

Chapter 6: Economics of Collective Decision Making

In 1930, government spending was around 10% of total GDP, and only a third of this at the federal level.

Federal government spending drastically increased by 2000, especially in the time between 1980-2000. By 2010, government spending accounted for almost 40% of GDP.

The main part of government spending, particularly federal, is **transfer payments**, or payments in the form of tax income from some people that is transferred to others.

Transfer payments have grown rapidly since 1930.

Similarities between government and markets:

1. Competition (competing for elective office)
2. Scarcity and the opportunity cost of resource use (if the government uses resources to achieve one goal, those resources are unavailable to achieve others.)

Differences between government and markets:

1. Private sector action based on mutual agreements, public sector is based on majority rule
2. When collective decisions are made legislatively, voters must choose among candidates who represent a bundle of positions on issues.
3. Income and influence distributed differently.
4. Public sector organization can break the linkage between payment and consumption of a good.

Public choice analysis applies the tools of economics to the political process to provide insight

Self-interested behavior in both public and private sectors.

Political process involves voters/taxpayers, politicians, and bureaucrats.

Voters are consumers- they vote for who the candidate they believe will provide them with the most government services and transfer benefits, net of personal costs.

Rational ignorance effect- voters have little incentive to find out information because it is costly and they believe their vote doesn't have a big impact anyway.

-This causes a lot of voters to be uninformed and they cannot use gained knowledge in the decision making process.

-Marginal benefit of voting: the chance that your vote was the deciding vote multiplied by how much you care that a certain candidate wins

-Marginal cost of voting: the cost of informing yourself (information is costly), registering to vote, and actually voting.

Politicians are suppliers- they are interested in winning elections (votes=profit).

-Have to convince uninformed voters.

Legislative bodies like Board of Directors.

Interests of bureaucrats are often complementary with those of the interest groups they serve.

-Larger budgets and program expansion generally serve the interests of both bureaucrats and their constituent groups.

A project is more productive if there are more widespread benefits.

Median voter theory: The idea that a vote maximizing politician in a two party system will be close to the middle so that there is little difference between candidates, and the preferences of the median voter will be represented.

The political process works well when voters pay in proportion to the benefits they receive

User charges: requires people who use a service more to pay a larger share of the cost (i.e. gas tax)

The political process works poorly when voters receive benefits in disproportion to the costs they incur, then unproductive projects will be passed and productive projects will not.

Causes of government inefficiency:

1. **Special interest effect-** an issue that generates substantial benefits for a small group by generating minimal costs to a large group (in aggregate, losses may exceed benefits.)
 - a. Interest group members feel strongly about issues that provide them with substantial personal benefits. Such issues will dominate their political choices.
 - b. In contrast, voters bearing the cost of such legislation are often uninformed on the issue because it exerts only a small impact on their personal welfare and because of the rational ignorance effect.
 - c. Politicians have a strong incentive to favor the views of special interests even if the action is inefficient.
 - d. **Log-rolling and pork barrel legislation** strengthen the special interest effect.
 - i. **Log-rolling:** the exchange between politicians of political support on one issue for political support on another.
 - ii. **Pork barrel legislation:** a package of spending projects bundled into a single bill. It is often used as a device to obtain funding for a group of projects intensely

desired by regional or interest groups that would be unlikely to pass if voted on separately.

2. Short-sightedness effect- issues that yield clearly defined current benefits at the expense of future costs that are difficult to identify.
 - a. The political process is biased toward the adoption of such proposals even when they are inefficient.
 - b. 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 taxes (to pay for them).
3. Rent seeking- actions by individuals and interest groups designed to restructure public policy in a manner that will either directly or indirectly distribute more income to themselves.
 - a. Widespread use of the taxing, spending, and regulatory powers of government that favor some at the expense of others will encourage rent seeking.
 - b. Diverts resources away from productive activities.
 - c. Income transfers promote rent seeking.
4. Lack of profit motive-unlike private firms, the public sector lacks the incentive to produce efficiently.

Crony capitalism is a situation where political decision makers direct subsidies, grants, tax breaks, and regulatory favors toward businesses willing to provide them with campaign funds and other forms of political support.

-It is a national outgrowth of increases in government spending, constant changes in taxes, and expansion in regulation.

-It is often driven by the **bootlegger-Baptist** strategy: greedy action packaged as moral behavior

-Opportunistic rent seekers often frame their programs in a manner designed to attract support from naïve idealists.

-They argue their programs will enhance child safety, promote energy independence, save family farms, or some other widely supported goal.

-Under the surface it is government favoritism providing handsome profits to the well-organized special interest groups.

Ex. Mattel, General Electric

Market entrepreneurs get ahead by providing consumers with products that are more highly valued than the resources required for their production.

Crony capitalism reflects government failure and undermines the legitimacy of the democratic political processes.