
Third Venue of Rational Exchange, Part II

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The most intrepid economic analysis of government behavior has come from public-choice theorists. Particularly interesting is that they play by formal rules of rational exchange (anchored by continuous equilibrium) in their modeling of the public venue. Public-choice theory is closely associated with the contributions of James Buchanan (for which he was awarded the 1986 Nobel) and Gordon Tullock.

PC theorists work with the same basic analytic tools as their counterparts who model optimizing price-mediated exchange in the marketplace and workplace, focusing on the pursuit of self-interest informed by axiomatic preferences for consumption, leisure, and fair treatment; mechanisms of exchange, the specifications of which tend to be particular to the venue being studied; and constraints assigning a central role to costly, asymmetric information.

In PC theory, rational self-interested behavior centrally motivates rent-seeking, which significantly motivates rational exchange in marketplace and workplace venues as well. However, given particular structure and nature of government exchange, the substantial latitude thought to be provided for rent-seeking makes it an especially important characteristic of the public sector. Self-interested firms or groups of individuals interact with self-interested government agents, seeking special market privileges that generate rents. The outcome is typically best understood as a negative externality, generally reducing the efficiency of the economy. PC theorists conclude that the ubiquitous pressures that rent-seeking exerts on politicians and bureaucrats are pervasive and for which any model of government exchange must account.

In a nutshell, rent-seeking government exchange are concentrated in the mechanisms of exchange and the constraints on the overall process, producing, in public-choice theory, a prototypical class of government exchange between politicians who seek election victories and groups that seek special benefits:

Special-interest programs that use government's monopoly on coercion to transfer benefits to a particular group at the expense of those outside the group are exchanged for the group's support in mobilizing votes, either directly or indirectly (mainly campaign funds), that help secure a successful election outcome.

Characteristics of exchange mechanisms that are particular to the public venue notably include:

- Mechanisms of exchange that facilitate the government exchange typically designed to obfuscate the transaction as much as possible;
- Majority votes in the legislature, imposing majority preferences on the minority;
- Exploiting costly, asymmetric information, majority votes that transfer resources from the majority to special interests engaged in the prototypical government exchange.

The latter mechanism, using majority votes to transfer resources away from the majority to special-interest groups receives substantial attention from PC theorists. From White (2012, p.356): "On an issue where the taxpaying majority is poorly organized, a well-paid special interest group may use plausible arguments (and campaign contributions) to persuade legislators to grant it monopolistic privileges or to tax the general public for the group's benefit. This is especially likely where the benefits are concentrated, while the burden is so diffused over the general public that it is hardly felt."

Constraints that are particular to the government venue notably include:

- Success in political campaigns is strongly increasing in the money that the candidate raises and effectively spends.
- Self-evident knowledge that no single vote will decide a significant election deprives the voter of rational incentive to invest in gathering unbiased information about relevant government programs and their effects.
- Rational self-interested voters attempt to free-ride on the information-discovery of others, who must engage in rent-seeking to make their investment rational, and therefore are especially vulnerable to be among those who lose in the prototypical government exchange.
- Rent-seeking government exchange is itself, in part because of the need to obfuscate, a costly endeavor. (Tullock (1967, in White, p.356) has argued that the cost of competing for monopoly

privileges in government exchange exceeds the cost of the misallocated resources that result from the rent-seeking transfer.

Public-choice theorists are typically, and probably excessively, skeptical of government's capacity to promote general welfare. There are, of course, exceptions, especially Mancur Olson whose insightful rent-seeking macrodynamic model was described in Chapter 3 of the website's e-book. It is shown to be an important contribution to the evolution of generalized-exchange growth theory. Olson opposed special-interest group lobbying but otherwise advocated activist states. Moreover, the e-book has constructed a broad expansion of the reach of optimizing exchange to the modeling of the workplace, motivated by self-interest and organized by general decision-rule equilibrium, that has demonstrated the welfare-enhancing consequence of discretionary public management of aggregate demand.

Systematically working through implications of rational, self-interested exchange is a powerful, useful research methodology that has supported generally reliable policymaker advice. Public-choice theory clearly has much work to do if it is to match the success of the formal method in explicating behavior in the marketplace and workplace. Perhaps heterogeneities, altruism, or some other limitation on the specification of self-interest, exchange mechanisms, or relevant constraints will turn out to fundamentally inform the capacity of PC theorists to adequately model government exchange. But what has been accomplished so far, despite my heavy dose of skepticism, is sufficient to justify applying the formal method to the public venue. Public-choice modeling should be required in any economics curriculum that aspires to inform students about the societies in which they live.

Perhaps Buchanan perhaps best captured the spirit of public-choice theory by describing it as "politics without romance". Along those lines, he and his colleagues have constructed a useful counterweight to the once-pervasive textbook view of idealized politics that provided an unflattering contrast with the market failure associated with public goods.

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