



ECONOMICS

PRIVATE AND PUBLIC CHOICE

16TH EDITION

GWARTNEY – STROUP – SOBEL – MACPHERSON

The Economics of Political Action

Full Length Text — Part: 2 Chapter: 6

Micro Only Text — Part: 2 Chapter: 6

Macro Only Text — Part: 2 Chapter: 6

To Accompany: “***Economics: Private and Public Choice, 16th ed.***”

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Slides prepared by Joseph Connors with the assistance of Charles Skipton & James Gwartney

The Size and Growth of the U.S. Government



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Government Spending as a Share of the U.S. Economy: 1930 - 2015

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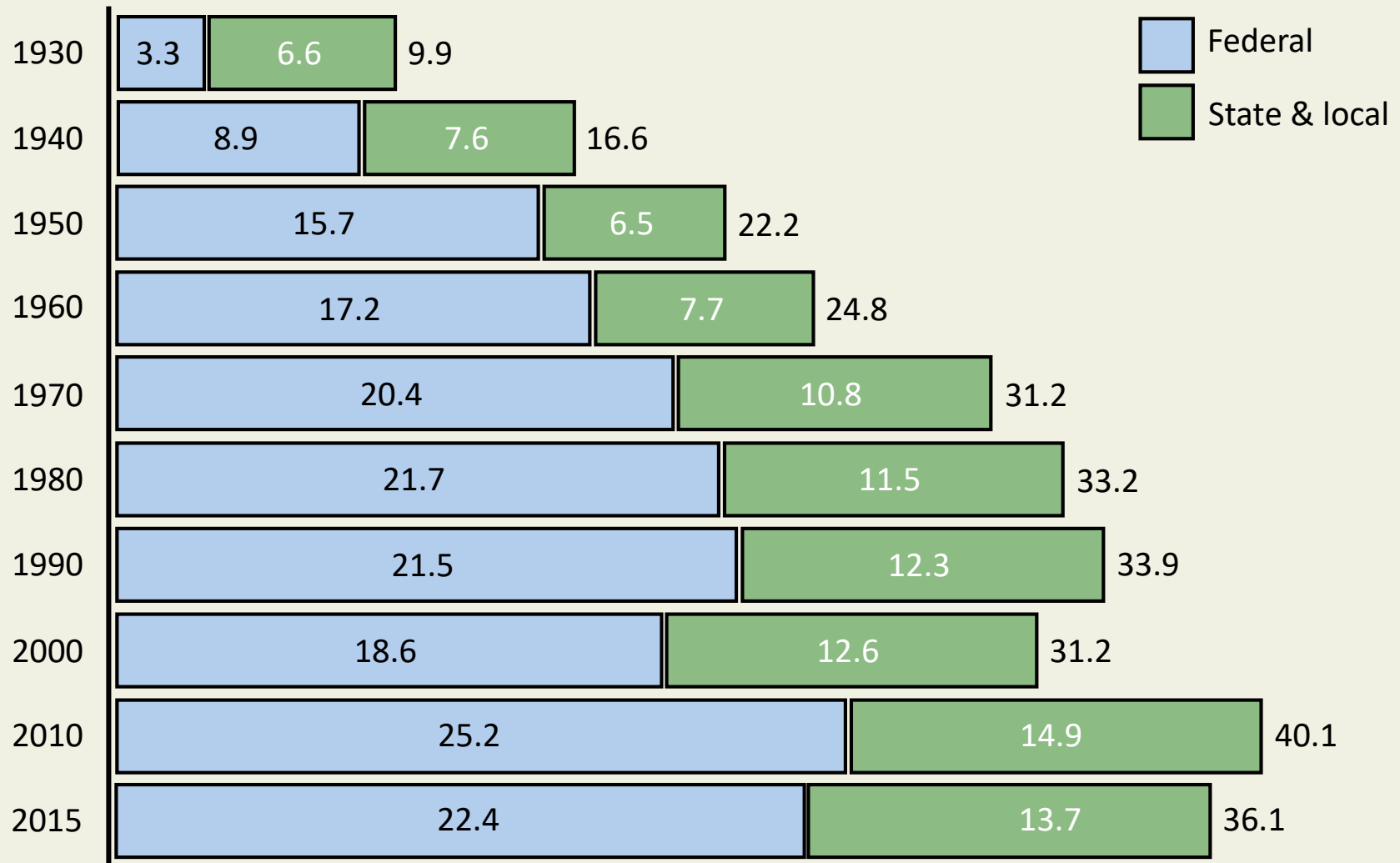
- The following slide shows total government spending (federal, state, and local) as a share of the US economy.
- Total government spending accounted for only 9.9% of GDP in 1930; only one third of this spending was at the federal level.
- Government spending, particularly at the federal level, soared from 1930 to 1980. Total government spending rose from 9.9% of GDP in 1930 to 33.2% in 1980 (more than 3 times its 1930 level).
- After remaining fairly constant between 1980 and 2000, the size of government increased substantially to 40 percent in 2010 and 36 percent in 2015.

The Size of the US Government: 1930-2015

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Government Expenditures as a Share (%) of GDP

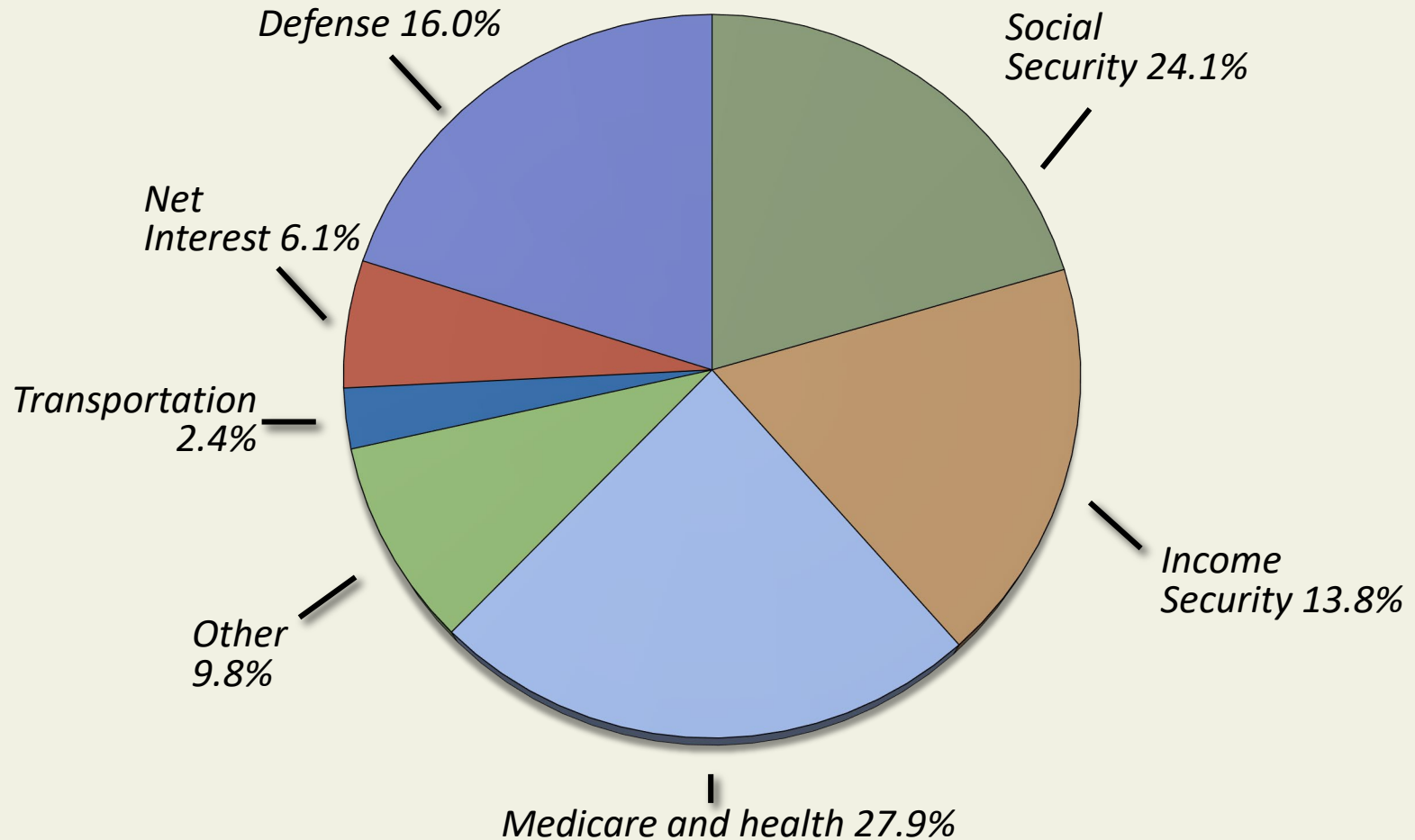


How the Federal Government Spends, 2015

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Federal Spending (2015) = \$3,688 Billion



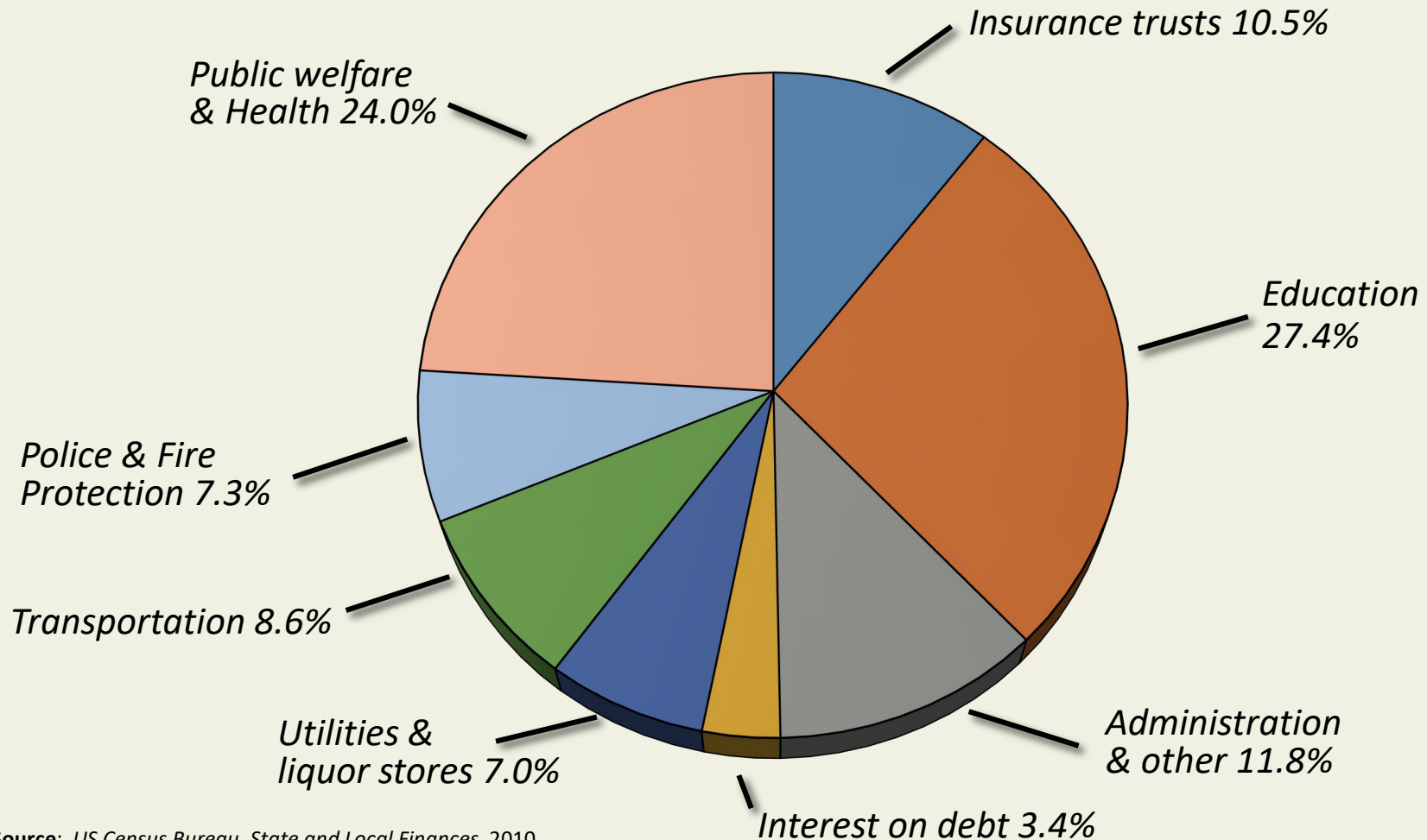
Source: Economic Report of the President, 2013.

How State and Local Governments Spend, 2013

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State and Local Spending (2013) = \$3,204 Billion



Source: US Census Bureau, State and Local Finances, 2010.

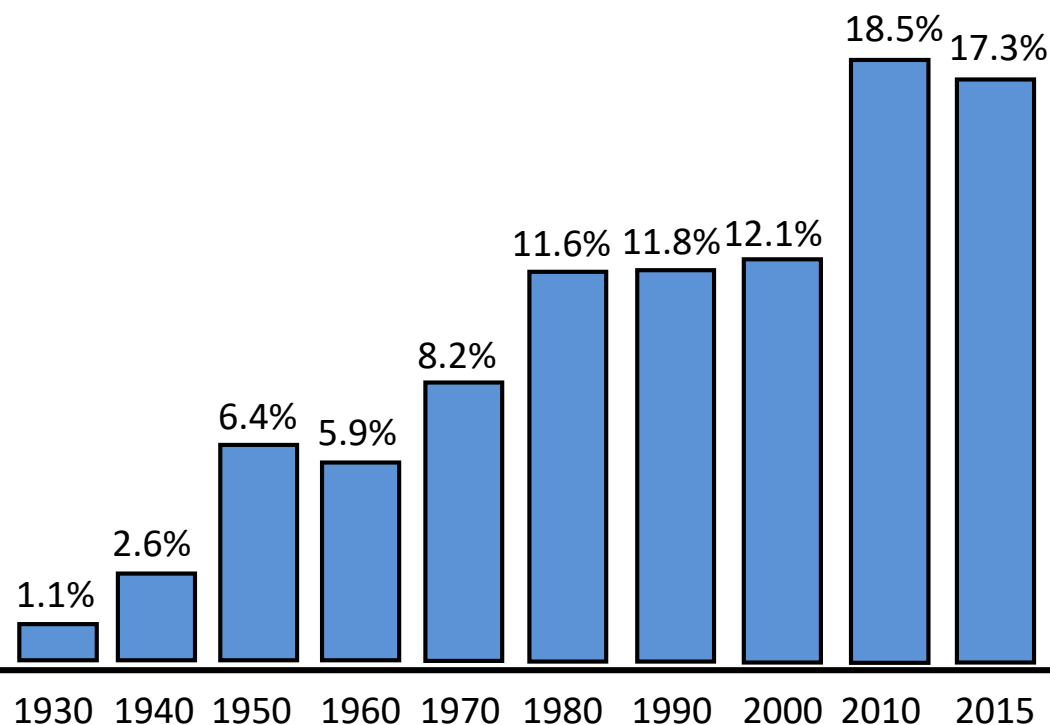
The Growth of Government Transfer Payments

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- ***Transfer payments*** tax income from some and transfer it to others.
- As is illustrated here, government transfer payments have grown persistently during the past eight decades.

Transfer Payments as a % of National Income



Source: Bureau of Economic Analysis, <http://www.bea.gov>.

Similarities and Differences Between Political and Market Allocation



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Similarities Between Government and Markets

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- Similarities between the two sectors:
 - Competition is present in both the government and market sectors.
 - Scarcity is present in both sectors. If the government uses resources to provide a good, those resources are unavailable for the production of other goods. This is true even if the good is provided free of charge to certain consumers.

Differences Between Government and Markets

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- Differences between the two sectors:
 - In the market sector, there is generally a one-to-one link between payment for and consumption of goods. Government allocation can break this linkage.
 - Private sector action is based on mutual agreement; public sector (*when democratic*) is based on majority rule.
 - When collective decisions are made legislatively, voters must choose among candidates who represent a bundle of positions on issues.
 - This greatly limits the power of individual voters to make their preferences count on specific issues.
 - There is seldom a bundle-purchase problem in markets.

Differences Between Government and Markets

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- Differences between the two sectors continued...:
 - Income and influence are distributed differently in the market and government sectors.
 - In the market place, people are able to purchase more goods and services when they have larger incomes.
 - In the political sector, those able and most willing to use their time, persuasive skills, organizational abilities, and financial contributions to help politicians get votes will have more political influence.

Political Decision Making: An Overview



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Public Choice Analysis

- ***Public Choice analysis***
 - *applies the tools of economics to the political process in order to provide insight concerning how the process works.*
- Self-interested behavior is present in both market and political sectors.
- The political process can be viewed as a complex interaction among three groups:
 - voter-taxpayers
 - politicians
 - bureaucrats

The Voter-Consumer

- ***The Voter-Consumer:***

- Voters will tend to support those candidates who they believe will provide them with the most government services and transfer benefits, net of personal costs.
- ***Rational Ignorance Effect:***
Recognizing their vote is unlikely to be decisive, most voters have little incentive to obtain information on issues and alternative candidates.
 - Because of the *rational ignorance effect*, voters will be uninformed on many issues. Such issues will exert little influence on their political decision-making process.

The *Politician-Supplier*

- ***The Politician-Supplier:***
 - Winning elections will be a primary motivation of politicians.
 - Just as profits are the lifeblood of the market entrepreneur, votes are the lifeblood of the politician.
 - Rationally uninformed voters often must be convinced to “want” a candidate.
 - Legislative bodies, like a Board of Directors:
 - establish the general direction of policy,
 - appoint and supervise bureaucrats who carryout the day-to-day operations of government, and,
 - set the budgets of agencies and bureaus.

Government Bureaucrats

- Civil servants (***government bureaucrats***) as political participants:
 - Bureaucrats (*individuals who handle the day-to-day operations of government*) seek promotions, job security, power, etc.
 - The interests of bureaucrats are often complementary with those of the interest groups they serve.
 - Larger budgets and program expansion generally serve the interests of bureaucrats.

When the Political Process Works Well



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Distribution of Benefits and Costs Among Voters

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- Consider how the 4 possible distributions of benefits and costs among voters affect the operation of representative government.
- When benefits or costs are either both widespread or concentrated (type 1 or type 3), representative government tends to undertake projects that are productive and reject those that are unproductive.

		Distribution of benefits among voters	
		Widespread	Concentrated
Distribution of costs among voters	Widespread	Type 1	Type 2
	Concentrated	Type 4	Type 3

Distribution of Benefits and Costs Among Voters

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- When benefits are concentrated and costs widespread (type 2), representative government is biased towards the adoption of counterproductive (inefficient) activity.
- Last, when benefits are widespread but the costs are concentrated (type 4), the political process often rejects productive projects.

		Distribution of benefits among voters	
		Widespread	Concentrated
Distribution of costs among voters	Widespread	Type 1	Type 2
	Concentrated	Type 4	Type 3

When Voting Works Well

- Other things constant, legislators will have a strong incentive to support political actions that provide voters with large total benefits relative to costs.
- If a government project is productive, it will be possible to allocate the project's cost so that all voters will gain.
- When voters pay in proportion to benefits received, all voters will gain if the government action is productive (and all will lose if it is unproductive). Under these circumstances, there is a harmony between good politics and economic efficiency.

Benefits Derived by Voters from Hypothetical Road Project

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- Consider this government program. The total benefits (\$40) exceed the tax cost (\$25). It is, therefore, an efficient program.
- Under plan A, the tax cost (\$5) imposed on each voter is the same. If decided by majority vote, the project would be rejected by a 3 to 2 margin.
- Under plan B each voter pays in proportion to benefits received. In this case, all voters gain and the program would pass unanimously.
- This example shows that harmony between politics and economic efficiency exists when costs are allocated in proportion to benefits.

Voter	Benefits received	Tax payment	
		Plan A	Plan B
Adams	\$ 20	\$ 5	\$ 12.50
Chan	12	5	7.50
Green	4	5	2.50
Lee	2	5	1.25
Diaz	2	5	1.25
Total	\$40	\$25	\$25.00

When the Political Process Works Poorly



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When Voting Conflicts with Economic Efficiency: Special Interest Effect

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- A ***special interest*** issue generates large personal benefit for a small number of constituents while imposing a small individual cost on a large number of others.
- Interest group members feel strongly about issues that provide them with substantial personal benefits. Such issues will dominate their political choices.
- In contrast, voters bearing the cost of such legislation often are uninformed on the issue because it exerts only a small impact on their personal welfare and because of the rational ignorance effect.

When Voting Conflicts with Economic Efficiency: Special Interest Effect

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- Politicians have a strong incentive to favor the views of special interests even if the action is inefficient.
- ***Logrolling*** and ***pork-barrel legislation*** strengthen the special interest effect.
- Politicians will tend to favor established businesses with a stronger record of political contributions and better knowledge of lobbying techniques than newer innovative upstart firms. For example:
 - Uber vs. taxi industry
 - Tesla vs. auto dealers

The Special Interest Effect: A “Sweet” Example

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- The sugar program provides an example of the special interest effect.
 - Price supports and import quotas cause the price of sugar in the U.S to be 50 to 100 percent above the world level.
 - Approximately 20,000 sugar growers derive huge personal gains (average = \$85,000 per grower) while imposing a small personal cost (\$25 per household) on sugar consumers.
 - The sugar lobby contributed more than \$16 million to politicians during the most recent election cycle.
 - The program continues even though it is counterproductive.

Trading Votes and Passing Counterproductive Legislation

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- Consider a bill in Congress that would put a post office in district A, dredge a harbor in B, & build a new stadium in district C.
- Benefits to A, B, & C voters vary by project. In total, voters in A, B, and C districts come out ahead despite the costs of paying taxes for activities in other districts – if they agree to vote together.
- With this bill, there are no benefits to voters in D and E; further, the sum of benefits & costs for all voters together is negative.
- With majority rule, representatives from districts A, B, and C, can, and often will, pass counterproductive legislation.

— Net Benefits (+) or Costs (-) to Voters in Respective District —

Voters of district *	New Post Office in A	Dredging harbor in B	New stadium in C	Total
A	+ \$10	- \$3	- \$3	+ \$4
B	- \$3	+ \$10	- \$3	+ \$4
C	- \$3	- \$3	+ \$10	+ \$4
D	- \$3	- \$3	- \$3	- \$9
E	- \$3	- \$3	- \$3	- \$9
Total	- \$2	- \$2	- \$2	- \$6

* Assume the districts are of equal size.

When Voting Conflicts with Economic Efficiency: Shortsightedness Effect

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- ***Shortsightedness Effect:***

Issues that yield clearly defined current benefits at the expense of future costs that are difficult to identify.

- The political process is biased toward the adoption of such proposals even when they are inefficient.
- The shortsightedness effect explains why politicians will find debt financing and unfunded promises attractive—they make it possible for politicians to provide current benefits to voters without levying an equivalent amount of current taxes to pay for them.

When Voting Conflicts with Economic Efficiency: Rent Seeking

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- ***Rent Seeking:***

Actions by individuals and interest groups designed to restructure public policy in a manner that will either directly or indirectly redistribute more income to themselves.

- Widespread use of the taxing, spending, and regulatory powers of government that favor some at the expense of others will encourage rent seeking.
- When the government is heavily involved in the granting of contracts, subsidies, tax credits, low-interest loans, regulatory favors, and other forms of government intervention, then business firms, labor organizations, and other well-organized interests will compete for the government favors.

When Voting Conflicts with Economic Efficiency: Rent Seeking

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- ***Rent Seeking continued...:***
 - Rent seeking diverts resources away from productive activities. The output of economies with substantial amounts of rent seeking will fall below their potential.

When Voting Conflicts with Economic Efficiency: Government Operated Firms

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- The structure of incentives and the efficiency of government operated firms and agencies
 - In the public sector, the absence of the profit motive reduces the incentive of producers to keep costs low. Neither is there a bankruptcy process capable of weeding out inefficient producers.
 - Public-sector managers are seldom in a position to gain personally from measures that reduce costs.
 - Because public officials and bureau managers spend other people's money, they have less incentive to be cost-conscious.

Political Favoritism, Crony Capitalism, and Government Failure



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Political Favoritism, Crony Capitalism, and Government Failure

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- As government spending, subsidies, income transfers, financial bailouts, and regulatory favors grow, businesses and other well-organized groups will expend more resources seeking to obtain government favors.
- As a result, crony capitalism grows relative to market allocation.
- ***Crony capitalism*** is the situation where the allocation of resources is determined by political favors rather than by consumer preferences translated through the market profit and loss system.

Political Favoritism, Crony Capitalism, and Government Failure

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- Under crony capitalism, rather than providing equal treatment of individuals and businesses under the law, government uses spending, subsidies, and regulations to favor those most willing to provide political decision-makers with campaign contributions and other forms of political support.
- Economic inefficiency is the result.

Bootleggers and Baptists

- Crony Capitalism is often driven by the ***bootlegger–Baptist*** strategy: greedy action packaged as moral behavior.
 - Opportunistic rent-seekers (the bootleggers) often frame their programs in a manner designed to attract support from naïve idealists (the Baptists).
 - They argue their programs will enhance child safety, promote energy independence, save family farms, or some other widely supported goal.
 - But when one looks below the surface, one discovers that these programs are about government favoritism providing handsome profits to the well organized special interest groups.

Bootleggers and Baptists

- Bootlegger—Baptist examples include:
 - Mattel incorporating costly testing procedures into the Consumer Product Safety Improvement Act of 2008.
 - The action increased the costs of rivals and drove used toy sellers like Goodwill out of the market.
 - General Electric partners with environmentalists to advocate subsidies and tax breaks for alternative energy sources.
 - This government favoritism increased demand for GE turbine engines, solar panels, and wind farms.
 - Result: GE earned \$15 billion in 2010 and paid zero corporate income taxes.

Market Entrepreneurs versus Crony Capitalists

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- *Market entrepreneurs* get ahead by providing consumers with products that are more highly valued than the resources required for their production.
- *Crony capitalists* get ahead by providing political players with campaign contributions and other political resources in exchange for government contracts, subsidies, tax benefits, and other forms of political favoritism.
 - Projects of crony capitalists will often be counterproductive.
- Crony capitalism reflects government failure and undermines the legitimacy of the democratic political process.

The Economic Way of Thinking About Markets and Government



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The Economic Way of Thinking About Markets and Government

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- Two key points about government:
 - Protective function of government:
When government protects private property, enforces contracts evenhandedly, maintains monetary stability, and refrains from regulations that restrict entry into markets, it provides the foundation for the smooth operation of markets.
 - Government failure:
Both political and market organization have shortcomings.

The Economic Way of Thinking About Markets and Government

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- Public choice analysis shows that there is sometimes a conflict between winning elections and following sound policies.
 - For some types of activities, there is reason to believe that the political action that will help one get elected will, at the same time, encourage counter-productive activities that reduce income levels.

The Economic Way of Thinking About Markets and Government

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- Understanding the strengths and weaknesses of both sectors is important if we are going to improve our current economic institutions.
- The following factors often result in ***market failure***:
 - Lack of competition
 - Externalities
 - Public goods
 - Poor information
- The following factors often result in ***government failure***:
 - The special-interest effect
 - The shortsightedness effect
 - Rent-seeking
 - Weak incentives for operational efficiency