

An Economic Theory of Political Action in a Democracy

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What is a THEORY?

Karl Popper: what shall we expect from a theory?

1. **Describe** the empirical world
2. **Explain**
3. **Prognose**
4. **Advise** decision maker to political action

+1. Only that can be true that is confutable. (Karl Popper)

What if it is not confutable?

Then it is not a theory it is an **ideology**.

1776: birth of political economy

United States Declaration of Independence

Declaration of the main values in democracy

What should governments do?

Idealistic approach of political behavior

(governments, bureaucracy, citizens)

Adam Smith: Wealth of Nations

The basics of „economic science“

The study of the conditions under which production was organised in the nation-states of the newly-born capitalist system

How does the economy function?

Rational description of the economy,

describing *market failures* to be solved by governments (e.g. imperfect competition, externalities, public goods)

How does politics function?

1950s: the birth of public choice theory

the politician is a human being who has rational motives and should not have to be idealised

Government can also fail (government failures)

Questions

- Why do citizens have apathy toward public affairs?
- Why do citizens ignore seemingly important issues?
- Why is there a tendency toward a two-party system in democracy?
- What is the reason for anti-consumer bias in government's actions?
 - Rational (efficient) reactions to imperfect information in a (large) democracy.

An Economic Theory of Democracy

- ✦ 1957, New York, Harper and Brothers
- ✦ Gives a real answer on political behavior (which is more current than ever...)



Government's role

- ✦ What is the role of government?
 - ✦ To maximize „social welfare”
- ✦ Nevertheless there are only two problems with „social welfare”
 - ✦ We do not exactly know what „social welfare” is...
 - ✦ How to maximize something we do not know what it is...
 - ✦ + „It does not follow that the social meaning of a type of activity will necessarily provide the motive power...” (Schumpeter, 1950)

Motivation

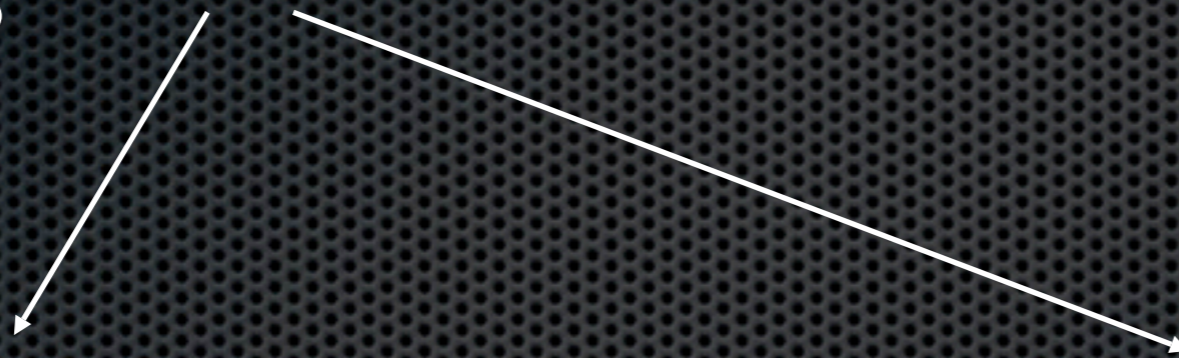
- ✦ What is the motivation for the economic actors?
 - ✦ „Every actor in the division of labor has a **private motive** and a **social function**”
- ✦ What is the motivation for politicians?
 - ✦ Government employees and politicians are not part of the division of labor?
 - ✦ Yes, they are.

Motivation



The question is...

- What is stronger? ...or is there any connection between the two fields?



Private motive

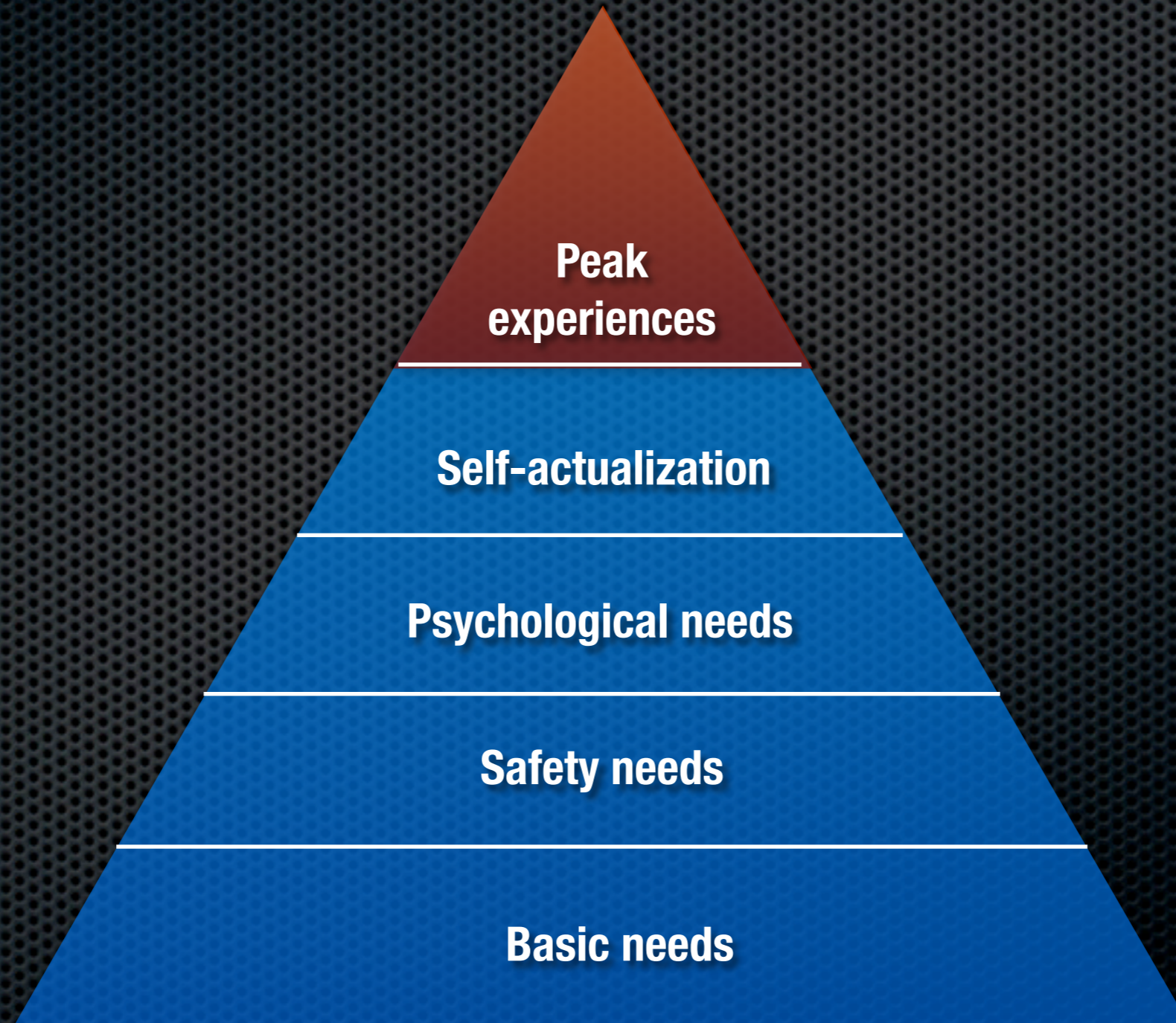
(income, prestige, power,
feed the family...)

Social function

(carry out policies in order to
serve the welfare of the
society)

It depends on...

Maslow hierarchy of needs



The model

- Government (definition): agency in the division of labor with „ultimate” power in a given area, in a society
- Democracy (definition): political system that exhibits the following characteristics:
 1. Two or more **parties compete** in periodic elections for control of the governing apparatus
 2. The party (or coalition of parties) winning a majority of votes **gains control** of the governing apparatus until the next election
 3. **Losing parties never attempt** to prevent winners from taking office, nor do winners use their power to vitiate the ability of losers to compete at the next elections
 4. Every citizen has **one and only one vote** in each election

The model

■ Axioms

1. Each political party is a team of men who seek office solely in order to **enjoy the income, prestige and power** that go with running the governing apparatus
2. The winning party has complete control over the government's actions until the next elections
3. Government's economic powers are unlimited
4. Only limitation: incumbent party cannot restrict the political freedom of opposition and citizens unless they seek to overthrow it by force
5. Every agent in the model behaves rationally

What is rational?

$$MR(\text{activity}) > MC(\text{activity})$$

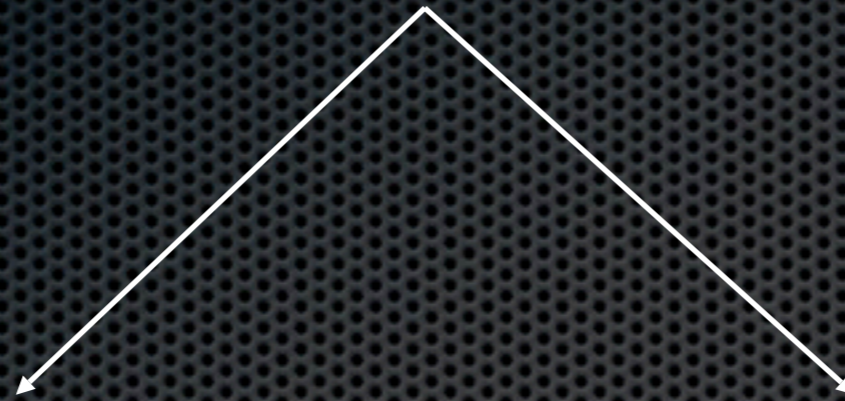
The hipotesis

- Political parties in democracy formulate policy strictly to gain votes and win the elections (and then do what serves their interests best...)
- They do not seek to gain office in order to carry out certain policies or to serve any particular interest groups
- Rather they formulate policies and serve interest groups in order to gain office

Conclusion

- Political market is an oligopolistic market
 - But instead of money actors run for votes
 - And instead of products actors (politicians) are selling policies
- Thus the „socially optimal output” is not necessarily equal to the „output optimal for the political party”
- What does it depend on?
 - The control, the power of the society, but as we will see, the rationally acting citizen is „weak”

The nature of government in two cases



- In a world in which there is **perfect knowledge and information is costless**

- In a world in which **knowledge is imperfect and information is costly**

Which is true in the real world?

Case1: perfect knowledge and information is costless

- ✦ Very simple
- ✦ Each citizen can reckon which party's policies bring him the most utility income based on the decisions taken in the recent election period
- ✦ Each party designs policies to maximize votes
 - ✦ The opposition has strategic advantage since does not have to carry the responsibility of governing and can react afterwards... (can examine the real effects of a decision and be wise afterwards)

Case2: knowledge is imperfect and information is costly

1. Parties do not really know what the citizens want
2. Citizens do not know what governments should do to serve their interests
3. The information needed to overcome this ignorance is costly

Consequences:

PERSUADERS, IDEOLOGIES, RATIONAL IGNORANCE

The existence of persuaders and its consequences

- As long as perfect knowledge exists each citizen can calculate what is the best for him, but as soon as ignorance appears, „the clear path from taste structure to voting decision becomes obscured by lack of knowledge”



- Persuaders can become effective:
- Persuaders are not interested per se in helping people, they provide only those facts which are favorable to whatever group they are supporting!!!

The existence of persuaders and its consequences

1. Persuaders are more important for parties than regular citizens (they can bring more votes)
2. Government is itself ignorant what its citizens want it to do: therefore they send out representatives to sound out the electorate and to persuade them it should be reelected
 - This is the (rational) reason for decentralization of power (geographical or by social groups)

Case2: knowledge is imperfect, information costly



The existence of persuaders and its consequences

3. (1+2) Persuaders, (specialist in influencing) appear
 - As “representatives” of the citizens (e.g. local politicians)
 - As real “persuaders” to influence people that the goals represented by them are desirable
 - (Persuading becomes a business: NBC – GE, ABC – Disney, CBS – Viacom, CNN – AOL Time Warner)

Sum of Consequences

- IMPERFECT KNOWLEDGE MAKES THE GOVERNING PARTY SUSCEPTIBLE TO BRIBERY
 - To buy television time, to pay for propaganda, to pay precinct captains and campaign captains
 - E.g.....

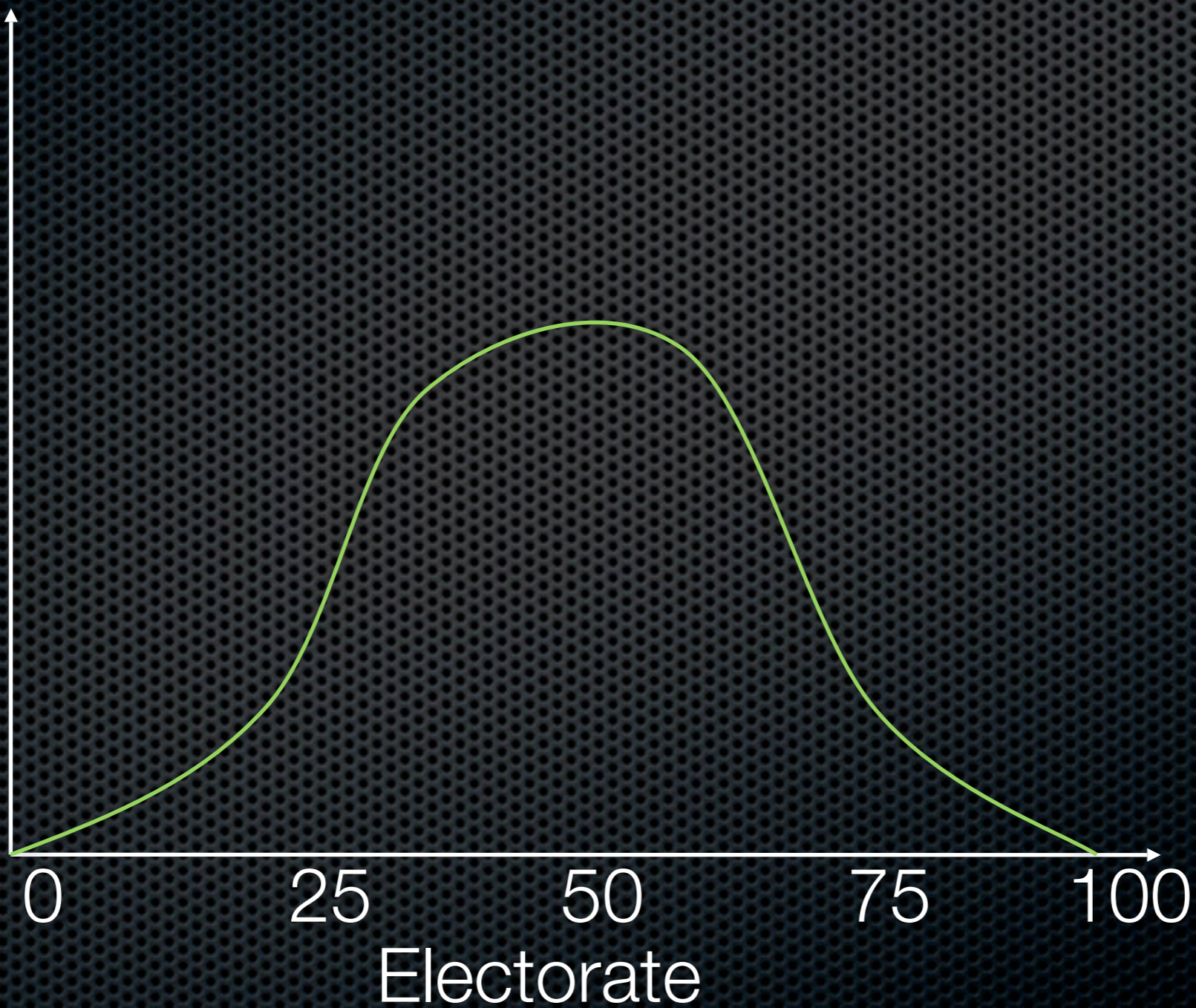
The existence of ideology

- In a complex society it takes enormous efforts to compare every detail of the competing parties' strategies
 - Citizens do not know what to compare
 - Citizens do not even know their preferences clearly (can be easily influenced)
 - Citizens cannot forecast the result of government actions and the forthcoming problems
- IMPERFECT KNOWLEDGE AND COSTLY INFORMATION ESTABLISHES THE NEED FOR **IDEOLOGIES** (which makes comparison easier)

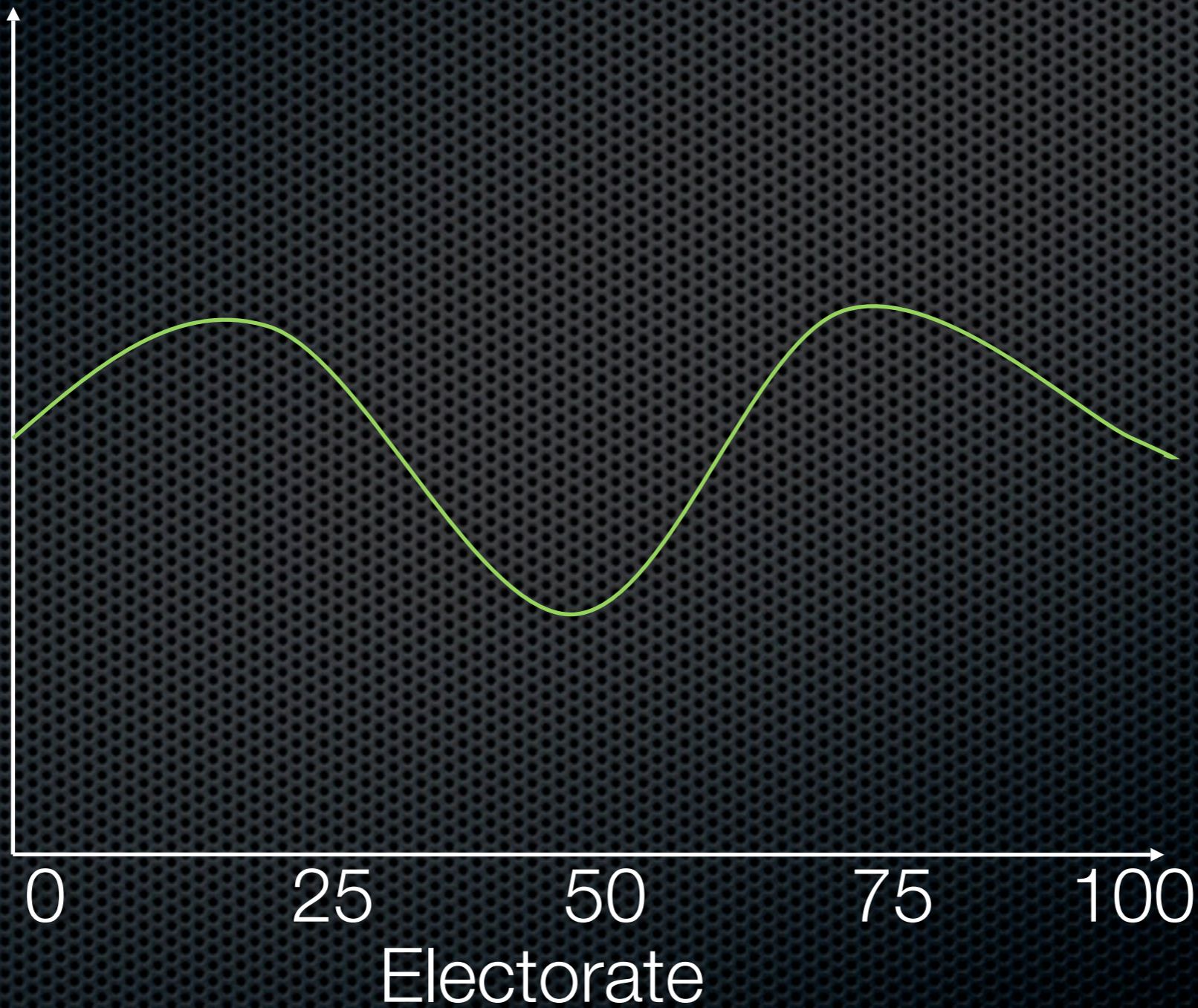
Ideologies

- Each society has a certain distribution of political preferences
 - Either parties were established to serve the interests of a certain group and thus to represent an ideology
 - Or parties are established to satisfy the society's need for ideologies

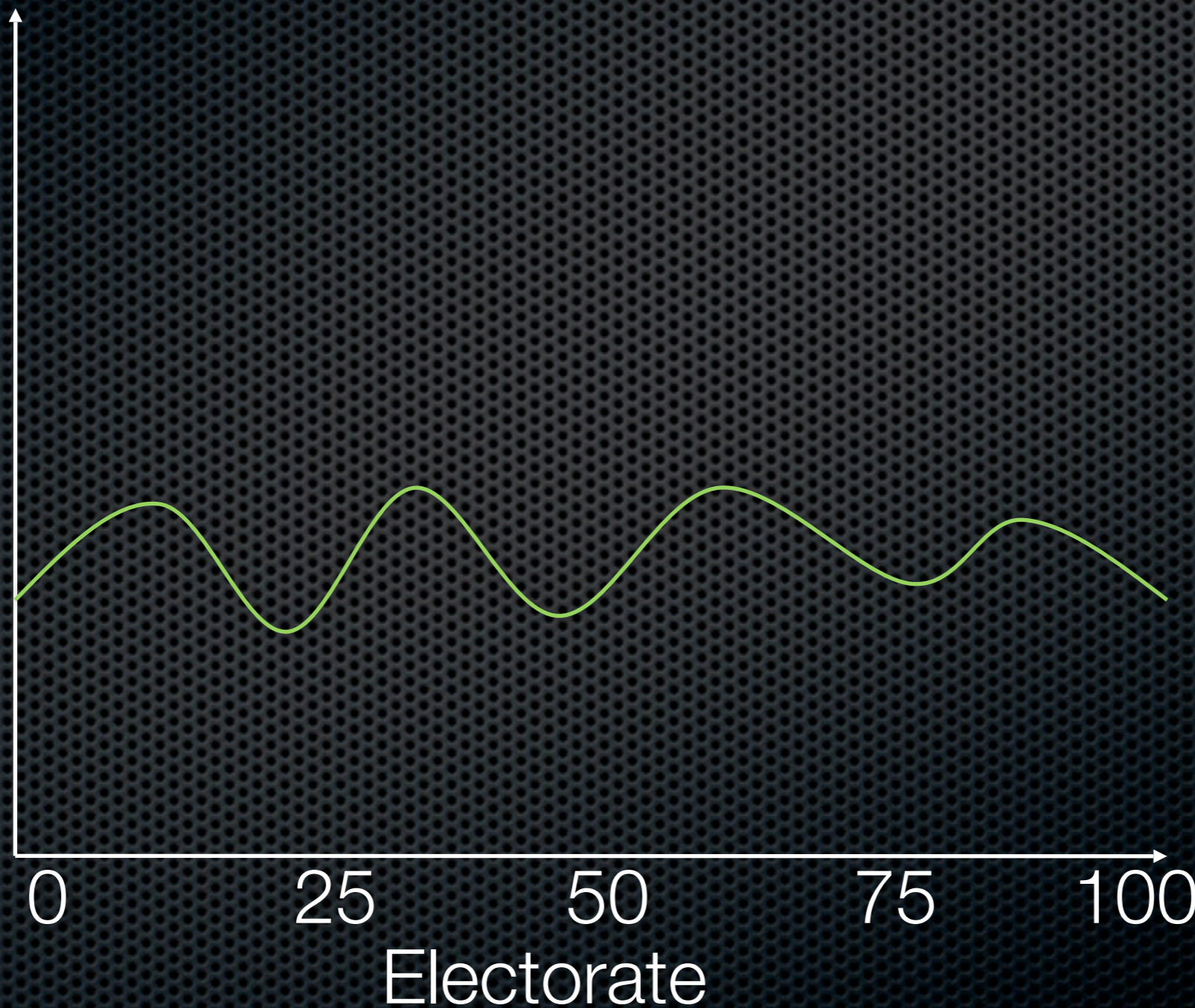
Central distribution of electorate



Bipolar distribution of electorate



Multimode distribution of electorate



Where can multiparty systems function?

The rational explanation of being ignorant (not informed)

$$MR(\text{activity}) > MC(\text{activity})$$

- The alternative cost of gathering information. What can it be?
- The marginal return of voting correctly: „0”
 - The probability that my vote will decide the elections:
 $\lim p(v)=0$
 - The effect on my personal income of voting correctly: „0”
(It is at least suggested by persuaders)



- It is irrational for most electors to gather information

Why are then some people well-informed?

1. Being informed is per se a value for him
2. He can believe that the election is going to be so close that his casting will decide the outcome
3. He wants to influence others
4. He wants to influence the government (lobbyist)

Lobbying

- Very costly. Why?
 - Lobbyist have to be prepared not only from their perspective but from their opponents point of view as well
- Then why is it worth to lobby?
 - Most of the people earns his income from one or two sources, but as a consumer spend it in several politically affected fields
- Conclusion: as a consumer it is not worth to lobby, but as a producer, yes. **That is why governments mostly design policies for the sake of producers.** (e.g. tariff legislation)

What is the guarantee of maximizing social welfare in a democracy?

The awareness of citizens on political actions and the moral standard of a certain nation-state (and elite).

What is the interest of politicians and interest groups standing behind politics?

What did Aristoteles say about political systems 2300 years ago?

<i>Number of people in power</i>	<i>Good</i>	<i>Bad</i>
<i>One</i>	Kingdom	Turannis (dictatorship)
<i>Few</i>	Aristocracy	Oligarchy
<i>Many</i>	Politeia	Democracy

The assignment for 30%

To present any topic crucial concerning the future of the international society
(e.g. environment, terrorism, gender, poverty, consumer protection, public transport, education etc...)

Group of 5 students, 15 minutes/group presentation