

## LECTURE 08: PUBLIC CHOICE

- I. What Is the Government?
  - a. A bunch of people with their own incentives. It is *not*, by definition, people who are out there to help you. While some people are motivated by helping others—and there might even be more of them on average working for the government than in other organizations—there is no reason to believe that is the ultimate motivating factor. Why should political actors be fundamentally different from everyone else?
  - b. Hence *public choice*—the application of economics to political actors (interest groups, politicians, bureaucrats, voters, etc).
- II. Key Assumptions
  - a. *Methodological individualism*. Political actors, not institutions, act. “The government does/wants something” is a nonsense phrase. People who work for the government do and want things. Only individuals act.
  - b. *Behavioral symmetry*. Political actors are no different than non-political actors. They have their own priorities. They respond to incentives and these incentives originate from the institution they govern. Changing who’s in charge will have little effect because the rules haven’t changed.
- III. Rational ignorance
  - a. Let’s begin with voters. Consider the Declaration of Independence and fireworks.
  - b. People often get upset when surveys reveal that a large number of Americans don’t know common things (politics, geography, mathematics).
  - c. However, it is expensive to learn such things. Just because someone is unaware of some things does mean they are stupid. It is often rational to stay ignorant to that which doesn’t really impact your life.
  - d. Thus we have *rational ignorance*: when the costs exceed the expected benefits of learning something, people don’t learn it. It’s a standard assumption of public choice.
  - e. Lesson: studies on what meaningless facts Americans don’t know tells use little of the strength of the economy or intelligence of people. It would be much more illuminating to tailor questions to professions. If

most political science professors couldn't find Europe on a map, I'd be much more concerned.

#### IV. Rational irrationality

a. Instead of focusing on voters being rationally ignorant, economist Bryan Caplan argues that people are *rationality irrational*—irrationality is a good that people indulge in when it is cheap to do so. They have emotional attachment to ideas such as economic isolation and since talk is cheap,<sup>1</sup> they gladly support tariffs and other poor economic ideas.

i. This has the advantage of explaining why people who oppose free trade also buy the cheaper import. When actually shopping, indulging in the romanticism of economic nationalism is too expensive.

#### V. Median Voter Theorem

a. Now we turn to the incentives of politicians. While some politicians could sometimes be described as benevolent, all want to be reelected.

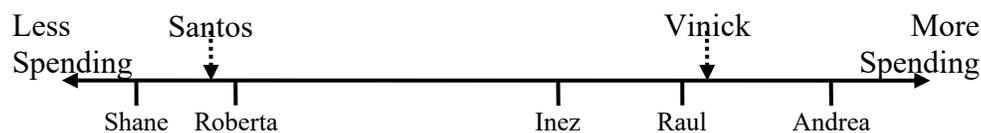
b. To be elected, you need to appeal to the *median*—or middle—voter.

i. Note “median” is not the same as “average.” If one person has \$60 and two people have \$0, the average amount of money is \$20, but the median is \$0.

c. The *median voter theorem* states when voters vote for the policy that is closest to their ideal point on a line, then the ideal point of the median voter will beat any other policy in a majority rule election

i. In other words, the median voter determines the election results.

d. To see why, consider how much five voters and two politicians prefer to spend on military:



i. Candidates Santos and Vinick prefer less and more spending, respectively. But what each really wants is to be elected.

ii. Note how Santos gets more votes if he moves right and goes out for more spending. Note that Vinick can respond by going left and demands less spending. Eventually, they will meet at the median voter.

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<sup>1</sup> If a protectionist withdrew her support, nothing would change as a single vote is too small to swing the election.

- e. MVT clearly plays out when politicians change their speeches when they are running in a primary election versus in a general election.
  - f. MVT doesn't always apply. If Santos or Vinick moves too far to the middle, the extremes might not vote at all. At the same time, most voters are in the middle; losing a few fringe voters is worth gaining several mainstream voters.
- VI. Political formula for success
- a. Why does the government pay farmers to not grow crops?
    - i. One group to consider is the consumers who pay slightly more for food because there are fewer people producing.
    - ii. The other group to consider is the farmers who receive a tremendous boost in revenue because millions of people pay a little more.
  - b. This is one of the key insights of public choice: *concentrated benefits and dispersed costs*.
    - i. Because the costs are dispersed, people are rationally ignorant about these additional costs. A penny or two more for apples is hardly worth worrying about or even bother noticing. But even if they did know, it's not worth taking to the streets for.
    - ii. Because the benefits are concentrated, those that receive them have an interest to spend a great deal of money to lobby the government and secure such benefits. Their pressure will easily outweigh any token resistance consumers will bother with.
    - iii. Politicians then have an incentive to impose laws that benefit the few at the cost of the many.
  - c. The ultimate result is *rent seeking*.
    - i. *Rent* is an increase in one's wealth that doesn't increase total wealth (and sometimes decreases it). Another way to put it is a payment for production beyond what's necessary to incentivize that production. While rent, as defined, isn't inherently bad, economists use the term "rent" to describe compensation that's inherently corrupt.
    - ii. *Rent seeking* is the act of pursuing rent. In practice, economists call rent seeking any act where someone tries to use politics to enrich themselves at the expense of society. Remember when we discussed crony capitalism at the beginning of the semester?
      - 1. Sometimes what seems like rent seeking is not rent seeking. If a company lobbies a government to change a bad law, that's not really rent seeking. When economists

talk about rent seeking, there is always a negative connotation.

2. Thus it's hard to tell if something is rent seeking because rent seekers dress up their language to hide their motivations. No one's going to admit to being a rent seeker because it's inherently unjust.
  3. One way to tell if someone's a rent seeker is if they are getting targeted benefits, benefits that are just for a particular firm/person/industry. For example, if a car company wants automobile tariffs, it might claim that it merely wants to protect American jobs. But that same company won't want steel tariffs even though their stated logic of protecting American jobs is the same. The difference is that steel tariffs make their profits lower (higher costs) while automobile tariffs makes their profits higher (less competition).
- iii. There are many examples of rent and rent seeking:
1. Sugar tariffs protect the sugar and corn industries in the U.S. (it's why high fructose corn syrup is in so many things).
  2. Licensing requirements are often very strong making it hard for new firms to compete with existing ones. This lower level of competition allows companies to charge higher prices.
  3. The Walt Disney corporation lobbied for copyright extension because Mickey Mouse and other works were about to enter the public domain. They succeed with the 1998 Copyright Extension Act, pushing the public domain date to 2023.<sup>2</sup>
- iv. Technology firms of all stripes pursue similar efforts to extend their patents, making it more difficult to build and improve on the initial invention. The Wright Brothers were particularly aggressive with their intellectual property, hamstringing early aviation development.<sup>3</sup>
- v. New York City requires cab drivers to purchase the right to drive a taxi. Each taxi cab requires a license, called a medallion, to legally operate. These medallions are easily the most

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<sup>2</sup> <http://artlawjournal.com/mickey-mouse-keeps-changing-copyright-law/>

<sup>3</sup> <http://knowledgenuts.com/2015/04/18/how-the-wright-brothers-set-back-aviation-history/>  
<https://www.amazon.com/Unlocking-Sky-Hammond-Curtiss-Airplane/dp/0060956151>

expensive part of running a taxi service. They've been sold for up to \$1 million each.

## VII. The Worst Form of Government?

- a. This all seems to suggest democracy isn't all that great. Perhaps we should go back to a monarchy.
- b. But just because democracy is problematic doesn't mean other options aren't more problematic.
  - i. As Winston Churchill once said: "Democracy is the worst form of government, except for all the others."
- c. Indeed, we shouldn't think of democracy or its participants as evil; public choice theory, like all economic ideas, is an incentive story.
  - i. This is why James M. Buchanan, founder of public choice theory, was most interested in constitutional rules. Just as the First Amendment prevents political actors—including democratically elected political actors—from abusing their power with respect to religion and speech, there should be additional constitutional constraints to prevent other kinds of abuses and inefficiencies.
- d. Don't forget there are alternatives to political based decision-making: market-based decision making! This of course comes with its costs and dangers (poor quality, high prices, fraud, etc.) which may occur at a higher rate than government services.
- e. So we must remember the ultimate takeaway: It is *never* a choice between a good thing and a bad thing. The choice is always either between two bad things or between two good things. The answer is never obvious.
  - i. If someone ever tells you the answer to a social problem is "really simple," immediately discount what they are about to say. They probably haven't thought about it carefully.