logrolling among special interest groups (SIGs)
 - Public Choice + Game theory
 - Best strategy – *A minimum winning coalition*

- Mancur Olson
 - *The Logic of Collective Action (1965)*
 - *Impact of SIGs on the political process*
 - *Ineffective lobbying campaigns of large interest groups*
 - *free-rider problem (trade unions vs. consumers and taxpayers)*

Modern Public Choice

- George Stigler (and arrival of the Chicago school)
 - Regulations would serve SIGs rather than general public
 - *'as a rule, regulation is acquired by industry, and is designed and operated primarily for its benefit'*. (1971)
- William A. Niskanen
 - Studied interests and objectives of Bureaucrats
 - Bureaucrats vs. Legislators (specialists vs. generalists)
 - *Bureaucracy and Representative Government* (1971)
- Anne Kreuger
 - Coined the term 'rent-seeking'
 - *The political economy of the rent-seeking society* (1974)

Present Day Public Choice

- Elinor Ostrom (2009)
- Roger Congleton
 - *40 Years of Research on Rent Seeking* (2008)
- James Gwartney
 - Co-author of textbook *Economics: Private and Public Choice* (2010)
- Bryan Caplan
 - *The Myth of the Rational Voter* (2007)
- Tyler Cowen
- Bruce Yandle
- Randy Simmons
 - *Beyond Politics: The Roots of Government Failure* (2011)

Nirvana Fallacy

“A Roman Emperor was once asked to judge a singing contest between two contestants, and upon hearing the first, gave the award to the second under the assumption that the second clearly couldn't be any worse than the first...”

— Gordon Tullock

What's the error here?

Market Failure

- **Public goods** – “non excludable, non-rival consumption/use,” “free rider” problem, uneconomic transaction costs
- **Externalities** – imposing costs on others
- **Opportunism** – monopoly power, asymmetric information

The market is clearly “imperfect”

Government Failure

- Government exhibits the same or similar problems as private markets.
- Government involvement **can** make problems **worse**.
- To avoid the Nirvana Fallacy we must not assume that government intervention will be better than imperfect markets; we must compare real-world choices between imperfect markets and imperfect governments.

Market Failure vs. Government Failure



Dialectics of the 3 Is

Private and Political Markets

Interest

Incentives

Information

Interest – Maximisation

What is the common objective that promotes the self-interest of these players?

What do they want to maximise?

Businesses

Profits (money, power, prestige, legacy, public good)

Consumers

Utility (lower prices, better quality, better service)

Politicians

Re-election (money, power, prestige, legacy, public good)

Bureaucrats

Budget & Turf (money, power, prestige, legacy, public good)

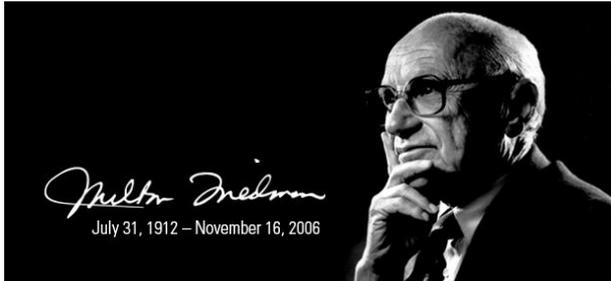
Voters

Utility (government benefits, lower taxes, liberty, public good)

Incentives



Incentives - Friedman's Law of Spending

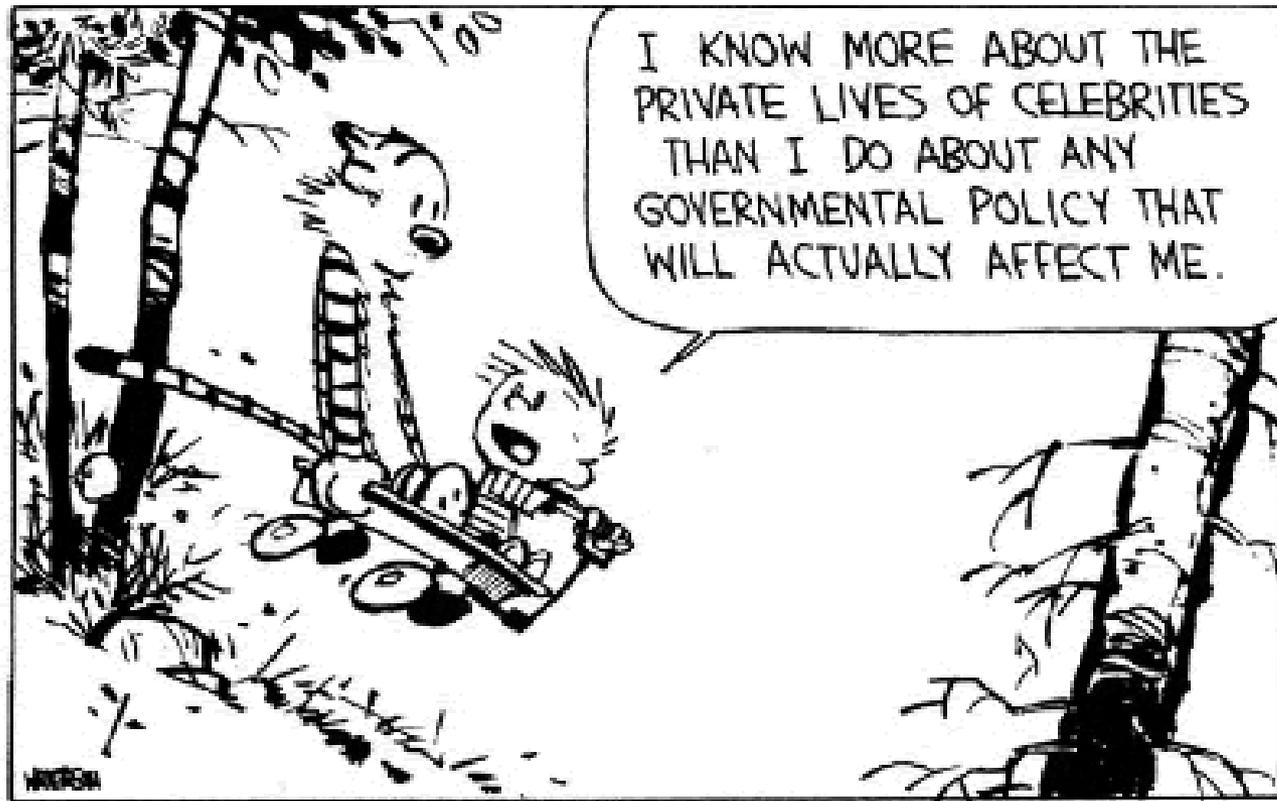


On whom money is spent

Whose money is spent

		Yourself	Someone Else
Yours	Strong incentive to economise & seek highest value	Strong incentive to economise , weaker incentive to seek highest value	
Someone Else's	Weak incentive to economise, strong incentive to seek highest value	Weak incentive to economise, weak incentive to seek highest value	

Information



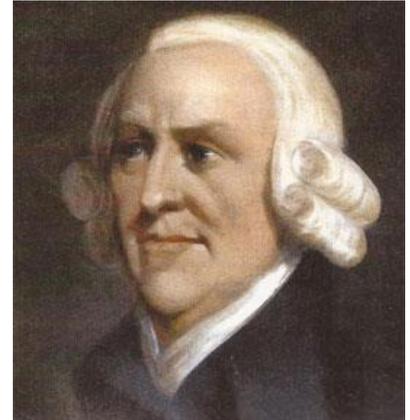
[Video: "Public Choice: Why Politicians Don't Cut Spending"](#)

- Concentrated benefits, diffused costs
 - Laloo Yadav as Minister of Railways
 - Bullet train
- Rational ignorance
- Costs of organizing with others
- Bootleggers and Baptists
- Regulatory capture
- Rent-seeking

Invisible Hand of the Political Market?

When does personal interest align with social interest in markets?

- Adam Smith's Invisible Hand works with
 - Private property
 - Open competition (free entry and exit)



What rules would harmonize self interest of the stakeholders with the social interest in political markets? What's the invisible hand in political markets?

- Constitutional rules, institutional structures of checks and balances?
- Competitive governance: Subsidiarity, super majority, referendums, private cities?

Lessons of Public Choice

1. We must **compare** the likelihood and extent of “government failure” against the likelihood and extent of “market failure”
 - *“Comparative Institutional Analysis”*
2. The danger of government failure persisting is often greater than that of market failure

Lessons of Public Choice

3. Government should be limited by rules (i.e., a constitution) that are above the legislature/majority vote
4. It is difficult for the public to make a case-by-case cost-benefit analysis of each government act, so general skepticism of government intervention on principle is more efficient

Public Choice: An Indian Research Agenda

- Public Choice
 - A research agenda or a school of thought ?
- A gold mine waiting to be explored
 - A two-party system vs. a multi-party system
 - A 50 percent+1 majority vs. a first past the post system
 - Rules at all levels of government (challenging the unitary bias)
- Buchanan and Tullock founded Public Choice Society in 1965
 - Time for a Public Choice Society of India?



Public Choice: History and Evolution

Thank You!

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