

Political Economics

Lec.4

www.ashraffeps.yolasite.com

Ashraf Samir Ph.D.

Contents

Economic Rationality

Choosing Goals and Trying to Achieve Them

The Role of Constraints and Information

The Role of Influence

Self-Interest, Altruism, and the Common Good

The Model of Economic Behavior in Contextual Economics

The Economics of Collective Decision Making

The Role of Influence

In modeling human behavior

➔ There is **no** known **decision rule** within human capabilities that guarantees an **entirely satisfactory** conclusion

There is **no** “**best of all possible**” conclusions

In the discussion of **behavioral economics**,

- **Others** can affect our decisions by setting a “**frame**”/ “special information” or providing extra **emphasis** on one **conclusion** at the expense of others.
- Many Actors other than the decision maker may have a **strong influence** on which **information** is **available**.
- These realities have long been well known to **politicians** and **advertisers**. (Who have often based their **successes** on assuming **irrational** consumers and voters).

Self-Interest, Altruism, and the Common Good

- “Rational people are only self-interested—any non-self-interested acts are irrational”- **is it true?**
- The opposite of pure self-interest is **altruism**

Altruistic Behavior:

actions focused on the well-being of others, with no thought about oneself.

- It is reasonable to assert that **some** elements of **altruism** enter into most people’s **decision making**
- Contrary to the simple **neoclassical model** of “rational” selfishness.

■ Example of a provision of the **Common Good**

The **general good** of society, of which one's own interests are only a **part**.

your own **well-being** is connected to the larger **well-being** of society

A **well-functioning** economy cannot rely only on **self-interest**.

and

Without **ethical values** that promote trust, **inefficiencies** would overwhelm any **economic system**.

and

And a **business** would grind to a halt

Recent **experiments** on human behavior **demonstrate** that people really do pay attention to **social norms**

The Model of Economic Behavior in Contextual Economics

- Chicago School → **individuals** who acted **solely** to achieve their personal goals could not be counted on to **operate** a **business** in ways that would be **good** for the **business** itself.
- This concern resulted in various efforts to reward business leaders for the success of their business. (escalating **compensation** of **top management**)

Externalities of business:

Large-scale frauds, Ponzi schemes, tax evasion, and environmental and human costs

were **evident** that the **definition** of economic activity can't be **stripped-down** to individuals' **selfishness**.

Economic activity is not one-dimensional view of human nature

Modern research in behavioral economics suggests that the neoclassical rationality axiom does not stand up to tests of **logic**, **experience**, or the **needs of society**.

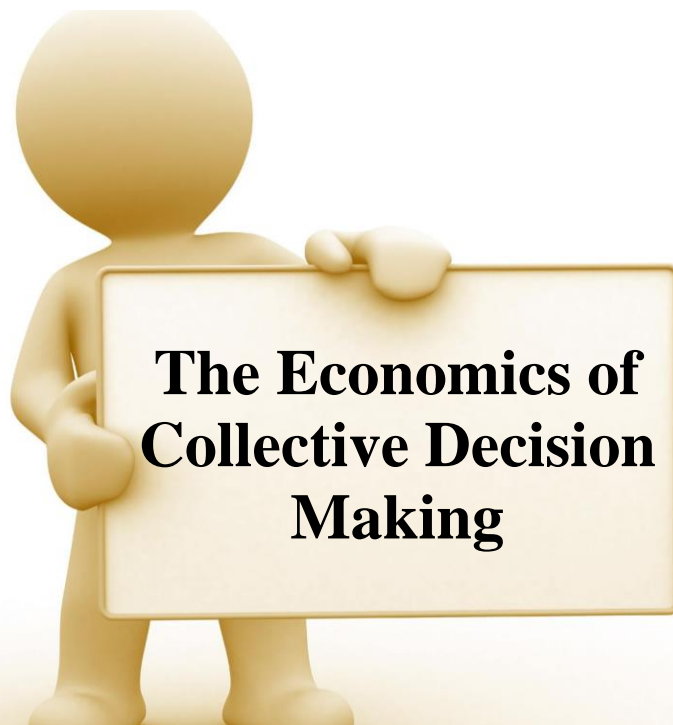
It is very important to **redefine rationality**:

1) choosing goals such that **(a)** when the actor achieves the goals, she/he will be glad to have done so; or **(b)** the pursuit of the goal itself contributes to well-being.

2) pursuing those goals in a manner that the actor expects will lead toward their **achievement**.

A mixture of gladness; well-being; and achievement

This definition does not insist that the goals be either entirely **self-interested** or entirely **altruistic**.



The important point of this part is to recognize that a **government** will **not always** implement policies that promote the **general welfare**.

What we are examining here is “**public-choice**”

Public-choice analysis applies the principles of economics to the operation of the **political process**.



It uses the same self-interest principle that is used in understanding the market (the invisible hand theory)

Public choice

It analyzes the **motives** and **activities** of politicians, civil servants and government officials as people with personal interests that may or may not coincide with the interest of the **general public** they are supposed to **serve**.

It is an analysis of how people behave in the world as it is.

“Arthur SeIdonl”

It does not follow that whenever *laissez faire* falls short, government interference is expedient; since the **inevitable drawbacks** of the latter may, in any particular case, be worse than the shortcomings of private enterprise.

“Harry Sidgwick, 1872”

Main Points

How large is the government sector, and what are the main activities undertaken by government?

What are the differences and similarities between market and government actions?

What insights can economics provide about the behavior of voters, politicians, and bureaucrats? How will their actions affect political outcomes?

When is democratic representative government most likely to lead to economic efficiency?

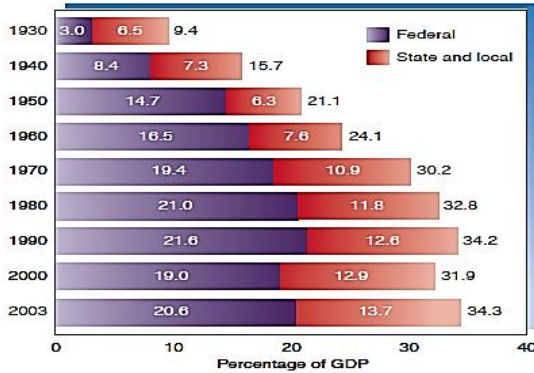
Why will there sometimes be a conflict between winning politics and economic efficiency?

The Model of Economic Behavior in Contextual Economics

How does economic organization influence the efficiency of resource use?

The size and growth of the U.S. Government

The major categories of government spending for both the **federal government** and **state and local** governments **grew very rapidly**

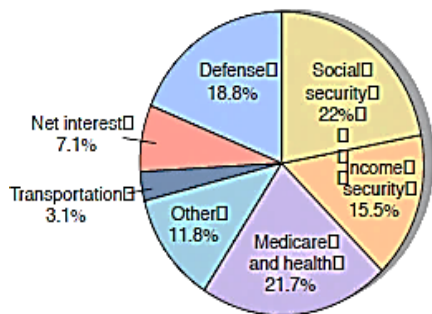


U.S. government expenditures as a share of the economy's gross domestic product have risen dramatically over the past 70 years.

- The major categories of **federal spending** are: health care, national defense, social security, and other income transfers.
- Education, administration, and public welfare and health constitute the largest areas of spending for **state and local governments**.

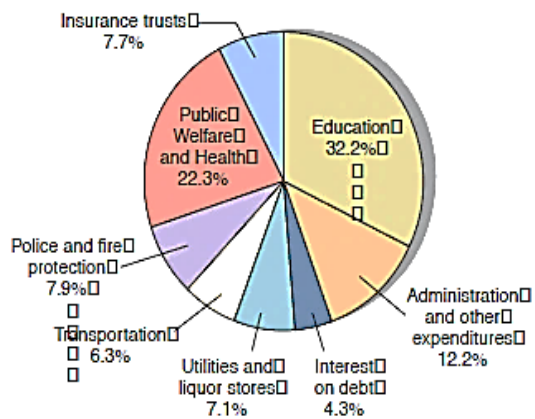
Government Spending by Category

Federal spending = \$2158 billion



(a) Federal government, 2003

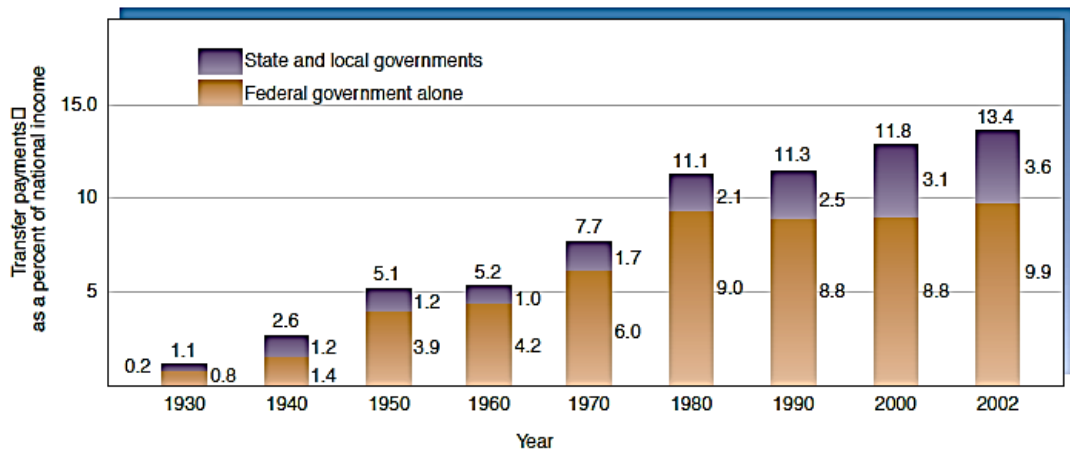
State and local spending = \$1743 billion



(b) State and local governments, 2000

Source: Economic Report of the President, 2004, and Statistical Abstract of the United States, 2003.

The Growth of Government Transfer Payments



Source: Bureau of Economic Analysis, www.bea.gov.

The differences and similarities between governments and markets

- When political decisions are made **democratically**, the **choices** of **individuals** will influence **outcomes** in the government sector- just as they do in the market sector.

In this case,

When we analyze the **political process**, we focus on **individuals** and how **incentives** influence their choices



➡ just as we do when we analyze markets

However, there are both differences and similarities between political and market decision-making

Differences and Similarities between political and market decision-making

1. Competitive behavior is present in both the market and public sectors.

The **nature** of the **competition** and the **criteria** for **success** differ between the two sectors, but people compete in both.

➡ Politicians compete for elective office

➡ Public-sector employees compete for promotions, higher incomes, and additional power, just as they do in the private sector

➡ Lobbyists compete for program funding, for favorable bureaucratic rulings, and for legislation favorable to the interest groups they present

2. Public-sector organization can break the individual consumption-payment link.

In the market sector, goods are allocated to those who are willing to pay the price

a one- to- one relationship

However,

When decisions are made **politically,**

➔ Sometimes people receive very large benefits from the government even though they do not pay much of the cost to cover them

➔ In other cases, individuals are required to pay dearly for a government program even though they derive few or no benefits

3. Scarcity imposes the aggregate consumption-payment link in both sectors.

Although the government can break the link between a person's payment for a good and the right to consume it,

the reality of the aggregate consumption- aggregate payment link remains.

➔ Since it is costly to provide goods and services through the government. This is true even if the good is provided "free of charge" to certain customers.

4. Private-sector action is based on mutual agreement; public-sector action is based on majority rule.

In the **market sector**, when two parties engage in trade, they do so **voluntarily**.

On the other hand

when **collective action** occurs in a **democratic** setting, **majority rule** is the key, either through **direct voting** or through **legislative procedures** involving **elected representatives**.

Although **market action** is based on **mutual benefit**, **government action** through the political process generates **losers** as well as **winners**.

5. When collective decisions are made legislatively, voters must choose among candidates who represent a bundle of positions on issues.

The **voter** cannot choose the **views** of one **politician** on poverty and business welfare and simultaneously choose the views of a **different politician** on national defense and tariffs.

limiting the **voter's power** to make his or her **preferences** count on specific issues

The situation in **markets**, however, is quite different. A buyer can purchase some **groceries** or clothing from **one store**, while choosing related items from **different suppliers**.

6. Income and power are distributed differently in the two sectors.

- People who **supply** more **highly valued resources** in the marketplace have **larger income**.

➔ This process results in an **unequal distribution** of income and power in the market sector.

- in a democratic government, one citizen, one vote is the rule. **But there are ways other than voting to influence political outcomes.**

➔ The greatest **rewards** of the **political process** go to those best able and most willing to use their **time, persuasive skills, organizational ability, and financial contributions** to help **politicians** get votes.

Political Decision-Making: an Overview

- **Public-choice analysis:** the study of **decision-making** as it affects the **formation** and **operation** of collective organizations, such as **governments**.
- In general, the principles and methodology of economics are applied to political science topics.



➔ Public-choice analysis **links** the theory of **individual behavior** to **political actions**, analyze the **implications** of the theory, and **tests** them against events in the real world.

Voters, Politicians, and **bureaucrats** are the primary decision makers in the political arena.

Let's take a closer look at the **incentive structure** confronting the three primary political players:

Incentives confronted by the voter

- Self-interest dictates that voters will ask:
“what can you do for me and my goals, and how much will it cost me?”

➔ the greater the perceived **net economic cost** imposed on the **voter** by the positions of a candidate, the less inclined the voter will be to **support** the candidate.

How well will voters be informed about political issues and candidates?

- The **probability** that an individual vote will decide a city, state, or national election is virtually **zero**.
- Realizing that their **votes** will not **affect** the **outcome**, **individual voters** have little incentive to spend much effort seeking the information needed to cast an informed ballot.

➔ Economists refer to this lack of incentives as the **rational ignorance effect**.

Because it is **highly unlikely** that an individual vote will decide the **outcome** of an election, a rational individual has **little** or **no incentive** to search for and acquire the information needed to cast an informed vote.

Incentives confronted by the politician

- Just as **profits** are the lifeblood of the market entrepreneur, **votes** are the lifeblood of the politician.
- Economics indicates that the pursuit of **votes** will primarily shape **politicians'** actions and political positions.
- **Are politicians selfish, caring only for their pocketbook and reelections chances?**

The answer is "**No**".

- Factors other than **personal political gain** may influence politicians' actions

Caring about public interest

➤ **The successful candidate needs:**

- ✓ An expert staff,
- ✓ sophisticated polling techniques to uncover popular issues,
- ✓ and high-quality advertising campaign.

This, of course, will be costly

Votes are the ultimate objectives of politicians, but **money** helps them get those votes.

The **politicians** most likely to remain in office are the ones who focus on how their **actions** will influence their **reelection** prospects.

- ✓ By **catering** to the views of voters
- ✓ By **enacting** rules that put potential challengers at a disadvantage.
- ✓ By **manipulate** the election process through a practice of “gerrymandering”
- ✓ By **using** government resources for their reelection campaigns
- ✓ By **adopting** “campaign finance “reforms” that make it more difficult for a challenger to raise funds

Incentives Confronted by the Government Bureaucrat

- Bureaucrats who staff government agencies have narrowly **focused interests**.
- They usually want to see their own **agency's goals** furthered.
- Furthering these goals, however, usually requires **larger budget**.
- **Economic analysis** suggests there is a strong tendency for government **bureaucrats** and employees to want to **expand** their **budget** to sizes well beyond what is economically efficient.

Thank you