Chapter 5

Public Choice and the Political process
Public Choice and the Political Process

- 2004 President Bush threatened to veto first bill, highway spending bill
  - Reason: So many projects of dubious value that he could not justify increasing the deficit further
    - Two bridges in Alaska
    - One cost $200 million
      - One of the highest bridges in America (Think Golden Gate)
      - Connected Ketchikan (pop. 7,845) to an island of 50 residents
    - The other would cost $2 billion – two miles long – Anchorage to a port town with one resident and almost no businesses.
  - Examples of Politicians deriving power by brining funds to their home districts
    - Example: Rob Bishop
Public Choice and the Political Process

- Don Young – Congressman for Alaska
  - “This is the time to take advantage of the position I am in…If I had not done fairly well for our state, I’d be ashamed of myself.”

- **Pork:** Federal spending for local projects that serve mostly to transfer federal dollars to a politician’s constituents

- Kit Bond – Senator for Missouri
  - “Pork is a mighty fine diet for Missouri, low in fat and high in jobs.”
Public Choice and the Political Process

- July 2005, Transportation Bill Passed
  - $1 billion earmarked for pet projects in Alaska including the two bridges
  - Congressman Young, “I stuffed it like a turkey”

- Emergency Stimulus Bill of 2008
  - Started out as a 4 page Bill
  - Subsides for timber firms
  - Tax Break for Teachers
  - Reduction on Tariffs on certain arrows
  - The Bill

- Why governments do what they do?
Intergenerational Transfers

How is Social Security Doing?

Why might the political system in the US have led to this pattern of intergenerational transfers?

<table>
<thead>
<tr>
<th>Age in 1998</th>
<th>Male</th>
<th>Female</th>
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<tbody>
<tr>
<td>0</td>
<td>$249.7</td>
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<tr>
<td>50</td>
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<td>–115.0</td>
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<tr>
<td>70</td>
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<td>Future generations</td>
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</table>
Public Choice and the Political Process

- We have seen how markets allocate goods and services
  - We have also seen their limitations
  - Government can step in and provide certain goods, but how does it work?

- Public Choice studies how decisions to allocate resources and redistribute income are made through a nation’s political system
  - Public Choice: A choice made through political interaction of many people according to established rules
Most Preferred Outcome

- Political equilibrium – an agreement on the level of production of one or more public goods, given the specified rule for making the collective choice and the distribution of tax shares among individuals
  - Given the political environment **Decide the level of the public good to be provided**

- Tax shares – the amount an individual must pay when the government provides a good.

- Thinking Caps
  - At issue: Providing a public good for a Price (For an individual the price is the tax share)
  - **How could we always ensure Unanimous Consent for the provision of a government provided public good?**
Most Preferred Outcome

- **Lindhal Pricing:** When each person pays an amount equal to their marginal benefit.
  - The government provides the public good and finances its provision through each person paying what it is worth to them

- **Most-Preferred Political Outcome:** the quantity of the government-supplied good corresponding to the point at which the person’s tax share is exactly equal to the marginal benefit of the good
  - $t_i = Mb_i$
Jack’s demand curve for fireworks is fairly steep. While Ava’s demand curve for fireworks is fairly flat. Adding up their individual demands curves vertically gives the aggregate demand. With this marginal cost, it is socially beneficial to produce the good. The socially efficient level is 75 units. This generates a tax price of 75¢ for Jack in Lindahl equilibrium. And a price of 25¢ for Ava in Lindahl equilibrium. Jack’s surplus is this area... Ava’s surplus is this area...
Elections and Voting

- Many citizens choose not to vote because:
  - The cost of time and effort to vote outweighs the perceived benefit
  - They believe that their votes do not make any difference
  - They may see little or no difference between the alternatives considered in the election
- Benefit = (Prob vote makes difference) x (Actual benefits received if candidate wins).
- Costs = Driving + Waiting time + Voting effort
- They have scarcity of information
  - Rational ignorance – lack of information about public issues that results because the marginal cost of obtaining the information exceeds the apparent marginal benefits of doing so
  - Are Political institutions the only place that rational ignorance exists?
  - Silicon
Determinants of Political Equilibrium

1. **Public choice rule**: the proportion of yes votes in relation to the number of votes required for approval of the issue

2. **Costs** of the public good

3. **Information** available to voters on the cost and benefit associated with the issue

4. Distribution of **tax shares** among voters and the way in which extra taxes vary with extra output of the good provided

5. Distribution of **benefits** among voters
Direct Democracy

- Do you think that widows who lost their spouse to active military duty should pay taxes on their house?
  - _________: A measure placed on the ballot by the government allowing citizens to vote on state laws or constitutional amendments that have already been passed by the state legislature.

- How did Proposition 8 in California come into existence?
  - _________: The placement of legislation on the ballot by citizens through petitions and the collection of signatures.

- Recently the City of Ogden Initiated a Trece Gang Injunction. Did the residents of Ogden help make that decision? How?
  - _________: Don’t vote on public goods directly, but rather on representatives.
Political Equilibrium Under Majority Rule

An example:

- Under simple majority rule, citizens must decide on the quantity of a pure public good to produce.

- Given the average cost of producing the good, a tax-sharing scheme is announced whereby each person will pay the same tax per unit of the good.

- If the good can be produced under conditions of constant costs and there are $n$ individuals in the community, each individual will pay a tax equal to $\frac{AC}{n}$ per unit of the public good.
The political equilibrium occurs at the median most-preferred outcome of four security guards per week under simple majority rule. Each voter pays a tax share of $50 per guard per week. In equilibrium, the weekly tax bill of each voter is $200.
TABLE 5.1  
Voting to Provide Security Protection and Election Results Under Simple Majority Rule

<table>
<thead>
<tr>
<th>INCREASE SECURITY GUARDS PER WEEK TO</th>
</tr>
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<tbody>
<tr>
<td>1</td>
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<tr>
<td>---</td>
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<tr>
<td>Voters</td>
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<td>B</td>
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<tr>
<td>H</td>
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<tr>
<td>Results</td>
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The Median Voter

- The **median voter** is the one whose most preferred outcome is the median of the most-preferred outcomes of all those voting.
  - The voter whose tastes are in the middle of the set of voters

- **If** the marginal benefit of a public good declines for all voters (single peaked), **then** the median voter’s most preferred quantity of the good always is the political equilibrium under majority rule
Vote maximization leads to the median Voter Outcome.
Median Voter

- The greater the dispersion of most-preferred outcomes from the median, the more likely there will be dissatisfaction with public choices under majority rule.
Assumptions of the Median Voter Model

- The median voter model is a powerful tool, but relies on a number of assumptions worth mentioning:
  - Single-dimensional voting: Voters only care about one issue.
  - Only two candidates: With a 3rd candidate, there is no stable equilibrium.
  - No ideology or influence: Assumes politicians only care about votes, not ideological positions.
  - No selective voting: All citizens actually vote.
  - No money as a tool of influence.
  - Perfect information along three dimensions: voter knowledge of the issues, politician knowledge of the issues, and politician knowledge of voter preferences.
Testing the median voter model

- Stratmann (2000) found that redistricting, which changes the nature of the district’s median voter for simply by redrawing boundaries, affected the voting preferences of legislators.
- He asked: When districts become more conservative through redistricting (as measured by the vote for the Republican presidential candidate in 1988 and 1992), but were represented by the same politician, did the politician start to vote more conservatively?
  - The answer: Yes.
  - Course website
Single and Multi-peeked Preferences

- **PUNCH LINE**: When multi-peeked preferences exist, there may not exist a political equilibrium
  - A single consensus on the amount of the public good to be provided does not exist.
  - **Cycling**: When pair-wise election does not deliver a consistent aggregation of individual preferences

- **Single Peaked Preferences** imply that individuals behave as if a unique optimum exists for them
  - There is one alternative that voters prefer to all others

- **Multi-peeked preferences** imply that people who move away from their most-preferred alternative become worse off first, but eventually become better off as the movement continues in the same direction.
Which of the following have multipeaked preferences, a or b? Which group exhibits the multipeaked nature of preferences?
Majority voting delivers a consistent outcome

<table>
<thead>
<tr>
<th>Preference rankings</th>
<th>Types of voters</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Parents</td>
</tr>
<tr>
<td>First</td>
<td>H</td>
</tr>
<tr>
<td>Second</td>
<td>M</td>
</tr>
<tr>
<td>Third</td>
<td>L</td>
</tr>
</tbody>
</table>

- First, vote on funding level $H$ versus funding level $L$.
- Then, vote on funding level $H$ versus funding level $M$.
- Then, vote on funding level $L$ versus funding level $M$. 
Now let's examine a case where majority voting does not work.
First, vote on funding level $H$ versus funding level $L$.

Then, vote on funding level $H$ versus funding level $M$.

Then, vote on funding level $L$ versus funding level $M$. 

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Arrow’s Impossibility Theorem

- **Def:** There is no social decision (voting) rule that converts individual preferences into a consistent aggregate decision without either (a) restricting preferences or (b) imposing a dictatorship
  - To turn individual preferences into a consistent social decision rule:
    - one has to restrict preferences
    - Impose a dictators preferences
Logrolling

- What Kind of outcomes do we see when we vote on more than one outcome at a time?
- **Def:** When intensities of preference differ on issues, groups may trade votes for those issues of great interest to them; this is called *logrolling*
- **Implicit logrolling** occurs when political interests succeed in pairing two or more issues of strong interest to divergent groups on the same ballot or the same bill
Lobbying (special-interest groups)

- **Def:** The expending of resources by certain individuals or groups in an attempt to influence a politician

- Politicians listen because:
  - Lobbyists usually have a lot of info on complicated issues
  - $$$

- Lobbying
  - Imposes small costs on a lot of people
  - Large benefits on small number of people
  - EX

- Large groups with small individual interest suffer from the free rider problem in trying to organize politically.
Lobbyists in action

- Protecting US Textiles from foreign competition
  - Without protection, 60,000 people would lose their jobs.
  - Impose tariffs, which increases the price of textiles (think, ‘clothing’) 46% in the 1930s
  - Cost to the Public was $52,000 per job saved. Each job only paid ______-to the person

- Farm Subsidies
  - $25 billion in direct price supports
  - $16 billion from the higher prices of food
  - Average recipient of the subsides receives $19,600, which is larger that most welfare programs
  - Average household has to pay $390
Subsidies for Sports Stadiums

Owners and politically powerful supporters influence the electoral chances of those choosing stadium policy.

General taxpayers left on the sidelines.
Does Direct Democracy Help?

- Direct expression and a more “hands on” process are expected to generate outcomes that are:
  - Viewed as more legitimate.
  - A better reflection of the “will of the people.”

- Weaknesses
  - Biased Turnout
  - Biased Information
Evidence on Direct Democracy

- Is spending lower when the vote is yes than if no vote occurs?
  -

- Is spending lower when the vote is no, but funding occurs anyway, than if no vote occurs?
  -

- Is the public share of spending on a stadium lower if the project is put to a vote than if no vote occurs?
Government Failure

- Is the Government gentle and kind?
- Is the only concern of the government to do what is optimal for the citizenry?

Government failure: the inability or unwillingness of the government to act primarily in the interest of its citizens.

- Areas to consider
  - Size Maximizing Bureaucracy
  - Corruption
Bureaucracy

- **Def**: Administration with many levels of authority among numerous offices.
  - Private sector rewards its employees for production with little waste
  - The bureaucrat receives wages based on the size of its agency.
  - → Goal of Bureaucrat is to maximize the size of its agency!
Size Maximizing Bureaucrat

- Where is the optimal quantity?
- 
- What would a size maximizing Bureaucrat do?
- 
- If the Bureaucrat were really skilled, perhaps they would convince agencies to provide funding like $Q_B'$ and waste even more resources.
Corruption

- **Def:** where government officials abuse their power in order to maximize their own personal wealth or that of their associates.

“But how do you know for sure you’ve got power unless you abuse it?”
Corruption Examples

- Former Illinois governor George Ryan was indicted in December 2003 for selling state contracts to his friends in exchange for cash, gifts, loans, and trips for his family. The case is still pending.

- This was uncovered as part of “Operation Safe Road,” which investigated bribes that many truck drivers had given to officials at then Secretary of State Ryan’s office to obtain a driver’s license.
  - At least 20 people had died in accidents involving drivers who had bribed officials for their licenses.

- The investigation resulted in 70 indictments and over 60 convictions of many people who were close friends and allies of the former governor.
Corruption Example

Governor of Illinois Rod Blagojevich

- Conspiracy to commit mail and wire fraud
- Solicitation of Bribery
- Several Pay-to-play schemes
  - Obtain personal gain while filling Obama’s vacant senate seat to the highest bidder.
- Dozen Separate Federal Investigations
- A December 11, 2008, article by the Chicago Sun-Times suggested that several psychologists believe Blagojevich's hairstyle may be a sign of narcissistic personality disorder.
Corruption Example

- Carlos Menem was elected President of Argentina in 1989 and immediately rewarded members of his political party with cushy government jobs requiring only the occasional appearance to pick up a paycheck.
Summary

- Market does not always provide public goods at the optimal level. Let’s see what how to government can help
  - Political equilibrium
- Mechanisms for aggregating individual preferences and problems with aggregation
- Types of Representative democracy
  - Pursue policies preferred by median voter
- Government Failure