The Democratic State
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The outlines of a consensus\textsuperscript{1} have emerged concerning the appropriateness of public-sector activities in representative democracies.\textsuperscript{2} This consensus holds that most public-sector programs in these nations are inappropriate, or are carried on at an inappropriate level, or are executed in an inappropriate manner. The evidence underlying this consensus grows out of four strands of research. First, public-sector size has increased at a rate that exceeds increases in private-sector size but without an increase in public-sector productivity (Borcherding, 1977a, 1977b; Meltzer and Richard, 1978; Nutter, 1978). Both theoretical\textsuperscript{3} and empirical\textsuperscript{4} evidence suggest respectively that the public sector cannot be and is not as efficient as the private sector. Hence, unless there is some unexplored reason for increases in public-sector activity, as additional resources shift from the private to the public sector, a net decline in the economy’s total productivity occurs, with a resulting erosion of individual welfare. Second, Western democracies have developed extensive regulations, ostensibly to improve individual welfare; but the actual statutes often embrace the least effective and least efficient means to accomplish this end (Commission on Law and the Economy, 1979; Aranson, 1979; Aranson and Ordeshook, 1981b; Noll, 1971; Breyer, 1979; Poole, 1982). In the United States the Equal Employment Opportunity Commission (EEOC; Lindsay and Shanor, 1982), the Environmental Protection Agency (EPA; Ackerman and Hassler, 1981; Aranson, 1982; Maloney and McCormick, 1982; Marcus, 1980; Margolis, 1977), the Pure Food and Drug Administration (FDA; Peltzman, 1973; Wardell and Lasagna, 1975; Weimer, 1982), the National Highway Traffic Safety Administration (NHTSA; Peltzman, 1975), the Occupational Safety...
and Health Administration (OSHA; Smith, 1982), and the New Deal agencies (Hawley, 1969) provide examples of this phenomenon. Third, many public-sector programs redistribute wealth from lower-income to higher-income persons (Stigler, 1970). Two well-documented examples are state-supported higher education (Hansen and Weisbrod, 1969; Hansen, 1970) and loan-guarantee programs (Hardin and Denzau, 1981; Lowi, 1979). Fourth, antitrust and antimerger statutes, rather than promoting a competitive economy, have protected inefficient firms and have further entrenched inferior management.  

None of these phenomena rests on a coherent normative theory of the state, although economists who are not familiar with progress in public choice often use elements of one such theory, welfare economics, to justify the adoption of these welfare-degrading programs. Nor is there a constitutional theory that explains why public policy fails to be welfare regarding. But because representative democracies purport to be representative, the observation that their citizens acquiesce in the ongoing degradation of their own welfare compels explanation.

This essay reviews a body of research on the general problem of the failure of representative democracy. Section 2 develops some commonly invoked standards for welfare judgments about public policy and rehearses the argument that welfare-related justifications for public-sector activities are often overdrawn. Section 3 develops demand-side models of the political process in representative democracies. These models consider the political character of the undifferentiated electorate and the problem of the formation and maintenance of interest groups, with special attention to the nature of their public-policy demands. Section 4 explores the supply side of the public sector by separately considering legislatures, bureaus, and courts. Section 5 then examines alternative formulations of public-sector supply-side characteristics by reporting a general model of candidate and executive decision making based on the nature of public-sector demand. Section 6 reflects on future prospects and possible correctives for present failures and offers some commentary on the limitations inherent in any correctives.

THEORY OF THE STATE

To conclude that most public-sector programs in representative democracies are inappropriate, or are carried on at an inappropriate level, or are executed in an inappropriate manner, requires an underlying theory of the state that provides criteria of appropriateness. It would be hyperbole to claim that such a theory prevails in Western intellectual communities. Nevertheless, certain elements of welfare economics have merged to form
a body of prescriptive sentences about public-sector activity (e.g., see Baumol, 1965; Buchanan, 1971; Musgrave, 1959). Indeed, some scholars in modern public finance still regard these sentences as providing the animus for actual decisions taken in the public sector, although most scholars now hold that welfare theory is purely normative and cannot explain actual practice.

Here, we use welfare theory as a tool of criticism of representative democracies, not as a cynosure for public-sector decision making. Commonly accepted elements of welfare theory provide a convenient set of standards for judging the appropriateness of various public-sector activities. While these standards form an intellectual justification for the liberal democratic state, we find no reason to believe that voters and politicians actually try to follow them. Indeed, as we report here, both theory and practice argue persuasively that voters and politicians ignore them, leaving their fulfillment at best a matter of pure happenstance.

The logical structure (as distinct from the historical development) of welfare theory has two variants. The first depends on an individualistic methodology and Pareto optimality. In this variant an institutional arrangement, specific statute, or regulation is welfare-preferred if at least one person is better off, and no one is worse off, under it than under some alternative institution, statute, or regulation. Using a strict Pareto criterion, one cannot balance one person’s loss against another’s gain, nor can one weight different persons’ gains or losses differently. In this sense, the Pareto criterion is highly individualistic and neutral in deciding among the conflicting claims of various classes of persons. Therefore, socialist or other class-related bodies of prescriptions would not rest comfortably beside the Pareto criterion.

A second variant of welfare theory tries to construct a social-welfare function, either by summing individual utilities or by maximizing the utility of a “representative” person. This variant loses its individualistic character and internal consistency. For as the body of knowledge beginning with Arrow (1963; see also Plott, 1976) demonstrates, the possibility of constructing an internally consistent social-welfare function that simultaneously satisfies a set of reasonable criteria is logically impossible. In place of such a function, many scholars, using a “second best” framework, have pursued wealth maximization as a standard of action. But wealth maximization, like welfare maximization, remains uninteresting until conflicting claims force it to make judgments that rest on interpersonal welfare comparisons, which remain inappropriate under the first variant of welfare theory.

There is one way to incorporate the judgments made under the second variant into those made under the first. This method is especially applicable
at the constitutional level of decision making. Suppose that some people are choosing a set of rules, a constitution, to govern their subsequent public-sector decisions. One proposal might be to mandate subsequent actions that maximize wealth, with or without compensation to the losers. Constitution writers might well choose such an arrangement, even though any one of them might be a net loser in a particular decision rendered under it. Prior unanimous consent for a constitutional order thus may signify that the regime is Pareto preferred, even though subsequent decisions made under it may be Pareto neutral, and occasionally, myopically, even Pareto inferior. When we find such an arrangement after the constitution is formed, we may regard one of its particular derivative policies as Pareto inferior, even though we would judge the entire constitutional order as Pareto preferred if we compared it, in toto, to some other arrangements.

Here, we use the first variant of welfare theory, but from time to time we elliptically intersperse the discussion with this constitutional hybrid, because we are concerned with outcomes that occur as a consequence of explicit constitutional arrangements and practices. If representative democracy fails, by not reaching Pareto-preferred states, then we must judge that failure either on an individualistic basis or on a wealth-maximizing criterion, with the explicit understanding that the loss of wealth, from a constitutional perspective, has unacceptably but avoidably eroded individual welfare. With these qualifications in mind, we identify somewhat arbitrarily the commonly accepted functions of the state in the view of welfare theory and describe the often-overlooked boundaries that this theory places on social choice.

WELFARE AND STATE FUNCTIONS

Welfare theory usually begins by recounting the efficiency properties of pure competitive markets. This beginning in no sense incorporates a historical or ideological supposition about the superiority of such markets as compared with other social arrangements. It merely identifies an institution under which people's individual decisions maximize welfare by achieving Pareto optimality and the greatest possible total wealth, and by sending resources to their subjectively most highly valued uses. The assumptions that underlie a pure competitive market include many buyers and many sellers ("many" means that no single producer or consumer alone can affect market outcomes), perfect information, zero transactions costs, an explicit (and efficient) property-rights system (e.g., effortless monitoring and enforcement of rights and contractual obligations), undifferentiated goods, long-run free (unimpaired) entry of buyers and firms, and the absence of collusion among buyers or sellers (see Henderson and Quandt, 1971, chap. 4). If, but certainly not only if, all of these conditions are met,
then there are no wasted resources, all resources flow to their most highly valued uses, and wealth is maximized. The allocation of resources that exists in the presence of such a market is Pareto optimal, because there no net wealth goes unproduced, and no reallocation could occur without harming at least one person.\textsuperscript{17}

There are two classes of departures from the pure competitive model. To the first class belong those departures that are self-correcting, because incentives exist for secondary or parallel markets or for integration or other contractual arrangements, to arise and restore efficiency. For example, in the absence of perfect information, markets, abstractly considered, may fail to maximize welfare. This absence may also signal profit opportunities from creating markets in information, however, such as occur with various brokerage and agency functions. Whether such markets can operate successfully may depend in turn on various aspects of the market for information, such as whether the information bought and sold can remain divisible (see Ackerlof, 1970; Alchian and Demsetz, 1972; Hayek, 1945; Hirshleifer, 1971; Hirshleifer and Riley, 1979; Knight, 1921; Machlup, 1962; Rothschild, 1973; Stigler, 1961). If so, then the imperfect-information departure from the conditions of the pure competitive model merely induces the development of a secondary market, requiring no further political specification of property rights nor other governmental actions.\textsuperscript{18} Several other departures from the assumptions of a pure competitive market, most notably those involving transactions and monitoring costs, can similarly create private entrepreneurial opportunities for organizational changes that restore efficiency (Alchian and Demsetz, 1972; Coase, 1937; Klein and Leffler, 1981; Klein, Crawford, and Alchian, 1978; Rubin, 1978; Marvel, 1982).

The second class of departures from conditions of pure competition are those that further market processes cannot easily circumvent. These traditionally have been identified as instances of "market failure," because some alternative allocation of resources not theoretically achievable in the marketplace improves upon the theoretical marketplace allocation (Bator, 1968). Stated differently, voluntary action within the structure of the market relation cannot reach this theoretically identifiable allocation. Since the allocation is Pareto superior to the one that the market reaches under present governmental arrangements, some political alteration of property rights or statutory or regulatory structure may be advocated to achieve the Pareto-preferred result. That is, the presence of the alleged market failure creates a justification for the public sector to perform some new function or to alter the manner in which it performs an existing one.\textsuperscript{19}

\textit{Public Goods}. The resources bought and sold in the pure competitive market are private goods, because they share two important characteris-
tics. First, either law or practice or technology has created defensible property rights to them, which effectively can exclude from ownership or consumption those who have not produced or paid for them.\textsuperscript{20} Second, in principle it is possible to create such property rights, because the goods that they circumscribe are not theoretically indivisible. A violation of either condition makes it possible that those goods to which the violation applies—public goods—will either be suboptimally produced or not produced at all (Samuelson, 1954). Classic examples of goods whose divisibility is theoretically impossible (or nearly so) include national defense and public peace, neither of which can be withheld from nonpayers. Of course, several goods (e.g., national parks) and services (e.g., education) are at least partly divisible in principle but have not been totally made so, either because property-right specifications are incomplete or because political decisions have been taken to make them free or nearly free to all users. The paradigmatic example of market failure concerns the inability to supply public goods or the suboptimal supply of such goods in pure competitive markets. The concept of a public good has become so ubiquitous and organic that it has lost much of its analytical power (e.g., see Steiner, 1974; Kahn, 1966). Here, though, we refer to a good as public only if its supply would create the particular incidence of costs and benefits that classical welfare theory would contemplate.

The public-goods problem arises in several instances that may or may not merit public-sector attention. All involve the failure to pay or contribute to the production of a jointly produced or consumed good or benefit; the relevant failure is called shirking, chiseling, or free riding, depending on the conditions under which it occurs.

Shirking arises in joint production processes, most notably those of the firm or franchise, in the presence of positive monitoring costs. For example, each worker in a complicated joint production process, in which no single worker's individual contribution is readily separable, has an incentive to shirk, thus collecting the benefits of others' efforts. The addition to the firm's net present value created by monitoring and by appropriate incentive structures (e.g., creating a market for management and control) goes in part to those monitored, to induce them not to shirk, and to monitors, who are themselves monitored by others and are ultimately disciplined by market forces (Alchian and Demsetz, 1972; Jensen and Meckling, 1976). The addition to joint product consequent to these monitoring activities is the public good.\textsuperscript{21}

Chiseling occurs in the presence of cartels. Generally, a cartel agreement restricts output, thus raising the equilibrium price of each unit of output to the level that, by assumption, would be the profit-maximizing price if all cartel members formed a monopoly. A single cartel member chisels on
the agreement by expanding output to capture the profit opportunity in the (higher) cartel price. If all cartel members chisel, then the cartel falls apart. The added profit to the cartel from successfully enforced cartelization is the public good.

Free riding occurs in several contexts. The term's traditional usage refers to those who enjoy the putatively higher wage rates and improved working conditions derived from union striking and bargaining efforts, without themselves paying union dues or the costs of striking. More recent usages expand the concept to cover failures to support traditionally nondivisible governmental services, such as national defense, public safety, conflict resolution (courts), and a host of other public-sector activities concerning which some imagination may be required to discover actual nondivisibility.

Welfare prescriptions related to the public-goods problem may reflect the context in which it arises. For example, in the case of shirking, all losses (suboptimal production levels) are internalized to the particular firm. Furthermore, external market forces discipline firms that fail to resolve these problems but reward firms that succeed. Hence, public policy should encourage or at least not hinder a firm’s internal ability to monitor, sanction, and reward, and should encourage or at least not hinder the workings of external market forces that discipline or reward individual firms.

In the case of chiseling, the formation of cartel-output agreements may impose a welfare loss on those consuming the cartel’s output. In keeping with welfare theory, public policy should make efforts to cartelize difficult or at least not encourage or require cartelization in specific industries, as commonly occurs with regulation. Stated differently, some public-goods problems, such as chiseling, may be resolved to the benefit of those affected by them, but to the detriment of others. Welfare theory tries to distinguish among such opposed claimants by ascertaining under which conditions wealth—usually measured as the sum of consumers’ and producers’ surplus—will be maximized.

The free-rider problem associated with labor-union activity probably falls more comfortably under the heading of redistribution, which we consider momentarily. More generally, public goods, such as national defense and public peace, or potentially private goods, such as highways and school systems, which are offered free, and therefore are made nondivisible by legislative fiat, are created by the usual taxing and spending mechanisms. Public policy should distinguish the efficient level at which to produce such goods (provided that they should be produced at all), and should encourage cost-effective means of production.

Public Bads. Public bads, or external diseconomies (sometimes called externalities or external costs), are simply the reverse phenomenon of
public goods. Indeed, a mere linguistic expedient makes them equivalent. For example, consider a common waterway that adjacent residents pollute at a constant rate. Their effluent reduces the waterway’s suitability for other uses, such as recreation or as a source of drinking water. If a particular person unilaterally filtered and purified the water or installed purification elements on each effluent source, then the waterway’s improved quality would be a public good for all adjacent residents. Their effluents into the waterway are equivalent to the production of a public bad, an external diseconomy. The failure to specify a property right in the purity of water, or the technical inability to specify such a right in the case of a common resource such as a lake, waterway, or ambient air, makes the formation of a market in suppressing the external diseconomy, or in producing the condition that occurs in its absence, difficult or impossible.

Philosophers sometimes distinguish between acts of omission and acts of commission, to point out the differences between positive and negative acts and obligations. But in the argot of public goods and bads, no such distinction occurs. A citizen who fails to produce a desirable public good or fails to contribute to its production is said to produce a public bad, and one who fails to produce a public bad, even though it would have been individually beneficial for him to produce that bad, thereby produces a public good. Thus, shirkers, chiselers, and free riders are equivalent to producers of public bads.

Property Rights. The traditional notion of property rights concerns those situations in which the common law, statute law, or administrative rule making (regulation) create legally defensible but sometimes limited rights to acquire and alienate tangible and intangible assets. The property-rights problem, however, is actually one of public goods and public bads. For example, one form of property right is the right to be compensated for the benefits that one’s actions or the use of one’s assets bestows on others. If an institutional arrangement could guarantee such a right, then the public-goods problem would be solved. By a similar reasoning, a property right may also contemplate the right to be compensated for the damage that others’ actions impose on us, the right to avoid such damage, or the right to contract explicitly to accept it for a mutually agreeable payment. An institutional arrangement that incorporated responses to such damage, if optimally constructed, would solve the public-bads problem.

The logical equivalence of the property-rights problem and the public goods–public bads problem has not always been explicitly drawn, although it is now widely recognized. A brief example illustrates the nature of the identity but also underscores the importance of property rights as a subject matter sui generis. That example concerns the allocation of rights to broadcast frequencies, which vest property rights in the recipients (Coase,
1959, 1962). This practice, carried on partially today by administrative rule making through the Federal Communications Commission, is rationalized by the expectation that in the absence of legally defensible property rights, a degradation in the value of a common resource pool—the radio frequency spectrum—would result. Naturally, a variety of possible patterns of rights to spectrum use might be adopted, only a subset of which would maximize the spectrum’s value (Coase, 1959; Posner, 1977).

Contemporary property-rights theory now goes far beyond the traditional concerns of regulation to embrace problems such as job tenure (Alchian, 1959; de Alessi, 1974b; Martin, 1972, 1977), industrial organization and corporate governance (Alchian and Demsetz, 1972; Coase, 1937; de Alessi, 1973; Jensen and Meckling, 1976; Klein, Crawford, and Alchian, 1978; Manne, 1965; Williamson, 1964), incentives structures within bureaucracies (Ahlbrandt, 1973a; Davies, 1971; de Alessi, 1974a; Lindsay, 1976; Niskanen, 1971; Tullock, 1965), and common ownership and usufruct rights with implications for cultural and economic anthropology (Anderson and Hill, 1975; Clark, 1973; Demsetz, 1967; Gordon, 1954; Hardin, 1968; Libecap, 1978; Libecap and Johnson, 1980; Posner, 1980; Smith, 1969; Trosper, 1978; Umbeck, 1977). In each instance, a property right or economic practice emerges (or fails to emerge) to resolve a problem of external economies or diseconomies, given the prior structure of rights.

Redistribution. The goal of wealth or income redistribution as a welfare-based function of the state is the subject of serious dispute. The theoretical justification for redistribution partly follows lines identical to those that support the public production (suppression) of public goods (bads). For example, in its utilitarian aspects, redistribution is a putative source of political stability (Brennan, 1973), public peace, and insurance (Rawls, 1971). But the more traditional theoretical justification for redistribution relies on two less practical and more esoteric grounds.

First, redistribution may rest on the assumption of diminishing marginal utility for money (Blum and Kalven, 1953; Stuart, 1967). In this view, a wealthy person loses less utility than a poor person gains by the redistribution from rich to poor. Therefore, an aggregate welfare function would be maximized if everyone’s wealth became equal. This justification accords with the second variant of welfare theory but not the first. Certain authors, however, have developed variations on this theme. Their implied constitution would guarantee that a collectivity’s least-well-off persons would benefit from any change in public policy (Rawls, 1971) and that any welfare gains from redistribution would not be offset by the amount by which total production falls because of a loss of incentive (Thurow, 1977).

This justification for redistribution may have some positive content (Meltzer and Richard, 1981, 1983), although in its pure second variant
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(social-welfare function) form the concept has no generally accepted scientific credentials. Nevertheless, redistribution may have some appeal in the constitutional variant of welfare theory. That is, behind a "veil of ignorance," people might unanimously agree ex ante on some kind of redistribution. Even so, this justification for redistribution is not without serious problems.

The more general argument supporting redistribution is consonant with a public-goods claim (Hochman and Rogers, 1969; von Furstenberg and Mueller, 1971). The outlines of this argument observe the existence of interdependent utility functions, those in which A's utility depends on B's consumption (or perhaps on B's utility, if it is believed to be measurable). If A's utility were solely dependent upon the amount of B's consumption accounted for by A's contribution, then no problem would emerge, because the returns to A's philanthropy would be a divisible benefit, flowing entirely to A. But if A's utility depended on B's consumption generally, including that part of B's consumption that C contributed, then a problem emerges. If C contributes to B, thus increasing B's consumption, then that increased consumption is a public good for A. In a society of such contributors, in which each gains some positive marginal utility from his own consumption, the free-rider problem is quite general, and the state might be called upon to redistribute coercively.

Monopoly. The monopoly issue today is hotly disputed as a scientific problem. The classic welfare argument concerning monopoly held that by operating over the entire industry-wide demand schedule, a monopolistic firm that maximized profits would produce less output and at higher unit cost than would a competitive firm facing a horizontal demand schedule (i.e., a fixed competitive price). A deadweight loss was said to result, because the sum of consumers' and producers' surpluses would be less than would prevail in a pure competitive market.

Until recently the literature on monopoly and monopolistic practices displayed a curious intellectual asymmetry. Scholars generally set the pure competitive market up as an ideal, found small theoretical perturbations from that ideal, linked those perturbations with real-world practices, and then recommended public-sector intervention to cure the defect. The same treatment was never accorded to the pure monopoly model, however, even though it seems far more susceptible to such a treatment than does the pure competitive model. For example, a pure monopoly model contemplates substantial barriers to entry and little product substitution, although those conditions are almost never met in the real world (Baumol, 1982).

Current scholarship (see note 1 of this chapter) now makes plain that this model of monopoly is far less robust than the pure competitive model,
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when robustness is measured as the degree to which the assumptions of the model can be violated by the respective markets without materially changing the outcomes. Many practices once thought to be monopolistic are now deemed highly competitive, because they lower unit production costs. For example, industrial-organization scholars seldom interpret vertical integration today as a respectable subject for antitrust prosecution, because vertical integration reduces or eliminates certain costs that consumers otherwise would have to bear (Klein, Crawford, and Alchian, 1978). Similarly, practices such as base-point pricing (Haddock, 1982), once regarded as indisputable evidence of conspiracies, are now interpreted as evidence of competitive markets. Theories of predation, likewise, no longer are regarded as intellectually respectable (Elzinga, 1970; Koller, 1971; McGee, 1958), and they have joined in the academic dust heap such outdated justifications for prosecution as administered prices (Alchian, 1970; Stigler, 1962; Stigler and Kindahl, 1970, 1973) and high industry concentration (Brozen, 1970, 1971b, 1971a; Demsetz, 1973b; McGee, 1971) as per se violations of antitrust laws.

The pure monopoly model has been linked with the public-goods problem, especially concerning natural monopolies, those firms that dominate a market and enjoy globally diminishing long-run average total cost curves, such as certain public utilities (Lerner, 1964). The connection occurs because a correctly designed public policy theoretically will increase the sum of consumer and producer surplus, and therefore social welfare. The particular public-goods application to the natural monopoly problem arises because as additional people consume additional units of the good that the natural monopoly produces, the average unit cost of production declines. Hence, new consumers effectively reduce the unit cost to prior consumers. This interpretation of the monopoly problem as a public-goods problem is obviously strained and tends to empty both the concept of monopoly and that of public goods of their assertorial power (Buchanan, 1971).

The principal problem remaining with monopoly and monopolistic practices concerns whether the problems cited belong to the first class of departures from the pure competitive model, those that are self-correcting in the marketplace, or to the second class, those that are not. Contemporary scholarship increasingly assigns these problems to the first class. Of course, the manner of correction remains in dispute. For example, there is evidence that price regulation of natural monopolies has no effect (Stigler and Freidland, 1962). And a better result may derive from auctioning off monopoly rights to private producers than from regulation (Demsetz, 1968).
The presence of at least one of these five problems is a necessary condition for welfare-regarding state action, but none of these five problems comprehends a sufficient condition for state action, although each is often treated as sufficient. Some of the most important recent work in public choice seeks to provide boundaries on social choice by ascertaining under what conditions each of these problems might find a welfare-regarding improvement through state action. The general lines of research identify three broad categories of boundaries. These concern the relative benefits and costs of state action, the appropriate method, and the appropriate jurisdiction.

**Benefits and Costs.** The absence or suboptimal supply of a potential public good does not by itself compel a public-sector solution in the form of public production or a subsidy of the production of a public good. There is an infinite variety of potential public goods or bads that clearly should not engage public-sector solutions, if only because the opportunity costs of state action exceed any possible benefits. A national program to eradicate acne is probably an example of such a public good.

The cost-benefit calculation recommending for or against state action is far more complex than simple accounting, however, and we can usefully approach the problem of computation by considering ex ante versus ex post welfare judgments. The computation problem is especially severe in the area of regulation. Congressional enactments concerning regulation have increasingly incorporated the requirements that cost-benefit analyses be performed and that only those programs whose benefits exceed their costs be adopted. One problem with such an approach concerns the inherent inability of a centralized decision mechanism, such as a regulatory commission, to calculate all of the costs and benefits, as well as all of the postregulatory reactions, that might occur because of a certain regulation. One useful way to look at this problem is to decide whether or not a particular “market failure” can be corrected in a secondary market or whether it is privately irreparable. If we have theoretical reasons to believe that a secondary market or subsequent producer or consumer choice will resolve the putative market failure, then we should expect the marketplace to produce the requisite solution. But suppose that it does not and that the regulatory commission calculates the benefits of its solution to exceed the costs. Such a computation does not yet justify public-sector action.

The reasons for this demurrer are complex but worth rehearsing. One of the earliest criticisms of central economic planning, and one not yet turned aside, is that decision makers out of the marketplace and in a centralized information-collection and -processing position cannot calculate
relative prices and marginal rates of substitution in the manner of the decentralized marketplace. Such people do not enjoy what Hayek calls the special knowledge of the circumstances of time and place (1945), nor can they work out the individual price-quantity ratios based on the individual utilities and marginal rates of substitution of all producers and consumers in the marketplace. The market can solve this calculation problem, however, and therefore, *ceteris paribus*, the market’s allocations will be superior to those made by central planners.

This result has a direct translation concerning public regulation of the marketplace to correct a public-good, or public-bad, problem. The legislature or administrative agency cannot possibly replicate each consumer’s marginal rates of substitution and each producer’s combinations of production costs and reaction to uncertainty. Therefore, without compelling evidence that a putative instance of market failure is not correctable in the market itself, there is no welfare justification for state action. That is, the information in the marketplace has already judged that its contemplated market-correcting action has costs that exceed the benefits. Otherwise, some producer would have undertaken it. But even if the problem is not correctable in the marketplace, there remains no sufficient condition for a public-sector response, because its costs still might exceed its benefits.

The problem of ex post versus ex ante calculation of costs and benefits still remains. That is, we must judge state actions against the constitutional conditions that made such actions possible. Stated differently, the perceived costs and benefits of various actions will change, depending on whether their calculation is made ex ante or ex post. For instance, ex ante we might judge that the aggregate costs of allowing prior restraints on freedom of the press exceed the aggregate benefits, although surely, external diseconomies flow from the exercise of that freedom. But ex post we might decide to ban pornography, or the publication of national defense secrets, or libelous utterances. Ex ante we might judge that the costs of prohibitions on religious practices exceed the benefits. But ex post we might decide to ban polygamy or liquor sales on Sunday. Such a distinction suggests that a state action taken following a prudential ex post judgment might seriously weaken a Pareto-preferred general rule adopted ex ante, which must be constantly protected for it to survive.

Finally, state action must contemplate its object with care. Certain public-goods problems should not be resolved in the public sector, because they are collective to a particular group but are not truly “public.” That is, their resolution might benefit a few to the detriment of many. For instance, in the case of shirking, a clear public-goods problem, all losses are internalized to the firm experiencing problems (suboptimal monitoring levels, and therefore, effort). Furthermore, external market forces do
discipline firms that fail to resolve these problems and reward firms that succeed. Hence, public policies should encourage, or at least not hinder, a firm’s internal ability to monitor, sanction, and reward, and should encourage, or at least not hinder, the workings of external market forces in disciplining and rewarding individual firms. That is, agents in the public sector probably should not concern themselves with the “‘small’” public-goods problem of private-sector shirking, which occurs in every firm. The problem has a marketplace solution, and the public sector has no way to collect the requisite information to find it.

In the case of chiseling, the formation of cartel-output agreements may impose a welfare loss on consumers of the cartel’s output. In keeping with welfare theory, public policies should make efforts to cartelize difficult, or at least should not encourage or require cartelization in specific industries. Stated differently, some public-goods problems may be resolved to the benefit of those affected by them but to the detriment of others.24 Welfare theory tries to distinguish among such opposed claimants by ascertaining under which conditions resources will be most efficiently used.

Methods of State Action. The four principal methods of state action are governance by common law, by statute, by regulation, and by public incorporation. The welfare consequences attending each of these methods differ from the others and from problem to problem, and therefore we review each method separately.

Social scientists are largely uninformed about governance by common law. Most economists and political scientists regard a market without formal statutory or regulatory-agency control as a variety of anarchy. Even the most laissez-faire economies, however, have gone far beyond anarchical structures,25 replacing them with a system of common law, or judge-made law. The regulatory aspects of the common law are seldom appreciated. Yet, recent research indicates that common-law processes can create dynamically efficient rules of liability for governing the areas of contracts, property, and torts (Posner, 1977; Rubin, 1977; Priest, 1977; Goodman, 1978; Journal of Legal Studies, 1979, 1980; Calabressi, 1970). It is not clear when an economy does (or should) move from anarchic structures to a system of laws. Property-rights theory (Aranson, 1974; Demsetz, 1967; Carneiro, 1970) suggests, however, that this change might (or should) occur when a common resource is overused, provided that the cost of the legal system itself does not overcome the benefits of divisibility or liability assignment created in law.

The efficiency of the common law rests on participants’ ability to bargain, to transact, and, at a reasonable cost, to monitor compliance with the terms of a contract or a legal duty. For example, a rule governing easements in property law might state the conditions under which one
person has a right to use or pass over another's property without committing a trespass. The efficient operation of this rule requires that the property owner, at low cost, can monitor use of the easement to see that its terms are not exceeded, can identify trespassers, and can alienate his property rights, if they are protected by a common-law rule of easements, in a bilateral negotiation with another party, which enlarges the terms of the easement. Similar conditions apply to the person owning the easement right, including his ability to alienate that right back to the property owner.

A straightforward application of simple price theory to the nexus of common-law rules and property rights provides additional boundaries on social choice. For example, consider a limited externality, such as that created by a rock group that practices in a residential basement, disturbing a cellist who practices quietly in a nearby home. The common law gives to the property owner, in this case the cellist, the right to a "quiet enjoyment" of his property. So, the cellist can enforce that right against the rock group. If the rock group wants to continue to practice, it must pay the cellist not to enforce his right. If it does so, then it must place a higher value on this arrangement than the cellist places on his quiet; otherwise, not. But if the common law gives a property right to the rock group to practice at its will, then the cellist must pay for quiet, which he will do if he values it more than the group values its right to practice in the basement. With either allocation of rights, the resource—in this instance the "use" of the "ether" for a configuration of sound waves—flows to its higher-valued use. That is, with any initial allocation of rights, with alienability of those rights, and with low transactions costs, the result is efficient. This much we know from the Coase Theorem (Coase, 1960).

Two boundaries on social choice grow out of this general principle. First, neither statute law, nor regulation, nor governance by public incorporation will resolve such externalities as efficiently as will the common law. Common-law rules ordinarily will allocate the right to the party to which it would flow most of the time as a result of explicit negotiations and will allow for contracting the right away, alienating it, if the parties can mutually gain from exchange. For reasons identical to those that give decentralized markets an advantage over central planning, other forms of governance cannot achieve the common law's level of dynamic efficiency in such cases. Therefore, governance by common law enjoys a putative superiority over other forms of governance. Second, legislatures and regulatory agencies will try constantly to overturn prior contractual agreements made under common-law rules, but such attempts should be thwarted in the view of welfare theory, because, inter alia, they make future agreements less valuable and thus more difficult to transact.
Agreements to accept an external cost eventually may be challenged in the courts, legislatures, and commissions in cases involving far subtler arrangements. For instance, a rock quarry may have operated in an uninhabited area, which is subsequently built up as a residential neighborhood. Presumably, home buyers sorted themselves out, so that those who did not value dust-free environs quite so highly bought homes in such a place for the reduced price that sellers usually could demand for their property. That is, these buyers "came to the nuisance," and courts at law at one time followed precedent by not recognizing claims that the nuisance must cease operations, although that doctrine has been breached in recent years. The successful prosecution of such a suit or its legislative or regulatory equivalent would bestow a windfall gain on the home owners and a windfall loss on the quarry owners. The long-run effects of clouding or reversing the coming-to-the-nuisance doctrine would be a reduction in both quarrying and home building in such areas, a Pareto-inferior result.

But suppose that home owners eventually come to value dust-free environs and would be willing to pay the quarry owners more than the net present value of the owners’ income stream, to suspend or diminish operations. The common law allows such a result, but transactions costs brought about by a free-rider problem among the (many) home owners may make its execution difficult or impossible. Common-law rulings might facilitate such transactions, but their completion often requires the formation of some kind of sovereign body. That is, in such cases the assumptions underlying the efficient operation of common-law rules are materially violated.

There are other instances in which these assumptions cannot be met. For example, common-law rules might interpret air pollution as a nuisance or a trespass. But with thousands, perhaps millions, of individual pollution emitters and receptors in a relevant "market," the calculation problem and costs inherent in forming transactions and monitoring compliance are overwhelming. Thus, there may be a welfare justification for moving from a common-law regime to one of statute law. This justification assumes that the benefits that such a statute entails exceed the costs. The costs of statute-law rules, however, may exceed those of common-law rules, even when they contemplate the same outcomes. In particular, the central characteristic that separates statute law from common law (although this characteristic need not apply universally) is that under statute law, those who enjoy rights cannot alienate them. Statute law solves an externality problem by making it impossible for those protected to alienate their rights, or for those who must bear an obligation to contract out of it.

This characteristic of statute law rides roughshod over individual preferences and therefore makes it more costly to apply than common law.
But it is also the reason for its use. Its advantages grow out of the nature of the externality involved as well as the high level of transactions cost. For instance, A may sell to a factory the right to pollute the ambient air around his home and property. But it is difficult to assemble all other home owners to agree to A's transaction with the factory. The assembly problem cuts in two directions. First, if A makes such a transaction, then the factory will almost certainly pollute the ambient air of B and C, whose assembly in large numbers for purposes of bargaining and transacting is costly. But if A and B make a transaction with the factory, then C, whose consent may also be required, might hold out for the entire surplus that the contracting parties gain from the transaction.

If an exchange involving A, B, C, and the factory were desirable in the absence of transactions costs, then a statute that specified duties among all participants might avoid these two problems of transacting. The statutory result cannot replicate the participants' individual preferences as they would be worked out in a market for rights that did not have the externalities involving A's contract with the factory, C's monopoly power, or the high transactions costs of bargaining and contracting with large numbers of people. But the statute may work a rough justice among the participants. The balancing tests involved in choosing between a common-law order and a statutory regime now seem apparent, although in practice, actual calculations based on a welfare-regarding model may be quite difficult or theoretically impossible to perform in all but the most extremely simple cases.

Governance by regulation, pursuant to statutory authorization, combines elements of both common-law and statutory governance. It is like governance by statute, because most regulatory agencies function as legislative bodies. It is like governance by common law, because most regulatory agencies also perform judicial functions in their specialized areas. The welfare-related justifications for adopting governance by regulation involve those that justify governance by statute and in addition rest on the desirability of flexibility, expertise, permanence, and the perceived inability of legislatures to engage in administrative tedium. In other words, governance by regulation is justified by amplification of the legislature (Posner, 1982; Aranson, Gellhorn, and Robinson, 1982) and, some would argue, by an intellectual structure that prefers public administration over political disposition.31 We shall find, however, that the animus of governance by regulation generates out of motives having little or no connection with improving the legislature's ability to form welfare-regarding statutes.

Within the category of governance by regulation, there are several possible modalities. The most prominent is command-and-control regulations, under which legislators or regulators set standards that private-sector producers must satisfy. For example, the Environmental Protection Agency
may set maximum discharge rates for pollutants from particular factories. Under a prescriptive election model to be described in the next section, this method presumably replicates the environmental-quality preferences of the electorate's median member. An alternative procedure is the use of effluent charges, which try to "cost" environmental damage by replicating market forces and the result that would emerge from a common-law process without transactions costs. While most economists prefer effluent charges to command-and-control regulation, there is growing interest in marketable pollution rights and "offset" and "bubble" procedures. These policies combine the notion of standards and an optimum level of environmental quality with an entitlement for producers to buy and sell rights to pollute up to that level, so that for any mandated level of use of the environment as a sink, rights would flow to their most highly valued uses.

Governance by common law, statute, and regulation all involve situations in which private action remains private, but the incentives and alternatives that participants face are shaped by rules emanating from the public sector. Governance by public incorporation involves the public adoption of the private activities involved to form a public enterprise, such as the Department of Defense, the Department of Justice, or the Post Office Department.

Welfare economics provides no clear, nonideological theory concerning the choice between other forms of governance and public incorporation. Rudiments of such a theory appear from time to time in observations that the costs of regulating private action may exceed those of a simple integration of the scrutinized activity into the public sector. For example, Henry Simons believed that natural monopolies could not be successfully regulated, and so he proposed to make them collective (Simons, 1935; Stigler, 1974). Certain other activities, such as national defense and the police power, appear to require a decision-making finality that only governance by public incorporation can achieve. Other state functions, however, such as the railroads and postal and lighthouse services (Coase, 1974), probably can be supplied more efficiently in the private sector. Questions of public-versus-private-sector supply form the core of many public-policy debates of both an economic and ideological nature. But as we shall see, as with decisions to regulate, the decisions eventually taken for public incorporation have very little to do with the positive economic substance of those debates, *inter alia*, because they seldom enjoy a complete accounting of benefits and costs.

These categories of methods of governance need not be exclusive. For example, public policy may leave a particular economic activity largely unregulated except for applicable common-law rules of liability. At the same time, very closely related or identical activities somehow (only) distin-
guished in the contemplation of law may be subject to statutory constraints, regulation, and even public incorporation. Mail and package delivery is an example. The post office delivers first-class mail, packages, bulk mail, and some express mail. Certain of these functions are carried on in regulated sectors (e.g., airline package deliveries and Federal Express) and in unregulated sectors (e.g., local courier services). Supplying public peace is similarly carried on by public incorporation (e.g., police departments), in regulated markets (e.g., licensed detectives), and in unregulated ones (e.g., unlicensed investigators and suppliers of small weapons and burglar-alarm systems). The legislature, regulatory agencies, and the courts may differ concerning the extent to which they will allow this simultaneous activity or will require that one activity preempt another.

Jurisdiction. The final boundary on social choice concerns jurisdiction. While this is a more substantial decision problem in a federal state such as the United States than in a unitary state such as Great Britain, nevertheless, to some extent, all polities decentralize both bureaucratic and legislative decision making. The problem of jurisdictions presents something of a conceptual muddle. Managerial theory has been developed that suggests the method and optimal degree of decentralization for private-sector activities (Chandler, 1962; Alchian and Demsetz, 1972; Coase, 1937; Klein, Crawford, and Alchian, 1978). Devolution may prevail both as to the extent of geographical territory covered and the degree of functional separation and independence within the firm. To some extent, such private-sector models of firm centralization and decentralization carry forward into public-sector bureaucracies, legislatures, and courts. The problems inherent in producing public goods and suppressing public bads, however, make it plain that the signaling capacity of price and the market for corporate control do not operate effectively in the public sector, to give decision makers appropriate incentives concerning organizational structure. Hence, those sentences that we might utter about the optimal degree of decentralization and the appropriate jurisdiction for various public-sector tasks remain largely precatory.

Abstractly considered, we might ask that the optimal jurisdiction for internalizing an externality, say, would be no larger than the area that the externality affects. For certain kinds of external economies and diseconomies, this recommendation seems appropriate. For example, if anyone, voters in Wisconsin probably should control the environmental quality of Wisconsin lakes, not voters in Maine or Tennessee. Similarly, chemical-waste dumps would seem to be an appropriate object of state and local control, not federal regulation. A limitation of state action and decision making to the smallest jurisdiction possible (the area over which the
externality from a particular source is spread) makes sense, because local political mechanisms are more sensitive to citizens' preferences than are regional or national ones and because the granting of rights to voters in state A to regulate some aspect of life in state B raises the possibility of very serious and untoward strategic consequences.

This recommendation has qualifications, however. For example, a crackdown on burglars in Kansas City, Kansas, will increase the burglary rate in Kansas City, Missouri. And polluters who face stringent controls in one state may move to states that exercise less-pervasive environmental-quality regulations. (Indeed, a consideration of market forces would predict and approve of such a result.) Thus, one state's decision to weaken or strengthen the costs that it imposes on a particular activity may produce a public good or a public bad for some other state. While many of these interactive problems are merely transitional, we must acknowledge their nature as jurisdictional external economies and diseconomies.

The most intriguing possibility in decentralization concerns the use of state and local control as a surrogate for marketlike competition. This notion, explicated most notably by Tiebout, concentrates on the problem of preference revelation in markets for public goods. Tiebout hypothesized that competition among a large number of decentralized polities (separate sovereignties) would lead to an optimal price and supply of public goods, insofar as scale economies do not constrain decentralization. This result would solve Samuelson's problem, that a unique producer of public goods could not identify an optimal price (Samuelson, 1954), as well as Olson's problem, that such a producer also could not discern a correct level of supply for such goods (Olson, 1972).

The problem of jurisdictions, like the problem of methods of governance, does not provide for exclusive categories. Various state functions may be carried on at all levels of government, with a rich menu of combinations and permutations of jurisdictional control. Furthermore, various levels of government may use different methods of governance to address the same problem. For example, the governance of banking is carried on at the federal level by public incorporation (e.g., Federal Reserve banks), by regulation (e.g., the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board), and by statute (e.g., the McFadden Act of 1927). At the same time, only one state (North Dakota) owns a bank, but most states govern banking by regulatory commission, statute, and certainly by common law (e.g., the law of contracts and frauds). Each possible combination and permutation of jurisdictional control and method of governance results in a conceptually different distribution of costs and benefits and level of productivity.
ANOMIC ELECTORATES AND ORGANIZED GROUPS

The preceding section reviews justifications for state action, methods of governance, and problems of optimal jurisdiction. We may summarize the matter thus. First, any state action must rely for a welfare-theory justification on the presence of utility interdependencies such as occur with problems with public goods and bads, property rights, monopoly, and redistribution.

Second, state action should not contemplate intervention in all cases in which one or another of these problems is present: (1) costs of state action may exceed benefits; (2) the problem may elicit the beneficial development of subsequent markets and other appropriate reactions in the private sector; (3) a problem may not be truly "public," because its public-sector solution would aid only a limited collection of persons at the expense of everyone else; and (4) the situation in which the problem exists may have been the efficient result of an explicit contract or agreement that anticipated the problem's persistence in exchange for compensation.

Third, the method of governance should correspond to the nature and extent of the specific utility interdependence. For the largest numbers of such interdependencies, involving rules governing ordinary torts, contracts, and property disputes, governance by common law would seem most appropriate, and the imposition of other forms of governance would create welfare-degrading, Pareto-inferior outcomes. Increases in transactions costs or monitoring costs would signal the possibility that a more nearly uniform approach, such as governance by statute law, may be desirable. Governance by administrative agency would seem appropriate in the presence of a potential decisional tedium. Governance by public incorporation would only occur in those instances in which the external and decision costs of any private action would seem intolerable.

Finally, with suitable modifications to allow for secondary external effects, the appropriate extent of jurisdiction should cover no more than the population over which the utility interdependence prevails. Of course, no matter which problem is involved or which manner of governance or jurisdiction is chosen, welfare theory would insist that only cost-effective (technologically efficient) public policies should be adopted.

THE ELECTORATE AND PUBLIC POLICY

The development of a welfare-regarding theory of public-sector action takes as its benchmark the operation of a perfectly functioning, competitive marketplace. It then identifies various classes of situations in which the allocations in the marketplace seem inferior to those allocations that
theoretically might be achievable under different institutional arrangements. Were the analysis to end there, we might suppose that the public sector effortlessly, costlessly, optimally, and appropriately achieves these putatively superior allocations, and therefore the corpus of welfare theory might find application in the service of political advocacy. Plainly, however, the analysis cannot end there, because human nature and decision making remain invariant between the private and public sectors; and therefore, as the rest of this essay demonstrates, the public sector is subject to all of the "imperfections" that welfare theory finds operating in the private sector.

The possibility of public-sector failure seems magnified beyond the limits of private-sector failure, however, because of the larger numbers of connections that successfully must prevail for the public sector to act in a welfare-regarding manner. There are at least five major connections. First, there must be an undistorted link between citizens' welfare and their political preferences. Second, a similar nexus must hold between those preferences and election outcomes. Third, election outcomes must bear an appropriate relationship to legislative outcomes. Fourth, legislative outcomes correctly must direct bureaucratic outcomes in implementation. Fifth, and to close the circle, bureaucratic outcomes must not contain within them the kinds of public-policy perversities that diminish citizens' welfare.

We begin our discussion of public-sector failure by concentrating on the connection between citizens' preferences and election outcomes, assuming that all of the other connections are correctly drawn. Here, we first describe the simple underlying model that connects those preferences for the production of various levels of public goods to election outcomes. Second, we review the argument that public goods may be undersupplied in the public sector. Third, we review a parallel argument that such goods may be oversupplied. Finally, we identify sources of instability in the model, leading us to doubt the robustness of the electoral process as a method of converting citizens' preferences into the production of correct levels of public goods.

Spatial Model in Public Goods. The basic election model for the provision of public goods found its roots in a spatial location theory, developed a half-century ago (Hotelling, 1929; Smithies, 1941). Bowen (1943) first formulated the model in a political context, and Downs (1957) gave the model its fullest verbal elaboration. Subsequent developments since Downs have brought the model to a high level of complexity susceptible to empirical testing (Enelow and Hinich, 1982; Aldrich and McKelvey, 1977; Rusk and Weisberg, 1972; Weisberg and Rusk, 1970; Page and Brody, 1972; Cahoon, Hinich, and Ordeshook, 1978; Hinich, 1978; Rabinowitz, 1978). Here, we consider the model in its simplest form. Suppose that there is some public good that the public sector might produce
in continuously adjustable levels, from zero to a very high level beyond anyone's preference. The dimension that measures the level of production is the "space" over which citizens form preferences and candidates compete for their votes.

Figure 4.1a depicts a possible representation of a citizen's utility function (evaluation) of different production levels of this public good. In the figure, the horizontal axis measures $x$, the level at which the public good will be produced. The vertical axis measures $B(x)$, the citizen's benefit from various production levels, and $C(x)$, the citizen's cost for those production levels. Under the usual microeconomic assumptions, $B(x)$ is marginally diminishing and $C(x)$, marginally increasing, with $x$. The citizen's most preferred level of production occurs at $x^*$, which is simultaneously the point at which the difference between costs and benefits is greatest, the slopes of the two curves, $C(x)$ and $B(x)$, are equal, and marginal cost equals marginal benefit. Figure 4.1b depicts another way to illustrate the same properties. Here, we define a new variable, $U(x) = B(x) - C(x)$, measured on the vertical axis, which is the citizen's utility for various levels of production of
the public good. Again, \( x^* \) identifies the citizen’s most preferred production level for this public good.

The basic spatial model’s problem is to identify the position on the dimension that a candidate will adopt as a platform (strategy) and that will subsequently win the election. To motivate the discussion, suppose that there are: (1) the citizen who most prefers \( x^* \); (2) a citizen like the one whose utility function is shown in figure 4.1b, but whose benefit and cost curves are such that he prefers a lower production level of this public good; and (3) a similar citizen who prefers a higher level than \( x^* \). If these three citizens make up the entire electorate, if all of them will vote in an election on this issue alone, and if two candidates compete by advocating various positions along this issue space, then the median citizen’s most preferred position, \( x^* \), defeats all other positions. Therefore, we expect candidates to converge to this position.

Today, this model finds its principal use to describe real election processes. But the model also enjoys a normative aspect. For instance, Bowen (1943) shows that under conditions similar to those offered here,
such an election would produce the public good at a level that maximized economic welfare. Similarly, Hinich and Ordeshook (1969) have used a fairly weak form of welfare comparisons, imposing symmetry, to demonstrate that this election process might also maximize social welfare.

Simple Elections and Social Imbalance. Eventually, we shall reject many aspects of this model as a description of public-policy formation. Several scholars have developed extensions and criticisms of the model, however, which accept it on its own terms but find sources of public-sector failure within its structure. The first of these criticisms, which Galbraith (1958) advanced in a different connection than the model contemplates, holds that citizens underestimate the benefits of public-sector action, leading to an underproduction of public goods. Galbraith views this underproduction as a consequence of a "social imbalance." In his view, tastes for private goods, such as automobiles and sporting goods, will accurately reflect consumers' real costs and benefits. But the derived demand for parallel public goods, really quasi-public goods, such as highways and public parks, will be understated, *inter alia* because agents in the public sector lack the ability and incentive to advertise. Galbraith explains:

Advertising operates exclusively ... on behalf of privately produced goods and services. ... Automobile demand which is expensively synthesized will inevitably have a much larger claim on income than parks or public health or even roads where no such influence operates. The engines of mass communication ... assail the ... community on behalf of more beer but not more schools. ... The competition is especially unequal for new products and services. Every corner of the public psyche is canvassed by some of the nation's most talented citizens to see if the desire for some merchantable product can be cultivated. No similar process operates on behalf of the nonmerchantable services of the state. Indeed, while we take the cultivation of new private wants for granted we would be measurably shocked to see it applied to public services. The scientist or engineer or advertising man who devotes himself to developing a new carburetor, cleaner, or depilatory for which the public recognizes no need and will feel none until an advertising campaign arouses it, is one of the valued members of our society. A politician or a public servant who dreams up a new public service is a wastrel. Few public offenses are more reprehensible. (1958:205)

Galbraith's explanation for the public-sector undersupply of public goods actually is a special case of a more general explanation, which Downs provides (1960). Downs argues that the benefits of many public goods "are remote from those who receive them, either in time, space, or comprehen-
sibility" (1960:551). For example, foreign aid "may prevent a hostile revolution . . . and save millions of dollars and even the lives of American troops, but because the situation is so remote, the average citizen—living in rational political ignorance—will not realize he is benefitting at all" (1960:551). Downs believes that other governmental programs, such as water purification and various kinds of regulations, share the same problem of remoteness, and therefore they will be undersupplied. Furthermore, in Downs's view, the benefits of many governmental actions seem uncertain, because they ensure against the ravages of complex problems, which themselves might never become manifest (1960:554). While Downs acknowledges that forces such as logrolling might create a tendency for the public sector to grow too large, nevertheless he believes that, on balance, the forces that lead to a suboptimal public-sector size probably predominate.

Figure 4.2a illustrates the effect of underestimating the benefits that flow from the production of a given level of a public good. \( C(x) \) remains unchanged in figure 4.2a from that depicted in figure 4.1a. The benefit curve, \( B(x) \), shifts downward, though, to \( B'(x) \), so that at every level
except zero, the citizen associates a lower benefit from the production of this public good. The citizen’s new most preferred position under this downward revision is at \( x' \), which is to the left of and lower than \( x^* \).

Figure 4.2b shows the resulting utility function from the downward shift of the benefit curve. Notice that the net benefits of producing the public good are everywhere lower in figure 4.2b, compared with what they were in figure 4.1b, and the citizen’s most preferred level of production, compared with that in figure 4.2a, has shifted to a lower level in figure 4.2b. If all three citizens in the hypothetical election described earlier share in this reduced perception of the benefits of this public good, so that the citizen whose utility function is depicted in figure 4.2b remains the electorate’s median member, then the dominant election strategy—the equilibrium public policy that candidates will advocate—similarly shifts to a lower level of public-good production.

The social-imbalance hypothesis exhibits two fundamental weaknesses. The first is theoretical. Surely, a particular public good occasionally might get lost in the confusion of complex elections, so that citizens
systematically underestimate its benefits. But the social-imbalance hypothesis must rest on the claim that large numbers of important public goods share in this reduced estimation of benefits. Yet, this eventuality would be such a large political imperfection that we would expect some counterforce to arise. In particular, social-imbalance theorists fail to explain why some candidate does not identify for the citizenry the full extent of its loss and thereby win the election. And as we shall see, a more general theory explains this failure; it similarly explains the nature of political advertising that now exists.

The second weakness is empirical. The public sector probably generates as much advertising as does the private sector, and perhaps more. First, political campaigning contains a large amount of advertising for particular public-sector programs (Demsetz, 1970). Candidates wish to identify themselves with their programs, and therefore campaigning and public-policy advocacy often occur simultaneously. Second, particular governmental agencies, in their lobbying activities with respect to congressional oversight, expend large amounts of money in preparing "information," which is really a public-sector form of advertising. Indeed, several executive-branch agencies have designated assistant secretaries or undersecretaries for congressional liaison who actually maintain offices on Capitol Hill. The direct "consumers" of the agencies' products are agents of the citizenry, but that observation in no way diminishes our estimates of the extent of lobbying as advertising that actually occurs. Third, most government agencies do expend large amounts on advertising in that term's more common usage (Clarkson and Tollison, 1979). The more general theoretical perspective that we shall offer will explain both the presence of high levels of public-sector advertising and the absence of advertising in favor of an enlarged production of public goods.

*The Fiscal Illusion and Public-sector Size.* An alternative approach to the problem of public-goods production concludes that such goods will be oversupplied because of a fiscal illusion (Goetz, 1977; Wagner, 1976). The fiscal-illusion hypothesis parallels the social-imbalance hypothesis, except that with a fiscal illusion people fail to perceive the full cost of all public programs, the real cost of particular programs, and the actual magnitude of their total tax burden.

The mechanism for inducing an illusion may take many forms. For example, many tax sources may be used, such as an income tax, a property tax, a sales tax, and an excise tax, all of which are held at fairly low levels, even though the total of taxes paid may represent a substantial proportion of a citizen's income. Alternatively, a particular tax may be collected in several small payments, as with periodic withholding of income taxes (Van Wagstaff,
1965) or payment of sales taxes at the time each purchase is made, again leading the citizen to underestimate his total taxes. Levies such as the corporate income tax are the most "hidden" taxes of all, because their incidences are obscure and their payers exist only "in the contemplation of law" (Aranson, 1977).

The creation of a fiscal illusion has an inherent political logic. For example, suppose that two election candidates are advocating identical public-policy programs with identical benefits. The costs of the programs may also be identical; but suppose that one candidate offers a tax plan based on a fiscal illusion to finance the program, while the other candidate does not. Presumably, the candidate who successfully induces the fiscal illusion will defeat the candidate who is more forthright about tax costs.

Figure 4.3a illustrates the nature of the fiscal illusion. In the figure the benefits from producing various levels of a public good are identical to those shown in figure 4.1a. Except at a zero level of production, however, the costs of producing various levels of the public good are everywhere lower than the associated costs in figure 4.1a. Hence, the citizen's most preferred

![FIGURE 4.3a](image-url)
position on the issue of producing this public good is higher than it would be in figure 4.1a. Figure 4.3b shows the resulting utility function from this lowered-cost estimate. Again, the argument that prevailed in figure 4.2a concerning underproduction prevails here concerning overproduction. The citizen's utility function has shifted upward, and if the fiscal illusion similarly affects all citizens, so that the citizen whose utility function is represented in figure 4.3b remains the median voter, then the election's equilibrium strategy shifts to a higher production level.

Social-imbalance theorists rest their claims concerning public-sector spending, *inter alia*, on an argument that compares advertising in the public and private sectors. Fiscal-illusion theorists make no such comparisons, and therefore it is neither surprising nor evidently counterfactual to find that private-sector producers also try to create something like a "fiscal illusion" by such artifices as installment payments and layaway agreements. There are few external costs to the use of such artifices in the private sector, however, but the public sector encourages the production of external costs to the extent that fiscal illusions occur.

FIGURE 4.3b
The fiscal-illusion hypothesis nevertheless shares the same theoretical weakness that afflicts the social-imbalance hypothesis. The pervasive use of fiscal illusions to generate a greater-than-optimal level of public revenues should call forth an election candidate to make the ruse plain. The failure of such a candidate to emerge requires some explanation, especially since the fiscal-illusion hypothesis enjoys more empirical validity than does the social-imbalance hypothesis. Both hypotheses point to an important governmental failure, and later we shall explain that failure more generally, as well as its particular applications to these hypotheses.

Absence of Electoral Equilibria. The final criticism of the simple model of elections with public goods as issues concerns the absence of equilibrium strategies that candidates might adopt. The absence of an electoral equilibrium is not a criticism of the model itself. It merely indicates that in certain situations the model might not predict what candidates will do, and therefore it will fail to predict the actual public policies that emerge from the electoral process. The absence of a prediction is itself a prediction, but we cannot discern the welfare consequences of an inherently unstable political mechanism, so judgments about the welfare properties of those mechanisms remain uncertain.

A simple example demonstrates the absence of an electoral equilibrium. Suppose that three citizens, 1, 2, and 3, must vote on public-policy proposals x, y, and z. Citizen 1 prefers x to y and y to z; 2 prefers y to z and z to x; and 3 prefers z to x and x to y. In pairwise majority voting, x defeats y, y defeats z, and z defeats x, leading to a cyclical majority. Clearly, if either candidate in a two-candidate election chooses any particular strategy (x, or y, or z), then his opponent can always choose a strategy that will defeat him.

The theoretical absence of equilibria has generated several hypotheses concerning political responses. One hypothesis is that candidates avoid advocating specific proposals by using a strategy of ambiguity (Shepsle, 1972b, 1972a; Page, 1976; Enelow and Hinich, 1981). But knowledge about ambiguity in political platforms gains us nothing for making judgments about the welfare effects of the public sector. Indeed, in itself, ambiguity represents a breakdown in the connection between citizens’ preferences and candidates’ election platforms.

A second alternative, but one that intervenes at the legislative stage, concerns the possibility that lawmakers use the presence of intransitivities, such as are found with cyclical majorities, to manipulate agendas to their advantage (Gibbard, 1973; Levine and Plott, 1977; McKelvey, 1976; Riker, 1980, 1958). For example, in the pairwise voting example just described, two pairwise votes are required. The motion presented for the first time in the second vote will always emerge the winner. Knowing this property of
intransitivities, the agenda controller can determine the election’s outcome. Again, however, the presence of agenda control can tell us nothing about the welfare properties of the public policies that emerge from such processes, unless we can identify the preferences of those in control.

We have no specific response to the problem of intransitivities within the framework of this essay and its concerns. Despite this, the general problem of disequilibria in elections and in other political processes remains troublesome for democratic theorists. We cannot comment on the virtues of that which we cannot predict, and therefore, to the extent that intransitivities or indeterminacies remain in the electoral process, to that extent social commentators at least stand mute.

PUBLIC POLICY AND POLITICAL GROUPS

The spatial theory of elections seeks to explain and predict the existence and location of equilibria in publicly supplied public goods, interpreted as election issues. Claims about the theory’s empirical verisimilitude, though, must also confront the paradox: that most public-sector programs in a representative democracy are inappropriate, or are carried on at an inappropriate level, or are executed in an inappropriate manner. The problems of social imbalance and fiscal illusion merely represent two special cases of this larger paradox. Another way to state the matter is that the public sector should supply an optimal level of particular public goods in the correct jurisdiction using the proper production method. The spatial theory of elections with public goods as issues contemplates such a result, at least through the electoral process, and, by implication, through legislative, executive, bureaucratic, and judicial actions consequent to preferences revealed in elections. That such a result does not occur seems evident. That particular or generalized movements toward such a result would themselves represent the production of a public good also seems apparent. The failure to create such movements in their general or particular manifestations stands not simply as an indictment of representative democracy but also as a potential claim that this explanatory model of representative democracy, spatial-election theory, at least requires substantial modification and probably has omitted large portions of political reality that might otherwise account for the perceived inadequacies.

The Political Advantage of Organized Groups. The central inadequacy of the model and of earlier conceptions of representative democracy as cast in welfare theory is that in the model, and in earlier conceptions, political action and public policy derive exclusively from the preferences (and by implication, welfare-related concerns) of the members of an undifferentiated electorate. The omission of organized groups from this accounting of the
political process, and indeed a lack of appreciation of the political dominance of group members' preferences over those of the general electorate, requires correction.\textsuperscript{41}

We begin the model's reconstruction by comparing the political efficacy of an organized group within an electorate to that of the unorganized members of the electorate in general. To cast the problem in familiar terms, consider a congressional district of about 500,000 persons, and suppose that 5,000 of them belong to an organized group. The existence of such a group connotes a superiority over the preferences of the general electorate in at least four activities.

First, the structuring of most organized groups allows for superior communications in two directions. Membership lists, mailings, and other ways of communicating with members, such as telephone pools and regular publications, enable the group's leaders to direct a remarkable amount of political and public-policy information about various officeholders and public-policy proposals to the group's members. This information often is extremely refined, addressing the particular interests of the group's members. The existence of an organized group also may enable leaders to communicate quickly and accurately to officeholders the members' preferences on a public-policy issue.

This aspect of communication deserves further elaboration. Concerning preferences on longstanding public-policy issues, an organized group's superiority over the general electorate may be somewhat diminished. On such issues candidates already may have taken positions, the citizenry's preferences already may have been revealed in elections, and some kind of public-policy equilibrium already may have been reached. There is little that is new about such issues, and organized groups may enjoy only a mild advantage over the unorganized electorate in communicating members' preferences to officeholders on such issues, and vice versa. On new and unanticipated issues, those that may never have been on the public sector's agenda, the matter is entirely different, however. At the margin of decision, group organization can make a difference concerning such issues. Group leaders do not simply summarize the members' preferences on new issues; they often "synthesize" those preferences by interpreting for members and for officeholders what impact the new issues will have on the members' welfare. Therefore, at the margins of public policy, in the creation of change, an organized group's superiority over the general electorate in communicating with officeholders and their challengers cannot be doubted. No such capacity exists for the general electorate.

An organized group's second advantage concerns public-policy transactions with officeholders. In the civics-book model, the electorate as an undifferentiated collection of persons makes a "contract" with an election
candidate concerning his public-policy decisions during his tenure in office. Performance under the contract is reviewed periodically, and the electorate may substitute new "suppliers" of public-sector services if superior possibilities emerge. This contract model has been subject to severe criticism concerning both its empirical reality (Ordeshook, 1970) and its desirability (Ranney, 1962; Wilson, 1925a, 1925b). But the relevant comparison is not between the ideal contract and the actual (implicit) contract that occurs, or its absence. Rather, the relevant comparison is between that actual contract and other kinds of contracts, namely those bargained out between elected officeholders, candidates, and organized groups.

The principal difference between these contracts lies in the costs of bargaining and transacting. Suppose that organized groups had no communications superiority in either direction. Even so, group leaders, as agents forming transactions, enjoy an enormous superiority over the unaggregated electorate. If an incumbent officeholder or challenger sought to bargain and make transactions with each and every member of the electorate, or even with a majority of them, the costs would be enormous, and each contract would have to be renegotiated in the light of each contract subsequently made, because positions on public goods, or external effects in general, might be involved. Assembling citizens into a group eliminates virtually all of these transactions costs and extraordinarily simplifies the officeholder's or the challenger's tasks. Therefore, at the margin the officeholder would always prefer to transact with leaders of organized groups rather than with individual citizens. The communication superiority that the organized group enjoys reinforces this advantage.

The third basis for superiority resides in the group's capacity to monitor compliance with the terms of any contract arrived at. Like communication, and indeed like transactions, monitoring goes in two directions. First, the group's leaders can monitor the actions of individual group members to see that they comply with the terms of any contract with public-sector agents. For example, group leaders might ascertain whether individual members had made campaign contributions to officeholders directly, and not to their opponents, or indirectly through the group's Political Action Committee (PAC); whether members had worked in the agent's campaign; and whether members had engaged in other supportive activities that were part of the bargain struck. In the other direction, the group enjoys an advantage in monitoring the officeholder's compliance with contract terms. Especially in labyrinthine legislative processes, it is difficult to find out whether a particular legislator acted favorably or unfavorably toward any given legislative proposal. Organized groups can develop expertise in learning about such matters, and they can monitor more easily
than can an individual citizen the quality of the legislator's intercession with the bureaucracy. 42

Finally, the organized group is superior in assuring compliance and in sanctioning noncompliance with the contract's terms. Of course, groups differ in their ability to sanction their members' noncompliance. For example, in earlier times, membership in county medical societies was required to practice medicine in certain areas and to have privileges in certain hospitals; and membership often accompanied enforced political support (Kessel, 1958). Today, medical societies have a greatly diminished capacity to ensure compliance with organizational directives. But an organized group's ability to sanction an officeholder's noncompliance with the contract's terms is clearly superior to that of unorganized citizens. Endorsements can be quickly withdrawn, and condemnations can just as quickly be applied.

The Nature of Interest-group Demands. In considering the putative political superiority of organized groups over unorganized members of the electorate, we must next inquire about the character of the public-policy demands that such groups might make. Again, the "civics book" model provides one interpretation of group action: groups form to pursue the public good. Indeed, some group political action appears superficially to correspond to this model. For example, the League of Women Voters increasingly has taken positions on large public-policy issues; the Nader groups and Common Cause similarly attack alleged inadequacies of public policy; and specialized groups, such as the Sierra Club, Friends of the Earth, and the Izaak Walton League, advocate their interpretations of what the public interest requires. Elsewhere, we discern in such groups' actions a clear diversion from welfare-maximizing policies (Aranson and Ordeshook, 1981b; see also Berry, 1977); and we discuss this diversion in the section of this essay devoted to bureaucracies. For the moment, we rely mainly on the common observation that most groups do not seem to devote their political resources to the pursuit of public goods, collectively supplied. Here, we wish to model the group decision-making process to explain this phenomenon.

We begin with a simple model of two interest groups, which between them share a positive preference for the production of a particular public good (it is public because the members of both groups would benefit from its production) but which individually prefer the collective production of different private goods. Furthermore, each group has a political budget, allowing it to lobby either for the public good or for its particular divisible, private good. Finally, assume that both the private-goods and public-goods programs are indistinguishable in the benefits that they would create as well as in their costs. Let B represent the benefit to each group of supplying
either program, and let C represent its cost. Table 4.1 shows the resulting two-person game between the two interest groups, assuming that members of these two groups make up the entire society (Aranson, 1981). The table’s entries assume that each group is pivotal or decisive for the program that it seeks, so that lobbying for a program is tantamount to its public-sector supply. If each group lobbies for the program that creates a public good between them, then each receives a benefit, B, and the costs of this program are shared equally, so that each pays a cost of $\frac{C}{2}$, for a net benefit to each group of $B - \frac{C}{2}$. If each group lobbies for its respective private-benefit program, then each receives that program and receives a benefit, B. By virtue of such a program’s supply to one group, however, the cost is collectively imposed on both groups. The resulting net payoff for each group is $B - (\frac{C}{2}) - (\frac{C}{2})$, or $B - C$. If one group seeks the collective supply of the public good, while the other seeks the collective supply of its private good, then the group that seeks the public good receives a benefit, B, but it pays a cost of $\frac{C}{2}$ for its share of the public good and $\frac{C}{2}$ for its share of the other group’s private good, for a net payoff of $B - C$. But the other group receives a benefit, B, from the public good that the first group pursued and an equal benefit, B, from its own private-goods program; it pays a tax share of $\frac{C}{2}$ for each program, yielding a total net benefit of $B + B - (\frac{C}{2}) - (\frac{C}{2})$, or $2B - C$.

To analyze this game, consider the payoffs from group 1’s perspective, and suppose that group 2 decides to seek its private-benefit program. If so, then group 1 receives $B - C$ no matter what it does, so that it is indifferent

<table>
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<tr>
<th>GROUP 1’s STRATEGIES</th>
<th>GROUP 2’s STRATEGIES</th>
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<td></td>
<td>Seek public good</td>
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<tr>
<td>Seek public good</td>
<td>$B - \frac{C}{2}$, $B - \frac{C}{2}$</td>
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<tr>
<td>See private good</td>
<td>$2B - C$, $B - C$</td>
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**TABLE 4.1**
**POLICY GAME BETWEEN TWO INTEREST GROUPS**

between these two strategies. Suppose, however, that group 2 seeks the public good. Under these conditions, group 1 will receive a net payoff of $B - \frac{C}{2}$ for pursuing the public good and $2B - C$ for pursuing its private-benefit program. Hence, for group 1 to pursue its private-benefit program, $2B - C$ must exceed $B - \frac{C}{2}$, which reduces to the condition that $B$ exceeds $-\frac{C}{2}$. That is, the group's benefit from either program must exceed its tax share, one-half of the program's cost. Since the game is symmetric—both groups share the same payoff structure—this is a general condition leading to the collective supply of two private-benefit programs and the nonsupply of a public-goods program. Furthermore, notice that if $B$ is less than $\frac{C}{2}$, then both groups will refrain from making any public-sector demands, because either program would have a negative net benefit.

This game is a prisoners' dilemma. Assuming that $B$ exceeds $\frac{C}{2}$, each group will seek its private-benefit program; it receives $B - C$ rather than $B - \frac{C}{2}$, for a net loss in this process of $\frac{C}{2}$ for each group. If we add up the net payoffs if each group seeks a public good, as compared with the case in which each group seeks its respective private benefit, we find that the social cost of this process is $C$.

This simple two-person game illustrates a disturbing result, namely that the structure of payoffs to groups in a representative democracy leads each group to seek the collective supply of private benefits for itself, rather than a jointly consumed public good. Hence, if public-policy outcomes bear some relationship to the demands placed on elected officeholders, and if organized groups enjoy a political advantage over unorganized collections of citizens, then we must reject the notion that representative democracies can easily produce public goods, as a welfare-regarding model of the public sector would predict. Unless we can find some way out of this dilemma, we must conclude that these polities, in the main, produce private benefits at collective cost.\(^{43}\)

The situation that table 4.1 models seems highly abstract and devoid of political or economic content, however, and a slightly more complicated model might provide further insight into the process of group-demand formation (Aranson and Ordeshook, 1978). Accordingly, suppose that each group has a political budget, exogenously determined, which it can spend to lobby for either a public-sector program that produces a public good or one that creates a private good, which only members of the group consume. But suppose that there are now $n$ groups of equal size. Furthermore, assume that the benefits and costs of the private and public goods might be different, so that $B$ and $C$ represent the benefit and cost of the public good, while $B'$ and $C'$ represent the benefit and cost of each private good. Assume that the $n$ groups bear equal tax shares. Finally, suppose that before any group
political action occurs, there are underlying expectations or probabilities of P and P' associated with the respective public-sector supply of the public- and private-benefits programs. The decision to allocate resources in pursuit of one program or another raises these probabilities by incremental amounts of dP and dP', respectively. In this n-group setting, an interest group lobbies for the public-benefits program if,

\[
dP/dP' > \frac{(B' - C)}{n} > \frac{(B - C)}{n}.
\]

To analyze inequality (1), we shall hold all other variables constant, to trace out the effects that changes in each variable would have on the choice between lobbying for a private-benefits program or a public-benefits program. First, suppose that dP = dP'. That is, a change in lobbying or other related activities produces an equal change in either P (dP) or P' (dP'). The left-hand side of inequality (1) now becomes 1, and therefore a group will lobby for the publicly supplied public good if (B - C/n) exceeds (B' - C/n).

Now if C = C', then the relevant decision is one of comparing benefits (B and B') from each program (assuming that in each instance a benefit will exceed the tax share; otherwise, no public-sector lobbying will occur). This comparison of benefits without reference to cost is not entirely revealing, since it raises purely empirical questions about the perceived benefits of public-sector programs. If the social-imbalance hypothesis holds true, however, then public-goods programs that are objectively worth as much as private-goods programs nevertheless will not experience full valuation by the citizenry, and therefore organized groups will lobby instead for their private-benefit programs.

Beyond the application of the social-imbalance hypothesis, though, we can say little. Both empirically and theoretically, public-goods programs are inherently neither more nor less valued than are private-goods programs, especially if programs are considered at the margin. For instance, the most general finding concerning public-sector budgeting is that the base budget of the previous year's allocation remains more or less untouchable, and political action concentrates on increments to this base (Davis, Dempster, and Wildavsky, 1966). Hence, organized groups seldom need to concern themselves with the value to them of the entire annual allocation for a public good such as national defense. Rather, such conflict as exists concerns increments to the previous year's budget. And in this decision setting, a 5 or 10 percent increase in national-defense expenditures, say, may not have an appreciably greater benefit (and probably will have a smaller benefit) than the absolute value of a similar increase in a particular group's private benefit (holding costs constant).
Now, suppose that \( dP = dP' \), but \( B = B' \). A group’s decision reduces to one of comparing costs of private- and public-benefits legislation. Here we can say more empirically, although not necessarily theoretically, than we could in comparing benefits. Public-sector action commonly finds justification in the size or cost of the programs undertaken. Beyond the free-rider problem, it is often argued that if very large expenditures are involved, capital markets may not operate as efficiently as they do with smaller programs, in which an investment in one program, even by a private-sector lender, represents but a small portion of that lender’s loan portfolio. Thus, because of the very large cost of public-sector programs such as highway systems, national defense, and educational plants, the central government, as a “perfect insurer” (risk-spreader), is called upon to finance the relevant program.

If real public-goods programs are exceedingly large and “lumpy,” however, then that would imply that \( C > C' \). Therefore, at the margin of decision, no organized group would lobby for the more expensive public-goods program. Hence, the central economic characteristics of such programs—largeness and lumpiness—which provide a justification for their public-sector creation, simultaneously provide the conditions under which we cannot expect them to find political support among organized groups. 44

Finally, consider the relevant increments to probability, \( dP \) and \( dP' \), and let \( B = B' \) and \( C = C' \). Inequality (1) thus reduces to \( dP > dP' \): a group will lobby for a public-goods program if that choice contributes more to the probability of enactment than does the alternative choice of lobbying for a private-benefits program. Except for this probability calculation, the model represented in inequality (1) is identical to the model represented in table 4.1, in the game between two organized groups. In table 4.1 the decision situation represents a game with decision making under conditions of uncertainty concerning the other player’s choice. Here, the others’ choices are taken as given, because the underlying probabilities represent estimates of what other groups are going to do and how the agents in the public sector will respond. That is, the decision situation that inequality (1) represents concerns decision making under conditions of risk. Differently stated, the game in table 4.1 represents a two-person free-rider problem, while the situation in inequality (1) represents an n-person free-rider problem.

While several formulations of \( P, dP, P', \) and \( dP' \) are possible, one way to look at the problem is to assume that \( dP \) and \( dP' \) are both functionally identical increments to probability whose values depend upon their underlying probabilities \( P \) and \( P' \). The most common assumption is that there is saturation: as \( P \), say, grows larger, \( dP \) declines as a consequence of applying equal units of political resources. Under this hypothesis, important
inferences emerge. For instance, the decision makers of any particular group would usually believe that no other group would lobby for the private benefits that their group wishes to have supplied. Hence, $P'$ equals zero. $P$, however, is bounded by zero but may take on a larger subjectively estimated value if a group's decision makers believe that there is any chance at all that some other group (or perhaps a median preference in the general electorate) would demand the public supply of the public good. If so, then the group in question would find $P$ greater than $P'$, and $dP'$ greater than $dP$; and thus the group would lobby for its private-benefits legislation.

Even if $P$ equals $P'$, so that $dP$ equals $dP'$, the same result pertains. With this equality of probabilities, the situation as inequality (1) describes it is the n-person version of the prisoners' dilemma in table 4.1. Hence, given our findings in that situation, we have no reason to expect that organized groups will pursue public-benefits legislation.

The discussion thus far assumes that groups allocate their political resources to pursue either a public good or a private, divisible benefit. But groups might oppose each others' demands for private benefits, and a full accounting of interest-group decision making must expand groups' opportunity sets to include this possibility. First, if the structure of costs and payoffs associated with a particular program represents a direct transfer from one group to another, with no other groups being directly concerned, then the resulting game is zero-sum-like, and we can expect opposition from the disadvantaged group. These cases characteristically occur in certain regulatory situations in which competing producers of substitutable goods and services would alternatively be favored or disadvantaged by regulation.45 These cases stand outside of the analytical framework constructed here, because they contain no prior assumption about cost spreading. Thus, we can say little about the welfare properties of the resulting public policies. Presumably, one group or the other might win, but we cannot be sure that a market process, whether or not devoid of imperfections, would have selected that particular winner.

Second, in the presence of cost spreading, but in the absence of a zero-sum structure, there remains the possibility that interest groups will oppose each others' demands for private benefits. Nevertheless, we might reject this possibility, because if a single group decides to mount opposition to another group's demands, then all other groups will benefit that would otherwise bear the tax share for supplying that program. That is, the supply of opposition would be tantamount to the supply of a public good for all other groups. And according to the analysis just reported, such opposition should not occur.

If a small number of groups are involved, however, then tax shares may be sufficiently large to generate opposition. We have constructed a
three-person game in normal form to examine this possibility (Aranson and Ordeshook, 1978). This game, which allows no coalitions among groups, partitions the set of likely situations into two categories. First, suppose that $B'$ exceeds $C'$. In this situation, all groups will pursue the public-sector supply of their private benefits. Second, if $B'$ is less than or equal to $C'$, then the possibility of opposition depends on the relative magnitudes of the probabilities, benefits, and costs. While no general results emerge from this inquiry, some reasonable constructions of these variables suggest that benefits need only represent some fraction of costs for opposition not to occur. In particular, if $B'$ exceeds two-thirds of the cost of each program, then independent action in pursuit of each group's private-benefit program will occur, but not opposition.

Extending this three-person game to a more nearly general $n$-person form requires greater specificity about the probabilities of legislative success. Nevertheless, the results deduced reveal more about underlying political processes. For example, suppose that $P_x$ is the probability that a group will successfully secure $B'$ in the public sector and that $x$ is the number of groups lobbying for their respective benefits. Let $P_x = P_{x-1} + dP_{x-1}$. The group prefers to lobby for the public-sector supply of its own private benefit rather than against the public-sector supply of all other groups' benefits if

$$P_{x-1}[B' - \frac{C'}{n}] + dP_{x-1}[B' - x\frac{C'}{n}] > 0.$$  

(2)

Suppose that the probability that a group succeeds in securing the public-sector supply of $B'$ equals the proportion of groups not opposing that supply. One formulation of this probability is that $P_x = \frac{x}{n}$. Inequality (2) becomes under this formulation,

$$B' > \left( \frac{C'}{n} \right) \frac{(2x+1)}{(x+1)} \approx 2 \frac{C'}{n},$$

for large values of $x$. Hence, if $B'$ exceeds only twice the amount of each group's tax share for each program, then all groups will lobby for their respective private-benefits legislation. This is a remarkably weak condition. Each group's net payoff becomes $B' - C'$, which by assumption may be negative.

$P_x$ may also reflect a majority-rule variant. Suppose that $n$ is odd and that $P_x = 0$ if $x$ is less than a majority but equals 1 otherwise. In such a situation, the group will pursue its private-benefit legislation, and not oppose the demands of other groups, if,

$$B' > \frac{C'}{2} + \frac{1}{n},$$

for large values of $n$.

We have also investigated a more general noncooperative $n$-person model, allowing for continuous adjustments in the amounts of resources
allocated to support and opposition (Aranson and Ordeshook). Let $P_i$ represent the probability that group $i$'s private-benefit program passes; $x_i$ is the level of resources that group $i$ allocates for this purpose; and $x_{ij}$ are the levels of resources that it allocates to defeat group $j$'s bill, for all $j$. If there is a budget constraint, if equal tax shares prevail, and if the various $x_{ij}$'s are arguments in a function determining $P_i$, then group $i$'s payoff, $V_i$, becomes

$$V_i = (B' - C')P_i - \left( \frac{1}{n} \sum_{j=1}^{n} C'P_j \right).$$

(3)

By placing additional restrictions on $P_i$, a general result emerges from equation (3). In particular, suppose that $P_i$ is monotonically increasing and marginally diminishing in $x_{ii}$, strictly convex and monotonically decreasing in $x_{ij}$, and that benefits, costs, and budget constraints are equal for all groups. In equilibrium, the $P_i$'s are equal, and each group's payoff becomes $P_i(B' - C')$. This result is invariant with respect to the relationships of benefits to costs and the level of resources expended in opposition. In equilibrium, except in those peculiar instances of corner solutions, $P_i$ exceeds zero, and the public sector grows, at some net cost if $C'$ exceeds $B'$.

There remains the possibility that groups will organize among themselves in a cooperative-game context to form coalitions opposed to the private-interest process. This possibility seems reasonable, because cooperative decision making is one way in which players may extricate themselves from prisoners' dilemmas. Yet, the possibility also remains that a majority of groups will form a coalition to secure their respective private-benefits legislation, to the detriment of the remaining minority.

Using a three-person cooperative game, the findings in this regard are thus. First, if one group, for whatever reason, decides to oppose the other two groups' public-sector demands, then those two groups will form a coalition in pursuit of their benefits, the only limit being that $B'$ exceeds two-thirds of $C'$. Second, if one group pursues its own private benefit, then the other two groups will form an opposing coalition. Once that coalition forms, however, it is individually rational for each of its members to defect. That is, the opposing coalition is unstable, and in the end all three groups will seek their respective private benefits. Third, if a grand coalition opposed to this private-benefit process does form, then each member of the coalition will defect and pursue its own private benefits, if $B'$ exceeds merely one-third of $C'$. Finally, if a group stands alone to oppose the other groups' demands, then it can do better for itself by joining the other two groups in politically pursuing its own private benefit. In sum, under very reasonable conditions, all coalitions in opposition to the private-benefit process are inherently unstable.
Efficiency and Inefficiency. The preceding discussion raises the possibility that each program's costs, although spread across all groups, will exceed its benefits, thus producing a Pareto-inferior result. Indeed, in our two-person prisoners' dilemma formulation, this inefficiency is embedded in the process, because the groups fail to pursue a jointly preferred public good, and thus produce a social cost of C. Hence, from an opportunity-cost perspective, we already know that the process is inefficient: the groups could not achieve a mutually preferred public-policy outcome.

Second, welfare theory provides no justification for these kinds of public-sector activities. That is, economists give no welfare-related credence to this variety of simple redistribution, absent an eleemosynary motive. Moreover, in the absence of specific forms of market failure, these programs would be welfare-inferior. If this were not so, then the groups presumably could purchase these programs in the private sector, where, in the absence of market failure, their production would be more efficient. Furthermore, there remains an additional cost of simple politically sanctioned transfers, which is the cost of the political action itself, a source of rents for politicians (see McCormick and Tollison, 1981; Aranson and Shepsle, 1983).

The only remaining justification for these transfers of benefits from the fisc—and ultimately, from other taxpayers, consumers, and producers—to private, divisible interest groups is that of political pluralism. For example, Dahl identifies one particular mechanism of political competition underlying this process but judges its effects as benign, and perhaps desirable (1961). In his study of New Haven politics, Dahl documents the manner in which the political parties alternated competitively in bringing one group of new immigrants after another into the political process. Presumably, each group received an identifiable benefit from this activity, and because the benefits ostensibly exceeded the costs, in Dahl's view, the resulting pluralism appeared to him to be appropriate.

The second variant of welfare theory might approve of such a result. Behind a veil of ignorance, people might choose a political order that sequentially produced programs for identifiable groups, provided that the benefits of each program exceeded the costs. Since the probability of being in such a group is very high, everyone benefits from this arrangement. Even in political theory, however, this benign judgment of pluralism has received substantial challenge, most notably from Lowi (1979).

We have sought to find general tendencies toward efficiency or inefficiency in the private demands that interest groups place on the public sector. But general sentences have been difficult to utter. Presumably, with scarce political resources the possibility of purchasing efficient (benefits in excess of costs) programs in the private sector will temper the number of
such programs sought in the public sector. As an empirical matter, our inability to find patently efficient public-sector programs gives us some confidence in this conclusion. The literature suggests a fairly substantial cost differential in favor of private-sector production (Borcherding, 1981; Borcherding, Pommerehne, and Schneider, 1981), while the lure of cost spreading provides the animus for the public-sector production of inefficient programs. Furthermore, the cost of foregoing the public pursuit of public goods in all of their manifestations must represent a social cost exactly analogous to the alleged costs of market failure. That is, groups use the fisc in the manner of an overgrazed commons (Shepsle, 1983; Aranson, 1983).

Beyond these observations, we have tried to construct examples in which groups have a choice of purchasing various goods and services in the public or private sectors (Aranson and Ordeshook, 1977). The preceding discussion indicates that in the large-number case there are virtually no constraints on the relationship of benefits to costs. Explicit examples reinforce this conclusion. We can construct situations in which interest groups will pursue both inefficient and efficient programs in the public sector, but we cannot construct situations in which interest groups will purchase inefficient programs in the private sector. Therefore, at best the relationship of efficiency to interest-group public-sector activities is random. Yet, when we overlay all of the considerations just mentioned, including the findings of empirical work, we rest comfortably with the presumption that the public sector remains an explicit source of divisible benefits for identifiable groups, with corresponding programs whose costs exceed their benefits.

A final perspective on interest-group public-policy demands sets aside the costs and benefits of particular programs and looks instead to the nature of political action. This approach concentrates on expenditures for securing public policies, including money and other resources allocated to lobbying, campaigning, and more obscure payments for buying public policies. We use the term "political services" to capture all of these activities and ask what is the economic nature of these services? In particular, we wish to know if such services are normal economic goods, in the sense that expenditures on them increase proportionately with increases in wealth, or whether they are inferior goods, because expenditures on them decline proportionately with increases in wealth.

To get at this problem, we construct each group's decision structure so that it must allocate a proportion of its budget to buying goods and services in the private sector or to buying political services in the public sector. Assuming that investments in political services exhibit diminishing marginal returns, we find that political services are inferior goods (Aranson and Ordeshook, 1981a). That is, they are much like hamburgers and hot
dogs, in that as people grow wealthier, they begin to substitute other foods, such as steaks and lobsters. Of course, if the interest-group public-policy demands identified here are satisfied sequentially over time, and if they reduce aggregate and individual wealth, then that datum alone will lead interest groups to purchase proportionately greater amounts of political services. 46

THE INSTITUTIONAL MATRIX

The preceding discussion assumes implicitly that the institutions of government—legislatures, bureaus, courts, and executive administrations—are responsive to the underlying public-sector demands of interest groups for private, divisible benefits. Each model reviewed assumes that public-sector satisfaction of these demands is either a step function or a monotone increasing function of the political resources allocated to pursuing the associated programs. If we could rely on this assumption, then our analysis would draw to a close, because we can find no way to aggregate demands for public goods, including the public good of opposition to inefficient private-interest legislation. A full analysis, though, requires that we examine the institutions of government, to ascertain how they respond to demands for the collective supply of private goods. This section attends to the reactions of legislatures, bureaus, and courts. The next section closes the circle by interpreting executive-branch (presidential) and legislative decision making, using a more general election model in which candidates build platforms out of the satisfaction or denial of demands for private-benefits legislation.

LEGISLATURES

Traditional Antecedents. Before proceeding to a formal modeling of legislative decision making with regard to interest groups’ private-benefit demands, we can best make sense out of, and reinforce our eventual findings about, legislative responses to such demands by rehearsing Mayhew’s partition of congressional action (1974). Mayhew divides congressional activity into three categories: position taking, advertising, and credit claiming.

Position taking seems analytically equivalent to the adoption of election strategies concerning public goods. It consists of voting on roll calls and of announcing one’s position on larger public-policy issues. The problems with position taking thus resemble those that candidates encounter in traditional spatial election models. First, because the voter identifies the strategy
chosen with the production of a particular level of a public good (unless it is the precise level that the voter most prefers), the candidate is susceptible to his opponent's opportunistic criticism and the formation of coalitions of intense minorities (see Downs, 1957; Oppenheimer, 1972). Hence, legislators try to avoid recorded roll-call votes, to bury politically damaging legislation in committees, and otherwise to utter innocuous platitudes. Second, position taking falls prey to the larger problem of absence of electoral equilibria in a legislator's district, which allows a potential opponent to defeat the incumbent legislator on any position that he might take. Accordingly, a strategy of ambiguity may prevail.

In sum, only when there is a clear majority in a legislator's district (and perhaps not even then) will the legislator take a forthright position on a legislative issue. Otherwise, position taking may turn out to be a politically destructive activity. Mayhew's discussion is revealing:

A solid consensus in the constituency calls for ringing declarations; for years the late Senator James K. Vardaman (D., Miss.) campaigned on a proposal to repeal the Fifteenth Amendment. Division or uncertainty in the constituency call for waffling; in the late 1960s a congressman had to be a poor politician indeed not to be able to come up with an inoffensive statement on Vietnam ("We must have peace with honor at the earliest possible moment consistent with the national interest"). On a controversial issue a Capitol Hill office normally prepares two form letters to send out to constituent letter writers—one for the pros and one (not directly contradictory) for the antis. (1974:64)

Advertising, the second form of legislative activity, merely seeks to give legislators public recognition, much as a brand name does for private-sector firms. Advertising is noncontroversial and has most of the benefits of position taking with few of its political liabilities. Advertising seems superfluous to the legislative process, however, because no necessary public-policy consequences flow from it, except that it allocates scarce resources away from the job of legislating and toward securing reelection. As a consequence, it represents a deadweight social loss, sustaining political rents for the private-interest group that we call the legislature. It would seem neither possible, nor socially desirable, nor even constitutional, though, to do away with legislative advertising.

Credit claiming is the most complex and interesting of legislative activities. The key aspect of credit claiming is credibility. Voters understand that a single member of the House is but one out of 435, and of the Senate, but one out of 100. They also understand that the president and the administrative agencies have a strong hand in public-policy decision making.
This understanding limits the extent to which individual legislators can claim credit for even small macroeconomic changes or foreign-policy successes. For instance, no single legislator could believably claim credit for reducing the rates of inflation, unemployment, or interest. Nor could any legislator credibly claim to have brought about peace in the Middle East, reduced armaments, or increased defense preparedness. Thus, while legislators may announce their support for various measures, believable credit claiming excludes entire categories of public-policy decision making; namely, the kind that ordinarily is associated with the production of nationwide public goods or the suppression of national public bads.

By the same reasoning, legislators will not claim credit for producing private benefits for those who do not affect their electoral fortunes. But they do claim credit for public policies that directly affect those who can advance their reelection or defeat. The associated programs are most closely identified with pork-barrel legislation, creating private, divisible benefits for individual legislative constituencies (Shepsle and Weingast, 1981; Weingast, Shepsle, and Johnsen, 1981). This form of legislation finds constant reference in the scholarly literature as the centerpiece of legislative activity (Ferejohn, 1974; Fiorina, 1977; Froman, 1967; Lowi, 1964; Manley, 1970; Mayhew, 1974; Plott, 1968; Schattschneider, 1935; Schwartz, 1981; Shepsle and Weingast, 1981; Stern, 1973; Stockman, 1975; Weingast, 1979; Weingast, Shepsle, and Johnsen, 1981). But the flow of political resources across state and district lines through the development of political-action committees and other artifices has also made it possible for widely dispersed but divisible interests to have an impact on public-policy decision making.

Credit claiming is hardly new, and it has long been the staple of scholarly analysis. Indeed, the language used to describe pork-barrel legislation and its close cousins is strongly reminiscent of the public goods–private goods distinction. For example, Lowi refers to “distributive benefits,” which seem very much like private goods (1964); Key refers to “particularism” and “particularistic causes” (1964); Mayhew speaks about “particularized benefits” versus “universalistic benefits” (1974); and Fiorina distinguishes between “the pork barrel” and “case work,” on the one hand, and “programmatic activities,” on the other (1977:45–46). In each of these juxtapositions, in regard to the legislator’s allocation of scarce political resources, private-benefit legislation takes precedence over the development of more universalistic, public-goods legislation. Hence, the traditional and more recent literature on the Congress concludes that the legislative process responds to and encourages interest-group demands for private, divisible benefits.
Recent literature on congressional committee structure reinforces this conclusion. Committees provide a decentralized decision-making process that encourages the uncoordinated granting of benefits that the traditional literature identifies. Legislators in committees grant reciprocity to each other by not challenging other committees' jurisdictions, and they practice universalism by which most demands finding a voice in the Congress are eventually heard and satisfied by the appropriate substantive committees (Weingast, 1979; Fiorina, forthcoming; Aranson, 1981).

Formal Analysis. Formal theories of legislative decision making concerning the choice between private- and public-goods legislation and the decision to oppose or delete existing programs have been hampered by attention to the legislative technology of logrolling. Economists have evinced an interest in logrolling, because it appeared to make majority rule in legislatures more nearly marketlike, rather than simply redistributive. That is, logrolling allows for public policies to reflect the working out of differences in valuations (intensities of preferences) (Buchanan and Tullock, 1962). More recent studies argue, however, that logrolling might be a source of degradation in legislators' welfare (Riker and Brams, 1973). If we interpret legislative activity as presenting no principal-agent problems between legislators and their constituents, then the degradation of welfare consequent to logrolling paradoxically extends as well to constituents (Aranson, 1981, chap. 9). The resulting configuration of public policies with divisible, district-level incidents had been documented as early as the works of Woodrow Wilson (1956:89). It is also theoretically possible for logrolls to eliminate all private-benefits legislation (Schwartz, 1981), although a generalized analysis of pork-barrel decision making suggests that legislators will adopt logrolling technologies to produce, not deny, such programs (Weingast, Shepsle, and Johnsen, 1981).

A more general analysis, which transcends the narrow technology of logrolling, constructs a parallel between interest-group decision making, as reported in the third section of this chapter, and legislative decision making itself. Legislators clearly enjoy incentives that differ materially from those of their constituencies and of identifiable groups. Yet, it proves useful to assume initially that legislators are merely instructed delegates for those who aggregate demands in their districts, organized interest groups. Accordingly, suppose that a constituency is an interest group and that legislators face decision-making problems much like those of the interest groups discussed previously. That is, to follow the structure of analysis in the third section, legislators must either support their constituents' programs or oppose all other legislators' constituents' programs in a non-cooperative context. Continuing the parallel, we find that for a three-person legislature using majority rule, all bills pass if \( B' > \frac{2}{3} C' \).
For n-person legislatures, assuming the formulation of inequality (2) concerning $P_x$, all bills pass if $B'$ exceeds one-half of $C'$, for large values of $n$.

If coalitions are possible, and if the benefits of each program are less than two-thirds of its cost, then a grand coalition fails to enact all three proposals. But if $B'$ exceeds two-thirds of $C'$, then a two-person coalition will form to grant at least two of the benefits and to deny the third. Total payoffs equal $2(B' - C')$, and if $C'$ exceeds $B'$, then inefficiency prevails.

The possibility of legislatively deleting existing programs requires a formulation outside of the model, because it adds a time dimension to both legislators' and interest groups' decision problems. Once a program is established, it is continuously subject to legislative recision. Therefore, both interest groups and legislators must calculate the net present values of programs that in the absence of recision would run in perpetuity. It is more convenient for us to analyze this possibility under the discussion of the judiciary, so we postpone it until that time.

**A Disgression on Interest Groups.** Throughout the preceding discussion, while acknowledging the political superiority of interest groups over the members of an anomic electorate, we nevertheless assume, with traditional group theorists, that the costs of organizing and maintaining interest groups remain inconsequential. Interest groups in this model are taken as given (Truman, 1951). The analysis surrounding this assumption, however, plainly recognizes that free-rider problems and associated prisoners' dilemmas pervade most aspects of political life. For example, the production of public goods and the suppression of public bads is said to require governmental action precisely because of free-rider problems. And when groups lobby for the public-sector supply of inefficient private benefits, they are engaged in an n-person prisoners' dilemma. As Olson has pointed out, if members of a group share a common goal, whose accomplishment for them would be equivalent to the production of a collective good, those persons, too, experience free-rider problems (Olson, 1971). Unless we can accommodate Olson's important insight, our analysis remains incomplete.47 We must nevertheless account for the formation of interest groups and explain certain regularities in existing legislation with regard to such groups.

To develop this explanation we divide groups into three categories. The first category contains those groups whose existence is assured by a parallel purpose. Large, dominant firms in concentrated industries are pertinent examples, as are governmental agencies and state and local governments, which act as interest groups with respect to their congressional lobbying activities. These groups already have been formed and maintained for other purposes, the returns from which are sufficient to sustain them.48 For such groups and their leaders, the decision to pursue
private benefits merely concerns the relevant private costs and benefits of lobbying activities. Such organizations experience no real free-rider problems, although smaller groups may take advantage of the political penumbra that they supply if legislatures find it difficult or impossible to fashion perfectly divisible programs and benefits that exclude such smaller groups.

A second category contains groups organized pursuant to statutes or regulations. These groups form among otherwise large-number or competitive firms in the same industry or in parallel social structures. Precisely because such groups would find it difficult to form and prevail, the respective statutes are passed and regulations promulgated. Considering labor unions, this situation is explicitly recognized, as evidenced by the labor origins of the term "free-rider." It is important to understand exactly what the legislature accomplishes by governmentally enforcing membership and contribution to such groups. Certainly, such activities overcome the free-rider problem inherent in competitive markets. But legally enforced membership also makes it far simpler for the legislator to fashion a divisible benefit and to extract a rent from the group in return. Large, dominant firms in concentrated industries require no such services, and therefore they bargain with legislators in a bilateral-monopoly context. But firms or persons in competitive economic situations require the additional legislative service of group formation and maintenance through statutory enactments and regulatory ukases. Thus, legislative services hold value to participants in competitive processes beyond the value to dominant, preexisting groups.

The third category of groups encompasses those that face pervasive free-rider problems that know no clear legislative solution. These groups include the more recently developed "public interest" organizations, such as the Nader groups and various environmental lobbies. Concerning such organizations, scholars have developed a large number of ad hoc explanations for their formation. Selective incentives may encourage contributions, and tangential product lines and services supplied only to members may also be of help. Such groups are at a competitive disadvantage in creating these selective benefits, however, if a competing firm could produce them without producing the public good as well (Stigler, 1974). Even so, in recent years, legislators have found ways to funnel benefits to such groups in the form of research grants and intervener fees (Berry, 1977; Downing and Brady, 1979).

The costs of legislative action with respect to this hierarchy of groups is the opposite of the order that welfare theory would contemplate. First, there is no sense in which groups whose prior organization is assured should be the easiest to satisfy, because their demands are solely for divisible benefits, simple redistributions from the many to the few. Second, the supply of the prerequisites of organization to groups such as labor unions
perforce converts them into members of the first category of groups, but they have been "captured" by their dependence on the legislature. Third, "public interest" groups are in reality demanders of supraoptimal levels of public goods, as well as private goods. To the extent that these groups form, a median preference in the electorate remains unsatisfied.

But in legislative allocations the central aspect of interest-group politics is divisibility itself. Legislators must ensure that programs are divisible among groups, because otherwise they could not secure payment for their enactments. That is why groups truly concerned with the public interest can seldom operate successfully. They cannot assemble adequate payments to legislators for their enactments. Were a legislator to create a pure public good, then, to pay him for his actions, a voter or group would be producing a public good for all other voters and groups. Legislators can create no such benefits unless somehow they develop a way to withhold payments in the form of programs to voters and groups that do not offer payment in return. That is, divisibility reasserts itself in political exchange, much as it does in private choice, to generate marketlike properties. Without such divisibility the legislative marketplace could not operate, or at least would not operate as it presently does. Yet, the external costs of this process, explicitly brought about through a cost-spreading arrangement that treats the fisc as a common resource, work a degradation of public welfare.

BUREAUCRACY

It was precisely the recognition that the political process could be subverted to the interests of discrete groups that provided the intellectual animus for the regulatory state. As early as the writings of Woodrow Wilson (1887), and later in the works of Herbert A. Simon (1947), scholars divided politics and administration, asserting that the president and the legislature, through a political process, should decide large matters of public policy but that administration should be carried out in depoliticized bureaus. The view of bureaucracy that emerged from this conception was that of a set of organizations with large powers and wide discretion, which would scientifically and nonpolitically produce the appropriate goods and services. A secondary aspect of this argument invoked the desideratum of centralization, a practice whose theoretical and empirical justifications have been seriously weakened.49

Regulation, one important aspect of bureau activity, is an explicit mechanism for producing private benefits at collective cost. For example, the Interstate Commerce Commission (ICC), the earliest of the federal commissions, may have been an instrument for aiding the railroads or the farmers; but in either case the public at large had little voice in the
commission's public policies (e.g., see Kolko, 1963, 1965; Hilton, 1966; Fiorina, 1982a; Martin, 1972). Later, the ICC would protect railroads against truckers and then switch its support to truckers, in a never-ending regulatory battle.\textsuperscript{50} The Federal Trade Commission emerged as a protector of high-cost products against cost-cutting competition. The alphabet agencies of the New Deal era were similarly constructed (Hawley, 1966). The Securities and Exchange Commission protected underwriters of blue-chip securities against the competition of wholesale underwriters and today protects the interests of the securities bar (Manne and Solomon, 1974; Mackay and Reid, 1979). The Civil Aeronautics Board, which is not yet entirely dismembered, protected the airlines against competitive entry, in a classic regulatory pattern (Breyer and Stein, 1974; Douglas and Miller, 1974). The Federal Communications Commission resolved the dispute between the navy and commercial broadcasters, but in the process it controlled entry and competition in the interests of the networks and local ownership.

The more recent "social" regulatory agencies seem no less interested in private-interest regulation. The Environmental Protection Agency (EPA) favors some coal producers to the detriment of others and to the detriment of the public at large (Ackerman and Hassler, 1981). The EPA's regulations also protect existing industries in the Northeast against competitive entry from nascent southwestern producers (Maloney and McCormick, 1982; Pashigian, 1982). More important, the EPA administers a large pork-barrel program of grants to state and local governments for sewer construction and related projects. The Occupational Safety and Health Administration makes it extremely costly for smaller, nonunionized firms to compete with their larger, unionized counterparts. There is no discernible evidence of improved worker safety (Smith, 1982). The litany of regulation in favor of private interests seems endless, and we repeat this list merely to provide examples. Any welfare-regarding purposes or achievements that emerge from these regulatory regimes are largely epiphenomena of private-interest motivations.

Many traditional bureaucracies, such as the Department of Defense, the Department of Health and Human Services, and the Department of Agriculture, are involved less with regulation and more with the direct production of goods, services, and subsidies. These executive departments, while explicitly or arguably engaged in the production of welfare-regarding programs (such as national defense and some forms of resource redistribution), nevertheless are fecund sources of private, divisible benefits. For example, during 1983 Senate hearings on defense appropriations, Senator Donald Riegle of Michigan and Secretary of Defense Casper Weinberger had a heated exchange concerning the Reagan administration's
proposed defense build-up. Riegle charged that Weinberger was an inflexible ideologue, whose proposals for increasing defense expenditures would actually diminish the amount of national defense produced. Weinberger responded to Riegle’s charges by saying that Michigan voters would be interested to learn that the lower levels of defense spending that Riegle preferred would cost the Michigan economy $150 million.

Plainly, in welfare terms, such considerations are irrelevant. For example, these reduced expenditures in Michigan would also translate into diminished tax liabilities for all taxpayers and a reduced crowding out of private borrowers from credit markets, because of diminished government borrowing. Pecuniary externalities, such as Weinberger described, also should have no consequence for the optimal level and distribution of defense spending. Legislative tactics such as those that Weinberger used appear to stand at the core of expenditure decisions for the production of many public goods besides national defense. As argued earlier, the actual level of national defense produced seems to be an epiphenomenon of these pork-barrel decisions.

Bureaucracy and the Principal-agent Problem. For many researchers the central problem of bureaucratic and regulatory decision making is the divergence between the interests of the principal (the legislature) and the agent (the bureau or agency). This problem is common to many relationships, not merely those that occur in the public sector. As Jensen and Meckling observe,

the problem of inducing an “agent” to behave as if he were maximizing the “principal’s” welfare is quite general. It exists in all organizations and in all cooperative efforts—at every level of management in firms, in universities, in mutual companies, in cooperatives, in governmental authorities and bureaus, in unions, and in the relationships normally classified as agency relationships such as are common in the performing arts and the market for real estate. (1976:309)

The principal-agent problem in governmental bureaus differs substantially from its private-sector manifestations, however. In a competitive marketplace, market forces discipline the extent to which principals can allow agents’ actions to diverge from those that principals intend, and they discipline agents in their divergence from principals’ wishes (Alchian and Demsetz, 1972; Manne, 1965). But in the public sector, certain additional monitoring problems diminish both the principal’s and agent’s ability to reduce the scope of agency costs. First, to the extent that bureaus do produce public goods or suppress public bads, the usual problems of correct pricing and output apply (Samuelson, 1954; Olson, 1972). As Mises points
out, in the classical welfare model of the public sector, government produces (suppresses) precisely those goods (bads) that have no natural market price (1944). Accordingly, it may be impossible to identify optimum production levels and prices.

Second, because of these price and output indeterminacies, legislative principals, encouraged by bureaucratic agents, use surrogate measures of output and price, which may bear little or no relationship to measures that would adequately monitor bureau production and costs. For example, Tullock argues that State Department officials gain more from providing benefits to specific American citizens and firms than from developing a full knowledge and understanding of the particular countries in which they serve (Tullock, 1965). Military officers gain promotion by virtue of their bridge-playing abilities, social skills, and relationships with superiors, defense contractors, and congressmen, not by virtue of their ability to provide for the common defense. Lindsay argues that bureaus often supply goods and services at zero price to users, without having any clear measures of quality. Hence, because output is readily measurable, bureaus maximize it—for example, the number of patient days in Veterans Administration hospitals—rather than provide an optimum mix of quality and quantity (Lindsay, 1976). Similarly, police create speeding traps, to maximize revenues from speeding tickets, rather than allocate forces to minimize highway accidents.

All of these divergences between the principal’s theoretical welfare-regarding preference and the agent’s actual allocations represent not merely agency costs but also the construction of private benefits for the agency. In short, the agencies really stand as private, divisible groups, facing a perverse set of incentives and rationally producing goods and services for themselves at collective cost.

Niskanen (1971) explicitly models the principal-agent problem in the public sector as a bilateral-monopoly situation between the agency and the legislature. In his model the bureau produces twice the output of an analogous private-sector firm, with an accompanying welfare loss. Niskanen assumes that the motivation for these high production levels, which derive from the demand schedules that bureaucrats face, takes the form of private benefits, perquisites of office, and the like, for agency personnel. While Niskanen’s assumption of agency budget maximizing has been subject to substantial reworking, his insights remain the benchmark for the study of bureaucracy.

Groups, Legislators, and Bureaus. Research on the divergence between legislative and bureaucratic interests and incentives serves to demythologize bureaucracies as giving undiverted attention to legislative goals and larger public purposes. But its lack of specificity about the nature
of the divergence remains problematic. For example, one could argue that legislatures tend to require by statute the underproduction of public goods and the overproduction of private, divisible benefits at collective cost, but that welfare-regarding bureaus redress the balance. Of course, this conjecture contradicts a very large number of studies that conclude that many bureaus, and especially the regulatory agencies, are captives of the industries that they were intended to regulate (Bernstein, 1955).

Furthermore, recent work on the relationships among legislatures, interest groups, and bureaus comes to a different conclusion: bureaus serve as explicit agents in the production of private benefits agreed to in bargains struck between legislators and interest groups (Moran and Weingast, 1982; Weingast, 1981). In the traditional regulatory-capture literature, the agency monitors industry practices, to enforce a cartel among firms. Cartel formation and maintenance is very difficult to achieve using statutory instruments. The unit price of the good or service must be raised to the level that a monopoly would impose, but to prevent other firms from entering the market and dissipating the rents that the cartel price creates, there also must be entry control. Because demand and factor-cost characteristics facing such an industry will change over time, there must be a constant adjustment of both price and entry rules. Hence, flexible regulation is preferred to specific statutory enactments.

The traditional model of a cartel induced by regulation suggests the presence of a concentrated benefit for regulated firms at the collective cost of users. The metaphor applied to the supporting political structure is one of "iron triangles," with a congressional oversight committee, an agency, and a regulated industry at the respective vertices. Of course, while economists can sometimes think up welfare-regarding justifications for this form of regulation (e.g., see Kahn, 1966), the actual regulatory regime imposed commonly bears no relationship to a welfare-regarding model's dictates.

More recent research suggests that this single-industry-versus-dispersed-public model of regulatory origins may be misleading, because most agencies were born in conflict among contending groups (Aranson, Gellhorn, and Robinson, 1982). One model of this process argues that the legislature delegates legislative authority to the agency and thereby creates a regulatory lottery for the competing groups and firms. Because of risk-preference characteristics, these competing groups and firms prefer the lottery to the equivalent statutory certainty. After the agency has been established, it either resolves conflict in favor of one of the groups or shifts support back and forth between them. But the agency and Congress continue to exact payments for the changing cartel protection thereby established. These recent models of regulatory and bureau processes, while not settling the principal-agent problem or the congressional versus bureau-
dominance debate, nevertheless establish bureaus and regulatory agencies as important contributors to the collective production of private benefits (see Posner, 1971, 1974; see also Peltzman, 1976; Aranson and Ordeshook, 1981b).

THE JUDICIARY

The judiciary ordinarily has had no place in accounts of the welfare-degrading tendencies of representative democracies. Most scholars set courts aside, believing that they are either sufficiently depoliticized or that the judiciary's concerns remain orthogonal to the principal political issues in public-policy debates. The Supreme Court is sometimes said to follow election returns; and in civil and criminal cases, lower courts, presided over by upper-middle-class or upper-class judges, are alleged to favor wealthy litigants. Whatever the merits of such claims, here we transcend them to consider other matters—namely, common-law efficiency and the interest-group basis of Supreme Court decision making.

The Efficiency of the Common Law. Earlier, we discuss governance by common law and conclude that common-law processes tend to adopt rules of liability that allocate resources to their highest-valued uses. Although the outcomes of suits at law and in equity will disadvantage particular litigants, the results are efficient in the hybrid sense of welfare theory, because behind a veil of ignorance, constitution makers would adopt such a process for large classes of disputes.

The common law's efficiency does not depend on judges' decisions, per se. Indeed, judges might even decide cases at random, with a slight bias toward not upsetting precedent, and the efficiency result would still hold. Following Rubin (1977) the demonstration of common-law efficiency proceeds thus. Suppose that the problem under study is accident liability in tort law.51 Let A be the tortfeasor-defendant and B, the victim-plaintiff. The court must decide whether liability for an accident is to fall on A or B. If A is liable, then he will spend (for him) an optimal amount, SA, to avoid accidents, and with this expenditure, NA future accidents will occur. An opposite holding, placing liability on B, will result in SB being spent on avoidance, leading to NB future accidents. Let X equal the cost of the present accident and of each future accident that occurs, and let TA and TB represent, respectively, the total costs of future accident avoidance and accident costs for A and B, if each is held liable under the different rules. An efficient rule would place liability on B, say, if

\[ T_B = S_B + N_B X < S_A + N_A X = T_A. \]
Let $R$ be the probability that $B$ will prevail in court if an accident occurs and litigation ensues. If precedent favors $B$, then $R$ exceeds .5, but if it favors $A$, then $R$ is less than .5. We now define additional variables, $V_A$ and $V_B$, the expected values to the litigants of going to trial, and $C$, each party’s litigation cost. The expected values to the litigants of going to trial are respectively:

$$V_A = R(-X) + (1-R)T_A - C,$$

and

$$V_B = R(X) + (1-R)(-T_B) - C.$$

Here, $T_A$ and $T_B$ represent future costs of different liability rules, the net present values of precedents that the court affirms or overturns. The litigants settle before trial if $-V_A$ exceeds $V_B$. But they litigate if

$$(1-R)(T_A - T_B) > 2C. \quad (4)$$

The important term in inequality (4) is the expression $(T_A - T_B)$. Suppose that the liability rule is inefficient and should hold $B$ liable, not $A$. Notice that, reflecting this inefficiency, as the difference in the stream of costs, $T_A - T_B$, increases, the defendant has an increased likelihood of challenging the inefficient precedent, even though $R$, by assumption, is less than one-half. Once continually challenged, precedent, perhaps randomly, switches liability from $A$ to $B$. *Ceteris paribus*, the parties no longer have as great an incentive to litigate and therefore to challenge the newly established efficient precedent. Similarly, notice that expression (4) is independent of the judge’s particular motives.52

Inequality (4) shows the robustness of common-law processes in producing efficient rules of liability for certain classes of social disputes, private disagreements whose resolutions govern larger questions about social resource allocation. The inequality also demonstrates those situations in which common-law processes may be random concerning efficiency. First, with the inclusion of $T_A$ and $T_B$, the inequality assumes that the litigants have a future interest in precedent. This condition may hold true for important classes of litigants. For example, insurance companies might be intensely interested in liability rules governing tort actions arising from automobile accidents. Therefore, in rear-end collisions, say, the following driver will be held liable, not the leading driver, who stopped short. Technologically, the following driver is the least-cost accident avoider, because if the leading driver must keep a constant watch in his rear-view mirror, he might have an increased chance of hitting an object in front of him.

The presence of litigants with precedential interests, such as insurance companies, will drive common-law processes to adopt efficient rules, which in turn will govern some cases involving litigants with no interest in
precedent. Precedentially uninterested persons will thus receive an external benefit from the litigating activities of larger firms, which bear part of the social costs and benefits of their activities. If no such precedentially interested participants are available for particular classes of disputes, however, and absent an interest in efficiency by judges, we might be less confident that common-law processes will produce correct results. Of course, judges experienced in following arguments concerning the public-policy consequences of their decisions, as expressed in litigants’ briefs and arguments, might reflect the pleadings of the cases before them and adopt efficient rules.

A second problem emerges, because of rules of judicial economy. For example, many such rules concern “standing to sue,” meaning that a “party has sufficient stake in an otherwise justiciable controversy to obtain judicial resolution of that controversy” (Black’s Law Dictionary, 1979: 1260). Rules of standing may remove some potential plaintiffs from access to the courts and their otherwise efficient rules and results. Similarly, narrow judicial construings of what constitutes a “cause of action” may produce the same effect. For example, before the 1950s, most courts held that a trespass required a physical invasion and derivatively ruled that air pollution by unseen chemicals would not constitute such an invasion. Such rulings stymied a common-law resolution of air-pollution problems. This narrow interpretation, which seemed reasonable in an earlier age, in which air pollution was less severe and the superior good of environmental quality was less highly valued at the margin, grew increasingly unreasonable in later years. Judges began to abandon the rule in the 1950s, but before the common law could work out new liability rules, federal legislation preempted common-law processes.

Finally, inequality (4) reveals the larger problem in depending upon individual litigants to drive common-law processes to efficient rules. Litigation costs might exceed the expected benefits to any particular plaintiff, but because of scale economies in litigation, all damaged persons would receive a benefit from litigation in excess of their share of the costs, were it possible to aggregate their interests. Public-goods problems thus emerge, and unless judges will accept class actions to assemble those dispersed interests, the cost of litigation, C, might undermine the robustness of the judicial process in correcting large-scale externalities. Hence, in certain situations in which welfare theory calls for governmental amelioration, the common law may find it difficult to achieve welfare-regarding results. This problem seems especially acute when disaggregated victims confront a monopolist, who internalizes the full benefits and costs of his litigation decisions.
Not surprisingly, when statute law preempts common-law rules, there is no guarantee that the result is efficient. Indeed, in many instances of conscious preemption, the result is inefficient, because of the private, divisible interests served in the legislative process. For example, in the case of industrial accidents, workers are usually the least-cost avoiders, although there are substantial grounds in the common law for holding firms liable for patently negligent conduct. Workmen's compensation statutes, though, often eliminate considerations of contributory negligence, imposing a regime of strict liability on firms. Arguably, the result is a greater number of accidents and a greater social cost (Chelius, 1977, 1976; Smith, 1982). Organized unions, having been guaranteed formation and maintenance by statute, lobbied for such a result; but individual firms, which enjoyed no practical way to assemble their interests, seemed equally disadvantaged in the legislative process. Thus, the monopoly problem just cited in common-law litigation carries forward into the legislature. And higher consumer costs are an additional result.

Supreme Court Jurisprudence. It seems more difficult to discern welfare-relevant considerations in Supreme Court decisions than in the decisions of state courts. Large classes of Supreme Court cases involve disputes in which welfare theorists must stand mute, or nearly so. For example, we can trace out the economic consequences of decisions concerning racial integration, abortion, prayer in the public schools, and pornography. But the original litigation in such cases often aligned the parties in zero-sum conflict. Many of the attendant costs and benefits seem symbolic, and therefore an analysis of such cases, using the tools of welfare theory, while they might often be instructive, might unduly size this body of law to a Procrustean bed. Such an analysis can clarify many of the issues involved. The resulting opinions and rules, however, might not be easily susceptible of interpretation using the tools that find application elsewhere in this essay.

The Supreme Court does affect the private-goods basis of legislation, though, and we can trace out the relationship between Supreme Court decision making and this character of legislation. Examining this relationship also illuminates the dynamic time dimension to private-interest legislation. The principal work is by Landes and Posner (1975), who find a connection between two characteristics of the federal government. The first is the persistence of an independent judiciary, "one that does not make decisions on the sorts of political factors (for example, the electoral strength of the people affected by the decision) that would influence and in most cases control the decision were it made by a legislative body, such as the U.S. Congress" (Landes and Posner, 1975:875). The second is an "interest-group theory" of government, such as this essay develops.
To explain this connection requires a recognition of the time dimension in the private-goods bargains that the legislatures generate. For instance, a particular subsidy program or entry control in a regulated industry might last for a year, ten years, or in perpetuity. *Ceteris paribus*, an interest group would prefer programs that last for longer periods than for shorter ones, and this preference holds important consequences for legislators. A congressman who expects to be in office for a limited time enjoys two important benefits from passing private-goods legislation in perpetuity. First, he need only once bear the costs of the initial legislative process. Incremental reappropriations and reauthorizations seem far simpler and less costly than initial ones, and he can immediately capitalize his share of a program's net present value, even if he only intends to remain briefly in Congress. Furthermore, this arrangement's single-payment feature circumvents his difficult contractual problem of enforcing payments in perpetuity.

Potential threats to this arrangement appear substantial. Legislators in future Congresses continuously might demand renegotiation of the original agreement and compensation for themselves. Legislative abrogation is a distinct possibility, which would reduce the net present value of the income stream to the interest group, thus simultaneously diminishing the price that the group is willing to pay to its original sponsor.

The possibility of abrogation also holds serious consequences for the abrogators, the incumbent legislators. If the members of Congress rescind agreements struck in earlier Congresses, they simultaneously reduce expectations of a long-term benefit flow among interest groups presently engaged in *de novo* bargaining with congressmen. Hence, with each abrogation of a prior agreement, an incumbent congressman reduces his expected payment from a present bargain. The entire Congress faces this problem, and it represents an institutional prisoners' dilemma for its members.

The congressional solution to this problem is institutional. Congressional procedures, such as the filibuster, bicameralism, and the capacity of committees to kill legislation, preserve the status quo by making it very difficult to terminate prior private-interest bargains. These procedures also make new legislation more costly. But Landes and Posner believe that the net benefit to the members of Congress from having status-quo-preserving procedures is greater than it would be without them. Stated differently, the additional permanence of the reduced number of bills that succeed is greater than the opportunity costs of those that fail.

This assumption about the relative costs and benefits of making legislation more difficult to pass is susceptible to a different interpretation, however, one that pervades our earlier analysis of interest-group and legislative decision making in regard to a choice to pursue a private benefit
or to oppose one. That analysis showed that interest groups have an incentive to seek, and congressmen have an incentive to pass, private-benefits legislation, but neither has an incentive to oppose such legislation. Landes and Posner incorporate the incentive to pass private-benefits legislation, but they worry about incentives to delete existing legislation. Yet, our earlier analysis explains that incentives to delete such legislation are equivalent to incentives to produce collective goods. We found no such incentives present. Hence, prior private-benefits legislation enjoys a presumptive permanence, even though a majority of the members of subsequent Congresses might oppose it.

The judiciary, and particularly the Supreme Court, represents a second threat to the long-run flow of private benefits from single enactments. Suppose that the judiciary were not independent, but instead were responsive to legislative changes in preferences, thus canceling certain long-term legislative contracts with interest groups. Judicial nullification may even be a preferred way for legislators to eliminate these prior bargains, because it would avoid the legislative gauntlet. Thus,

suppose that Congress in year one ‘‘sells’’ the dairy industry a heavy tax on margarine, but the next year the producers of margarine offer Congress generous inducements to remove the tax. Congress is unlikely to respond to this demand by enacting repealing legislation, due to the impediments to swift legislative action. . . . But if the judges are the perfect agents of the current Congress, they will refuse to enforce the margarine tax, and the effects will be the same as legislative repeal. (Landes and Posner, 1975:879)

Hence, members of present Congresses share an incentive not merely to structure their decision-making process, to avoid legislative nullification of earlier agreements, but also to avoid compromising the independence of the judiciary. To avoid conflicts with the Congress, the Court also has an incentive to affirm earlier private-interest legislation, and indeed the Supreme Court seldom overturns such legislation. Rather, the Court acquiesces in these enactments, thus reinforcing its own ‘‘independence.’’

The Supreme Court’s activity is thus notable, not for what it does, but for what it does not do: namely, interfere with the private-interest bargains struck in the legislature. One can even sense in the Court’s decisions the operation of implicit rules requiring the preservation of prior legislation. The Supreme Court goes beyond not tampering with prior enactments to finding ways to enhance their survival. For example, in statutory interpretation, the Court often examines the original congressional hearings and speeches, to discern the intent of the originating legislators. While this activity some-
times results in peculiar readings of the legislative record, nevertheless, statutory construction is a common judicial practice. Indeed, even when the Court confronts an otherwise unconstitutional statute, it usually tries to narrow the scope of the statute or otherwise interpret its terms so that it will pass constitutional muster, to preserve as much of the original bargain's intent as possible. 55

ELECTIONS IN PRIVATE GOODS

We have come full circle from an analysis of electorates and the place of interest groups in them through the decision-making processes of the institutions of government. Our central conclusion is that most participants in the political process engage in the supply and demand of private benefits at collective cost, with scant regard for welfare-related criteria. Four tasks remain. First, we must reconcile the social-imbalance and fiscal-illusion hypotheses, which predict different public policies, with the private-goods view maintained here. Second, we must explain why the public sector does not yet account for the total gross national product. Third, we must revise our election models by departing from that of public goods as issues and moving to the notion of private goods, supplied at collective cost, as issues. Fourth, we must explain how issues cast as explicit public-goods decisions transcend that form to become decisions about private benefits, supplied at collective cost.

The accomplishment of the first of these tasks appears simple. Both the social-imbalance and fiscal-illusion hypotheses seem correct, because they do not predict mutually exclusive decisions. The social-imbalance hypothesis asserts that public goods will be underproduced. Our analysis does not predict whether such goods will be underproduced or over-produced, because the actual level of production seems epiphenomenal to the political process. For instance, we argue that the animus for national-defense production rests largely with the demands of divisible constituencies and firms, as well as with members of the military and the Department of Defense. Whether those interests coincide with the production of a proper level of national defense, or with a level of defense that is either too small or too large, we cannot say. We can merely indicate that there is too large an expenditure on private, divisible benefits, and we can identify sources of inefficiency. This means that at present expenditure levels, by making reallocations of spending, we could produce much more of the public good of national defense than we have today; or we could produce the same level of national defense at a greatly reduced cost, if we eliminated the entire private-goods nexus, and provided that there were another way to
assemble a demand for an optimal production of this particular public good—national defense.

The fiscal-illusion hypothesis is a close cousin to the kinds of cost spreading identified earlier. We have indicated how an effective political demand for a private, highly concentrated benefit might be formed, to the detriment of dispersed taxpayers. The inducement of a fiscal illusion merely reinforces this tendency. The social-imbalance and fiscal-illusion hypotheses thus refer to separate decision contexts. The first predicts the public-sector undersupply of public goods, and the second predicts its oversupply of private goods. Because any sensible model of electoral processes must incorporate illusions symmetrically, we construct our election model with that desideratum in mind.

Second, we must account for the public sector's failure to account for the total gross national product. To some extent an explanation for this datum rests with the simple observation that private benefits may be more easily produced collectively by having the public sector leave certain activities private. For example, regulation and the divisible benefits that flow from it could not exist without a private sector. Similarly, in many of the tax code's adumbrations, the ability to grant loopholes allows for the further production of private benefits, sometimes at the collective cost of private-sector inefficiencies pursuant to tax avoidance and the enhanced taxation of "unprivileged" activities. But these explanations probably remain less important than the more significant limitation, that there are macrolevel sources of inertia, preventing the public sector from growing at a faster rate than at present. Like social imbalances and fiscal illusions, the causes of this inertia should be an explicit deduction from a model of electoral processes with private benefits as issues.

AN ELECTORAL PROCESS IN PRIVATE GOODS

The private-goods-election model is constructed out of assumptions concerning voters' thresholds of perception and candidates' decision procedures (Aranson and Ordeshook, 1978 and forthcoming). We assume that voters may differ systematically in their ability or willingness to perceive the net costs or benefits of alternative public policies and that candidates differ in their decision procedures between variants of global and incremental decision making. Interest groups in this model are price takers, which merely observe candidates' platforms and assess their expected welfare under each contestant's incumbency.

Voters. The discussion of the political superiority of groups over the members of an anomic electorate concentrated on the group's superior ability to monitor and enforce compliance with bargains and on its related

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capacity to convey political information. This process is bound to be imperfect, and therefore group members will vary in the amount of political information that they can and do absorb. The opportunity costs of collecting political information also vary systematically across the entire electorate, and these costs affect the amount of public-policy information that any particular citizen might have. Here, we characterize information in each group by a distribution of thresholds of perception concerning net benefits or costs of public-policy programs. Figures 4.4a, 4.4b, and 4.4c illustrate three of the many possible general functional forms. The horizontal axis in each figure measures net benefits or costs, while the vertical axis depicts the threshold distribution's rate of change for alternative values of net benefits and costs, labeled here as $X_i$.

To interpret these figures, suppose that they represent the distribution of thresholds for the members of a particular group, and that an election candidate proposes a program of private benefits supplied at collective cost, which would create a net benefit or cost of $X_i$ for each group member. The entire area under each threshold function is one. The shaded area to the left

\[ \text{FIGURE 4.4a} \]
of $X_i$ shows the proportion of members that would perceive the net benefit or cost and act on it. Members with thresholds to the right of $X_i$ would perceive no net change in their welfare. The distribution's skew and its general shape will affect the proportion of members that perceive a net welfare change. In figure 4.4a the members tend to be highly sensitive to small changes, while those in figure 4.4c appear largely insensitive.

It is tempting though speculative to provide interpretations of these figures. One possible interpretation is that the group whose threshold is depicted in figure 4.4a has excellent communications with its members, or that the group is small and closely knit, providing instant communications about political knowledge; by contrast, the group in figure 4.4c is only loosely constructed, with poor communications. Figure 4.4c may even represent the threshold distribution of the entire electorate.

An alternative interpretation allows for dynamic changes in thresholds as the result of changing economic and political conditions. For example, if tax shares increase rapidly because of increasing federal expenditures for various public programs, thresholds might soon pile up near zero, as citizens

FIGURE 4.4b

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become highly sensitive to small changes in aggregate public-sector spending. Alternatively, during periods of economic expansion, citizens might be less aware of small changes in their tax shares and in regulatory welfare losses. While we may infer these two observations from diminishing marginal utility for wealth, they also suggest the presence of forces operating at cross-purposes. For example, if citizens become extremely sensitive to small tax-cost increases, they may also begin to demand proportionately more private, divisible benefits from the public sector, a result that the preceding analysis of political service as an inferior good would suggest. Figures 4.5a, 4.5b, and 4.5c show the respective cumulative densities of these threshold functions, \( f(|X_i|) \). In these figures the vertical axis depicts the area under the threshold function, which translates into an election candidate's plurality gains or losses generated in each group from advocating a policy associated with \( |X_i| \).

Candidates' Strategies. This model was originally constructed to explain the decisions of an incumbent chief executive seeking to be reelected and the decisions of his challenger. Later, though, we generalize

FIGURE 4.4c

net benefits or costs

|X_i|
the model to include legislative decisions. The present characterization of executive decision making concerns whether such persons pass on various private-benefit programs incrementally, one at a time, or globally, all at once. The actual decision variable involved concerns the number of programs to be added, deleted, or left unchanged.

Most of the time we expect presidents and their challengers to decide incrementally, choosing to add, delete, or leave unchanged particular programs one at a time. This procedure seems attractive, first, because interest-group demands probably are pressed serially rather than all at once. Second, as noted in the discussion of the judiciary, legislators are constrained to leave most programs untouched, making changes only at the margin. Third, executives and their challengers seem physically and informationally constrained to accept what has gone before and to operate at the margin by adding or deleting programs one or a few at a time. Information costs alone preclude a "zero-base" scheme. Fourth, the strategy of ambiguity likewise restricts the number of programs on which candidates will take forthright positions.

\[
\text{plurality} = f(|X_i|)
\]

\[
|X_i| \rightarrow \text{net benefits}
\]

**FIGURE 4.5a**
Global decision making—the simultaneous considering of all present federal programs as well as those demanded or under review—may exist in an ideological space, but it is hardly realistic to believe that it prevails in day-to-day deliberations and in the private promises that candidates make to individual interest groups. Candidates who sometimes adopt global strategies or global approaches to public-policy decisions usually achieve the label of “radical.” We assume that such a strategy is possible, however, if only to round out the analysis.

We also assume that each group has at most one program that can be added or deleted and that groups are of equal size. We let \( x \) equal the number of groups having programs added, and let \( y \) equal the number having programs deleted, such that \( x + y \) is less than or equal to \( n \), the total number of groups. A candidate associates a plurality with each group, which depends on that group’s net benefits or costs, \( X_i \), and the group’s distribution of thresholds. For instance, if a candidate advocates adding a benefit, \( B \), at collective cost \( C \) for some group, if \( B \) and \( C \) are common for all of the groups’ programs, and if tax shares are equal across groups, then compared

\[ f(|X_i|) \]

\[ |X_i| \]

net benefits
to the status quo of no net changes, the candidate's net plurality gain from the benefited group is $f(B - \frac{x - y}{n} C)$. The expression $\left[\frac{(x - y)}{n}\right] C$ represents the net addition to or subtraction from the tax or regulatory cost for each group, associated with a program addition or deletion. Since x groups have programs added, the total addition to the candidate's plurality, compared with his plurality in the status quo, is $xf(B - \frac{x - y}{n} C)$. Similarly, for the y groups whose programs are deleted, the candidate receives a plurality change (probably a loss) of $yf(-B - \frac{x - y}{n} C)$. And for the n-x-y groups whose programs or status remain unchanged, the candidate's plurality change becomes $(n - x - y)f(-\frac{x - y}{n} C)$. The candidate must choose a value of x and y to maximize his plurality, $V(x, y)$. In terms of the preceding formulations, we can state $V(x, y)$ as

$$V(x, y) = xf(B - \frac{x - y}{n} C) + yf(-B - \frac{x - y}{n} C) + (n - x - y)f(-\frac{x - y}{n} C).$$ (4)

Incremental decision making requires candidates to adjust x and y by adding or deleting programs one at a time, as an election campaign or a legislative session progresses. Global decision procedures allow x and y to

FIGURE 4.5c

plurality

$f(|X_i|)$

net benefits

|X_i|
take on any values up to an including n. An intermediate, hybrid form of
global decision procedure assumes that the number of groups affected will
be greater than one and less than n. That is, certain preexisting programs
will not be deleted.

ELECTIONS WITH GLOBAL DECISION PROCEDURES

In earlier work, we report on the results of global candidate decision
making, assuming the absence of thresholds or the presence of a uniform
distribution of thresholds (1978 and forthcoming). That analysis provided
few surprises, except that if the benefit of each program equals its cost in
the presence of zero thresholds, then the net number of programs added or
deleted may be ambiguous. The most important conclusion from examining
electoral processes under these two very highly specialized assumptions is
that maximum redistributive expropriations fail to occur. There is some
inertia, even in these highly stylized electorates. Here, we analyze the more
general cases of thresholds as depicted in figures 4.4a and 4.4c.

Sensitive Electorates. Suppose that thresholds are distributed as in
figure 4.4a: citizens are sensitive to relatively small changes in their
welfare. Using global decision procedures, candidates will find a strategic
optimum in which each and every group’s program must either be added or
deleted. At an optimum strategy, however, x cannot equal y. And
surprisingly, x exceeds y: more programs will be added than deleted. This
last finding is independent of the relative values of benefits and costs.

Insensitive Electorates. If thresholds are distributed as in figure 4.4c,
under global decision procedures, then more programs are deleted than
added, provided that costs exceed benefits. If benefits exceed costs, then
the actual configuration of outcomes depends on the parameters and the
actual functional form of f.

ELECTIONS WITH INCREMENTAL DECISION PROCEDURES

Incrementalism seldom finds explicit definition in the literature, but our
analysis requires specificity. Accordingly, we include analyses of three
separate forms of incremental decision making: naïve incremental decision
making and two forms of local optimization.

Naïve Incrementalism. Under naïve incremental decision making, the
candidate or officeholder decides at the margin whether to add or delete
some group’s program. If citizens are relatively sensitive to small changes
in their welfare, then the candidate adds programs one at a time only if each
program’s benefits exceed its costs. Otherwise, he deletes them. But if
citizens are relatively insensitive, then the opposite configuration holds.
Depending on functional forms and parameters, adding programs dominates over deletion as an inverse function of the level of costs, as a direct function of the level of thresholds (insensitivity), and as a direct function of the size and support of the group that benefits.

*Opportunity-cost Local Optimum.* In the second incremental decision procedure, candidates serially adjust $x$ and $y$ to find a local optimum. For instance, suppose that a candidate’s first decision is to add a program. Under an opportunity-cost local optimum, he will continue to add programs one at a time until one of two events occur. Either the marginal plurality from these additions would equal zero, or the marginal plurality from deleting a program would exceed that of adding one. When this second condition prevails, the candidate will then delete programs serially until a parallel change occurs. This decision procedure allows for recontracting of prior commitments, and it continues until the election is held or until there are no further gains as a result of additions or deletions.

*Non-opportunity-cost Local Optimum.* A third incremental strategy has the candidate use the same considerations as under the opportunity-cost optimum, except that he would not compare the marginal returns from additions and deletions, but would simply add programs serially until the marginal additions to plurality became zero or negative, and then he would delete programs until the same condition obtained. This procedure does not require the candidate to compare the opportunity costs of his full strategy set, and it depicts a decision maker who allows the public sector to grow until taxpayers become angry, after which he joins the tax-cutting bandwagon. Former Governor Jerry Brown of California used such a strategy in the face of Proposition 13’s success in his state.

Under this decision procedure or the opportunity-cost variant, invoking the threshold distributions in either figures 4.4b or 4.4c, and allowing for recontracting of previously advocated policies, there will be a net addition of programs. That is, candidates set $x$ greater than $y$. Under a nonopportunity cost, local-optimum strategy, if thresholds are distributed near zero, the previously identified pattern with naïve incrementalism probably prevails, in that $y$ exceeds $x$, and more programs are deleted than added. If thresholds are distributed far from zero, then under the same decision procedure, candidates add more programs than they delete.

**Hybrid Global Decision-Making**

If candidates can operate in a greater than incremental fashion but are limited in the number of programs they can affect, then a hybrid global decision procedure prevails. For example, each of the political parties may regard a different set of programs as belonging to its traditional constitu-
Peter H. Aranson and Peter C. Ordeshook

ency, so that such programs cannot be deleted. If program benefits equal costs, and if thresholds are symmetrically distributed, as in figure 4.4b, then a candidate who is limited to considering only one-half of the programs under review will add more than he deletes. In a special case of figure 4.4c, using a quadratic payoff function, if a candidate adds no new programs, then he must be able to delete more than one-half of the programs under consideration, to achieve a net plurality increase. As public-sector size then grows by the accretion of more programs, the number of groups whose programs the candidate must deny, to increase his plurality, will decline. If the candidate's payoff function is concave, then these results are reversed. Accordingly, under a hybrid global decision procedure, welfare-sensitive electorates will produce a smaller public sector. The opposite result holds with thresholds distributed far from zero, the case of convex payoffs.

LEGISLATIVE DECISION MAKING

Constituency as Interest Group. To make sense out of legislative decision making by using the preceding election model in private benefits, suppose that a constituency is an interest group, so that a pure pork-barrel relationship prevails. Furthermore, suppose that separate threshold distributions describe each constituency. This formulation of the legislator's problem allows for the deletion of programs as well as their addition. The analysis of the legislator's decision becomes more difficult than that for chief executives and their opponents, because legislative coalitions become possible. But suppose that a winning coalition has formed and that it will add or delete programs under a generalized incremental decision procedure. Because legislative coalitions may be unstable, winners and losers can change places quickly. We assume that all winning legislative coalitions will adopt identical decision rules, and that if the number of groups with programs added is less than a majority, then the coalition will delete only the programs that members of the losing coalition support. Let $P(W)$ represent the probability that a legislator belongs to a coalition of $w$ legislators, and suppose that all coalitions are equally likely to form. Under this assumption, a legislator's expected payoff becomes,

$$V(x,y) = P(W) \left[ \frac{x}{w} (B - \frac{x-y}{n} C) + \frac{w-x}{w} f\left(-\frac{x-y}{n} C\right) \right]$$

$$+ \left[ 1 - P(W) \right] \left[ -\frac{y}{n-w} f\left(-B - \frac{x-y}{n} C\right) + \frac{n-w-y}{n-w} f\left(-\frac{x-y}{n} C\right) \right].$$

(5)

Because $P(W) = \frac{w}{n}$, equation (5) becomes equation (4), and the earlier findings of this election model remain invariant between executive and legislative decision making, if constituencies are equivalent to interest groups.
Nonconstituency Interest Groups. If constituencies are not the fundamental interest groups, but if interest groups are national, finding representation in most or all constituencies, then there is bound to be no real public-policy conflicts among legislators. If this condition prevails, then each legislator is equivalent to an executive or his challenger, and the results from the election model carry over unchanged.

Heterogeneous Constituencies. Some interest groups may have members in certain constituencies but not in others. There may be neither rhyme nor reason to the actual distribution of groups in constituencies, and therefore there are no general findings from the election model in private goods. If payments from interest groups to legislators are politically fungible and transferrable across district boundaries, however, so that legislators share in the rents from added programs or in the marginal plurality from deleted ones, then the preceding election model again finds use.

**IMPLICATIONS FROM THE MODEL**

Table 4.2 summarizes certain of the findings from the election model. While these results are overgeneralized and do not contain many of the caveats in the original research, for purposes of speculation we discuss them here somewhat more liberally than a closer reading might allow.

**Strategic Premises.** Most conjectures about this election model require an empirical interpretation of the kinds of conditions in the electorate or in

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**TABLE 4.2**

**Summary of Decision Procedure and Threshold Effects on Public-Sector Growth**

<table>
<thead>
<tr>
<th>Decision Procedure</th>
<th>Threshold Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>Net growth</td>
</tr>
<tr>
<td>Nonopportunity cost</td>
<td>Near zero</td>
</tr>
<tr>
<td>incremental</td>
<td>Far from zero</td>
</tr>
</tbody>
</table>

Qualified net reduction

Net reduction

Net growth

political competition that would lead a given threshold condition or decision procedure to apply. For example, *ceteris paribus*, the distribution of thresholds may reflect the electorate's size. Larger electorates may be insensitive, with threshold distributions far from zero, as in figure 4.4c; smaller electorates might be sensitive, as in figure 4.4a. Using incremental decision procedures, candidates in smaller electorates would therefore create a leaner public sector, but as the electorate grows, the public sector might increase at a proportionately greater rate. Hence, those candidates or interest groups favoring (their share of) public-sector expansion should prefer centralized decision making in larger constituencies, annexations, and federalization of public-policy decision making. Devolution would be a preferred strategy for those who prefer a smaller public sector.

For those groups that find themselves in small electorates of unchanging size, but that wish to improve their chances of receiving private benefits at collective cost, an alternative strategy is to urge the agents of government to adopt global decision procedures, because this departure from incremental processes would result in a net public-sector expansion. Alternatively, if global procedures are already in place in a large electorate, such officeholders or interest groups might prefer a devolution of political authority to smaller units, because in the presence of global procedures and of citizens who are sensitive to small welfare changes that result from public-policy alterations, a net increase in public-sector size will again result.

**Dynamic Aspects.** Dynamic considerations invoke the possibility that thresholds and decision procedures are not merely exogenous to the political process but are also subject to manipulation. For example, as noted earlier, rapid increases in public-sector size, and the accompanying higher tax and interest rates occasioned by additional programs, might make citizens more sensitive to small changes in their welfare as their wealth declines. Alternatively, a robust economy might make citizens relatively more insensitive to public-policy-related changes in their welfare. The first possibility, of a government's growing under incrementalism in the presence of an insensitive electorate, may have characterized the development of public policies before the Reagan administration. At least in its official announcements, the Carter administration sought to use global decision procedures in the presence of an only partially sensitive electorate. As predicted, that result led to a net growth in public-sector size and, by a reasonable interpretation, the incorporation of a large number of public-spending programs into the category of "entitlements," with automatic cost-of-living adjustments, perhaps as a protective strategy, or as a legislative attempt to capitalize immediately on long-term spending programs.
The Reagan administration, faced with a greatly reduced distribution of thresholds of its own making, tried a mix of global and incremental decision procedures: global with respect to the entire body of defense programs, and incremental with regard to each reauthorization of social programs. It ended up with a net growth in public-sector size but with a concomitant shift of spending from domestic to defense categories.

One interesting aspect of the model’s dynamic implications concerns the shift from cell to cell in table 4.2. We might begin with a condition of incremental decision making and an insensitive electorate, realizing net growth. As the citizenry grows poorer because of the resulting inefficiencies and higher tax costs, people will become relatively more sensitive to public-policy-related changes in their welfare. Hence, conditions will move from the right-hand to the left-hand column of table 4.2. But it remains unclear what public-policy change this shift will create, because we cannot predict the candidates’ or officeholders’ responses. Those who continue to decide incrementally will support a net reduction in public-sector size, but those who take a global view will advocate additions to the number of private benefits, collectively supplied. To the extent that “cost cutters” try to depart from the status quo, they will often defeat themselves by adopting global decision procedures as part of a larger public-policy attitude.

Perhaps we can best describe the experience of the United States and other representative democracies during much of the nineteenth century as a limited public sector, declining in size, in which officeholders could use global decision procedures in the presence of an electorate with thresholds distributed far from zero. That speculation gains force from the observation that in the United States and Great Britain, public-sector size relative to national product declined throughout most of the nineteenth century.

MACROECONOMIC POLICY

The preceding discussion demonstrates that under certain conditions the public sector will actually shrink. Thus, the election process itself provides a method for constraining the accretion of private-benefit programs. While this observation answers our third question about limitations to public-sector size, the conditions that prevail in most instances—incremental decision procedures with insensitive electorates—provide the theoretical assumptions necessary for net increases in public-sector size over time. Even so, we have provided an additional partial explanation of why the public sector does not yet account for the total gross national product, by beginning the theoretical construction necessary to complete the third task—namely, developing an election model in private goods. The final task is to explain how issues cast as explicit public-goods decisions
For certain of these public-goods issues, we have already explained their transformation. Public goods—such as national defense, public peace, and environmental protection—remain at least partially public in consumption. But in their production the incidence of expenditures creates a set of private-benefit programs for individual firms and constituencies. Yet, for larger macroeconomic issues, the political engines of transformation seem less apparent. Issues such as inflation, unemployment, interest rates, and overall tax policy seem less readily susceptible to the private-benefit interpretation suggested here. Macroeconomic policies do exist, and politicians do manipulate them. The result for our analysis is thus a confrontation of two views. The first adheres to a microlevel model about the political pursuit of individual public-sector programs. The second observes the presence of macrolevel phenomena concerning these larger economic measures. Indeed, micro- and macrolevel policies may conflict, for example, because increases in private-benefit programs may occasion higher taxes and a lower gross national product.

The reconciliation of these conflicting views begins with the observation that politicians enjoy a wide variety of strategic responses to those macroeconomic outcomes that threaten or enhance the chances of election or reelection. Under a theory that we have criticized here, they may attend solely to larger macroeconomic considerations, either to gain reelection (Tufte, 1978; Nordhaus, 1975) or to develop truly welfare-regarding macroeconomic policies. But that conclusion rejects the notion that elected officeholders and challengers respond principally to organized groups, rather than to the entire anomic electorate. A closer examination of specific policies suggests that even when macroeconomic problems do occur, the demands of particular groups prevail in the fashioning of public-sector responses. Unemployment, interest rates, taxes, and deficits provide four examples (Aranson, 1983).

Unemployment. The traditional analysis of unemployment distinguishes between its cyclical and structural variants. Cyclical unemployment (and employment) occurs with the ebb and flow of the economy, as a result of changes in demand brought about by economic recession and expansion. Structural unemployment occurs as the result of a mismatch between the skills of the affected labor-market sector and the skills demanded in both the private and public sectors. The commonly suggested set of programs to reduce each form of unemployment depends upon its cause. Many economists, adopting a rational-expectations view, believe that cyclical unemployment requires no public-sector solution, because workers in cyclical industries receive a wage premium to compensate them for periods of
unemployment. The high hourly wages of auto workers provide one example. Retraining programs or a negative income tax may be the most efficient solutions for structural unemployment.

Enacted solutions to unemployment problems contain few of these elements or considerations. Rather, as in other areas of political life, here, too, legislators respond to the demands of the organized, who tend to be unionized workers in cyclical industries, seeking additional public-sector support to compensate them for periods of unemployment over and above the compensation that they receive in their wage differential. For example, these groups constantly demand and sometimes receive government protection from foreign competition, even when it would be more sensible to do nothing or to relocate these workers temporarily, or even permanently, in other industries. This protection hardens investments and makes relocation more costly. Elaborate unemployment-compensation schemes, which do little for the structurally unemployed, exacerbate unemployment in cyclical industries. The hard-core and the structurally unemployed, who remain largely unorganized, only receive benefits from programs demanded by their organized sponsors—members of the welfare establishment, whose jobs are secure. These programs are not designed to reduce case loads or to allocate benefits efficiently.

Hence, the private-benefit pattern prevails in unemployment policies. The unorganized go unserved. But the organized receive divisible benefits at collective cost, with the additional problem that these benefits provide incentives for the cyclically unemployed to remain so. These programs also indirectly subsidize cyclical industries. It is estimated that the addition of these private-benefit programs to the public sector has contributed to the increase from 4 to 6 percent in long-term unemployment rates since World War II (Feldstein, 1982).

Interest Rates. Economists may disagree over policies that determine interest rates. Nevertheless, interest rates appear to generate from public policies more nearly concerned with public-goods production than is the case, say, with unemployment. Yet, even here, particular policies and general macroeconomic decisions are responsive to organized-group demands, not to the service of a larger public purpose. Specific policies include bailouts for banking institutions, construction-industry subsidies, and occasionally usury laws, which work the greatest hardship on lower-income citizens, who may not be sufficiently credit worthy to secure loans at lower, statutorily regulated rates. More commonly, the larger macroeconomic policies themselves are designed to respond to the demands of large, organized groups, such as labor unions, the construction and real-estate industries, and cyclical industries in consumer-product lines.
Taxes. We describe earlier the manner in which tax legislation is responsive to private-interest demands. Each new “tax reform” or “tax-reduction” bill contains a laundry list of exceptions and loopholes to benefit particular classes of firms or individual taxpayers. Sometimes, statutes are written to benefit a particular firm. The inefficiencies that tax-avoidance strategies—such as the purchase of economically unprofitable tax shelters—create, the implicit subsidies of tax loopholes and their distorting effects on the economy, as well as the high cost of tax preparation, must be counted as deadweight losses for the entire economy. Hence, these programs, too, represent private benefits supplied at collective cost.

Deficits. As a political issue, deficits during the Reagan administration attracted bipartisan appeal. Deficits are troublesome to politicians, _inter alia_, because they require debt servicing, and therefore they act as a “tax” on future public spending, thereby reducing the public sector’s ability to supply future private benefits. Here again, the response to increasing deficits is consistent with the public-policy patterns described earlier. Those least well organized are affected first. For example, reductions in Social Security payments are enacted to the detriment of future recipients, not present ones. These recipients, who also bear the present burden of the program’s cost, remain largely unorganized. By contrast, present recipients are organized. Similarly, student-loan programs—a benefit for a largely unorganized group of recipients—are cut from the budget, but not particularized benefits for tobacco growers, a well organized group.

In sum, concerning unemployment, interest rates, taxes, and federal deficits, public-policy decisions reflect less a coherent macroeconomic policy process, and more the demands of the organized for private-benefit legislation.

THEORY AND REFORM

Our analysis here finds grounds for rejecting the descriptive and conditionally normative conclusions of two bodies of scholarship. The first is welfare economics. Despite its theoretical elegance—asserting that the state _should_ produce public goods, suppress public bads, establish property rights, control monopolies, and optimally redistribute wealth—we can find no real political or economic incentives, aside from constitutional strictures, for the actual accomplishment of these objectives. Furthermore, among economists and some political scientists, welfare theory has become something of an ideology. The discernment of a welfare-regarding task finds use in justifying governmental activity whose real motives concern the development of private, divisible programs at collective cost, which com-
monly are inefficient in their jurisdictional structures, methods of govern­
ance, allocations, and production levels. Scholars commonly brush aside the
necessary theoretical limitations of welfare-related prescriptions, with
regard to costs and benefits, jurisdictions, and methods of governance.
Therefore, in its most practical form, welfare theory has become a body of
 scholarship in the service of advocating the addition of private-benefit
programs in the democratic polity.

The second body of knowledge that finds criticism here, if only
indirectly, is the Madisonian view of representative democracy, as formu­
lated in "Federalist Paper Number 10" (1961) and in the works of more
recent pluralist scholars (Dahl, 1961). Madison acknowledges economic and
other causes of political divisions and the resulting demands for public
policies that would work a hardship on the citizenry at large. Nevertheless,
he believes that a republican form of government will oppose large interests
adverse to the electorate's welfare and will disperse smaller interests that
would unduly impose on the fisc. Our analysis suggests that when large
interests collide, one or the other may prevail, but a larger public purpose
goes unserved. More important, precisely the dispersion of smaller inter­
est in a large republic, which Madison regarded as a solution to the private-
interest problem of "factions," is the precondition for cost spreading that
our models identify as a potent source of public-sector inappropriateness.

INSTITUTIONAL SOLUTIONS

Attempts to reform political processes in representative democracies
either seek directly to limit public-sector growth or to rearrange institu­
tions, to affect expected costs and benefits of private-goods production.
These reforms accept motivations as they exist but try to constrain the
resulting decisions. As we shall see, motivational changes at the level of
fundamental incentives seem more nearly speculative.

Tax and Spending Limitations. The most prominent of institutional
reforms are various constitutional amendments that would require a
balanced budget and a limit to spending increases as some function of
growth in the gross national product, with the provision for an emergency
override by an extraordinary congressional majority. The several variants of
this proposal contain details susceptible of political manipulation. Under
these proposals, the political branches would find an immediate constraint
on their ability to create some private benefits at collective cost. Four
beneficial, and not necessarily contradictory, tendencies would result.

First, the private-goods nexus of legislation might continue, and
programs would be sorted out according to their political profitability, much
as they are today. At the margin, however, the addition of a new program
would require the elimination of an old one, and new programs would compete with each other for passage. This competition might reduce the political attractiveness of such programs. First, the eliminated program’s supporters would constitute a natural opposition to favored measures, because they would bear the greatest cost. Second, the expectation that programs might run in perpetuity would be substantially reduced, because all programs would be subject to recision if politically superior substitutes emerged. Hence, interest groups would be willing to pay less to have such programs enacted. Third, because of the higher political costs associated with enacting such programs, consequent to the expected opposition, interest groups would demand a smaller number of them. In short, the tax and spending limit might work a serious mischief with the present structure of interest-group politics.

Considering the now increased costs and reduced benefits flowing from the balanced-budget spending limit, a fourth tendency might emerge, in that legislators, at the margin, might search for truly public-regarding legislation. Certainly, the private-interest basis of legislation would continue; but to the extent that it became less profitable and more costly, legislators might find real optimum arrangements of public-goods production relatively more profitable. Interest groups might then discern that legislatively created rents would be lower under budget limits, but the payoff in public welfare might be commensurately greater.

Three problems emerge from attacking the private-interest problem with balanced-budget and spending constraints. First, the provision for larger budgets consequent to votes by extraordinary congressional majorities makes it possible that such majorities will indeed emerge, perhaps increasing public-sector size and the number of groups whose demands find public satisfaction. Hence, upon the artificial creation or recognition of an “emergency,” a larger coalition will form, whose members pursue yet more private programs at collective cost. The likelihood and dimensions of this possibility may be suspect, however, because in the absence of such a limit, much omnibus legislation now finds support by more than the constitutionally required supermajority. Whether such coalitions would take a different form under an amendment to balance the budget and limit revenue, we cannot say.

Second, the proposal to balance the budget and limit revenue does not directly assault the fundamental motivations underlying the private-goods problem. Instead, it merely seeks to constrain the resulting legislative outcomes. Of course, as just noted, certain changes in motivations and incentives will occur, perhaps improving the nature of legislation, and perhaps not. The approach of balancing the budget and limiting revenue, however, would deny what valid lessons might be gained from welfare
theory. Stated differently, under the dictates of welfare theory the public sector should embrace programs whose opportunity costs are less than the opportunity costs associated with alternative public programs and potentially foregone private-sector activities. That is, public programs should pass welfare-regarding tests of their fitness. Even under such tests, however, it is plausible that the public sector might grow larger. Yet, the macrolevel constraints of a balanced-budget approach would prevent welfare-regarding expansions and thus diminish welfare. Hence, were the president and legislators suddenly converted into sincere trustees for a larger public interest, they might find themselves constrained by an approach of balancing the budget and limiting revenue, in a manner that might deny their newly found regard for the citizenry.

The third problem may seem more technical, but it is no less acute for being so. Public-sector spending represents merely one technology for producing private goods at collective cost. Other technologies include loan guarantees, tax preferences (loopholes), and regulation. If for both legislators and their clients, direct spending suddenly should become politically more costly and less certain, then a partial shift out of direct-spending activities and into these less-hampered technologies might occur. For example, the federal government might issue a greater number of loan guarantees, reducing interest rates for the benefited classes of borrowers, while carrying the implicit subsidy off the books. Or tax-code provisions might increase in their exceptions and loopholes, to benefit particular groups, thus imposing more inefficiencies and greater tax shares on those not benefited, taxpayers at large. Or the federal government might issue a greater abundance of regulations to produce a relatively larger number of private benefits through that technology. For example, if the Social Security system found itself with mounting financial problems, the members of Congress, constrained not to increase spending, might require private employers to create highly regulated private pension funds, to siphon off part of the system's fiscal problems. Again, this activity would be carried "off the books," thus evading the constraint of balancing the budget and imposing a limit on spending. In sum, a solution by parts may turn out to be no solution at all.

Regulatory Reform. Problems of tax preferences and loan guarantees might find partial solutions in a better accounting of federal liabilities, although off-budget manipulation will remain a serious problem for any balanced-budget requirement or spending limit. The collective costs of regulation, however, remain entirely off the books, and therefore it might represent a preferred method of governance in the face of tax and spending limits. Like the public production of private benefits by spending, tax preferences, and loan guarantees, the regulatory creation of private benefits
finds broad and nonideological recognition as a problem of representative democracy. Solutions to this problem are varied and contradictory (Breyer, 1982; Commission on Law and the Economy, 1979; Noll, 1971; Poole, 1982).

Direct assaults on regulatory processes seem much like balanced-budget and revenue-limit constraints, because they seek to alter regulatory legislation by constraining it rather than by changing fundamental motivations. For example, in the literature and in legislative proposals, one finds recommendations for and opposition to legislative vetoes (Bruff and Gellhorn, 1977), cost-benefit analyses, and sunset laws, which would automatically eliminate regulatory statutes after a fixed time period. Under a legislative-dominance view of the regulatory process (Moran and Weingast, 1982), however, a legislative veto would merely tighten the control that Congress exercises over regulatory-agency activities, without breaking the fundamental interest-group nexus of regulation. Cost-benefit studies are subject to serious manipulation and may serve merely to increase the amount of documentation required before regulations are promulgated. And sunset legislation allows Congress to renegotiate basic agreements with interest groups. This possibility may affect the interest group’s expectations about future income streams from regulation. Yet, because Congress can influence the direction of regulation under present arrangements without renewing the legislation, that effect may be slight for the case of regulation (Ehrlich and Posner, 1974). More important, periodic renewal may allow Congress to perfect the production of private benefits through regulation by bringing a larger number of firms and industries under the purview of a single agency.

A proposed proximate solution to the regulatory problem is the reinvigoration of the delegation doctrine in constitutional law (Aranson, Gellhorn, and Robinson, 1982). This doctrine, an ancient rule of agency law, would constrain the further delegation of delegated powers, such as those that the electorate delegates to the members of Congress. It would require the members of Congress to pass fundamental regulatory statutes and to settle political questions rather than to delegate this task to an agency, with the vague directive to regulate “in the public interest, safety, and convenience.” By requiring the explicit settlement of political questions, Congress could no longer create a regulatory lottery, as it now does by establishing regulatory regimes in the presence of conflict. The resulting specificity would encourage disadvantaged firms or industries to oppose the regulatory production of private benefits for their competitors. Were opposition absent, because regulation occurred pursuant to the traditional model of a single industry’s using regulation for cartel formation, then transient regulatory agencies might result. Nevertheless, the umbrella of
price and entry protection that regulation would afford to such an industry would invite competition from suppliers of substitute goods and services. In the absence of specific legislation, the delegation doctrine would forbid the extension of regulatory purview to these new competitors, and therefore the entire regulatory structure as a producer of divisible benefits at collective cost might fall of its own weight.

Decentralization. A third set of reform proposals concerns the locus of political control. As noted earlier, the production of public goods evinces problems of choosing price and output levels. Tiebout (1956) argued that radical decentralization of competing jurisdictions might create a marketlike condition in which more nearly optimal decisions might prevail. For our purposes, however, three other aspects of decentralization loom large.

First, decentralization of all governmental functions to the jurisdictions in which material effects occur would eliminate or substantially reduce the opportunity for cost spreading. That is, the costs of programs for dams, highways, schools, and other public services and regulations in state or city A would be borne in that jurisdiction, not spread to state or city B. At the margin, this reduction in cost spreading might promote an enhanced attention to the relative costs and benefits of alternative programs.

Second, decentralization might create more nearly homogeneous jurisdictions, in which constituents would be more difficult to isolate as divisible recipients of goods and services. Certainly, even in small modern jurisdictions, a fairly heterogeneous electorate provides opportunities for legislating divisible programs. But at the margin, decentralization would increase homogeneity, and thus opposition might be raised to the legislative creation of private-benefit programs.

Finally, if welfare models of the political process enjoy any prescriptive robustness, then a variant of Tiebout’s interpolity-competition hypothesis might prevail. That is, we might rely on the original purpose of a federalism to generate experiments in governance. Those jurisdictions that succeed in limiting governance to the production of public goods at optimal levels and prices perforce will leave their citizenry better off than those that fail in these tasks. Hence, we need not prejudge the exact form of local governance. We need merely allow jurisdictions to compete not only in the public and private goods and services that they create but also in the manner of creating them.

Political Incentives and Reform

All of these reforms, while partially constraining underlying motivations to produce private benefits at collective cost, do little to change the incentives of politicians and their clients. Nor have we described strategies
of enactment: first, because we are less than entirely sanguine about the effectiveness of any of these reforms and, second, because we are less certain about the enactment strategies that might be effective or appropriate. Surely, the underlying instability of political processes, as reflected in the absence of equilibria in electorates and legislatures, might itself aid in the adoption of one or more of these reforms in a political world in which "anything is possible."

While none of these reforms attacks the underlying motivations of political persons, they do change the rules enough to divert efforts partially away from the collective production of private benefits. Whether these changes are sufficient to create a substantial impact we cannot say. If they do succeed in suppressing the collective production of private benefits, however, then the payoff structures in legislatures and among interest groups will change. These structures probably create at least a modest self-selection among political persons, especially in light of the competitive nature of politics. Politicians also gain personal capital by practicing their skills under current incentives. But those who, under reform, no longer could succeed at the collective production of private benefits may find politics to be an unappealing vocation, in which their human capital has lost value. Those who remain or those who enter into politics to fill the vacuum may be differently motivated, producing yet further changes in the rules to accelerate the deprivatization of politics. In the absence of such a change, we cannot discern a set of reforms that would fulfill the requirement that "the citizen has a constitutional right to demand that public law be public-regarding" (Mashaw, 1981:28).

NOTES

1. For example, economists of the left, center, and right now seem to agree, to an extent that they have not before, that present antitrust policies in the United States erode economic welfare. Chicago economists long have opposed current antitrust activities. See Brozen, 1970; Demsetz, 1973a, 1973b, 1968; Posner, 1975, 1976; Stigler, 1966. More recent developments have buttressed this view. See Klein, Crawford, and Alchian, 1978. Baumol (1982), in the political center, has recently summarized the Chicago School's objections to antitrust policy, and he, too, finds that policy to be destructive of welfare. Scholars on the left, such as Thurov (1980), have also joined in condemning antitrust policy. In Thurov's view, present policies ignore competition from larger and (because of scale economies) more efficient firms in other industrial nations, which are not saddled by antitrust constraints. An attack on antitrust with regard to mergers and tender offers has also developed. See Easterbrook and Fischel, 1981; and Fischel, 1978.
2. Here, we concentrate on public policy in the United States, because we are familiar with it. But our knowledge of public policy in other democracies persuades us that the problems in those nations are not unlike those experienced in the United States. See, generally, Olson, 1982; and Benjamin, 1980. For a comparison of public-sector growth rates see Nutter, 1978.

3. For example, see Lindsay, 1976; Mises, 1944; and Niskanen, 1971. For an alternative view see Baumol, 1967.


6. For example, "Governmental provision of public goods is required precisely because each individual in uncoordinated [sic] pursuit of his self-interest must act in a manner designed to frustrate the provision of these items" (Baumol, 1965:21).

7. "The Constitution presumes that private activities will be constrained only to promote public purposes. The recognition first, that there is a wide range of such purposes, and second, that democratic, collective choice may pursue any or all of them in a complex and eclectic body of regulatory statutes, in no way reduces the force of the basic principle. The citizen has a constitutional right to demand that public law be public-regarding. Otherwise, his private harm is constitutionally inexplicable" (Mashaw, 1981:28; emphasis added).


10. In its pure form, welfare economics contemplates as Pareto optimal those changes that would exhaust the possible universe of alternatives and make at least one person better off while making no one worse off. Here, we forego the intellectual conceit of Pareto optimality and instead adopt the lesser conceit of Pareto-preferred changes, which do not necessarily exhaust the possible universe of alternatives but are consistent with present knowledge.

11. This claim seems to be true of Marxist social and political analysis. It may not have been true of Marx's thought itself, for he noted, "What is to be avoided above all is the re-establishment of 'Society' as an abstraction vis-a-vis the individual" (1959:104), as quoted in Sen, 1970:1 n.1.

12. This approach is implicit in most cost-benefit analysis, which has therefore been justly criticized. See Mishan, 1971. More recently, Posner (1979) resurrects wealth maximization in law and economics. See also two symposium issues of Hofstra Law Review: "Efficiency as a Legal Concern," vol. 8 (Spring 1980), and "Response to the Efficiency Symposium," vol. 8 (Summer 1980). For a general theoretical discussion see Davis and Winston, 1965.

13. In welfare theory, a test for Pareto optimality under wealth maximization is the compensation principal. In general, state A is Pareto preferred to state B, first, if those who prefer a change from B to A could compensate those who lose from the
change, secure their consent, and still be better off in A than in B and, second, if
those who lose could not compensate those who gain to get them to forego the
change. See Kaldor, 1939; Hicks, 1939; and Scitovsky, 1941. Whether or not ex
post compensation must be paid is strenuously debated. See Scitovsky (1941), which
views the payment of compensation as a "political question," about which
economists have no special expertise. The opposite view, requiring compensation, is
argued in Buchanan (1959).

14. The mechanism of consent is ignorance of one's state after the constitution
is enacted. The idea is first developed in Buchanan and Tullock (1962), and applied as
a "veil of ignorance" in Rawls (1971). In essence, those who consent to a
constitutional order under such conditions are choosing a particular lottery over
alternative outcomes, whose selection the constitution will eventually govern.

15. Historical and anthropological evidence suggests that tribal, communitarian
arrangements predate the kind of market contemplated in the pure competitive
model and precede it in economic development. See Posner, 1980. Hayek argues
that market relations developmentally have followed centralized community (collective) control. This process resembles the chronological order that Marx contem­
plated in historical dialectic, but whereas Marx would view the reimposition of
collective control as the next step in economic development, Hayek would view it as
social retrogression.

16. Returns in "payoffs" other than wealth find a place in recent work in
economic theory. The more nearly inclusive term "welfare" may be substituted into
this discussion, so that economic theory, as applied to the public (or private) sector
refers to decision making in the presence of any kind of scarcity. The method is
entirely general, incorporating nonmonetary concerns.

17. A large class of Pareto-optimal allocations may be produced in a pure
competitive market. Once one such allocation is arrived at, however, it is Pareto
optimal. A change from that allocation to another, without compensation, will harm
at least one person. Hence, the primacy of the initial distribution of resources figures
importantly in the final Pareto-optimal outcome chosen under the prescriptive,
welfare-regarding regime described here.

18. Further political specifications of property rights to information may be
appropriate, to make information private. This purpose appears to be the function of
patent and copyright laws as well as of various common-law protections of trade
secrets. The principal argument here is that creating more extensive property rights
to information may be desirable, but regulating the primary market, because of an
alleged market failure created by information inadequacies, may be undesirable.

19. The particular governmental program carrying out this function may
(rarely) be strictly Pareto-preferred, based on the first variant of welfare theory.
More commonly, it may require explicit ex post redistributions from a few to a few,
from a few to many, from many to a few, or from many to many. If the enacted
program requires redistribution, then to be Pareto-efficient, the program would have
been unanimously preferred behind the veil of ignorance had it been chosen there
(had the participants not known their subsequent postconstitutional and legislative
roles). For example, the entire citizenry—all potential plaintiffs and defendants—
might agree ex ante to an active common-law process (see Rubin, 1977). Under the
actual operation of such a system, however, there will be losers who would not consent ex post to specific results.

While not objecting to the existence of winners and losers as a particular statute
or regulation is worked out and applied, some scholars do object to changes in the
law or the constitution that may be adopted with less than unanimous or near-unanimous consent. Therefore, they reject the second variant of welfare theory and require a strict application of unanimity standards, which themselves imply Pareto optimality. For example, Buchanan (1959) argues that the political economist's task is to formulate hypotheses about public-policy changes that would garner unanimous consent. Anything less than unanimity (applying a rule of reason to exclude madmen) would vitiate the persuasiveness of the policies adopted and introduce several other problems inherent in the political system, some of which we consider in this essay. Hence, the political economist not merely must operate on the principal vectors of public policy but also must develop compensation arrangements to secure the consent of those who otherwise might be harmed by policy changes.

20. Rarely are property rights certain. More commonly they are probabilistic and more or less complete. Only in unusual polar cases can we expect them to be entirely unassailable. This complication, while analytically interesting, is not damaging to the concept of a private good.

21. The good is "public" only for the collection of persons who own the firm, not for those outside of it. Presumably, there is a unanimous ex ante social interest in finding optimal monitoring arrangements and incentive structures within the firm, those that would equate the marginal cost of these arrangements and structures (adding monitoring costs, for example) with the marginal return (the value of the last unit of the public good added). That is, ex ante, a worker whose earnings reflect productivity, a consumer whose prices reflect the costs of production, and an owner whose returns reflect profit—all would prefer such an arrangement. To the extent that a competitive market process generates efficient levels of monitoring, say, to that extent a monitoring problem within firms belongs to the first class of departures from the pure competitive model: it is self-correcting within the structure of the market itself, and it merely requires political neutrality or common-law (contractual) enforcement.

22. Excellent reviews are available in de Alessi (1980) and Furubotn and Pejovich (1972).

23. The theory is developed in an expository but careful manner in Posner (1972b); see also Kamerschen (1976).

24. The original narrative of the prisoners' dilemma, which also models the cartel problem, was a dilemma whose failure of resolution at the prisoners' expense served a public purpose: the imposition of a "correct" sentence (see Luce and Raiffa, 1967).

25. The properties of an anarchy in operation may differ, depending on various conditions such as shared values, the size and population of the community, and the nature and location of scarcity (see Tullock, 1972; Buchanan, 1975; and Demsetz, 1967).

26. Easements may be created by specific contractual arrangements, by adverse use (e.g., A "openly and notoriously" passes over B's land for a given period of years), or by such common-law doctrines as "easement by necessity," which prevents the formation of "land-locked" parcels of property, those without access to a common roadway.

27. These conditions are restatements and applications to the law of easement of the famous Coase theorem (see Coase, 1960).

28. An excellent example of this phenomenon concerns the legislative disposition of "due-on-sale" clauses in home-mortgage contracts. These clauses allow mortgagees, usually banks, to require the full payment of a mortgage-loan balance at
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the time that title to the mortgaged property is transferred from a seller to a buyer. In periods without interest-rate inflation, buyers usually would refinance a home at the time of purchase, rather than assume an existing mortgage, if their ability to pay the seller his full equity was limited. In times of rapid increases in home-mortgage interest rates, however, it pays the buyer to do whatever he can to assume the seller’s mortgage. Under conditions of stable interest rates, the actuarial life of a mortgage was about seven years. But with an increase in the interest rates, the actuarial life grew to approximately eleven years, leaving the mortgagee with a low rate of return on its loan. When this situation grew acute during the 1970s, most banks changed their standard mortgage contracts to incorporate the due-on-sale clause in future transactions. Several state legislatures then outlawed due-on-sale clauses, but the Suprême Court has overturned such actions insofar as federally chartered banks are concerned, in *Fidelity Federal Savings & Loan Association v. de la Cuesta*, 102 S. Ct. 3014 (1982) (see Haddock and Hall, 1983).

At first blush it might appear that a legislative reversal of the due-on-sale clause would merely create a transfer of wealth from the mortgagee to the mortgagor. Home sellers and real-estate agents, however, also claim that maintaining the assumability of mortgages would allow them to sell homes at a lower price, thereby benefiting buyers, sellers, and real-estate agents. This proposition is dubious, because it assumes that the market is not already at equilibrium and that sellers would not beneficially absorb the full value of the reduced mortgage interest rate. Furthermore, in the wake of statutes invalidating due-on-sale clauses, banks will increase their interest rates and as well might turn to short-term mortgage instruments.

The due-on-sale clause essentially transfers the risk of unanticipated changes in the interest rate from mortgagees to mortgagors. If it were more efficient, mutually beneficial, for mortgagees to bear that risk, then that result would have occurred in the market, as it did during the period of relative price stability before the 1970s. Individual borrowers and lenders could negotiate such terms themselves, or such terms might become standard contract features.


30. Such a government might redistribute wealth by majority rule from the quarry owners to the home owners, with no regard for efficiency. Thus, the danger remains that a move from common law to statutory or administrative law might find its motivation in a desire to create an inefficient result, thus increasing the value of the homeowners’ assets while destroying the greater value of the quarry in operation. See supra, note 28, for a similar case.

31. "Self-government does not consist in having a hand in everything, any more than housekeeping consists merely in cooking dinner with one's own hands. The cook must be trusted with a large discretion as to the management of the fires and ovens" (Wilson, 1968:374).

32. For example, see *Brennan v. United States Postal Service*, 439 U.S. 1345 (1978).

33. The judicial rules of venue and standing may provide appropriate models for other public-sector decisions. The Supreme Court's decisions concerning several areas of law involving the possibility of federal preemption, however, are confused and contradictory, both between and among specific subject matters. See *Middlesex County Sewerage Authority v. National Sea Clammers Assoc.*, 453 U.S. 1 (1981), and
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34. This is not an ideological claim for "states' rights" and "local options." Rather, it rests on the simple parallel with comparative statics in economics, that with large numbers of competing producers (here, governments) the price elasticity of demand is perfectly elastic.

35. Exactly this phenomenon of strategic use of regulation to limit productivity in competing states is documented in Ackerman and Hassler, 1981.


37. An elementary review of the model is contained in Aranson, 1981, chap. 7; a more rigorous review of developments through 1972 is available in Riker and Ordeshook, 1973, chaps. 11 and 12.

38. The discussion of instability in the text concerns a simple example of three voters and three alternatives using pairwise majority voting. The more interesting developments, however, concern the absence of equilibrium in a spatial context. The first full elaboration of this problem is in Plott, 1967. For more-recent developments see Ordeshook and Shepsle, 1982.

39. This statement may be too strong, because if the citizenry is risk-averse, then ambiguity induced by any cause will reduce welfare. This judgment afflicts elections in which there is no pure-strategy equilibrium or in which the candidates are tied in equilibrium but adopt different equilibrium strategies. For a discussion of such elections see Ordeshook, 1970.

40. The absence of an equilibrium in the legislature (or perhaps, even in the electorate) will obviously have public-policy consequences generally, and especially if agenda control is present. We would have to know who was controlling the agenda, however, what their preferences were, and other institutional rules and constraints, before we could say exactly what those public-policy consequences might be. Therefore, we might not be able to predict the legislature's public-policy decisions without first studying the institution and its rules. See Riker, 1980; see also Shepsle and Weingast, 1981b; Shepsle, 1978, 1979; and Fiorina and Shepsle, 1982.

41. Of course, group theorists such as David B. Truman and Robert A. Dahl account for public-policy outcomes largely in terms of group processes. But as we argue later, their formulation of group influence, insofar as welfare judgments are concerned, is inadequate. See Dahl, 1951.

42. For a discussion of the nature of this intercession, especially in matters of case work, see Fiorina, 1977.

43. Representative democracies obviously supply public goods. Examples include national defense, environmental quality, and public peace. To sustain the models depicted in table 4.1 and later in inequality (1), in the face of this observation, requires little imagination; for such goods are public in various aspects of their consumption but are principally private in production. For instance, national-defense production creates a multitude of pork-barrel opportunities—divisible benefits politically allocated to identifiable firms and constituencies. See Weingast, Shepsle, and Johnsen, 1981; and Shepsle and Weingast, 1981. Probably, constitutional forms sanctioning the public production of goods such as national defense provide one explanation for their production. But the explanation is largely hortatory, because games such as the one depicted in table 4.1 predict that no group will lobby for the
technologically most efficient supply of an optimal level of a public good such as national defense. But they will lobby for the production of particular weapons systems or base locations, say, whose principal incidents remain largely private. Thus, the animus for efficiency or optimality in the good's public aspects, considering the underlying political process, seems profoundly epiphenomenal.

44. Once again, the creation of many divisible benefits from the production, and sometimes from the consumption, of such programs, simultaneously accounts for their existence and their failure to bear a systematic relationship to efficiency criteria (see note 43 supra).

45. The theoretical genesis of regulatory agencies as legislative lotteries in such situations is developed in Fiorina, 1982; see also Aranson, Gellhorn, and Robinson, 1982. A case study of such a situation is described in Hacker, 1962.

46. There appears to be a parallel process occurring in the demand for regulation. Scholars of the regulatory process have long identified the decline of an industry with increased demands for regulatory protection (see Hillman, 1982).

47. Incomplete, but not self-contradictory. After all, the thrust of our argument is that interest groups and legislatures fail to solve their prisoners' dilemma, as evidenced by the continued production of inefficient private-benefit legislation. And the production of public goods and the suppression of public bads appear to be epiphenomenal.

48. Congressional constituencies are organized to do legislative battle in the person of their congressional representatives.

49. A review of the attack on centralization is provided in Aranson, Boyd, and Lancaster, 1983.

50. For example, see the events surrounding American Trucking Associations, Inc. v. Atchison, Topeka, & Santa Fe Railway, 387 U.S. 397 (1967), in which the Supreme Court acceded to an ICC change of heart. For years the ICC had abjured authority to require railroads to offer “piggy back” services to truckers; then the ICC asserted that it had the authority to do so.

51. Posner shows that the same framework applies equally to property and contract law (1972b).

52. Precedent is usually established or changed at the appellate level, so that jury decisions seldom figure in this analysis.

53. “Under plausible assumptions the increase in the value of legislation will exceed the increase in its cost, since a modest increase in the cost of enacting legislation could multiply manifold the length of the period in which the legislation was expected to remain in force” (Landes and Posner, 1975:879).

54. Presumably, Congress could eliminate the life tenure of judges, pack the Court, or limit its appellate jurisdiction.


56. There may be several sources of imperfect information. As noted earlier, in the presence of a possible coalition of minorities or cyclical majorities, candidates might obfuscate their real public-policy intentions. Furthermore, citizens might not fully understand the manner in which proposed public-policy changes, even if adopted, would affect their welfare. See Fiorina, 1982b.

57. With the symmetric density in figure 4.4b, the results require that candidates operate only on the convex portion of the cumulative density.

58. The Supreme Court has probably eliminated legislative vetoes, in Immigration and Naturalization Service v. Chadha, 103 S. Ct. 2764 (1983).
59. There is a substantial incentive for jurisdictions to export taxes and higher costs to the extent that that is possible. Severance taxes on the mining of natural resources, taxation of foreign (i.e., out-of-state) corporations, and regulatory impositions on in-state producers of exported goods and services provide three examples of this phenomenon. Judicial nullification of these actions under the "negative commerce clause" provides only a partial and uncertain constraint on this process (see McLure, 1983). A radical decentralization of governmental functions, however, might create new possibilities for judicial review of these actions.
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