

Chapter 1

The Field of Public Choice

Before the beginning of Public Choice in the 1960s, most professional economists who were interested in public affairs spent their time searching for optimal government policies, given certain objectives. For example, they looked for ways to achieve low unemployment, moderate inflation, or national defense at the lowest cost. Or they sought efficient ways to build roads or to deal with pollution and congestion. They did their research without thinking about whether the government was an autocracy or a democracy. These economists implicitly held what we might call a *benevolent despot view* of the government. They regarded the government as benevolent in the sense that it would adopt the recommended policy and faithfully carry it out.

Professional economists in the American and European democracies today are not so naive. They realize that policy decisions in their

Benevolent despot view of the government: The government will adopt the best policies and faithfully carry them out.

countries are made by means of a collective decision-making process in which efficiency is often only a secondary goal. They know that an elected legislature and, to some degree, an elected chief executive actually make the decisions. The political and economic futures of these politicians depend on their ability to please a conglomeration of

independent voters, pressure groups, and political parties. Modern economists also know that even if an economist's recommendation is faithfully passed into law, the bureaucrats who are assigned the responsibility to carry it out are not usually very efficient in satisfying their sponsors' demands. All of these people usually think more about their private interests than about implementing the optimal policy recommended by economists.

Economists are not the only ones to recognize the reality of policy making in a democracy. In the late 1960s, some political scientists joined with the economists in forming the U.S.-based Public Choice Society. The political scientists joined because they believed that the economic approach was superior to other approaches to studying democratic government in their profession.

These modern students of democracy see the government as being created by human beings with the purpose of helping them to achieve their goals. In this view, a democratic government is a tool. It is not like a carpenter's hammer, however. When a carpenter wants to hammer a nail, he can simply pick up the hammer and command it with the swing of his arm to perform its function. No single individual can command a democratic government to do anything. Before a democratic government can be used to accomplish a goal, the members of the collective or their representatives must make collective decisions. Each member has his own personal goal and the goals of different members are likely to differ considerably. Public Choice scholars try to understand the interaction that results in collective decisions by putting themselves in the shoes of members of the collective, politicians, and the bureaucrats who are hired to implement the collective decisions.

Public Choice scholars have certainly not abandoned the aim of finding and recommending optimal government policies. However, they pay less attention to specific policies than to the process of policy making and policy implementation.

Public Choice is a logical extension of economists' concern with improving efficiency. Nevertheless, it

Public Choice focuses on the process of policy making and policy implementation.

is a radical departure from the concerns of most professional economists during the 20th century. Before the late 1950s, no professional economist as such was concerned with forms of government, voting systems, and government bureaucracy. Indeed, before that time, economists would have been very doubtful whether economic tools could be used to analyze these institutions.

1. PUBLIC CHOICE AND RELATED FIELDS

The field of Public Choice was born in the minds of professional economists in the mid-1960s. Until that time (and for a considerable period after that) most intellectuals associated the economic view of politics with the thinking of Karl Marx and his radical economist followers. With the emergence of Public Choice, many mainstream professional economists began to study politics using procedures developed by the “neoclassical economists” of the late 19th century. As this happened, the meaning of the economic view of politics shifted away from the radical thinking. These developments were complicated and we cannot describe them in full here. However, a brief discussion is appropriate.

Early Political Economy

The most renowned early study of the market economy was that of Scotland’s Adam Smith (1776), who economists usually regard as the founder of scientific economics. Smith was a social philosopher who was interested in many subjects. Although his greatest contribution was his acute understanding of the market economy, he studied and taught other subjects, including the role of government and ethics.

Before Smith, religious leaders and other moral philosophers saw the market economy as a haven for selfishness and competition. They taught that buyers and sellers act impersonally without regard for others. Since buyers and sellers do not care about their fellow men, they cannot be counted on to be just and kind. The moral philosophers thus saw the market economy as a threat to social cooperation and to what they regarded as the time-honored virtue of altruism.

Smith tried to change this point of view. He sought to enlighten his contemporaries by pointing out that, under certain conditions, self interest has the potential of conferring great benefits on society members. These conditions are a private property system and limited monopoly. Under these conditions, although a person is only interested in his own gain, he discovers that he can do best for himself by producing goods or services for trade. To be successful at this, he must produce a good or service that others regard as more valuable than what they already have or can produce for themselves. Because he must trade something of higher value with his trading partner to get what he wants, we say that when an individual acts in his self interest he enables others to gain. Trying to get

rich in the marketplace bestows riches on others through trade. It also encourages individuals to specialize. Trade and specialization make it possible to produce vast quantities of goods at costs much lower than in a non-trading society.

Individuals who would not be able to survive in a non-trading society can do so in a trading society.

Selfish action in the market economy leads to social cooperation on the grandest scale.

And those who would be able to survive can obtain more benefits because of the self interested actions of other producers and traders. Contrary to the teachings of the moral philosophers, selfish action in the market economy leads to social cooperation on the grandest scale.

The market economy may be a threat to time-honored virtues. However, subscribing strictly to those virtues may impoverish a nation. Moreover, a person who becomes rich through his production and trade may use his wealth to help others. There is no necessary connection between trying to earn money in the market economy and being unkind, unjust, or selfish.

Smith also taught about competition. He taught that under the conditions of the market economy, it is not a vice. Instead, it is a social situation that constrains producers so that their actions benefit consumers. The opposite of competition in the market economy is not cooperation, but collusive monopoly. When sellers conspire to monopolize, their aim is to harm buyers by raising prices.

According to Smith, there are two main requirements for achieving the great benefits of a modern trading society. They are (1) to enforce private property rights and (2) to stop conspiracies to monopolize, including those due to government-created special privileges. We may or may not be able to change the human propensity to be self interested, he argued. But if we design our institutions properly, we can redirect that propensity so that each person contributes to the benefit of humankind.

During the 19th century, most writers on the market economy followed Smith. They studied not only the market economy but

Adam Smith: If we design our institutions properly, we can redirect the propensity to act selfishly so that each person contributes to the benefit of humankind.

government and society. They called their studies *political economy*. The vast majority of the most important writers saw a small and non-intrusive government as a useful complement to the market economy. A large

government, they believed, was inclined to grant special privileges, thereby reducing the benefits of the market economy.

These early political economists did not favor a minimal, *law and order*, government. They believed that the government should supply some goods and services. For example, they maintained that roads, education, sewers, and aid to the very poor could not be efficiently supplied through markets. Thus, they made proposals about how a government should raise the funds necessary to pay for these and other goods. At a later time, the work of these economists became the basis for a sub-field of professional economics called *public finance*.

Marx

An early writer on the market economy who stood apart from the rest was Karl Marx, whose writing appeared around the mid-19th century. Marx (1867) wrote that the institution of private property was destined toward self-destruction. To him, the market economy contained a natural conflict between capitalists and workers. Workers transform the other resources into material goods. Yet the capitalists who finance the ventures receive most of the gains. This inequity, which Marx believed would increase over time, would ultimately result in a highly dissatisfied and expanding laboring class. When the time was ripe, this class would rise up in revolution against the oppression of the class of capitalist employers. The resulting political conflict would usher in a new society of socialism.

Neoclassical Reaction to Marx

Marx and other advocates of socialism had a major influence on political economy. They forced the political economists to refine their view of the market economy. Before Marx, political economists divided their studies of capitalism into divisions based on what they believed were natural divisions among the resources. Thus they studied the land and land rent; labor and wages; capital goods and the income received from them (“interest”); and management, or coordination, and profit. Thus, they viewed the economy in terms of (1) classes of people and (2) their incomes. The classes were landowners, laborers, capitalists, and managers of manufacturing businesses. They did not mean to imply that these were strict social classes. Instead, they separated people and income into classes as a matter of convenience.

Marx’s reasoning was based on the assumption that there was a strict division between the suppliers of labor and the suppliers of capital and

management. In assessing Marx's argument, the more clever thinkers began to see more clearly that separating people into classes is only a makeshift. It is a way for political economists to give convenient examples of interaction in the market economy. The political economist does not mean to suggest that people are confined to social classes, as they might be in a strict caste system. In the market economy, practically everyone is partly a financier, partly an employer, and partly a laborer. And each person can and often does own land and capital goods from which he earns income.

Besides this, the more clever thinkers drew the Marxists' attention to free enterprise. Free enterprise means that anyone who has the ability and financial support can start a new business. Suppose that a factory worker did not want to be called a laborer. Then he could save his money and later risk his savings in business. Or he could join with other factory workers and start a business. The market economy contains many people who have saved by acquiring training and developing their skills. The many different grades of skilled and specialized labor are ample evidence that no one is trapped in a "laboring class." The more clever thinkers argued that Marx was wrong about the market economy, as it was understood by the classical economists, because he mistakenly assumed that people in the market economy are trapped in classes.¹

Emergence of Professional Economics

The level of reasoning needed to understand the new view of the market economy was higher than that needed to understand Smith. To achieve the higher level of reasoning requires nurturing and training. Toward the end of the nineteenth century, those who adopted the new view came to see themselves as part of an elite professional group. To distinguish themselves from their predecessors who studied the market economy, they increasingly began to call themselves "economists" and to identify with an "economics profession." The growth of formal university education provided opportunities for this elite to channel government and philanthropic monies into distinct departments and institutes where the

¹This is not to say that Marx's historical observations about class were wrong. The societies that he observed all contained more rigid class systems than we observe in the developed capitalist societies of today. The systems were partly a holdover from a feudalism and partly due to government restrictions. But Adam Smith and the classical economists had in mind a society that was relatively free of these encumbrances. They were writing about an image of a society that had not yet fully blossomed anywhere yet one that seemed to be on the horizon. For more on the concept of class in relation to early political economy, see Mises (1981), Chapter 20.

new economics could be taught. The term “political economy” was gradually abandoned. Also, as a distinct economics profession emerged, the interests of students of the market economy narrowed. Followers of Marx continued to discuss the relationship between government and the market economy. In the simplest of their theories, they saw the government as a tool of the capitalist class. It was a tool for oppressing the laboring class. In contrast, professional economists increasingly adopted the benevolent despot assumption about government. In their view policy was a tool that could be used to improve and even fine-tune the market economy. In their professional work, they seldom expressed the view that policy was also a means for some groups to gain at the expense of others.

The Study of Market Failure

One example of the benevolent despot view is the study of market failure. During most of this century, professional economics has been busy modifying and finding exceptions to Adam Smith’s proposition about the benefits of free markets. They have explored special cases in which production and exchange in the market economy cause consumers, as a role, either to be worse off or not as well off as they could be. We call such special cases and exceptions *market failure*. Consider the example of a new town that develops in the wilderness. Peoples’ desires to build houses and produce food leads the residents to cut down nearby trees. As the population grows, the town expands, roads are built, and new farms are created. More trees are cut and, as a result, the climate changes. Water becomes increasingly scarce and smoke from factories and other machines pollute the air. Everyone knows that the people would have been better off if they had used the original trees more judiciously. However, markets did not register the fact that cutting down trees had harmful effects on the environment. Even now, if people agreed to plant trees in vacant areas, the situation for practically everyone would improve. But markets do not give individuals an incentive to take account of these external benefits. People ordinarily only plant trees if their personal benefits exceed their personal costs.

Practically everyone gained as the town expanded, in spite of the fact that they were harmed by the gradually disappearing trees and increasing pollution. Hardly anyone would want to go back to the situation that existed before the development. Nevertheless, things could have been better.

Consider another example. Individuals in the market gain from buying mosquito abatement and vaccination

Market failure: The market is less efficient in enabling wants to be satisfied than we can imagine it being.

against communicable diseases. But their personal gains are substantially less than the gains to the community as a whole. If people could be persuaded to include the benefits to others in their calculations, they would increase their innovations and abatement. Practically everyone would gain.

These are examples of market failure. The market is less efficient than we can imagine it being. The members of the new economics profession searched for ways to correct for the inefficiency of the market economy. In these efforts they assumed that their task was to find a solution and then present it to the government. The (benevolent despot) government would hopefully adopt it and the inefficiency would be corrected.

Macroeconomics

Another example of the benevolent despot view is modern macroeconomics. Most non-economists today associate economics with what has become known in the profession as macroeconomics -- the study of unemployment, inflation, and economic growth on a national scale. To some extent, economists were interested in macroeconomics from the very beginning of political economy. However, after the Great Depression in the 1930s, there was a huge increase in the proportion of professional economists who studied macroeconomic policies. These economists typically subscribed to the belief that the government should "guide the economy," as a boat captain guides his ship.

It is difficult to judge from the statistics whether the macroeconomic policies of the last four decades have helped or harmed economies. Measures of effects are crude and there are a variety of conflicting, competing hypotheses. Nevertheless, macroeconomics continues to be a strong sub-field within professional economics. Like their counterparts who studied market failure, the macroeconomists believed that their function was to provide the (benevolent despot) government with solutions, at least until the late 1960s.²

²See James Buchanan and Richard Wagner (1977) and Wagner (1980) for a more thorough discussion of the relationship between macroeconomics and Public Choice.

The Emergence of Public Choice

To cause an economic policy to be carried out in a democracy requires more than merely convincing a government leader that a particular economic policy is sensible. Enough voters must believe that the policy is in their interest that they will approve it, through some form of collective decision-making process. How do these collective decision-making processes operate? Are there ways to make them more efficient? Economists who asked these questions were led to analyze a constitution, a representative legislature, political parties, and pressure groups.

Later, they turned to the study of the more permanent agencies and institutions of a formal government – the bureaucracy. Put yourself in the shoes of the head of a bureaucratic agency. Your task is to carry out collective decisions. In what way are you similar to the economic entrepreneur and how are you different? How do your customers and your resource suppliers differ from those in the market economy?

Still later, economists began to study the various ways that individuals might use the collective decision-making process to redistribute wealth from others to themselves. In economic jargon, they studied “rent seeking.” An example is a manufacturer who contributes to the political campaign of a candidate who advocates higher restrictions on competing imports. Another example is the employees of a public school system who join a union. Their usual aim is to increase their money income or other employee benefits by pressuring governments who fund them to redistribute wealth from others.

Political Science

Public Choice emerged from a growing sense among some professional economists that the policy recommendations of their colleagues failed to account for political reality. Later it attracted political scientists who were also dissatisfied with their profession. In that field, writers on democracy had a long history of advocating good moral conduct on the part of politicians, bureaucrats and voters. Many political scientists followed this lead. Most, however, took a more descriptive, or historical approach. Rather than make judgments about behavior, they aimed to merely describe the political events that had occurred in the past. In an effort to make their descriptions “scientific,” many of them adopted an approach called “behaviorism.” In the extreme, behaviorism refers to a meticulous recording of the observable behavior of individuals without any reference to their motivations. Behaviorists in psychology, for example, study physical responses to various stimuli. In the ideal situation, the

psychologists can completely control the stimuli, like a chemist controls the amount of oxygen he adds to some mixture. In experimental psychology, a behaviorist often connects sensors to various parts of the human body in order to record physical responses that are hidden from the naked eye.

In a complex field like politics, behaviorists could not be so precise. So they tried to capture political behavior by gathering statistics. As they became more skilled in using statistical analysis and attitude surveys, a large body of descriptive data became available to the young scholars. This was the state of the art in the 1950s.

Political scientists who only used behaviorism had no means of *understanding*. Understanding refers to what happens when you put yourself in someone else's shoes and ask, "If I were she, what would be my goals and how could I best achieve them." Although many political scientists had collected and described detailed statistical information about politicians', bureaucrats', and voters' behaviors; they often did not appreciate the fact that in order to understand the behavior, they had to do two things. First, they had to assume self interest on the part of the actors. Second, they had to try to determine how those actors could best achieve their own personal ends. Because this is what the Public Choice scholars were doing, young political scientists in the 1960s and 1970s were attracted to this field.³

Today it is difficult to tell whether the author of an article using economic tools to analyze some aspect of democracy was originally an economist or a political scientist. Most proponents of Public Choice, however, are scholars who started in one of the two subjects. They were attracted to interdisciplinary work by what they saw as a better explanation of politics than that provided in mainstream economics or political science.

2. ETHICS IN POLITICAL CONDUCT

Public Choice and Morally Correct Action

The economic approach to politics raises ethical issues, if only because it poses a challenge to the teachings of those who have traditionally studied politics. Much of traditional political science was devoted to finding the morally correct policy to follow. This issue will not be

³See Ordeshook (1993) for a more detailed history of this phase in political science.

discussed in this book. People differ in their views about what is morally correct. History suggests that we are not likely in the near future to reach general agreement on the morality of egalitarian policies, on the death penalty for murder, on “just” war versus pacifism, etc. Instead of trying to find out what is morally correct, Public Choice aims to study democracy as a means of achieving the aims that most people want achieved through government.

Some people have called Public Choice, “amoral” because it does not take a specific ethical stance. The Public Choice defense

Public Choice begins with the view that whether democracy will help to accomplish any specific goal is uncertain.

against the moralists is that amorality is a characteristic of the scientific attitude toward the subject matter. If we want to understand democracy, we must begin with the view that we are uncertain whether it will help to accomplish any specific goal. Our study is not intended to advocate democracy, small government, or any other ideology. Our aim is to understand democracy by using our ability to put ourselves in the shoes of those who operate in a democracy.

Market Economy Bias

Public Choice begins by assuming that people live in a system of private property rights and that they already have a market econ-

Where capitalism has existed, citizens produced a greater amount of what ordinary people call wealth than in their non-capitalist counterparts.

omy. This has led some critics to claim that it is biased because Public Choice theorists support the market economy. There is an important reason why Public Choice assumes that a market economy already exists. It is a belief that an informed citizenry would demand a market economy. Informed people know from experience that in countries where capitalism has existed, citizens produced a greater amount of what ordinary people call wealth than in their non-capitalist counterparts. They realize that the alternative is *central* planning, which has fared badly relative to the *decentralized* planning that occurs in a capitalist system. By putting ourselves in the shoes of actors who have experience with a market economy, we can reason that informed citizens would want their society to have a market economy. Chapter Three discusses the reasons why the

market economy is associated with the production of what ordinary people regard as wealth.

Many newer democracies in the world today were instituted before their citizens had experience with the market economy. Some were imposed by a victor of war, a former dictator, or political party. As a result, the people were not in a position to demand a market economy. The people in these democracies may need lessons in economics even more than they need lessons in Public Choice.

Making Assumptions about What People Want

Like the economists who study the market economy, Public Choice theorists examine democratic political structures in terms of how well we can expect them to give the people what they really want. We might say that the ultimate objective of Public Choice is to help people get more of what we think they want. To achieve this objective, we must make assumptions about the things that people want. We then ask about the conditions under which various democratic rules and institutions are likely to help them satisfy the assumed wants. If our assumptions about wants are correct, our analyses will be *relevant*. Otherwise, they will not be relevant. In either case, the Public Choice scholar states his assumptions for all to see and to possibly dispute.

3. THE MEANING AND HISTORY OF DEMOCRACY

Democracy Defined

Democracy is a type of government. Government means the existence and use of a monopoly over physi-

cally coercive force. A government has laws and it uses its monopoly over force to enforce them. In all sizeable governments, the making and enforcement of laws is the task of hired agents. The hired agents direct the monopoly over force. In an autocracy, the dictator hires all of the agents and gives them general directions about the laws he wants and the methods of enforcing them. A distinctive feature of democracy is that “the people” control the most significant agents through periodic elections. They exercise their control either directly through a plebiscite

Democracy: a type of government with two characteristics: citizen representation and rule of law.

or indirectly by the election of representatives. In this sense a democracy is “of the people, by the people, and for the people.”

Democracy has two fundamental characteristics: (1) *representation* and the (2) *rule of law*. In the ideal, representation means that each citizen’s preferences are represented in law making and law enforcing. In a large democracy, this must be achieved through voting. The rule of law means that decisions about whether individuals have violated the

Representation: each citizen’s preferences are represented in law making and law enforcing.

Rule of law: decisions about whether individuals have violated the law and upon their punishment are made according to general principles.

law and upon their punishment are made *according to general principles*. General principles are principles that apply equally to everyone, regardless of their appearance or creed. In the ideal, all citizens are subject to the same laws, enforcement procedures and punishments. There is no discrimination based on status, occupation, heritage, wealth, race, gender, religious beliefs, etc. The ideal rule of law requires the agents charged with making and enforcing laws to explain their decisions by referring to the general principles. When explanations are given, the members of society will be best able to predict future decisions in similar situations.⁴ To assure that such explanations are reasonable seems to require that the agents themselves be subject to a higher law. The right of appeal and lawsuits against agents who violate the non-discrimination principle are methods used in modern mature democracies to invoke this higher law. Since neither of these two characteristics of democracy exists in ideal form, we call those countries that come closer to the ideal “more democratic” and those that are farther away “less democratic.”

The history of democracy is the history of the development of the dual characteristics of (1) representation, by means of the voting franchise, and

⁴Nobel Prize winner F. A. Hayek described three characteristics of the rule of law: generality, equality, and certainty (1955: 34-36). Generality means that the laws are not against behavior that only one or a small number of people would be inclined to perform. Laws themselves should not be discriminatory. Equality means that no one is exempt from surveillance, prosecution and punishment and that these acts of administering justice are equally applied. The administration of justice should not be discriminatory. Certainty means that individuals are informed about the laws and are able to predict when laws will be applied.

(2) the rule of law in conjunction with a written explanation and an appeals forum. The history of the rule of law begins in ancient Greece where, for a time, the king set a standard of assuring that laws would be enforced consistently and certainly for all citizens. Representation is a more recent phenomenon. These characteristics seem to have first developed together in England over a period of about nine hundred years. Thus the history of democracy is in large part contained in the history of England. We cannot present a complete history of British democracy here. But it is worth identifying parts of that history in order to provide some perspective.

History of Democracy

The year 1066 marks the time at which the seed was planted from which democracy would gradually grow and mature. During this year, the Normans completed their conquest of England. The Normans, who were descendants of the Vikings, or Norsemen, ruled Normandy in France. They brought to England unprecedented military power and organization that assured a long period of relative security against invasion. In addition, they brought the rudiments of a system of property rights that promoted economic growth on the one hand and democracy on the other.

The Feudal System

The system of property rights introduced by the Normans is called the *feudal system*. It was a system of centralized control but delegated decision-making powers. The king was the supreme landlord. He was the ultimate owner of all real property. However, since he could not control the land by himself, he made land grants to barons, who in turn made grants to their retainers, or vassals. Thus, the king was the ultimate landlord, but he sublet the land to the barons. And the barons sublet the land to the vassals. The vassals then became the landlords in practice and proceeded to rule the people who had survived the conquest.

The dominant economic feature of the feudal system was its network of countryside manors, some of which were protected by a newly built or fortified Norman castle. The manor was basically a large self-sufficient farming and security enterprise governed by a vassal, who was called the *lord*. The security function was performed by the lord's castle. When threatened by invasions, farmers, who ordinarily lived near their farms in the countryside, could retreat to it. The lord ordinarily kept a large store of food on hand partly to feed the farmers in case of emergency. Given the technology of war at the time, the only way to defeat the castle was by a lengthy and costly siege. The cost of such a siege, along with the

potential of rescue by the king's army and the sea between England and Europe, was typically enough to deter an invader.

The lord of the manor was a local dictator. He or his appointees made the laws, enforced them, and settled all disputes among the peasant farmers and artisans. As a result, the living conditions of the peasants varied from place to place, depending upon the character of their respective lords.

The Rule of Law

In the early thirteenth century, an agreement was reached between the king and the barons. This agreement, which was called the Magna Carta, initiated what was to be a gradual replacement of the numerous systems of local, baron and vassal-made laws with a common law for the whole country – the *king's law*. A set of royal judges was appointed to visit each of the local courts at roughly seven-year intervals. Upon their arrival at a manor, they would hear numerous complaints, including those against the local lord. In ordinary times the judges were backed by the authority of the king. As a result, a vast segment of the population had recourse for the first time to a kind of appeal if they believed they were being treated improperly by their local law and court. The royal court judges became the first true court of appeal for ordinary people. Previously the only notion of a “higher law” for most common people was the “law of God.” Now, there was a national law, to which local governments had to conform at least in some measure. The idea of the *rule of law* was born in the minds of the lower classes of ordinary people.

For the rule of law to truly exist, more is needed than simply a hierarchy of courts, or system of appeal courts. The appeal courts must act according to a set of general principles that can be learned by both the lower courts and the ordinary people who are governed by the laws. The principles must be general enough that they can be applied to a wide variety of cases; they must not greatly contradict the variety of local traditions; and they must be plain enough for ordinary people to understand. The judges of the royal court took on the task of developing these principles. They did so by recording their judgments and then trying to apply the principles used in earlier judgments to later cases that were similar. By the sixteenth century, a collection of judgments was published which guided both judges and lawyers in their decisions.

This system, in which the principles used to decide previous cases of dispute are applied to future cases, is called

Common law: judge-made law in which future cases are partly decided by applying the principles used to decide previous cases.

the *common law*. It is, in a sense, *judge-made law* derived from the effort to settle disputes in a way that is consistent with the traditions of a society. It differs from *civil law*, which is law made by leaders. As England spread its empire to the Americas, Asia, Africa, and the Pacific; the common law went with it. Today, the former British colonies of the U.S., India, South Africa, Australia, Canada, and New Zealand, among many others, use the common law.

It should be evident from this discussion that the common law is a prime example of what we have called “the rule of law,” as opposed to rule by leaders. This is one reason why we say that democracy developed first in England.⁵

Representation

The other characteristic of democracy – representation – also developed out of the feudal system. But it developed more as a result of the king’s weakness than from his strength. Over a period of centuries, there was a succession of kings. Some were strong; others were weak. Weakness in a king may be due to a lack of will or a lack of ability to manage. It can manifest itself in a number of ways. First, under the feudal system, a weak king may simply give up some of his power to various barons. In the worst case, a civil war could break out. Second, a weak king may engage in reckless military ventures or make unwise alliances that threaten the nation. Third, he may allow his military to weaken in the eyes of enemies thereby inviting invasion and war. Faced with a weak king, the barons would have no choice but to try to take governance into their own hands.

The first important case was in 1215. In exchange for an agreement to end a civil war, the king granted collective decision-making concessions to the barons in the Magna Carta. This was a kind of compromise *contract*. The king agreed not to impose taxes without permission from “representatives” of the kingdom. He also granted freedom of religion and other liberties to free men. In return, the barons agreed to allow the king’s law to be extended to the regions they controlled, provided that subjects were granted “due process.” Thus the Magna Carta not only was an important step in the development of the rule of law, it granted representation to the barons in the making of government decisions. King John violated the contract, however, and the civil war resumed. Because of this, the Magna Carta might be regarded as a failure. However, when

⁵A more complete discussion of the evolution of the concept of the rule of law in the minds of political philosophers is provided by Hayek (1960), Chapter 11.

the civil war ended, John's successor reinstated it. So the system prevailed.

In the latter thirteenth century, with another weak king at war with the barons, the leader of the barons summoned a meeting, or *parliament*. Included in the meeting were not only the barons but also the local gentry from each county, middle-class people from the leading towns, and members of the clergy. The baron leaders apparently aimed to have all of the important factions in the country represented in an effort to stop the war. The meeting not only helped achieve peace, it established a precedent. Subsequently, kings often called together a parliament in times of national emergency – for example, during foreign wars or rebellions. Summoning the parliament was particularly important when the king wanted to reduce opposition to new taxes that he might regard as necessary to finance emergency actions.

When terrible religious wars broke out in the seventeenth century, the ultimate result was a dictatorship under the leadership of a powerful military leader, Oliver Cromwell. Although Cromwell had the military power and wisdom to suppress the deep religious divides that had developed within the Republic (which now included Wales, Scotland, and Ireland), his successor was not likely to be so strong or wise. To avoid a renewal of civil war, a compromise was reached in which a *permanent parliament* was created. The new king, following Cromwell, was required to consult with this parliament before taking action. In the late seventeenth century, a subsequent king attempted to act without parliamentary backing. By this time, however, the parliament had sufficient support from the barons but, more importantly, from the growing number of wealthy merchants, to replace him. With this support, the parliament, England's first truly representative body, established itself permanently.

From then on, England's democracy developed in two directions. First, as experience in making collective decisions grew, the members of parliament developed workable decisions-making rules to avoid conflict and to "get things done." Second, the members of parliament became elected representatives, with parliament eventually extending the voting franchise to all normal adult citizens.

Varieties of Democracy

Democracy, as defined here, has definite characteristics. However, in the countries of the world today that ordinary people call democratic, these characteristics are present in different forms and to different degrees. There are several reasons for such differences. First,

democracies had different traditions at the time of their beginning. The democracy that was created through the cooperation of the colonialists in the U.S. could begin with little regard to tradition. The founders could regard their government as an experiment in democracy. However, the creators of the European democracies had to respect traditions, partly because those traditions were the foundation of their political power. To ignore them would have led to revolt, civil war, and/or a possible return to pre-democratic conditions. The more recent democracies emerged from different traditions that their creators had to respect.

Consider the difference between India and the Philippines, each of which became independent after World War II. The Hindu-Muslim split in India led to the separate countries of India and Pakistan. The post-split, predominately Hindu Indian government had a caste tradition. This tradition was ideal for the emergence of a socialist democracy administered by a cadre of bureaucrats, appointed by the leaders with charisma or by traditional class-based authorities, who easily won elections. This socialism resulted in a stagnant economy in which initiative was strangled by economic regulation and prohibitions against doing business. In other circumstances, one might have expected a new government to be elected, one that was more favorable to economic development and especially to free enterprise. However, the majority did not know about free enterprise. The market economy was not a substantial part of its traditions. The conditions were also not amenable to revolution. The 160 years of Indian experience as a British colony gave the country a legal system that enabled the elected leaders to control the military and the police. The continuation of the democracy was assured. The rule of law developed and strengthened under these special conditions.

Compare this with The Philippines. Instead of British colonial rule, which emphasized efficiency and the rule of law, the Philippines was colonized by the Spanish dictatorship. The Spanish ruled until around 1900, when the U.S. took control. The Spanish system was primarily a patronage system in which the local population was ruled by governors and plantation managers appointed by the Spanish king. Law was administered by force of arms. Plantation managers possessed the arms and ruled the peasant farmers and workers. In essence, the Spanish imposed a feudal system. The Filipinos were ruled by persons not by law. In addition, missionaries taught the farmers and workers to be humble. The Americans, who replaced the Spanish, had little experience with colonial rule and mainly promoted independence. At the time of Philippine independence, the country was an assembly of different provinces and local governments, many of which had very different

traditions. Most were ruled by wealthy, strong local families, which functioned very much like the lords of the feudal manors. These families filled the positions left by the departing Spanish patrons after the American victory over the Spanish.

World War II left The Philippines with democracy and a strong army, whose leader could command great power relative to the previous landowners. The diversity of traditions, the fragmented nature of its provinces and localities, and the post-war central police power made it relatively easy for a strong leader, like elected president Ferdinand Marcos, to transform the new democracy back into a dictatorship. So, while India's problems have been primarily economic, The Philippines' problems have been primarily political. As both countries overcame these problems in the early 1990s, they appeared to be on the road to economic growth and political stability under democracy. Each seemed poised for the gradual expansion of free enterprise.

A second reason for differences among democracies is that at the point before the democracies began, they had different political systems. Some like England developed gradually, as kings traded off their traditional rights for military help and security. The U.S. formed as a confederation of previously separate states. The democracies of Japan and Germany were imposed by the victors of war. The democracies of India, Canada, and Australia emerged when the countries were granted independence from England. Most of the recent democracies were creations of former dictatorial governments, typically one-party dictatorships. In some cases, the democracies could not be formed until constitutions were written or agreements made to grant amnesty to members of the former government for their atrocities.

Third, at the beginning point, the democracies had different economic systems. South Korea and Taiwan had highly developed internal market economies and good trade relations with the rest of the world when they shifted from military dictatorships to democracy. The new Eastern European and Asian democracies that emerged after the breakup of the Soviet Union had little experience with the market system and few trading relationships with other countries. The main problem of the former countries has been corruption of the government officials. These officials inherited the authority to decide on such things as who should receive government contracts, who should be allowed business licenses, and who should be prosecuted for violating business regulations. The main problems of the latter countries has been gangsterism by former political leaders and soldiers, combined with a lack of "entrepreneurial spirit."

Fourth, the different democracies started at different times in history and therefore with different technology. The voter-produced ballot paper, ballot boxes, and hand-counting of ballots in the early U.S. is quite different from the

computerized systems developed today. Similarly the local soap box speeches of the past differ from the high-priced, national TV political advertisements of today. Because of these differences, the founders of the more recent democracies have been in a position to avoid some of the problems of other democracies, such as persistent voting fraud and the high cost to voters of learning about candidates.

Fifth, the democracies of today have different systems for making collective decisions. The most obvious difference is that between the parliamentary system, which most countries have, and a presidential system. Also the rules pertaining to political parties and pressure groups, as well as the legal rights of citizens to use these organizations, differ greatly.

These differences suggest that there is no clear blueprint for constructing an ideal democracy. Although we believe that the rule of law and representation are necessary general characteristics of democracy, the existence of so many different forms suggests that there is a great deal of room for speculation about whether one or another specific characteristic is necessary or desirable.

Reasons for differences among democracies:

1. Different traditions at the time of their beginning.
2. Different democracies previously had different political systems.
3. Different democracies started with different economic systems.
4. Different democracies started with different technologies.
5. Democracies instituted different collective decision-making systems.

4. THE INEFFICIENCY OF DEMOCRACY

This book identifies many reasons why democracy is not efficient and it is a good idea to describe them briefly before going on. First, in a democracy, individuals typically have only a relatively small incentive to reveal their true demands when they are called upon to join in the making of a collective decision. They also have a relatively small incentive to learn enough to participate informatively. Second, individuals have an incentive to use the politicians and bureaucrats who administer the government for their personal gain, even though their gain comes at the

expense of others. Third, elected officials often have an incentive to act against the interests of the electorate either by shirking their duties or by outright fraud and corruption. Fourth, there are inefficiencies that result from representative democracy. Representative democracy means that laws and administrative policies are made by elected representatives instead of by the people directly. This procedure seems to make the best use of voter information about candidates for office. However, it leads to situations in which each representative has an incentive to promote the interests of the people in her voting district at the expense of people in other voting districts. Fifth, there is pressure group activity. Because the costs of forming different pressure groups vary, those that have a cost advantage will tend to form while others will not. Members of pressure groups can cause laws and policies to be made even when their total benefits seem less than the costs. Sixth, government supply often means supply by a bureaucracy. Neither the bureau chief nor the ordinary bureaucrats have the kind of strong profit incentive to please consumers that the owners and employees of a private firm have. We shall see that their incentives may cause potential benefits to be squandered. Seventh, if the government takes an active role in the market economy, it may prompt action from individuals seeking to gain an advantage over their competitors. As mentioned above, this is called rent seeking. Eighth, once a government begins to supply some good, the suppliers often have a vested interest in continuing their supply even after the reason for it disappears. The result is a special political resistance to privatization.

Some of these inefficiencies, like bureaucracy and rent seeking, also exist in a dictatorship. The others, however, are unique to democracy. Thus, it might appear that the economic approach to democracy will lead to the conclusion that democracy is a bad idea. Keep in mind, however, that regardless of whether democracy is efficient in correcting or supplementing the market economy, it remains a means of enabling citizens to control the government monopoly over force. This monopoly can be useful in other ways.

First, in a modern economy, force is necessary in order to establish a private property system and then to enforce it. Coercion is practically always needed to deter theft and extortion. The private property system is essential if people are to enjoy the fruits of the market economy. Second, in belligerent times, a government must protect its citizens against invasion and confiscation by covetous foreign powers. Third, a monopoly over force can be used to enforce contracts thereby facilitating the exchange of promises. This promotes specialization and the division of labor in a market economy. Fourth, a national government can use its monopoly over force to help enforce local government laws. This may be

important because local thieves and extortionists may employ technology that is costly for the local government to rival.

Even though a democratic government is likely to be inefficient, the alternative – a dictatorship – may be worse. Dictators can

Democratic government is inefficient. But dictatorship is may be worse because the abuse of power by dictators can cause more serious damage to citizens.

use their power against their subjects directly by taking away their property and other rights. Or they can use it recklessly in international affairs, inviting disastrous retaliation. Democracy provides a measure of protection against the worst abuses.⁶

Hayek may have been exaggerating the inefficiency of democracy when he wrote:

While immensely and oppressively powerful and able to overwhelm all resistance from a minority, [our democracy] is wholly incapable of pursuing a consistent course of action, lurching like a steam roller driven by one who is drunk (1979: 11).

Inefficiency is a negative, to be sure. But it must be balanced against the positive, as Hayek also recognized:

[Democracy] is an ideal worth fighting for to the utmost, because it is our only protection...against tyranny. Though democracy is not freedom...it is one of the most important safeguards of freedom. As the only method of peaceful change of government yet discovered, it is one of those paramount through negative values, comparable to sanitary precautions against the plague, of which we are hardly aware while they are effective, but the absence of which may be deadly (ibid.: 5).

5. PLAN OF THIS BOOK

We can define Public Choice as the study of democracy from an *economic point of view*. This means that we describe democratic interaction and institutions in a particular way. We want to know whether they contribute to the satisfaction of the wants of the members of a collective better than alternatives. In other words, we ask whether democracy is *efficient* from the subjective viewpoints of the actors who

⁶For an excellent discussion of the advantages of a democracy compared with autocracy, see Mancur Olson (2000).

we assume are ultimately responsible for creating and maintaining its institutions. The “economic point of view” also refers to the assumptions we make about the people who interact and who make the institutions. We assume that all the actors – the voters, politicians, and bureaucrats – act in their self interest. They do not follow some general moral principle or act in accord with the “public interest,” however we might define it. Chapter Two describes the self interest assumption. It goes on to introduce market failure and to consider the possibility of government failure when policies are made to correct for it.

Chapter Three describes the benefits of the market economy and explores the idea of market failure in greater depth. It devotes special attention to goods that have “public goods” characteristics. Chapters Four and Five concern the fundamental agreement between members of a collective to create a government – the constitution. Chapter Four describes the demand for a government as a demand for an agreement, or contract, among members of a collective that will enable them to more efficiently obtain public goods. The constitution is defined as an agreement relating to the hiring of agents and control over their actions. Members of a collective want to find a way to hire the agents they regard as most suitable to cause public goods to be supplied. So they devise rules for electing politicians and hiring bureaucrats. The chapter goes on to discuss the nature of such rules.

Government officials who are elected or hired must be allowed to control the monopoly over force. This is potentially harmful to members of the collective. Chapter Five discusses the two main dangers: the prospect that collective decisions will go against some members of the collective and the prospect that elected or hired officials will abuse their power. It goes on to describe safeguards that can be built into a constitution to protect against these dangers. These include separating the government into branches, defining rights to convey and obtain information, and rules against buying votes.

Having discussed the most fundamental part of a democracy, the rest of the book goes on to describe particular interaction and institutions. Chapter Six describes different methods of electing representatives to the legislature. It also shows how the particular method chosen can influence strategies adopted by political parties to win elections. Chapter Seven presents elementary economic models of voting, elections, and election strategies. It introduces the rational voter hypothesis and the median voter theorem. Chapter Eight continues on the same subject. It describes a principle for choosing a political platform – the center of opinion strategy; it presents a simple model of campaign spending; and it describes the voters’ paradox. Chapter Nine demonstrates the logic that,

under any rigid tax system, majority rule is extremely unlikely to result in the most efficient supply of a public good. It also discusses voter dissatisfaction with the majority rule decision. Chapter Ten is concerned with vote-trading, or logrolling. It shows that under some circumstances, vote trading can improve efficiency but under others, it may reduce efficiency.

Chapter Eleven discusses the legislature. The popular idea that politicians should act in the public interest is strongest in the writings about legislators. Thus, it discusses the assumption that legislators act in their self interest at some length. It goes on to discuss the various kinds of decisions that legislators must make and how numerous individuals attempt to influence those decisions. Chapter Twelve discusses political parties and pressure groups. It presents a brief history of political parties in the U.S. and describes the various functions performed by political parties. It goes on to define pressure groups and presents the most popular economic model of such groups.

Chapters Thirteen, Fourteen, and Fifteen are about bureaucracy. Chapter Thirteen introduces the subject by describing the earliest theories of bureaucracy and presenting a brief history of bureaucracy in the U.S. Chapter Fourteen turns to the issue of bureaucratic efficiency. It describes the budgeting process, which is the main political means of influencing bureaucracy in a mature democracy. Then it presents the most popular economic model of bureaucracy. Chapter Fifteen discusses possible reforms, including the requirement of benefit-cost analyses, decentralization, and charging user fees.

Chapter Sixteen describes the economic idea of rent seeking. This is a proposition about what we can expect when a government has the power to make laws that affect individuals' well being. It holds that individuals have an incentive to pressure government officials to make laws that enable them to gain even if the laws result in economic inefficiency. The chapter gives two examples of rent seeking and then tells how economists have come to identify a hierarchy of rent seekers.

Chapters Seventeen and Eighteen present the increasingly popular idea of privatization. Chapter Seventeen focuses on the problem of liquidating a bureau. It shows why the liquidation is typically delayed beyond its optimal time. Chapter Eighteen discusses forms of incomplete privatization, which are substitutes for providing services by means of government bureaus. The subjects included are contracting out, subsidizing demand by means of a voucher system, and breaking up government-sponsored monopolies.