

Public Choice

Public choice, or the economic theory of politics, is the application of the economist's way of thinking to politics. It studies those areas in which economic and political forces interact, and is one of the few successful interdisciplinary topics. The behaviour of the individual is taken to be rational, an assumption which political scientists and sociologists have also found to be fruitful.

While the term public choice was coined in the late 1960s, the type of politico-economic analysis has a long history. Condorcet was the first to recognize the existence of a voting paradox: in a system of majority voting, the individual preferences cannot generally be aggregated into a social decision without logical inconsistencies. Italian and Scandinavian public finance scholars have also explicitly dealt with political processes, in particular in the presence of public goods. Another forerunner is Schumpeter, who regarded the competition between parties as the essence of democracy.

The following four areas are central to public choice:

- (1) *Preference aggregation.* Condorcet's finding of a voting paradox has been generalized to all possible methods of aggregating individual preferences. The impossibility result remains in force, in particular when many issue-dimensions are allowed for.
- (2) *Party competition.* Under quite general conditions, the competition of two vote maximizing parties leads to an equilibrium: both parties offer the same policies in the median of the distribution of voters' preferences. The programmes proposed differ substantially when there are more than two parties competing, and when they can form coalitions.
- (3) *Interest groups.* The product of the activity of a pressure group is a public good, because even those not participating in its finance may benefit from it. Consequently, economic interests are in general not organized. An exception is when the group is small, when members only receive a private good from the organization, or when it is enforced by government decree.
- (4) *Public bureaucracy.* Due to its monopoly power in the supply of public services, the public administrations tend to extend government activity beyond the level desired by the population.

In recent years, the theories developed have been empirically tested on a wide scale. The demand for publicly provided goods and services has been econometrically estimated for a great variety of goods, periods and countries. An important empirical application is *politico-economic models* which explicitly study the interaction of the economic and political sectors. A vote maximizing government, which has to take into account the trade-off between inflation and unemployment, willingly produces a political business cycle. More inclusive politico-economic models have been constructed and empirically tested for various representative democracies: economic conditions such as unemployment, inflation and growth influence the government's re-election requirement, which induces in turn the government to manipulate the economy to secure re-election.

Viewing government as an endogenous part of a politico-economic system has far-reaching consequences for the theory of economic policy. The traditional idea of government maximizing the welfare of society has to be replaced by an emphasis on the consensual choice of the appropriate rules and institutions.

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Further Reading

Frey, B. S. (1978), *Modern Political Economy*, Oxford.
Mueller, D. (1979), *Public Choice*, Cambridge.
See also: *interest groups; public goods; voting.*

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Public Goods

Public goods are characterized by non-excludability (individuals not paying for the good cannot be excluded) and by non-rivalry in consumption (that is, it does not cost anything when, in addition, other persons consume the good). The supply of a public good is Pareto-optimal (efficient) if the sum of the marginal utilities (or the sum of the marginal willingness to pay) of the persons benefiting equals the marginal cost of supply. This efficiency condition differs from the one of the polar opposite, private goods, where marginal utility has to equal marginal cost of supply.

The basic problem of public goods is that the prospective consumers have no incentive to reveal their preferences for such a good and are thus not ready to contribute towards financing the provision of the good. In the extreme case this incentive to act as 'free rider' leads to no supply of the public good at all, although everyone would potentially benefit from its provision.

Public goods is one of the few theoretical concepts in modern economics often used by other social sciences. One of the most important applications is to the problem of organizing economic interests. Pressure groups largely provide a public good because all persons and firms sharing these interests benefit from the activity. For that reason, there is little or no incentive to join. The (pure) public goods conditions apply, however, only when the interests are shared by a large number of persons or firms, for example by consumers and taxpayers, and when there are no exclusive benefits offered to members only.

The incentive to act as a free rider in a market setting may (partly) be overcome by resorting to the political process. The direct use of simple majority voting does not guarantee that the resulting public-good supply is Pareto-optimal. This is only the case if the median voter (who throws the decisive vote) has a 'tax price' equal to his marginal willingness to pay. This will rarely be the case. In a representative democracy the competition between two parties leads under ideal conditions to the same outcome for public goods supply as simple majority voting. With more than two parties and/or imperfect political competition, the resulting public goods supply cannot in general be determined. Public goods should not be identified with public provision: some public goods are privately provided, and there are many non-public goods which are politically provided.

Decision-making procedures have been devised which solve the free-rider problem. These 'preference-revealing mechanisms' result in no one gaining by understating his preference for the public good. However, these proposals are difficult to understand by the participants and violate the principle of anonymity of voting.

In laboratory experiments, it appears that individuals are ready to contribute to the cost of providing a public good to some extent, even in the large number setting. Ethical considerations seem to play a significant role in the public goods context; many people appear to have moral qualms about behaving as free-riders.

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See also: *public choice*.